

Analysis of independence for bank of Albania

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Abstract

The main objective of the Bank of Albania is to achieve and maintain price stability. Other objectives of the subject BOA its main objective, to promote the preservation of liquidity, solvency and proper functioning of the banking system based on market principles. Typically, a central bank may perform a combination of three main functions. First, it can execute a macro function, through the exercise of monetary policy to soften, which affects the price level, and through its foreign policy. Secondly, it can perform a function of the micro-level sectorial, offering support and regulatory and supervisory services for the banking sector performance. Third, the central bank often has a special relationship with the state and may perform some secondary functions, among them, he banker and fiscal agent or the economic adviser.

Objective of the paper

- ♣ Increasing central bank independence from the executive branch, at least in relation to monetary policy decision making;
- ♣ Promote the coordination of central bank decisions to the public interest;
- ♣ While secrecy was previously a hallmark of central banks, transparency and openness are seen today as an element contributing to its success

Methodology

The methodology was chosen in accordance with the purpose of the study, which deals with the study of the role of the Bank of Albania. Each chapter is filled with mathematical analysis, the analysis of questionnaires and analysis financial with the relevant recommendations from such Albanian reality. Analyses out the importance of the Bank of Albania monetary stabilization and politics. The information collected is processed, analyzed and conclusions are given and recommendations.

I. The role and functions of the bank of albania as the high monetary authority of country

History of the Albanian banking system has gone through five major periods: the period before the monarchy, the monarchy period, the period between 1939-1944, the period after World War II and finally the period after 1990. After the liberation of the country, the priority given to the creation of the monetary system and the end of the 1946 currency reform. From 1946 onwards, the State Bank of Albania was clothed with more responsibility and attention moved to central planning and management of money in circulation. Bank functioned as the central bank and commercial bank simultaneously.

Until 1976, the country's banking system was centralized, consisting of a single bank, State Bank. However, the Bank had a very limited role as monetary policy and credit allocation was run under a centralized plan. In 1977, a part of the Bank which covered agriculture sector funds took the form of a separate specialized bank, Agricultural Bank was formed. However, a broader transformation of the banking system occurred after 1990.

After the fall of communist regime in 1991, banking sector remained underdeveloped and centralized, while the money had a limited role as a medium of exchange. A reform process was quite necessary for the banking system. The main pillars of this reform were the establishment of a two-tier banking system, privatization of state-owned banks, the introduction of a new regulatory framework and the entry of foreign banks. Until the mid-90s, the banking system has continued to represent an underdeveloped financial segment, dominated by the public sector and poor infrastructure and thus provide lower quality services. In more analytical structure of the domestic banking system was that of a typical centralized economy, consisting of four state institutions:

§ State Bank of Albania, which acted as a central bank liability company;

§ Bank of Agriculture and Development, which provided credit cooperatives and state farms;

§ Savings Bank, for all households;

§ Commercial Bank of Albania, which dealt with foreign trade transactions.

Albania joined the IMF in 1991, and after having worked for a credit agreement. The Albanian government, assisted by specialists from the IMF and World Bank, prepared by introducing two-tier banking system. It was directed by the

laws imposed on you as the central bank and commercial banks, called the Central Bank Law and the Law on Commercial Banks adopted in April 1992, replacing the previous law "for State Bank of Albania". Under the new banking law, the Albanian State Bank was re-appointed to the Bank of Albania and retained the functions of a central bank clean. The 1992 law froze bank dependence on government and decided that the Bank will be controlled by Parliament. Its main objective would be "maintaining internal stability and foreign currency." Within the new legal framework, the Bank of Albania began operating as the central bank with three other state banks, National Commercial Bank (NCB), the Savings Bank, and Bank of Agriculture and Development, which later changed its name to Agrarian Commercial Bank.

1.1 The role and functions

Under the Statute of the Bank of Albania, it has as its object of:

- Drafting, adoption and implementation of monetary policy in the Republic of Albania
- Drafting, adoption and implementation of foreign exchange regime and policy, currency exchange in the Republic of Albania
- Granting or revoking their licenses to banks and banking supervision to ensure banking stability.
- Availability and management of its reserves.
- Acting as banker, adviser and fiscal agent for the Government of the Republic of Albania.
- Progress of the banking system in particular and the financial system in general.
- Promoting the smooth operation of payment systems in the Republic of Albania
- Trading of securities, distribution of securities on behalf of the Government of the Republic of Albania and the issuance of securities for its own account
- Supervision of international payment arising from the actions and non-foreign trade, and the engagement of licensed banks in Albania, under contract with states, banks or foreign companies
- Compilation of balance of payments of the Albanian, and organization and management system of this balance of payments statistics
- Exclusive right to be the sole issuer of banknotes and coins as legal tender within the territory of the Republic of Albania and the right to determine the shapes, weights, model and other features of banknotes and coins national which are legal tender, the coins and banknotes, which will be printed for numismatic.
- Design plans for the issuance and securing a regular supply of banknotes and coins to meet the demands of the economy before.
- Licensing or revocation of a license for foreign exchange brokers, supervision and regulation of foreign exchange agents, including banks under foreign exchange regulations prepared by the Bank of Albania.

Today, central banks are public policy-making institutions, whose main objectives are the preservation of monetary

stability and promoting financial stability. It provides the basic elements of the payment system: banknotes and coins for use by the general public and various services to banks through accounts at the central bank. Manages the central bank gold reserves in the country and foreign exchange reserves. In cooperation with other authorities, the central bank plays a key role in monitoring the development of financial system.

1.2 Importance of monetary policy

Monetary policy objective is to achieve and maintain price stability. In quantitative terms, the Bank of Albania has translated the objective of price stability in keeping inflation at 3%, with a chance fluctuation of ± 1 percentage point around this central value. To achieve the inflation target, the Bank of Albania aims to control the growth of cash in order to offer them to correspond with the need for real cash economy.

The monetary policy of Bank of Albania entered a new phase in late 2000, when the hand was removed permanently from the use of direct instruments of monetary control. For eight years, monetary policy implementation was entrusted to two main instruments, which were just two administrative decisions of the BOA. These decisions consisted of limited growth of outstanding loans by commercial banks and the obligation of the state banks had to comply with the minimum interest rate for deposits in domestic currency, announced by the Bank.

Bank of Albania has available a range of instruments that allow it to influence market interest rates and manage the amount of liquidity in the service of realizing the operational objectives:

Open market operations

They are in the market buying and selling securities by Bank of Albania, in order to increase or decrease the money supply in the banking system. According to their purpose, open market operations is divided into the main operation of the market, regulatory operations and structural operations. Open market operations used by the Bank are repurchase agreements (repo) and reverse repurchase (R / REPO), sales of treasury bills.

Permanent facilities

Instruments that are used for providing and absorbing liquidity on a temporary basis with a daily timetable and the establishment of the corridor where you can vary the interbank market interests. Characteristic is that their use is realized almost exclusively on the initiative of commercial banks. As permanent facilities, the Bank of Albania offers instrument overnight deposit and overnight lending. Banks use overnight deposit instrument to invest their excess liquidity at the Bank of Albania with a daily deadline.

Supporting instruments

For banks that lack liquidity but are financially stable, the Bank of Albania may grant Lombard loans. Lombard loan is a debt instrument, whose purpose is to help commercial banks overcome temporary liquidity problems. Lombard loan may only be used once every 3 months, against collateral. The largest amount that a commercial bank may earn credit by Lombard, lies between 20% of paid up capital and 2% of deposits in money, according to the

latest state of its balance sheet submitted by the BOA . Interest in the loan rate has reference Lombard repo rate and serves as the highest rate of interest on the money market, so it is more expensive loan available to commercial banks. The maximum period of its maturity is up to 3 months.

The minimum reserve

Compulsory minimum reserve represents that portion of the funds that banks must hold in their account at the Bank of Albania, Lek and foreign currency. Keeping the minimum reserve required by banks serves to regulate the liquidity in the banking system, in terms of creating demand for liquidity and interest rate stabilization in the market. In order to minimize the volatility of interest rates in the interbank money market that can be caused by unexpected liquidity needs, banks were allowed to use the reserve but preserving its average level during the holding period. The interest that banks take the minimum required reserve is calculated as a percentage of the repo rate announced by the BOA for currency reserves and as a percentage of core European Central Bank and Bank of the U.S. Federal reserve force respectively in the euro and the dollar.

II. Importance of central bank independence

Arguments in favor of the idea of "an independent central bank" are numerous. Argument or persuasion more prevalent and more important is that "independent central banks are associated with a lower inflation rate." Many authors have accepted this argument and they are also trying to find the link between indicators of central bank independence and low inflation rate. On the basis of this argument is a practical example known of Germany's central bank, the Deutsche Bundesbank. German monetary policy during the last hundred years has reflected an excellent example for the evaluation of empirical evidence on the application of rules and regulations and on central bank independence in monetary policy.

