

Measuring Joblessness: The Unemployment Trends in Albania

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Abstract

This paper deals with one important problem that is very common in too many countries including Albania. This paper shows a general knowledge about unemployment and discussed some points about unemployment in Albania like: unemployment trends over years, unemployment by gender, unemployment by education and age, unemployment by region. Also it is seen the relationship that has the unemployment rate with inflation rate and real GDP growth rate and are explained with concrete examples in Albania.

Key Words: Unemployment, Albania, Job, Worker

OUTLINE

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1. INTRODUCTION

“ A man willing to work, and unable to find a work, is perhaps the saddest sight that fortune’s inequality exhibits under this sun.” - Thomas Carlyle

This paper, as we can understand from the title, is about joblessness and the unemployment. In the center of this paper will be Albania. The aim of this paper is to understand the unemployment rate in Albania, is it normal, or Albania is a problematic country and how it has changed over time.

Now let’s have a look to the general meaning of unemployment, its impact and the types of unemployment. The unemployment rate measures the fraction of the labor force that is looking for a job but cannot find a job. Unemployed are called peoples that are not employed but are looking for a job or waiting to return to work. Unemployment has both economic and social impact. It has an impact on economy because if unemployment increases this means that economy is throwing away goods and services that the unemployed workers could have produced. It has an impact in society because the unemployed workers will have many problems as a cause of reduced incomes.

There are three types of unemployment:

Frictional unemployment, that arises from continuous movement of people between regions and jobs or through different phases of the life cycle. Frictionally unemployed often are called voluntarily unemployed. Voluntarily unemployed means that peoples chose by them self to be unemployed. Peoples chose to be unemployed for many reasons. Maybe they are looking for a better job or they prefer leisure or other activities rather than work.

Structural unemployment is a mismatch between the supply and demand for work. Those mismatches can occur because the demand for one kind of labor increases while the demand for another kind decreases and labor supplies don’t adjust quickly.

Cyclical unemployment exists when the overall demand for labor is low. When total output and savings decreases the unemployment increases. Involuntarily unemployment means that workers are qualified and they want to work at the prevailing wage but cannot find job.

The ways that a worker can end unemployed are: some workers lose their jobs because of layoffs they are also called job losers; some other workers decide by their owns to leave the job they are called also job leavers; some others decide to enter in the labor market after spending some times in the nonmarket sector they are called reentrants; and some others are new in the labor market for example students that have just been graduated and are looking for a job.

Unemployment is measured by: $\text{Population-out of labor force} = \text{Labor force}$

$\text{Labor force} - \text{Employed} = \text{Unemployed people}$

Unemployment rate is: $\text{Labor force} / \text{unemployed people}$

The purposes of this paper are:

- ✓ To see the relationship between unemployment rate and Inflation rate, does they have a negative or a positive correlation. Also to see the relationship between unemployment rate and real GDP growth rate.
- ✓ To see the unemployment trend in Albania. How it has changed over time. How is the unemployment rate now-days relative to that before the democracy. Was it grater in the communism period or post communism area. Also we will see the unemployment rate according to gender and age.
- ✓ To see how is the unemployment rate in different regions of Albania.

2. LITERATURE REVIEW

There are done to many studies about joblessness and Unemployment.

Paul A. Samuelson and William D. Nodhaus have written about the Economics in general and they have treated the unemployment in a chapter, they have pointed out the definition of unemployment, how are called unemployed, the impact of unemployment, factors that affect the unemployment level.

The John Maynard Keynes in his book “ The General Theory of Employment, Interest, and Money” had written about unemployment explaining the Prof. Pigou’s Theory of Unemployment; this theory makes the volume of employment to depend on two fundamental factors, 1) the real rates of wages for which work people stipulate and 2) the shape of the Real Demand Function for labor.

In the book of Labor Economic it is explained the Philips Curve (that shows a negative relationship between unemployment rate and inflation rate.)

Margareta Nikolovska in her paper has studied the unemployment distribution in different region in Albania. She compared the unemployment level in different regions with the average unemployment in Albania.

Mjaft Foundation has done a study for the Albanian Youth on the Road towards Employment. In this paper is explained the unemployment by education and age in Albania .

Besard Hobdari also has done a study about the unemployment distribution in different regions of Albania during the years 1994, 1995.

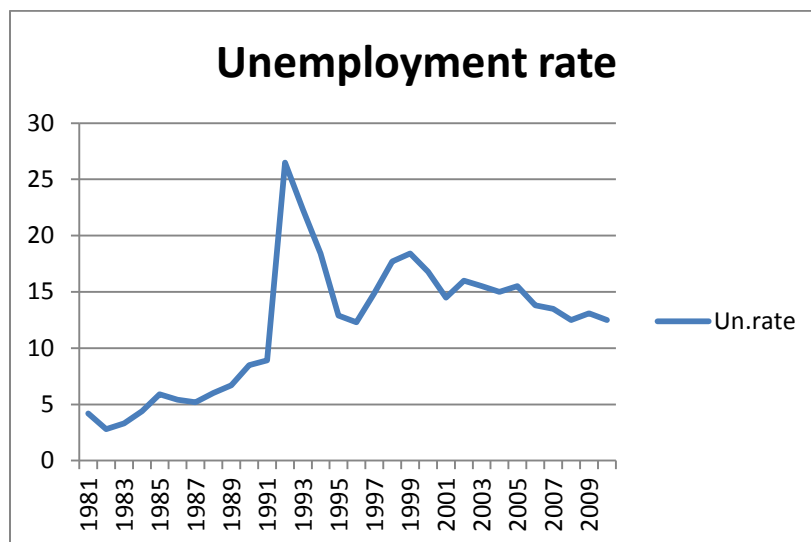
3. DATA AND RESEARCH METODOLOGY

For this paper I have taken data from IMF(International Monetary Fund) and INSTAT(Statistical Institute of Albania).

➤ Unemployment rate

Years	Unemployment rate	Years	Unemployment rate
1981	4.2	1996	12.3
1982	2.8	1997	14.9
1983	3.3	1998	17.7
1984	4.4	1999	18.4
1985	5.9	2000	16.8
1986	5.4	2001	14.5
1987	5.2	2002	16
1988	6	2003	15.5
1989	6.7	2004	15
1990	8.5	2005	15.5
1991	8.9	2006	13.8
1992	26.5	2007	13.5
1993	22.3	2008	12.5
1994	18.4	2009	13.1
1995	12.9	2010	12.5

Source: IMF



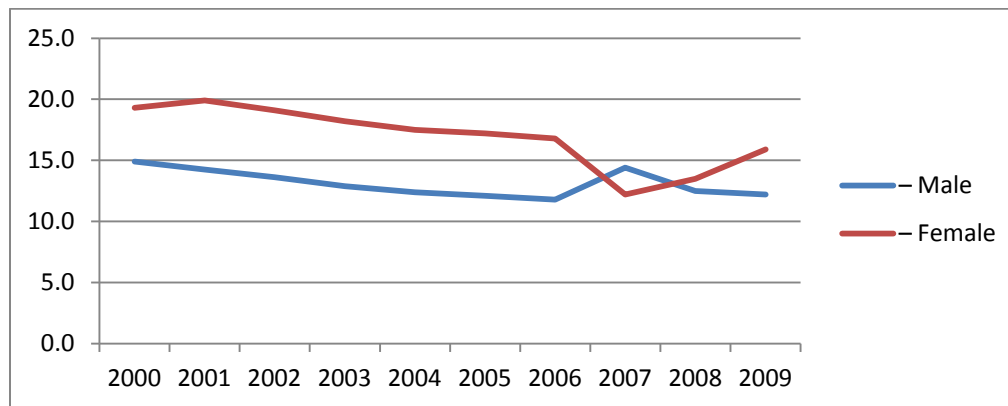
As it is shown on the graph we can notice with a general view that the unemployment rate in Albania before 90's is lower than that after 90's. This may be because before 90's there were cooperatives and too many people were employed there, so it means in agricultural sector. The highest level of unemployment was in 1992 when the system is changed from a dictatorial system in democratic system. It has dropped again at 1996 was 12.3% and rose

again at 1998 was 18.4% after the civil war in Albania in 1997. From year 2006-2010 the unemployment rate hasn't changed to much it varies from 12-14%.

➤ Unemployment rate by gender

Description	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
– Male	14.9	14.2	13.6	12.9	12.4	12.1	11.8	14.4	12.5	12.2
– Female	19.3	19.9	19.1	18.2	17.5	17.2	16.8	12.2	13.5	15.9

Source: INSTAT

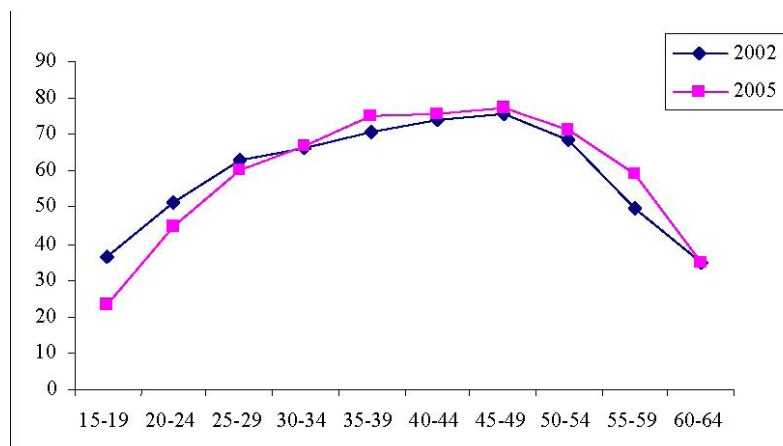


As it is shown on the graph the unemployment rate of females is higher than that of males. Only in year 2007 the unemployment rate of males is higher than that of females. This phenomena is known in Albania because too many of females are households in Albania.

➤ Unemployment by education and age.

Education lowers unemployment rates for two reasons: 1) educated workers invest more in on-the-job training. Because specific training “marries” firms and workers. Firms are less likely to lay off educated workers than they face adverse economic conditions. 2) When educated workers switch jobs, they typically make the switch without suffering an intervening spell of unemployment.

Younger workers are more likely to be unemployed than older workers.



Source: LSMS 2005

During the years 2002-2005 young people in Albania have been at a disadvantage on the job market. The age group of people over 32 years old has a slight increase in employment rates whereas the young age group 15-32 old has decline. The challenge of securing employment has specifically been more difficult to overcome for the younger age group 17-22 old. The data presented should sound the bell of alarm for an impending crisis that, apart from the job market, will exert ubiquitous effects upon Albanian society as a whole. It will fuel a phenomenon that continues to plague Albania even after 17 years of transition – emigration.