Why central bank independence, *ceteris paribus*, would lead to a lower rate of inflation? Various literature give us three kinds of responses to this question: those based on public choice arguments, those based on the analysis of Sargent and Wallace (1981), and those based on the time inconsistency problem of monetary policy.

As a result, the government may prefer "easy money". Proof of bank independence can be obtained either by ordinary inspection of the contacts between the government and central bank, or through verification tests to determine if expansive monetary policy before the election results, or changes to an administration with different political orientation. This phase majfton to reach the conclusion that the more independent a central bank is much less under political influence. How much impact have the government in appointing board members, the more likely that the central bank to pursue those policies that are desired by the government.

A second argument to explain why central bank independence lowers inflation rate was raised by Sargent and Wallace, who made the difference between fiscal authorities and monetary authorities. If fiscal policy is dominant, which occurs when the monetary authorities

can't influence the size of government budget deficit, money supply is endogenous. If the public is no longer able or willing to pay additional government debt, it will result in forcing monetary authorities to finance the deficit by creating money. If monetary policy is dominant, the fiscal authorities will be forced to reduce the deficit. As an independent central bank, the less the monetary authorities may be forced to finance deficits by creating money.

The third argument, and most notably, the central bank independence is based on the time inconsistency problem. Dynamic inconsistency arises when the best one made at present to a future period is not optimal when that period actually begins. The best solution to the problem of time inconsistency lies in the introduction of fixed rules in monetary policy, so the authorities are committed to following certain rules.

Central bank independence may reduce the manipulation of monetary policy before the election. Also central bank independence may lead to a sustainable economic growth and, therefore, less variability in inflation. Another argument explains why CB independence may lead to less variation in inflation. Politicians, not just try to stay on task as much as they can, but they also want to bring benefits to their local constituencies. Records show that the motive of unemployment and inflation is systematically related to political orientation of governments. While governments are usually the thought right to give higher priority to reducing inflation, leftist governments are supposed to be more concerned about unemployment. Effects of inflation on income redistribution policy provides an incentive left to support the expansionist policies and the right to fight inflation. This means that the variability of inflation might be higher if the government changes regularly, especially if monetary authorities are dominated by elected politicians. However, a relatively independent central bank would not change its monetary policy after the election of a new government. As a result, central bank independence may reduce the mobility of inflation.

Milton Friedman (1977), provides another reason why central bank independence can affect the variability of inflation. Friedman has sought to explain why there is a positive correlation between the level of inflation and inflation variability in any place and at any time. In Friedman's analysis, the government may temporarily follow a series of monetary policy purposes (such as production, unemployment), which leads to higher inflation, this fact, in turn, triggers strong political pressure to reduce devaluation of the currency.

Two opposing views regarding the effect of central bank independence on the level of economic growth. Some authors have argued that the real interest rate depends on the growth of money supply. A low level of inflation caused by monetary policy tightening causes higher real interest rates, which have harmful effects on the level of investment and, consequently, and the level of economic growth. After all the positive arguments against central bank independence, we can say that, like any theory, and "CB independence" has its critics and skeptics, who argue that independence is neither necessary nor sufficient to achieve stability thresholds. Central bank independence is a

necessary condition for achieving price stability, it is simply an instrument of monetary policy among many others, which can be used to achieve these objectives. Central bank independence and conservatism of her not being complementary to each other. If between the government and central bank monetary policy negotiations, any desired result can be achieved by making the bank more conservative, thus reducing the rate of inflation to the extent that the bank prefers or giving more power but with a level lower conservatism. In both cases inflation is taken the same line.

2.1 Importance

Central bank independence from the government is itself a very important aspect and extensively examined the entire monetary policy framework. It has been part of the topics discussed in the literature on monetary policy in recent decades. Empirical studies on the relationship of independence on monetary policy results strongly support the idea that central bank independence is an important political element, which sets monetary policy in view of long-term macroeconomic stability and avoid the impact of short-term interests or political cycles. A. Cukierman (2000) and W. Maliszewski (2000) conclude that monetary policy delegation to an independent institution that fights high inflation may reduce the steady increase in price beyond the optimal level for society. These studies identify a negative relationship between the level of central bank independence and inflation rate, as in developing countries and in countries in transition. According to their views of central bank independence is a particularly important tool for maintaining price stability, rather than to achieve it. Even the authors conclude that in the transition countries of central bank independence has had an effect only after the last significant steps to liberalization of the economy, therefore it can't serve as substitutes for other stabilizing elements.