The employment rates are lower for young people who possess lower levels of education. In 2004 the employment rate for 15-24 year-olds reached 37.1%. This is significantly lower than the national average of 60.1%. According to the World Bank's study, "Job Market Evaluations 2006" there are two distinct causes for this effect. Firstly, many young people abstain from working while they are still completing their studies, which is why 68.8% of Albanian youth were not included in 2004's national workforce.

The fact that many young people are still currently partaking in the education process signifies that a more qualified workforce is being cultivated for the future. The second reason for low young employment rates is the considerable number of daunting obstacles that young people must overcome to successfully cross the job market threshold. This fact particularly rings true for young people who possess a low level of education. This contingent is often unemployed, sometimes even refusing to seek out employment, thereby creating a very disturbing number of dejected young people.¹

➤ Unemployment by region

Unemployment varies by region. The territory of Albania can be divided into four main areas, which differ by size, population density and the nature of the problems they face. These areas are: the north, the central area, the south, and Tirana, the capital city. The northern area of the

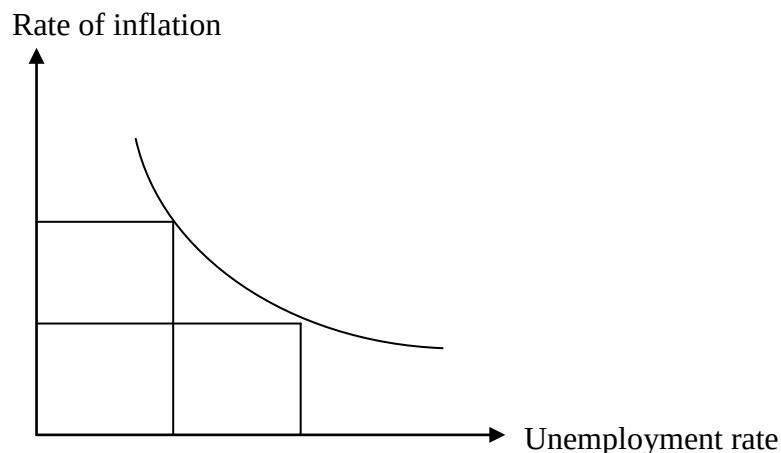
¹ Mjaft foundation. "Challenges Facing Albanian Youth on the Road Towards Employment", Policy brief Nr.6, pp. 13-14

country covers the region of Diber, Kukës, Shkodër and Lezhë. Some 23% of the total population live in this area and the average unemployment rate is 24%, which is higher than in any other region of the country. The southern part of the country covers the region of Gjirokastër, Vlorë and Fier, where 25% of the total population of the country lives. Its average unemployment level is 12%, which is lower than the country average. The central part of Albania covers the regions of Durrës, Korçë, Berat and Elbasan, where 35% of the total population of Albania lives. The average unemployment rate here is currently 12%.²

4. APPLICATION AND RESULTS

➤ Relationship between Unemployment and Inflation rate.

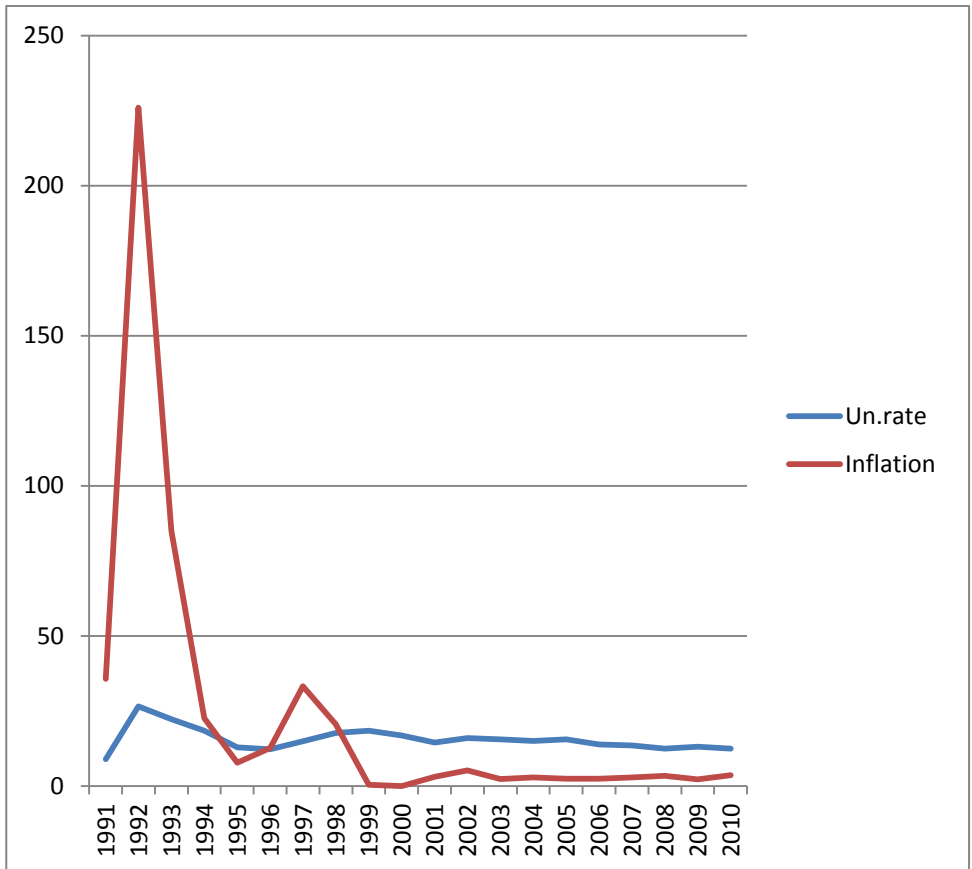
In 1958, A.W.H Philips published a famous study documenting a negative relationship between the rate of Inflation and the rate of unemployment. This negative relationship is called as **Philips Curve**. The Philips Curve describes the negative correlation between the inflation rate and the unemployment rate. The curve implies that an economy faces a trade-off between inflation and unemployment.



Now let us see if the Philips Curve is true for the Albanian case.

²Margareta Nikolovska. “ **Human Resource Development Country Analysis Albania**”, ETF working paper, May 2008, p. 5

Years	Une rate	Inf rate
1991	8.9	35.7
1992	26.5	226
1993	22.3	85
1994	18.4	22.6
1995	12.9	7.8
1996	12.3	12.7
1997	14.9	33.2
1998	17.7	20.6
1999	18.4	0.4
2000	16.8	0
2001	14.5	3.1
2002	16	5.2
2003	15.5	2.3
2004	15	2.9
2005	15.5	2.4
2006	13.8	2.4
2007	13.5	2.9
2008	12.5	3.4
2009	13.1	2.2
2010	12.5	3.6

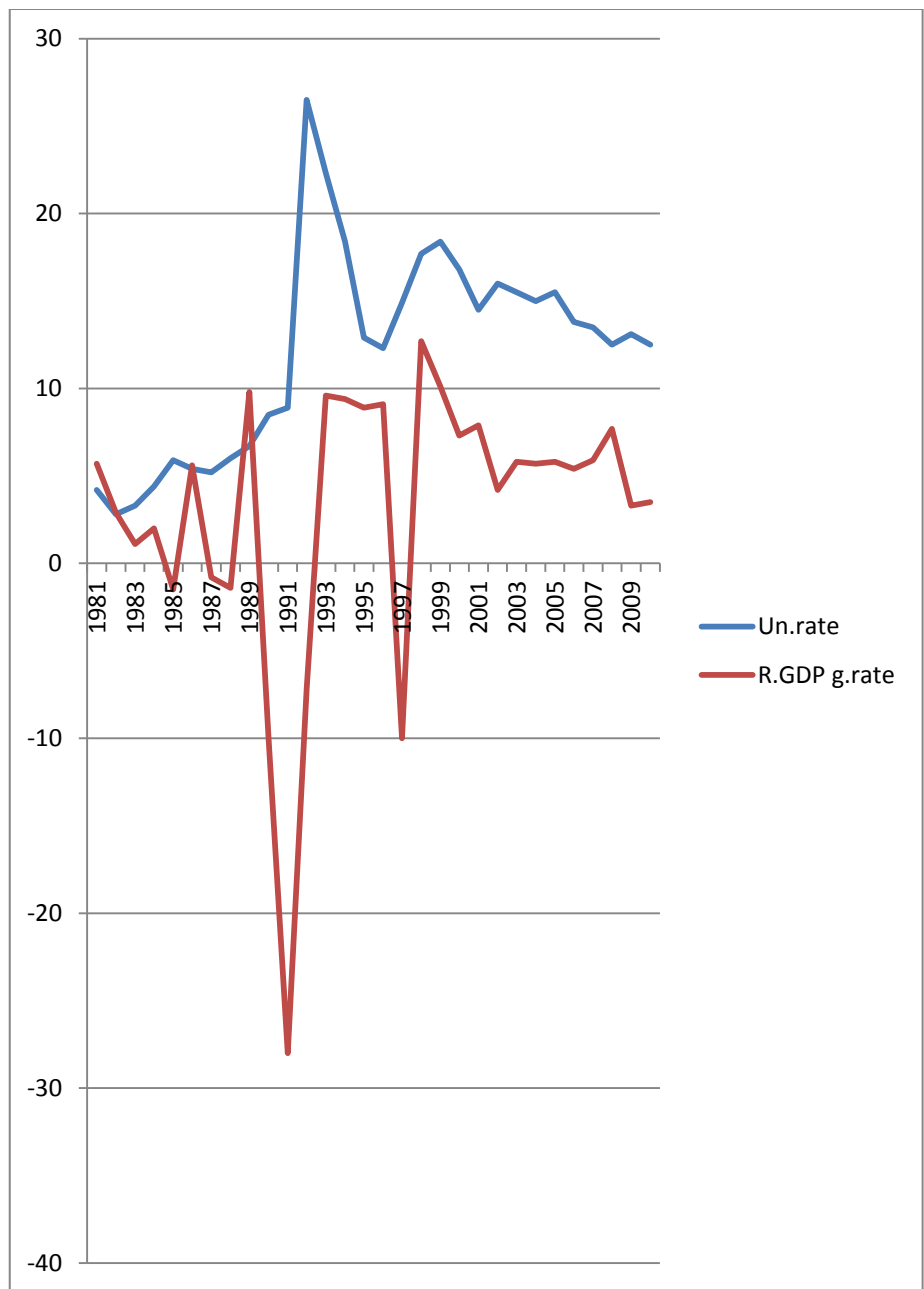


Source: IMF

As it is seen from the data and the graph there doesn't exist that negative relationship between Inflation rate and Unemployment rate in Albania. We can see that in year 1992 the inflation has increased also the unemployment rate has increased so they had a positive relationship. The inflation and the unemployment rate is too high in this year because of the change of the system from a dictatorial system into a democratic system. From year 1997-1999 we can see a negative relationship between the unemployment and Inflation rate. The inflation rate has decreased and unemployment increased. From 1997-2010 there is no certain relationship between these two variables. Sometimes we can see a negative relationship sometimes a positive relationship, this may happen also because the rate of inflation and unemployment rate hasn't changed too much. As a conclusion we can say that the Philips Curve is not true for the Albanian Case. Here we can't see an exact relationship between unemployment and inflation rate. This may be because of the different policies that the government had taken and different factors.

➤ **Relationship between Real GDP growth rate and Unemployment rate.**

Years	Un.rate	R.GDP g.rate
1981	4.2	5.7
1982	2.8	2.9
1983	3.3	1.1
1984	4.4	2
1985	5.9	-1.5
1986	5.4	5.6
1987	5.2	-0.8
1988	6	-1.4
1989	6.7	9.8
1990	8.5	-10
1991	8.9	-28
1992	26.5	-7.2
1993	22.3	9.6
1994	18.4	9.4
1995	12.9	8.9
1996	12.3	9.1
1997	14.9	-10
1998	17.7	12.7
1999	18.4	10.1
2000	16.8	7.30
2001	14.5	7.9
2002	16	4.2
2003	15.5	5.8
2004	15	5.7
2005	15.5	5.8
2006	13.8	5.4
2007	13.5	5.9
2008	12.5	7.7
2009	13.1	3.3
2010	12.5	3.5



If we refer to the graph and data which are taken from IMF in general we can say that there exist a negative relationship between the unemployment rate and the real GDP growth rate. This may be also by the fact that if unemployment rate increases the real GDP will decrease because as I mentioned before one of the impact of the unemployment was the impact on the economy, if unemployment rate increases this means that the economy is throwing away the goods and services that an unemployed worker may produce. But we can see also a positive relationship between this two variables during years. For example in 1998 both unemployment rate and real GDP growth rate increased.

5. CONCLUSION

In this paper we have seen the meaning of unemployment, its impact, who are called unemployed, the impact of unemployment in economy and society, the types of unemployment, factors that cause the unemployment and how to measure it.

We have seen the unemployment rate's trend in Albania and we have seen that the unemployment rate in communist system was lower than in democratic system. We have seen the unemployment by gender, and that the number of females unemployed were higher than that of males. We have seen also that the higher the education the lower the unemployment rate, and that young people has a tendency to have a higher unemployment rate than adult. Another point that was covered in this paper was the unemployment by region in Albania and it was seen that the unemployment rate in the north region of Albania was higher than in other regions.

There was discussed also about the relationship between unemployment rate and inflation rate, and unemployment rate and real GDP growth rate. It was shown that the relationship between unemployment rate and inflation rate changed year by year and in general the relationship between unemployment and real GDP growth rate was negative.

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Money Growth and Inflation

(Albania application)

Prepared by: Anduena Halla

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Abstract: This paper will give you a large view of the correlation of money growth and inflation and as a sub views, we are going to see it more deeply in Albanian economy. The aim of this paper was to prove this correlation in the long run, as in the short run it isn't evident, theoretically and practically in Albanian economy. We have used the regression analyze to find a strong correlation between money growth and inflation in Albanian economy.

Keywords: Inflation, deflation, money supply, Quantity Theory of money, CPI, M1, Classic dichotomy .

Introduction:

In this paper we are going to deal with one of the most important issue of macroeconomics, money growth and inflation.

We will talk about theoretical approaches from different economists during time. We are going to see in details the correlation between money growth and inflation, how can money growth predict inflation and which are the main factors that influence this correlation, its strengthens and its sources.

We have analyzed it in different periods, in the long-run, and built up this correlation for Albania economic indicators. At the end we will close our paper with the proper conclusions.

Inflation:

Inflation, in economics is considered to be a continuous rise in the general level of prices of goods and services over a period of time in an economy. According to president Gerald Ford , inflation is the greatest public enemy in an economy.

Inflation as a major economic problem, firstly appeared in 1970', where prices rose more than 7% in U.S.A., and till then it has become a worldwide problem. Inflation is related with different economic concepts, such as deflation (is considered to be a fall in the general price level; disinflation (a decrease in the rate of inflation), hyperinflation (inflation rate more than 50%, in a short period of time), stagflation (a combination of inflation, slow economic growth and high unemployment) .

What determines inflation?

There are two main determinants: 1) The level of prices and the value of money. It is aid that inflation is more about the value of money, so losses its value during time, than the correlation with the value of goods. Price it is measured with the value of a basket and as inflation occurs means that your purchasing power will decrease and as a result the value of money during time will decrease, as each Lek buys less things.

2) Money Supply, Money Demand and Monetary Equilibrium:

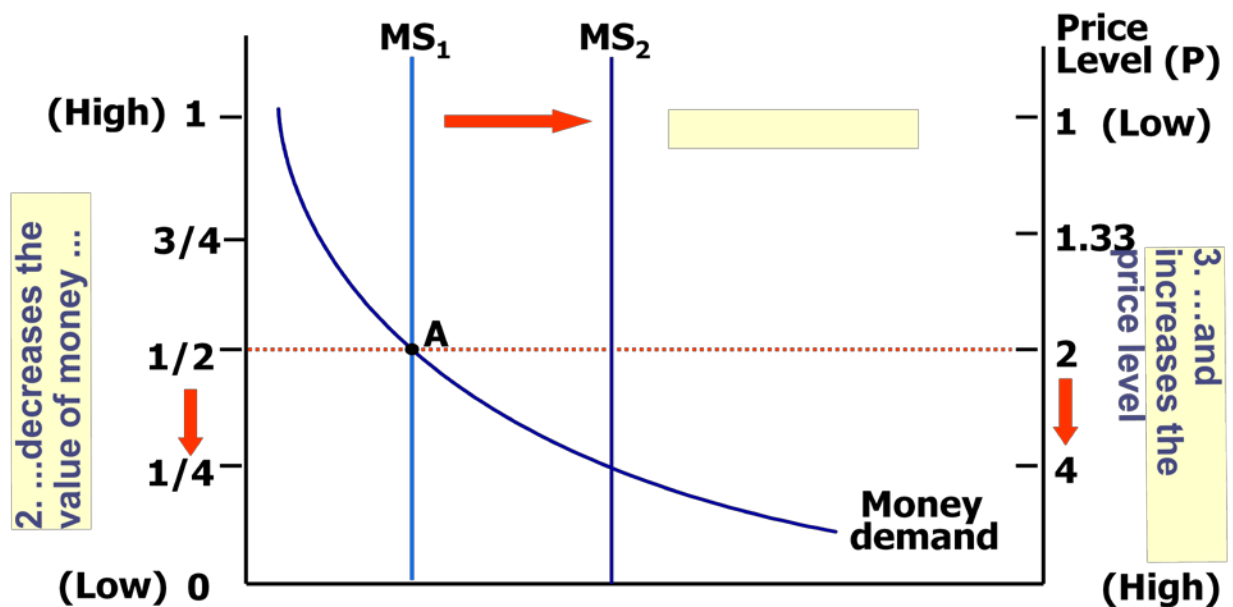
As we know, every deregulation in the economy has it origin from the disequilibrium between supply and demand. In our case we have a deregulation between money supply and money demand.

In order to determine the value of inflation we should be able to determine the value of money, which is determined by supply and demand for money.

Money Supply is determined by the central bank of a country, through open-market operation etc. Money Demand represents the amount of money that

consumers want to hold over a specific period of time, or if we can say it in another way, it represents the amount of wealth that people want to hold in liquid form. And monetary equilibrium is achieved when money supply intercepts money demand.

When government decides to increase money supply (such as the example below), MS shifts in the right to MS₂.



MS increases, this means that people will have more liquid money, so quantity supply exceeds quantity demand. People will get rid of this excess through investing this amount, usually in bonds, so the level of loans will increase.

As a result the level of investment will increase, so the demand for goods and services will increase. The ability of an economy to supply goods and services is determined by the available amount labor, physical capital, human capital, technology. And these factors cannot be changed in the short run, as a result price

will increase, by putting the market in the second equilibrium and decreasing the value of money at $\frac{1}{4}$.

The Quantity Theory of Money:

To give an appropriate answer to this question we have to analyze **The Quantity Theory of Money**, which is considered to be one of the ten principles of Economics. This Theory gives us a correlation between money and the general price level, so it give an in-deep relation between total aggregate demand to the total value of output .

It was first discovered by Irving Fisher and sometimes it is called the Fisher identity. Fisher claimed that:

$$M \times V = P \times Y$$

Where:

1. M is the money supply
2. V is the velocity of circulation of money (represents the number of times that a unit of currency it is used in a given period of time. It is calculated by dividing the money value of national output by the money supply.
3. P is the general price level
4. Y is the real value of national output (i.e. real GDP)

In this equation we treat V and Y as constant. V measures the velocity, and as we assume the velocity of money predictable, this means that we can treat it as constant.

Y represents the real value of national output, in this theory we make an assumption that the real value of GDP is not influenced by monetary variables, therefore we can treat it as constant.

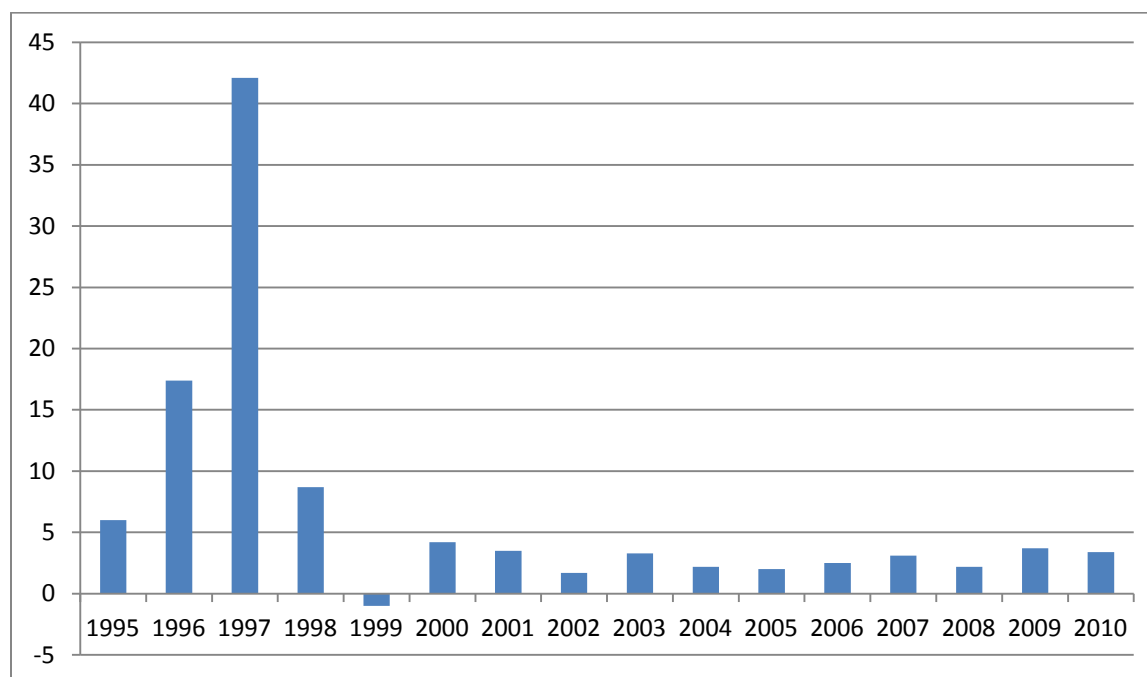
Albania Application

In the first graph we can see the deviation of CPI (which Consumer Price Index, measured by basket of necessary goods and services) through time.