Economic independence can also be assessed on average, because the law creating the Bank of Albania space directly finance the government's fiscal deficit. However, direct funding not done automatically, it was temporary, in line with market rates. Here it should be noted that during the early years of this period there was no primary and secondary market for government securities. This lack of necessity impose direct government funding. Presentation of the securities market and limited government direct financing by the Bank up to 10% of budget revenues.

Law no. 8269 "On the Bank of Albania", adopted in December 1997 made significant improvements to the expansion of the central bank's political independence, while innovations over increasing economic independence remain clouded. In fact the consolidation of political independence recognized two steps forward and one step back. The law clearly expressed and in particular the independence of the Bank of Albania, he knew that the whole powers of drafting, approval and implementation of monetary policy, but also define the Governor's proposal to BOA by the President of the Council of Ministers. Revision economic independence, which were to redraw the border

directly to government funding up to 5% of revenue during the previous three years and determine the limit of funding through primary or secondary market as above, except in cases of non-infringement The main objective of price stability.

Transparency of the Bank of Albania during the period 1997-2001 introduced limited improvements. Changes were undertaken mainly in terms of political transparency, and other aspects of transparency does not recognize any meaningful development. The main change relates to redesign the main objective of achieving and maintaining price stability. The announcement clearly the quantitative definition of this target, after a break of some years and his identification as the main objective of the Bank of Albania exclusive. For the first time in this period the Bank of Albania publishes medium-term development strategy as a document that presents a summary of the BOA vision for the objectives, nature and monetary policy instruments and the way to all other aspects of development.

Despite the legal definition of price stability, the law does not define the price index, the target value and legal obligation to publish the target, but acknowledges the right of the Bank of Albania. At the same law does not provide accountability in the event of failure of the target. Consequently, the definition of the target and to achieve his goal was just a commitment of the Bank of Albania. For the first time in this period, monetary policy framework includes an element of inflation targeting regime, as already publicly announced the final quantitative target for inflation. However, the new framework still remain within the old regime, as long as the law does not define a formal framework of accountability and announced interim target was to increase the total money.

In reality, changes in the law of 1997 extended the independence of monetary policy as its objective clearly formulated for achieving and maintaining price stability very quickly began to determine quantitatively.

The 2002 amendment took a step further perfection of legal central bank independence. Governor's proposal, which was previously a prime power, already attributed to the President of the Republic. This difference was highly significant in terms of increasing the central bank's political independence. As a result, the consolidation of democratic and institutional culture over the years, and improving the implementation of laws seem to have paid off in the convergence between the legal and real independence during the last period.

III. Conclusions & recommendations

Bank of Albania legally enjoys considerable independence. This institution was conceived as independent and are given legal spaces to function as such. This fact is evident as the various indices calculated, then compared with the central bank itself, but also in comparison with other countries (comparable, in transition). But considering that many have been made in this direction in recent years, years that have seen a particular interest for central bank independence, especially of our country's ambition for EU entry, and all the steps that lead to the road .

Calculated various indices gave different results. This should not be taken as a contradiction, but has to do with focusing on different aspects of the bank's independence. But the truth is the fact that there is a well studied theory of Albanian theorist in this area recently (last publication of 1999). The lack of studies of this aspect of the Bank of Albania, may derive from a lack of real independence of the central bank.

Over the years, the adoption of new laws, more attention was paid to change and adjustment clauses that affect them as much avoidance of political interference. The risk of such interference has been more palpable. These interventions are made in order to approach as much legal independence on the real independence of these, which in the case of Albania, at certain moments were very far apart. If we take as a point of support for this argument governor turnover rate, it is clear that much has been done the last 10-year-old, and very few 10-year-old First Bank of

Albania, when the average actual residence of a governor in office representing 30% of legal mandate, the executive can be said that has not been willing to comply with central bank independence and the level of public relations has been weak, leaving the desired transparency.

Central bank transparency has been added recently. Suffice it to open the website of the Bank of Albania, and each publication is there so much open to the entire public. But the approach of real independence that legal action is the merit factor "IMF".

Recommendations for the Bank of Albania would be:

- Increased legal independence
- Establishing domestic periodic scientific studies on this aspect, which will increase attention towards central bank independence, and thus greater sensitivity to its
- Growth of real independence and compatibility with the best legal independence

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