Years	1995	1996	1997	1998	1999	2000	2001
CPI	6.0	17.4	42.1	8.7	-1.0	4.2	3.5

2002	2003	2004	2005	2006	2007	2008	2009	2010
1.7	3.3	2.2	2.0	2.5	3.1	2.2	3.7	3.4

Source: INSTAT



As we can see from the graph, the level of inflation has increased in pretty high percentage from 1995 till 1997. This is due to the political conditions that Albania was facing during that period of time, such as the entry in democracy etc.

In 1999 till 2000, Albanian economy was facing a negative inflation, and this is related with the Albanian banking system faced serious problems.

And from 2001 till 2010 inflation in Albania has been pretty constant.

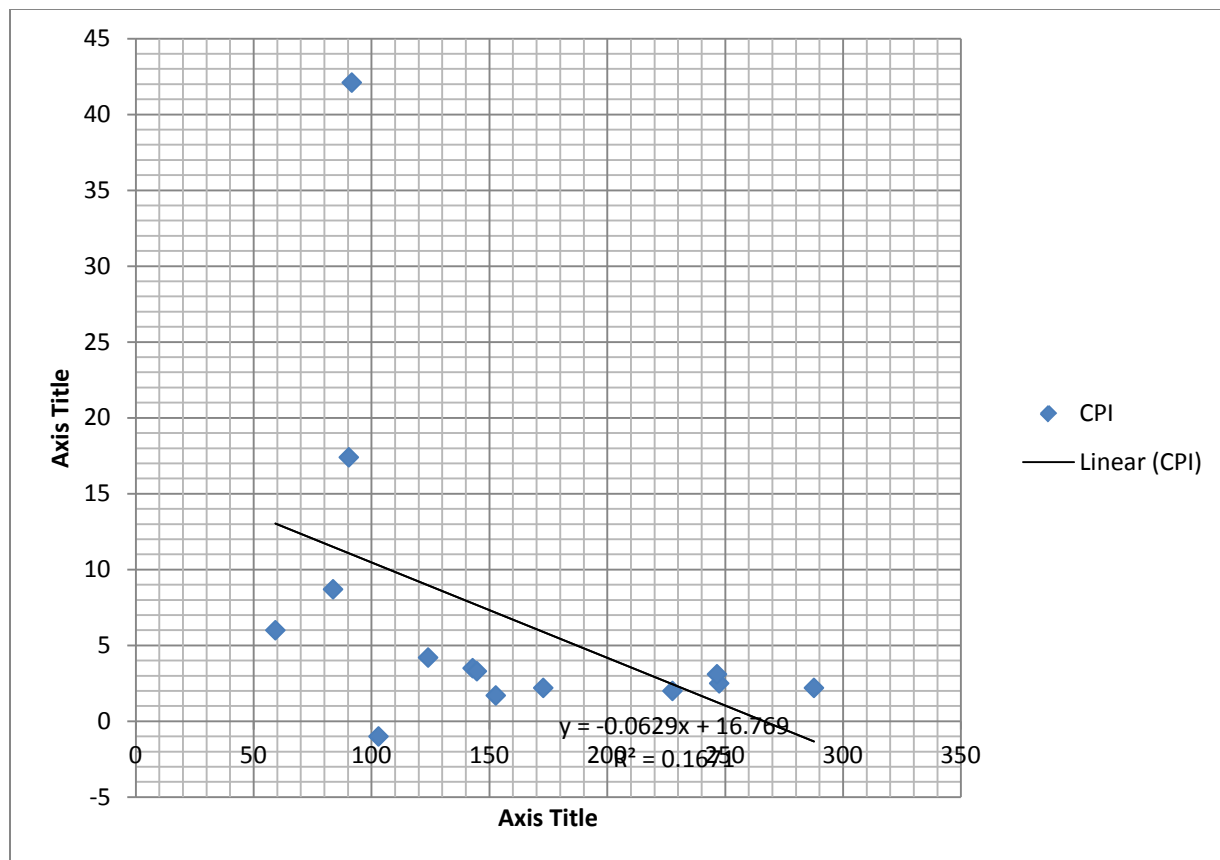
M1, CPI correlation:

In this graph we have provide the correlation of the relationship between money supply and inflation. I have used M1, which includes currency held by the public, plus travelers' checks, demand deposits, other checkable deposits.

Years	1995	1996	1997	1998	1999	2000	2001
M1	59.252	90.406	91.667	83.729	103.004	124.041	142.041
CPI	6.0	17.4	42.1	8.7	-1.0	4.2	3.5

2002	2003	2004	2005	2006	2007	2008
152.741	144.730	172.833	227.684	247.505	246.575	287.696
1.7	3.3	2.2	2.0	2.5	3.1	2.2

Sources: INSTAT



We have plotted the data in excel, the regression analyze

$Y = -0.0629x + 16.769$ and R square is 0.1671

Beta in our case shows that a 0.0629 correlation this means that there is no correlation between the two variables (according to statistical theory).

As we can see from the graph, in the scatter plot, the data too wide spread.

This relation was first discovered by David Hume's, in 1752 in the essay "Of Money", in which he analyze the the increases in money with the increase in price, and as it is too old and it was proven too many times from different economists, we can say that INSTAT is lying or that it has given false data.

Conclusions:

I would like to conclude this paper with a claim of M. Friedman. Milton Friedman in 1963 , claimed that “Inflation is always and everywhere a monetary problem “
It takes a long time in which we can see the relationship between money growth and inflation or to be evident but it do exists.

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APPLICATION OF UNIFORM RULES OF INTERNATIONAL DOCUMENTARY LETTER OF CREDIT IN BANKING OPERATIONS IN THE REPUBLIC OF MACEDONIA

FULL PAPER

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Abstract

International trade and international business working, by the time have made more instruments which are used for insurance of payment, that by the experiences are shown as necessary for working and insurance of the involved parties in transactions. Among these kinds of instruments, international letter of credit takes the first place. The letter of credit as a form of payment is recommended for a large amounts of money or high-risk transactions. It provides a high level of safety and protection of unpaid bills, which presents undermine of the fundamentals of the international trade in general. That's why the world economists call this method of payment "the lifeblood of international commerce". Because of that is shown a need of respectable knowledge of the working rules with letter of credit by the banks side which is directly involved in conduction of this form of payment. A letter of credit transactions are governed by ICC rules, and whilst these provide an international standardized process. The problems that might arise mostly are because of the differences of interpreting UCP – rules. More frequent use of this method of payment by companies in the R. Macedonia would lead to a reduction of documentary discrepancy rates and financial risks. This article examines how this rules are interpret and how they are used in banking operations in R. Macedonia.

Key words: A letter of credit, ICC rules, methods of payments, banking regulations

JEL Classification: G20, K1, K12, K40

1. Introduction

The letter of credit is a form of payment, which we can define as a written obligation for payment taken by the bank, issued upon order and instructions of the buyer (principal) for payment of a certain amount to the seller (beneficiary) of the letter of credit after all conditions assumed in it are provided. The documentary letter of credit represents a kind of guarantee that the payment will be done at sight or on exact determined date in the future, providing that all conditions from the letter of credit are met. The documentary letters of credit most often are used as a form of payment in the external economic trade between the entities with minor trade history and the level of trust between the two parties is still very low. Although this form of payment is the most complex one in the banking business, however in practice it proved as a safe asset since it enables greater security for both parties involved (sellers and buyers). In practice it can happen for the seller and the buyer not to be in contact, i.e. not to see or meet

each other, which brings the necessity of using the form of payment which protects the interests of both parties, and the most suitable one is the form of letter of credit payment. When the goods are bought or sold abroad, the transactions can become very complex due to many reasons such as the time required for transport of goods or the time of transport, the accidents that may occur during the transport, the customs formalities, as well as the fact that the buyer and seller are distant between each other with borders.

The rules which apply to the operation with the documentary letter of credit are legal practices, i.e. codified customs. To overcome the differences existing in the legal systems which apply to the trading business and the differences in the trading customs in different participating countries or parties in the letter of credit, for the first time in 1993 unifying of the rules for using the International Documentary Letter of Credit was done, known as (UCP-rules) by the International Chamber of Commerce based in Paris ¹.

These Uniform rules and practices have been reviewed, amended and supplemented several times since their first codification and publication till the present day, the last time being in 2007 known as "UCP - 600 rules". They are subjected to reviewing due to their adjustment to the frequent changes of the conditions in the trading in general, which makes it necessary to be followed, studied and applied in practice by the members of the International Chamber of Commerce. Many companies and associations dealing with international trading appear as members of the Chamber of Commerce; they are organized in national committees or groups, and in the countries which are still without these committees, the companies can independently become members of the International Chamber of Commerce. There is still no such ICC committee formed in our country. The insufficient knowledge of the rules in operating the international documentary letter of credit arises many problems and disputes, which take a lot of time, money and energy for their solving, due to the complexity of this form of payment.

2. Application of the International Documentary Letter of Credit in R. Macedonia as a means of letter of credit payment, forms of letter of credit used and the role of the International Chamber of Commerce (ICC) in letter of credit payment

As we already mentioned in the introductory part of this presentation, the documentary letter of credit is a written obligation for payment taken by the bank, issued upon order and instructions of the buyer, and in favor of the buyer, guaranteeing that the payment will be done at sight or on exact determined date in the future, providing that all conditions from the letter of credit are met. These conditions will be considered fulfilled when the principal of the letter of credit (the seller) provides the exact stated documents in the letter of credit to the bank within the precisely determined time. While working with the documentary letter of credit a great number of different documents appear as a condition for execution of payment, and which of them will be used in each letter will be identified by the parties when concluding the

¹ R.Radkov, V.Adamov, A.Zahariev, "Currencies and currency systems", publisher "Abagar", Veliko Trnovo, 2000, p.383-384

purchase agreement. In practice, as most often used documents are those which refer to the goods, such as commercial invoice, packing list, certificate of origin of goods, certificate of quality of goods, then documents referring to the transportation of the goods such as bill of lading, the shipment list and the documents for insurance of the goods, such as the insurance policy, the insurance certificate, etc. While operating with the documentary letter of credit must be taken into consideration that they are completely separate transactions from the purchase of goods agreement or service performance and the other agreements to which they are based upon. When talking about letter of credit payment, the question arises about the responsibility of the banks when using this instrument of payment. The banks, through which the letter of credit payment is done, work and are responsible only for the submitted documents referring to the goods and services, and not for the goods and services themselves. In their work, they rely only on the text of the letter of credit. The banks are not responsible for the legal disadvantages of the agreements on which payments are made to a letter of credit, even if such agreements are referred to in the letter of credit, and consequently they do not correspond to the physical and legal disadvantages of the goods which is a foundation of this legal matter. The banks do not undertake any obligation or responsibility for the shape, the accuracy, authenticity, abuse or legal validity of any document which is submitted or for the specific conditions listed in the documents. The bank is obliged only to investigate if the documents comply completely with the requirements stated in the order of the applicant. In case of higher force (*vis major*), the bank has no obligations or responsibility for the consequences which will appear after the termination of the business relations between the both parties, strikes, redundancies, wars, etc. After receiving the documents, the bank must check them as soon as possible, and inform the principal if there are any irregularities or discrepancies found². While opening the letter of credit, its provider and his bank conclude a special agreement for opening letters of credit for payment abroad. The same happens between the credential beneficiary and the bank which makes the payment.

As basic subjects in letter of credit payment appear:

1. Provider of the letter of credit (principal)
2. Issuing bank (credential bank)
3. Advising bank
4. Credential beneficiary

Provider of the letter of credit (principal) is the one who is a buyer or payer according to a given purchase agreement which provides the payment to be realized by opening letters of credit.

Issuing bank is the bank where the letter of credit is opened and which performs the payment upon opened letter of credit.

Advising bank is the one usually based in the country of the beneficiary, through which the issuing bank (credential bank) requires to notify the beneficiary about the terms of the letter of credit. It is important to note that there is no obligation for the advising bank regarding the payment of letters of credit.

Credential beneficiary is actually the entity in whose favor the letter of credit is opened. This regards to the exporter or the seller.

² G.Galev, J.D.Anastasovska, "Law of Obligation", practicum, Book2, Prosvetno delo, Skopje, 2002, p.994-995

From a legal perspective the decision to use this form of payment covers the occurrence of certain number of separate individual agreements. The first agreement is the one concluded between the seller and the buyer which states or specifies the fact that the payment will be executed through documentary letter of credit. Since this form of payment involves more parties in its implementation, the buyer appears as an applicant in some bank (credencial bank), which is required to compose or edit the letter of credit in favor of the seller or the credencial beneficiary, thus making a new agreement between the credencial bank and the applicant (the buyer). This agreement by its own legal nature represents an order agreement ³. Furthermore other agreements occur between the credencial bank and the credencial beneficiary (the seller). This is a conditional agreement ⁴, since the credencial bank guarantees payment of the assets to the seller (credencial beneficiary), only if all documents are presented in the advising bank in the correct form, provided by the International legal rules for documentary letters of credit (USP-rules).

However the letter of credit as a form of payment is typically channeled through the banking system and the payment of the assets is not done directly by the credencial bank of the credencial beneficiary (seller), but the credencial bank enters, i.e. signs another agreement with other bank (advising bank) in order to protect itself of fraud or related actions. Thus signed agreement is in service of mediating between the credencial bank and the advising bank in the country of the seller (credencial beneficiary). In the end an agreement is signed between the advising bank and the credencial beneficiary (seller).

All of the above mentioned can be easily presented in the following scheme:

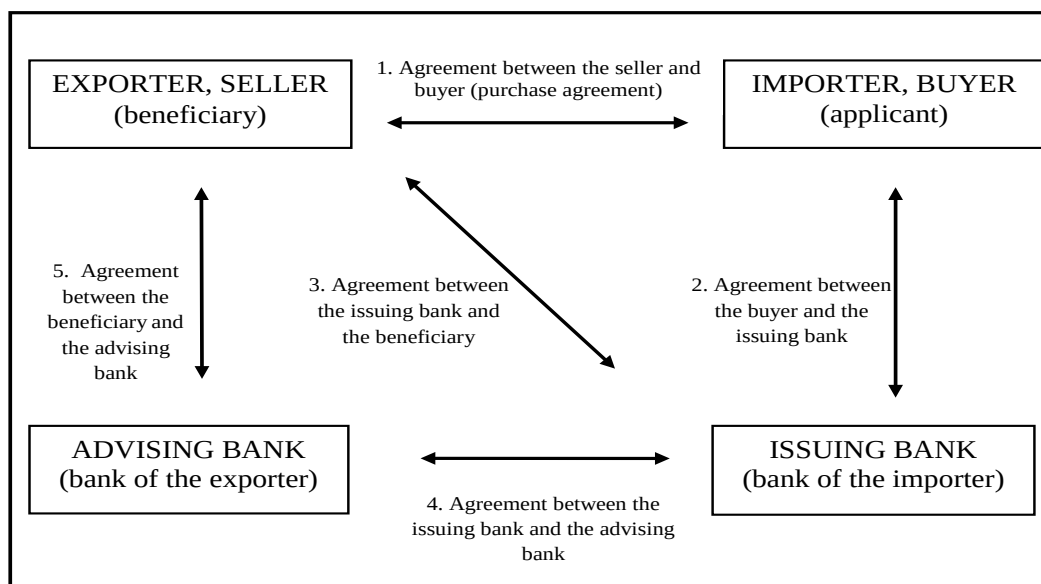


Figure 1. Procedure for letter of credit payment

Source: R.Bergami, "UCP 600 rules-changing letter of credit business for international trades", *Int.J.Economics and Business Research*, vol.1,No.2,2009 – pp.193

³ See: Law on Obligatory relations, art.805, Government Gazette of RM, no.18/01, no.4/02, no.84/08

⁴ *ibid*

According to the international legal rules (UCP-rules) after concluding the whole procedure for credential payment, i.e. after all documents are be given to the importer (buyer) and his account is obliged by the bank, the letter of credit is closed according to the type of credit and the expiration of the time limit provided as a condition in the credential order.

The question arises why the banks accept this complex form of payment. The answer to this question simply implies that for every conducted operations of credential payment, the banks gather commission awards – when opening, confirming, condition changing, payment, and closing of the letter of credit. In most cases, the burden for payment of these awards is at the expense of the buyer, i.e. the importer, the one who opens the letter of credit. Thereby they enable increased profits of the bank.

It is important to notice which forms of documentary letter of credit are used and are known in the banks in R. of Macedonia.

First and most important division of the documentary letters of credit, known also to the Macedonian Law on Obligatory relations is the one which divides them into: revocable and irrevocable letters of credit⁵.

Irrevocable documentary letter of credit is the one when the issuing bank assumes an irrevocable, independent and immediate obligation to pay if the beneficiary has met all necessary conditions. Such decision may be discontinued or modified only with the consent or agreement of all involved parties.

The revocable letter of credit does not oblige the bank towards the beneficiary, thus at any time it can be modified or revoked on request of the principal or on his own initiative, if it is in favor of the principal (applicant).

The next division of the documentary letters of credit is the one which divides them into **Nostro** and **Loro** letters of credit. Such division is connected to the movement of the goods, i.e. is it import or export of the goods. According to this:

Nostro letter of credit is the one which is opened on order of the domestic buyer-importer.

Loro letter of credit is the one which is opened by the foreign buyer-importer in favor of the domestic seller-exporter.

Other types of letter of credit are the advising and confirming letters of credit.

Advising letters of credit are those which are forwarded to the credential beneficiary bank. These types of letters of credit always include obligation of the issuing bank for credential payment, while the advising bank has no obligation for payment of the same, and it only acts on behalf of the issuing bank.

Confirming letter of credit is the type of credit where the advising bank, while confirming the credential, takes responsibility to perform the payment on the presented legal documents and at the same time, this responsibility is independent of the irrevocable obligation of the issuing bank. The confirming bank takes the responsibility for payment regardless the fact if the credential bank is capable to perform the payment. Here the exporter or the seller uses two confirmations for payment of the letter of credit, one by the bank which opens the letter of credit, and another by the bank which confirmed the letter of credit⁶.

⁵ G.Galev, J.D.Anastasovska, "Law of Obligation", practicum, Book2, Prosvetno delo, Skopje, 2002, p.995

⁶ R.Radkov, V.Adamov, A.Zahariev, "Currencies and currency systems", publisher "Abagar", Veliko Trnovo, 2000, p.381-382

Besides these, there are other types of letter of credit such as: letters of credit at sight, differed payment letters of credit, acceptance credit, negotiation letter of credit and advance payment letter of credit (with red clause). However, due to different situations which can occur to the businessmen in everyday trading and due to the improbability to satisfy these specific needs by most of the already mentioned standard types of credentials, other solutions are sought. Thus, special types of documentary letters of credit have been formed, such as: portable letters of credit, back to back letters of credit, revolving letters of credit and standby letters of credit.

The usage of documentary letter of credit is unified in order to avoid the differences in the trading practice and the trading customs of the various interested parties. Such differences may cause great difficulties in using the letters of credit as a form of payment ⁷. Therefore, it is of great importance to have thorough knowledge of the international legal rules. These rules are revised and modified many times: in 1951, 1962, 1974 and 1983, and the most important made in 1993, known as UCP-500 rules, and the one from 2007 known as UCP-600.

The revisions are done by the International Chamber of Commerce (ICC), in order to accommodate them to the modified conditions of operation, the changes in the international banking and the modified needs of the beneficiarys of this banking instrument ⁸.

The international chamber of commerce (ICC) with the revision of the rules from 2007, according to some researchers, lowers the discrepancy rate when using the documentary letters of credit to 70% ⁹

UCP-600 rules, unlike all previous versions, are clearer and written in simpler form in order to remove the ambiguities and differences in interpreting of the same ones, with hope to lower the rate of non-payment and financial risk. These rules refer to all letters of credit opened after 1st July 2007. The rules are applied to all types of letters of credit where possible to be used, and where the text of the letter of credit strictly refers to their application. With the latest changes of the UCP - 600 rules, the number of members and titles is lessened from 49 in the previous revision, to 39 in the present, which clearly states the tendency of the International Chamber of Commerce (ICC) to their simplification. UCP - 600 rules provide four significant changes.

The first change means substitution of the previously used term “reasonable time” with the exactly determined number of days during which should be done an inspection of the documents and their compliance should be determined by the bank (5 working bank days). With this change the possibility to delay the procedure of realizing the payment is reduced. According to the new changes, the bank is not responsible for the mistakes in the translation or interpretation of the technical terms, and reserves the right to deliver and execute the credential services without their translation.

The second important change refers to the address of the beneficiary and principal. According to UCP-600 rules, when the beneficiary and principal’s address occurs in any

⁷ Ibid, p.383

⁸ R.Bergami, “UCP 600 rules-changing letter of credit business for international trades”, Int.J.Economics and Business Research, vol.1, No.2, 2009 – pp.195

⁹ R.Bergami, “UCP 600 rules-changing letter of credit business for international trades”, Int.J.Economics and Business Research, vol.1, No.2, 2009 – pp.191

document provided, they do not have to be the same with those stated in the text of the letter of credit, but must be within the same country stated in the letter of credit.

The third change refers to the broadening of the explanation of the “original” documents, therefore according to the new rules the bank treats all documents with original signature, sign, stamp etc. as original ones, except those where the document itself indicates that it is not the case of an original document. The International Chamber of Commerce based in Paris is making serious efforts to affect the electronic contracting and e-commerce, thus it mentions the possibility of substituting the traditional written documents with electronic documents when it comes to the international documentary letter of credit ¹⁰. There is almost no country in the world where a special law is adopted by which the companies are allowed to make electronic agreements verified by electronic signature, therefore it logically follows that these documents will be used in the international documentary letter of credit as a form of payment.

And in the end there is the last greatest change referring to the modification of the articles regarding to the transportation documents and finally solving the confusion about the transporter and the agent ¹¹.

Due to these changes of the rules, when used in practice, in the letter of credit itself should be stated which rules will be practiced in the case, to avoid the situation of misunderstanding between both parties. In practice we rarely have such situations since the term “subject to UCP latest version” is used in the text of the letter of credit, which means automatic implementation of every new version.

To avoid the problems which may occur when using this term, the best way for both sides involved in the specific credential payment is to make an agreement between each other about the rules by which they will be guided.

Due to the complexity of this form of payment which covers occurrence of several agreements between the participants in the procedure, some misunderstandings may arise, or even a dispute. The question arises how to settle down the already present dispute about the documentary letter of credit.

Besides the court’s jurisdiction, as a classic example of resolving disputes, the UCP-600 rules predict the possibility of arbitration dispute resolution, i.e. the possibility of using the ICC-arbitration (International Chamber of Commerce arbitration) ¹². The arbitration as an alternative way of resolving the disputes is more effective, reducing the costs of the procedure itself and the time needed for obtaining the final solution of the specific matter. Therefore, the businessmen who pay particular attention in rapid resolution of the matters, very often decide to use the arbitration as an alternative way in resolving the dispute. However, to put it into practice, it is necessary for the parties expressly to state that fact in the text of the opened documentary letter of credit, since the very issuing of the letter of credit does not have the obligation to use the ICC - arbitration. For its practice, there must be mutual consent with the both parties in the agreement made between them at the beginning. The ICC - arbitration is also used in case when the dispute may occur in the relations with the credential bank, the

¹⁰ Lawyers Association of R.M., “Business Law, edition for theory and law practice”, year X, addition, Prof.D-r. G.Koevski, p.247-248

¹¹ ICC Publication no.600 (UCP), 2007

¹² ICC Publication no.600 (UCP), 2007

advising bank and the confirming bank, i.e. the bank which performs a kind of confirmation of the letter of credit and belongs to the range of worldwide recognized banks.

The International Chamber of Commerce (ICC) has been a world's leading organization in the field of international trading for a long time. Thus, it plays a great role in the letter of credit as a form of payment, mostly used in the international transactions. For the first time it formed the uniformed legal rules for letter of credit operations. Its role is to take care if the rules correspond with the working conditions in the international banking, to revise and adjust them to the newly evolved conditions, and to reduce the discrepancies which occur when using this form of payment. Its obligation is to post publications, holds seminars and trainings through which it will bring the rules closer to the beneficiaries of this form of payment and will reduce the problems that may occur while implementing it, because of incorrect interpretation of the same. Within the International Chamber of Commerce there is arbitration for resolving of the disputes caused when using this form of payment, but we must mention that its usage is not compulsory, but alternative if the parties strictly determine its competence in the concluded agreement. The International court of arbitration was founded in accordance with and by the International Chamber of Commerce based in Paris in 1923, in order for fast and efficient problem solving in the international trading. The beneficiaries of the letter of credit as a means of payment often use the arbitration for solving the caused problems because of the arbitration's speed, efficiency and independence.

The International documentary letter of credit as a form of payment most often used in the international transactions, also finds practical application in our country. The credential bank's liabilities, the form of the letter of credit and the bank's obligations are regulated with our country's Law on Obligatory relations¹³ by eleven articles, but my personal opinion is that there should be supplementation of the Law in the letter of credit section, since I believe the rights and the liabilities of the credential and the advising bank, and of the beneficiary and the applicant of the letter of credit are not enough covered. Also, I think the section on the forms of letter of credit should be amended and few other articles should be added that will give more detailed explanation of the other forms of letter of credit, such as Nostro and Loro letters of credit, the advising and back-to-back letters of credit, as well as the newer forms or shapes of letters of credit. The Law on Obligatory relations as types of documentary letter of credit, in the articles 1116, 1117, and 1118 refers only to the revocable and irrevocable letter of credit, which makes me think of it as nonsufficient and needs supplementation.

The Macedonian commercial banks use this form of payment, and some of them have special sectors in charge only for operations with documentary letter of credit. However, the small and medium enterprises dominant in our society rarely use this form of payment, and the reason for it is the insufficient knowledge of its advantages and the safety it offers them. The letter of credit most often is used by the big companies in import and export of the goods. When using the documentary letter of credit, great role play the banks as a part of this diverse relation. While making the decision if the client will use this form of payment, it is also very important how big the client's trust towards the bank's work is.

As practical example how the whole procedure of credential payment goes, a specific example from our practice can be taken. First of all, an agreement for delivery and payment of

¹³ See: Law on Obligatory relations, art.1111-1121, Government Gazette of R.M, no.18/01, no.4/02, no.84/08

the concerted goods is concluded between two business partners from two different countries. A Macedonian limited liability company “Mak Mak” concludes an agreement for sale of safety glass with another limited liability company “Modernet Ithalat” from Turkey, in which agreement they have determined the payment to be done through documentary letter of credit. The “Mak Mak” company with this agreement goes to one of our banks and concludes an agreement with the bank for opening a letter of credit for payment abroad. In this agreement between the company and the bank the company’s name is stated and the fact that the company is the principal of the bank. For that purpose, the principal, i.e. the applicant fills out an application of the bank for opening letter of credit.

Furthermore, in the agreement it is stated what type of letter of credit is used, in this case irrevocable, non-confirmed letter of credit. Thus, in this case we are not dealing with confirmed letter of credit, which means there is no such bank that will perform confirmation of the same, i.e. there is no third bank participant in the whole procedure. The agreement between the bank and the principal determines the subject of the letter of credit, in this case import of safety glass. The agreement clearly states that if during the letter of credit’s validity the principal and the beneficiary make any changes in it and for the same ones the principal submits written instructions to the bank, then they will be considered as an integral part of the agreement since the very beginning. With the letter of credit the bank takes obligation towards the beneficiary of the letter of credit to pay the amount up to the level of the letter of credit if the conditions given by the principal are provided. In the agreement it is clearly stated that the bank will open the letter of credit according to the International uniform rules, publication 600 of the International Chamber of Commerce in Paris. It is also stated that the bank works exclusively with and based upon the presented documents determined in the letter of credit by the principal, and it is not responsible for the faults and the commercial relations between the principal and the beneficiary of the letter of credit. With this it is clearly specified for the client to know where the bank’s responsibility ends for the letter of credit it opens. The principal of the letter of credit is liable two days prior to the individual payments upon the letter of credit, but not later than the date of the payment abroad, to provide foreign currency means for payment of the obligation of own foreign currency income, or by buying foreign currency on the bank’s currency market. If the due day for payment is nonworking day, the principal is obliged to provide coverage for the next working day at the latest. In case if the letter of credit is not used and the bank stays indebted by the foreign bank for the costs of the letter of credit, the same should be paid by the principal through the bank. For the opened letter of credit the principal is obliged to pay the bank the costs according to the current rate of fees and services done by the bank in the payment operations and foreign currency affairs, such as: 1. Provision, of 0,3 % in our case, for opening a letter of credit and unspecified percentage for providing confirmation of a foreign bank, and 2. SWIFT – compensation – of 500 denars at once in our case.

In the agreement the documents needed for the principal to submit to the bank for opening letter of credit are clearly determined. In our case it is about:

- One blank signed intent for purchase on the currency market and,
- Three blank signed delivery notes for purchase of foreign currency on the currency market.

In the agreement between the bank and the principal, the bank in one of the articles determines the safety instruments, and in our case it is about the bought currencies on the currency market in amount of 4.500 euro. The bank will use the blank signed documents if invoked to pay upon the letter of credit. In this agreement also the jurisdiction court is determined, if eventually any issue occurs between both parties, and in this case it is the Primary Court – Skopje.

After the agreement is done and signed between the principal and the bank, the bank itself by using the SWIFT - communication provided with the international rules for banking, will inform the advising bank for the opened letter of credit. In this SWIFT - message or communication realizing between both banks (the buyer and seller) will be determined what form of letter of credit is used, in our case it is irrevocable letter of credit, then the number of letters of credit, the issuing date of the letter of credit, in our case 03.02.2009, the rules under which the payment will be done, i.e. which rules will apply, in our case it is UCP - latest version, which is not the best solution since it can cause confusion between the participants in the credential payment if they are not familiar with the latest version of these rules. It is also determined the expiry date of validity of the letter of credit, in our case 14.05.2009, the name of the applicant's bank, the name of the applicant itself, the name of the credential beneficiary and his bank, the currency used for the payment, in our case euro, and the amount presumed to be paid, in our case 4.500 euro. The SWIFT - message contains the information if a partial delivery is allowed or not, in this case it is not, and if transshipment of goods is allowed, in the case it is, and as a transshipment port in our case is the Shanghai port – China. The SWIFT-message may contain information about the final destination of delivery, in our case it is Turkey, as well as the deadline for delivery of goods, in our case it is 23.04.2009. It also includes description of the goods delivered and it is noted according to which document the inventory of goods is determined. In our case it is about safety glass provided by invoice number A – 6025 from 03.04.2009. It is stated that incoterms 2000 are used, and the necessary documents needed to be submitted to the bank for payment of the letter of credit. In our case the documents needed are: one signed original invoice addressed to the applicant, where the applicant's and the credential beneficiary's whole name can be seen, one original packing list and one copy, quality certificate in original and a copy, and insurance policy that covers all risks. As supplementary conditions in our case the following are mentioned: documents issued by a third party are acceptable for confirmation of credential payment. At the end of the SWIFT-message it stands that these documents should be presented to the commercial bank of R.M where the letter of credit is opened for further forwarding to the bank of the credential beneficiary. In our case the time for presenting these documents in the bank is limited to 21 days after the completion of delivery. At the very end of the message it stands that there are no confirming condition needed to be completed when talking about non-confirming documentary letter of credit. It also states that if all documents provided are in accordance with the ones appointed in the agreement, i.e. with the requested ones, the payment will be done in favor of the credential beneficiary. With such exact stated conditions in the SWIFT - message the banks communicate between each other and conduct the letter of credit transactions in favor of their clients (the principal and the beneficiary of the documentary letter of credit).

3. Conclusion

Knowing the rules for operating the international documentary letter of credit and their more frequent application in practice make the payment requests between the businessmen much simpler worldwide. On the other hand, if there are no international standards for operations with the documentary letter of credit such as UCP - rules, greater difficulties would appear at every participant in this form of payment. That's why it is necessary solid knowledge of the same and their regular interpretation, so that all problems possible to occur will be avoided before even they appear.

Our country as a member of the International Chamber of Commerce officially has accepted and is using the uniform legal rules for documentary letter of credit, but what is missing is proper implementation of the same in practice and their proper interpretation. That's why it is necessary to carry out more debates, seminars and forums on this very topic, where the questions on operations with documentary letter of credit will be dealt with, and where the benefit from using this instrument of payment will be explained to the wider range of subjects dealing with trade. Indirectly it affects the total economic development of the country and establishes a favorable business environment in it.

The proper usage of this instrument of payment leads to greater legal security of the trading entities, to benefit for the banks which implement the payment, and to the most general resolving of the biggest issue in our society, the issue of payment.

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GOVERNMENT POLICIES AND WORKFORCE PLANING IN THE KNOWLEDGE BASED ECONOMY

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Abstract

As the world nowadays is shifting towards a new economic order based primarily on human knowledge and innovation, human resource development has become the most important factor for boosting and improving the productive and competitive capabilities of nations' economies. Human capital, intellectual capital, knowledge and skills are increasingly recognized as vital constituents of future economy and the key elements to successful organizational growth. In well-known system of tripartism government has always played significant role in structuring labor markets, creating an employment system policy and developing human resources. But yet many questions have been raised about what this role should be and do governments have the capacity and capability to play any useful role in today's free market and global economy.

Key words: *human capital, economic development, knowledge economy, knowledge management, education, human resource management, workforce planning, government policy.*

Introduction

The most of traditional economic literature on growth and growth factors relied on production functions based on using capital and labor as inputs. Knowledge has always been considered as external factor and its impact on production has always been questioned. Nowadays, recent approaches in economic literature are introducing knowledge as a specific input to growth and there is a much talk of knowledge economy and key role of knowledge in generating economic growth. Investment in knowledge lead to increased productive capacity of the other factors of production and also can change these factors into new products and operations. This points that knowledge and investing in knowledge is one of the main factors for increasing returns and long term economic growth.

In recent years we are witnessing how countries of the developed world are shifting from stage of industrial era to stage of what is referred to as post-industrial era or knowledge based economy. In knowledge based economy productivity and economic growth are generally determined by the rate of technological development and accumulation of knowledge.

In this paper it will be argued about the role and capacity of government policies in creating and maintaining human capital and specific workforce planning in knowledge based labor market. In this connotation government should be creator or should become a catalyst for innovation and for ensuring that all the workers are able to contribute to and prosper in a knowledge based economy and afforded opportunities to use their knowledge in their work. Government policy or we can say government knowledge management policy will have some key roles in today's labor markets such as:

- creating and maintaining human capital
- supporting knowledge based work for achieving high performance
- creating and supporting institutional infrastructure needed for interaction with modern labor markets

The main or the key challenge of government policy makers today is the nature of work, the workforce and the global economic labor market which all of them have changed faster than the policies and institution that govern and support labor and employment relationships. This paper will try to anticipate the future of work and labor in knowledge based economy or in the worst case scenario will just open a debate about changing the structure of the workforce and labor market and the needs of different government policy and workforce planning in economy based on knowledge as a fundamental resource.

Descriptive analysis

If we start with the basic assumption that most of existing education, human resources and labor policies are built to fit manufacturing and needs of existing national economies we can conclude that there is emergency need for changing the policies or part of the policies that remain from earlier era or stage of development.

This starting assumption no longer fit the work settings in nowadays global labor market and we can point some important new aspects:

- Employment relations are seen in different forms – full and part-time jobs, long-term stable jobs and short-term contractual arrangements, regular employees and independent contractors, freelancers ...
- Work environment and different employment settings – industrial and service sectors, small and large firms, new entrepreneurial start-ups, marketing and service providers ...
- Formal schooling – human capital and knowledge is not necessarily created on the job. It takes effort to stay current with changing new technologies and new work requirements.
- Thinner line between managers and workers – decentralization of decision making, independent judgment.

The most of the important changes and implications of government policy and labor market institutions flow from these differences. Policies can no longer be built around the expectation that the most employments will be long term and stable jobs. Nowadays workers must start from assumption that they will work for different employers and for that reason they must remain employable by keeping their human capital current with new job requirements and upgrading and increasing through what is called life-long learning. If in general, firms cannot assure long term stable jobs there is no need to invest in creating human capital and the main role of creating human capital in this case will be or should found in government policy. In this sense the task of government policy is to create and support a system of labor market policies and strategies that update the features of its system to meet the needs of today's economy and workforce, system that values an requires human capital and knowledge.

There are several indicators for quality of the human resources in a society or labor force, for example, quality and distribution of basic education of children and young adults, the ongoing or life-long learning opportunities and uptake of the current workforce, the labor force participation and utilization of the educated population etc. All these factors together are defining the quality of overall workforce in the country.

In order to facilitate the development of the economy, it's necessary to invest in education to create a strong flow of educated people.

Table1. Sales and Market Capitalization of Companies in Various Industries, September 2011¹

<i>Natural resources</i>	Revenues	Capitalization
Placer Dome Gold	1.3	3.5
USX – US Steel	6.9	1.7
Alcoa Aluminum	24.4	35.1
Inco (Nickel)	2.5	3.1
Phelps Dodge (copper)	4.5	3.3
Georgia Pacific (paper)	26.7	9.9
Weyerhaeuser (forest products)	16.0	12.1
Total	82.3	68.7
<i>Oil</i>	Revenues	Capitalization
Ashland	8.3	2.8
British Petroleum	164.0	199.0
Chevron	45.4	62.4
Conoco	40.4	18.6
Exxon Mobil	200.0	310.0
Phillips Petroleum	19.3	15.9
Sunoco	14.0	3.2
Total	491.4	611.9
<i>Software and Internet</i>	Revenue	Capitalization
Adobe	1.4	8.3
Intuit	1.26	7.5

¹ Source: The Value Line Investment Survey, September 2011

Microsoft	25.3	326.0
Oracle	10.9	82.0
Siebel	2.3	11.0
Verisign	.985	8.9
Yahoo	.715	7.7
Total	42.86	451.4

The efficiency of economic development in the last two hundred and fifty years is because of the technological development. The technology is represented by the knowledge and mastery to manage machines and importing innovations in production. Through the history are marked moments of successful and unsuccessful economic development. Thanks to that, modern economists do not make trips.

Accelerating pace of technological growth and development appears tendency to the economy to become “knowledge-based”, meaning that the most important thing in the coming economy model will be knowledge and skills, not the material products. By the Peter Drucker, the knowledge based economy is a term that refers either to an economy of knowledge focused on the production and management of knowledge in the frame of economic constraints, or to a knowledge-based economy. It refers to the use of knowledge technologies, to produce economic benefits as well as job creation. The main traits of a twenty-first century knowledge-based economy may be identified as follows:

- The GDP growth to a great extent depends of knowledge in the area of information technology, IT industries, and other high-tech sectors. They also include financial, business, health and educational services.

- Goods and services that we are using every day are obtained by the “knowledge content”

- The presence of entrepreneurial spirit including high tolerance of risk.

- Because of the rapid technological development, the companies have to be innovative, because of losing themselves in the competition.

- Possession of “creative destruction”

- High levels of education, skills and workforce between the populations

- Working in teams and reciprocally cooperation with people will bring a better success

- Insistent pressure on individuals to upgrade their skills and knowledge bases in order to remain employable

- The development of the computers, internet, telecommunications and other forms of technologies in houses, schools and institutions.

With the globalization, the demand for a knowledge workforce is increasing very rapid. Computer-based tools are becoming crucial elements in organizing the activities and groups of people. The demand for knowledge workforce is increasing and in any organization is a critical factor for its success. Knowledge is also central to the knowledge

economy. Every success of firms and individuals depends of the ability to produce new ideas, combination of the ideas to produce new product. Also the success can be notch up with individual and collective abilities to produce and use knowledge.

The workforce level can be increased by combining the knowledge and skills, the ability of workforce members to work in teams.

In the period of nineteenth and twentieth century, workforce planning was not described on the way which is explaining today. Workforce planners were known as educators or educational administrators or maybe educational policy makers...Workforce planning is fashionable since the period between the two great wars of the twentieth century.

CENTRAL BANK INDEPENDENCE: CASE OF BANK OF ALBANIA



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Abstract:

In this paper, I am going to analyze the Central Bank Independence case of BoA. There have been debates whether central banks should be independent or not; and at what extent their claims of being independent or dependent, stand. Enhancing central bank independence is a recent worldwide trend, greatly supported by academics and researchers.

Central banks are an important element of governance in most countries. There is a widespread agreement among central bankers around the world that the stability of the nation currency should be entrusted to independent central banks. Governments generally have a certain influence over central banks, even in the case of banks who claim to be independent. This paper is going to include the current state of Bank of Albania and the difficulties or barriers it faces to reach the desired state. Next will shift toward publications regarding same macroeconomic indicators that central bank and INSTAT publish, but are however represented different from one another. Undertaking a study for Albania's case creates a possibility to compare our system to foreign systems. The comparison will be toward Federal Reserve and European Central Bank.

Key words: CBI, government, stability, Inflation

Introduction:

The History of the Bank of Albania and its credit and monetary system in Albania is the history of the attempts preceding the foundation of the National Bank of Albania (1925-1944), the transformation to the State Bank of Albania (1944-1992), to be concluded in 1992 with the Bank of Albania, which enjoys with the attributes of a modern central bank. Albania had its first central bank institution in 1913. It was founded under the agreement concluded between Ismail Qemali Government with Mr. Karol Pitner and Mr. Oskar Pollak, representatives of Wiener Bank Verein, acting on behalf of the Austrian-Hungarian bank-group and Mr. Pietro Fenolio and Mr. Guido Ansbahe, representatives of the Banca Commerciale Italiana, acting on behalf of the Italian banking group. This institution did not live long due to the political climate of the era and to the outbreak the First World War. The circulation of the first Albanian currency unit took place in February 1926. The gold franc was set out as the official monetary unit. Our currency had its subdivisions (Lek, cents, 1 gold franc equated to 5 Lek and 100 cents) and its manifolds (5, 20 and 100 gold francs). The National Bank of Albania, throughout this period, implemented the gold standard implying that banknotes are converted into gold and into strong foreign currencies, as dollar, lira, pound, etc.

At the end of 1990, the transition of the political system in Albania reflected vital changes, leading the economy to enter into a transforming stage from a state-owned economy in a free market one. This changeover gave life to the two-tier banking system in Albania. Thus, on April 22, 1992, the Bank of Albania was established by the approval of the Law No. 7559, "On the Bank of Albania", which was reviewed latter in accordance with the models taken from the western countries and the recommendations provided from the international organisations.

The Bank of Albania is the central bank of Albania. The economical- political and social developments since the establishment and so far, have enriched the functions carried out by the Bank of Albania (they have augmented and enlarged the functions of the Bank of Albania). The Bank of Albania is a fully state owned-bank and is accountable to the People's Assembly of the Republic of Albania. The Bank of Albania is managed by the [Supervisory Council](#), composed of 9 members, appointed by the People's Assembly of the Republic of Albania for a term of seven years, eligible for reappointment. [The Supervisory Council](#) is headed by [the Governor](#), who serves as General Executive Director as well, in charge of the day-to-day business of the Bank of Albania. Mr. Ardian Fullani is the current Governor of the Bank of Albania appointed by Decision No. 152 of the People's Assembly dated October 28, 2004.

The Head Office of the Bank of Albania is located in Tirana. It has 5 branches in the districts of Shkodra, Elbasani, Gjirokastra, Korça, and

Literature Riview:

A large literature dealing with central bank independence already exists. Different authors have developed various indices to measure central bank independence. They have also tried

to compare central banks from different countries and provided central bank rankings in terms of the degree of independence. On the other hand, different countries show different experiences in this regard, sometimes proving that the relevant theories are true and sometimes false.

There is, however, one well-known outcome: *Typically, developed countries have established independent central banks. These countries proved to be successful in achieving price stability.* Based on this, developing countries as well as Eastern and Central European Countries in their transition period have attempted to establish independent central banks. At least, the new central banking laws have been based on the charters of Western central banks. In other words, the first step was taken through granting a substantial legal independence. The same happened in Albania. By creating a two-tier banking system, a central bank was first established in 1992. The Law “On the Bank of Albania”, passed by Parliament in April 1992 and subsequent amendments were formulated in line with the respective laws in Western countries and recommendations of international organizations (particularly IMF).

Is the Central Bank of Albania, legally independent? How has legal independence evolved over the years? These issues are examined in this paper.

In order to answer these questions, we examine the provisions of the central bank law; compare central bank of Albania with central banks in other countries; and measure Bank of Albania independence based on indices developed for this purpose.

First of all what is central bank independence? In fact this term is a misnomer since no economic institution can be completely free from politics. Thus we cannot conclude a unique definition for independence; however it can be explained as the freedom of monetary policy makers from the direct influence of the central government. To get a better understanding of this concept we may include two important statements: “Independence refers to the ability of the central bank to use the instruments of monetary control without instruction, guidance or interference from the government (Henning, 1994).” And “On the other hand, according to Amtenbrink (2004), the three pillars of central bank governance are: i). central bank independence, ii). central bank accountability, and iii). central bank transparency.”

Measuring central bank independence is not easy work due to differences in central bank laws of different countries and changes that have occurred in the central bank law of our country during the last years, which has led to a change in the behavior of the central bank. Central Bank Independence (CBI) is an important institution that sets the relationship between the Central bank (CB) and the Government relating to such aspects like CB’s operation procedures, monetary policy and borrowing to the government. An independent central bank should have a clearly objective, price stability. Second, the central bank should have both sufficient authority (*de jure* and *de facto*) and adequate instruments to manage liquidity in the banking system to meet its primary responsibility. Lastly, a central bank’s operations should be transparent, and information should be disclosed on a regular basis so that the central bank can be held accountable for its monetary policy and inflation performance.

Why should we ask for an independent central bank?

This is one of the most important points of all papers conducted on central bank independence. A lot of models have been built and a lot of ideas have been discussed regarding the issue that why does a country have as a necessity the independence of the central bank? This is best explained by the negative relation between CBI and the inflation. Trying to reach the primary goal of price stability a country with an independent central bank will face a stable and low inflation. But the positive impacts of central bank independence are not limited to only this fact. Independent central banks can put downward pressure to

government deficit. Implying that the policies undertaken by the bank will lower the deficit gap. On the other hand an independent monetary policy may force or impose stronger fiscal discipline on government. It also contributes to long term growth. Central bank independence is not an absolute good, it has also its drawbacks.

It is obvious that in developing countries, independence for the central bank can be dangerous. Because growth and development is the most important objectives of these countries and undeveloped rules and regulations and lack of sound principles may cause contradiction between fiscal and monetary policies. While many countries have granted their central banks more independence, the idea that central banks should be completely independent has come under criticism. This criticism focuses on the danger that a central bank that is independent will not be accountable. Although maintaining low and stable inflation is an important societal goal, it is not the only macroeconomic goal; monetary policy may have no long-run effect on real economic variables, but it can affect the real economy in the short run.

We can say that CBI has an important impact on economic growth.

Albania is one of transition countries where the correlation between central bank independence and inflation is not very strong. Developments in inflation have been affected by other factors different from one year to another. However, the trend to increase central bank independence will show its effects over medium-term periods.

In fact the historical, legal, and de facto relationship between a country's government and its central bank is far very complex.

Most discussions have focused on two key dimensions of independence. The first dimension encompasses those institutional characteristics that insulate the central bank from political influence in defining its policy objectives. The second dimension encompasses those aspects that allow the central bank to freely implement policy in pursuit of monetary policy goals. Grilli, Masciandaro, and Tabellini (1991) called these two dimensions "political independence" and "economic independence"

The more common terminology, however, is due to DeBelle and Fischer (1994) who called these two aspects "goal independence" and "instrument independence." Goal independence refers to the central bank's ability to determine the goals of policy without the direct influence of the fiscal authority. While instrumental independence refers only to the central bank's ability to freely adjust its policy tools in pursuit of the goals of monetary policy.

Another more important fact for Albanian central bank is that it is fully state owned.

The basic functions that independent central banks must undertake. First of all an independent central bank under normal conditions should only provide credit to the central government. While in times of financial crises that pose a serious systemic risk to financial and macroeconomic stability the Central Bank has a lender of last resort function. Under such circumstances the central bank should lend freely, against the best available collateral, and at punitive rates. While in even more severe economic recessions like in cases when a liquidity crises becomes a solvency crisis, the central bank does not have the resources to act effectively. Only the state, though the Treasury and its power to tax, has the resources to recapitalize insolvent financial institutions.

Central Bank of Albania is independent but papers regarding this issue are rare, and most of the people accept it as a fact. Is it really independent? This is what we are trying to find out with the conduction of this paper. In fact if we see in the web page of bank of Albania we see in bold the fact that Central Bank of Albania is an independent institution. In fact even in the Albanian constitution we can find separate articles regarding the legal

independence and the main duties of Bank of Albania. The law for Bank of Albania changed in 1996 and it states: "The Bank of Albania, within the competences defined by the Law, is independent of any other power for the accomplishment of its main objective and in exercising the tasks assigned

According to the governor of Bank of Albania, Mr. Ardian Fullani "BoA is a consolidated, independent, responsible, and above all, a vigilant institution. Being an independent institution, it should be at the same time, a responsible and collaborative institution, with the Government, Ministry of Finance, Ministry of Economy and other ministries, in order to achieve the main goal, macroeconomic and financial stability. It is important for the Bank of Albania to take decisions independently of the executive authority, politics or markets. The powerful authority that law confers to the central bank may be misused under the conditions of a formal accountability and transparency, which might cause damage to this institution, falling a prey to politics. For this reason we will always have as a principle that Bank of Albania should be an independent and accountable institution. This will be our guiding principle." Ends his statement Mr. Fullani for the Voice of America.

The model:

At the beginning of this model I am going to include brief information for the Federal Reserve and European central Bank and their independence.

The Federal Reserve System is the central bank of the United States. It was founded by Congress in 1913 to provide the nation with a safer, more flexible, and more stable monetary and financial system. Over the years, its role in banking and the economy has expanded.

Today, the Federal Reserve's duties fall into four general areas:

- conducting the nation's monetary policy by influencing the monetary and credit conditions in the economy in pursuit of maximum employment, stable prices, and moderate long-term interest rates
- supervising and regulating banking institutions to ensure the safety and soundness of the nation's banking and financial system and to protect the credit rights of consumers
- maintaining the stability of the financial system and containing systemic risk that may arise in financial markets
- providing financial services to depository institutions, the U.S. government, and foreign official institutions, including playing a major role in operating the nation's payments system

Is the greatest and most influential central bank - The independence of Fed has some positive and negative sides. In fact it has three lack of being independent and these are;

- Too big a responsibility, the power is concentrated in the hands of a few men irresponsible to the people- Jackson, 1832
- Fed is not democratic - "President elects members of Board of Governors, but then the majority of Fed is elected by these members and other members of Fed branches, commercial banks & financial institutions- Mishkin" and finally
- Too many pitfalls - A wrong move in haste & the whole country suffers

But on the other side Fed has more advantages than shortfalls in being independent, most important ones are;

- Smooth Monetary Policy- Stability - (Mishkin) because it does not have to ask the Senate for every little move it makes
- Immediate Decisions to avert crisis There seems no need to explain how slowly

the government makes its decisions

- Long Term Benefits - Fed can be a wonderful toy in the hands of a President hoping to be re-elected.
- Macroeconomic Evidence - in countries where the central banks are entirely dependent upon the ruling governments, inflation is high and increasing from year to year, negative relation between inflation rates and independency.

European Central Bank was establish 1 June 1998 - It is owned by other central banks of the European Union countries. The independence of the ECB is conducive to maintaining price stability. This is supported by extensive theoretical analysis and empirical evidence on central bank independence. The ECB's independence is laid down in the institutional framework for the single monetary policy (in the Treaty and in the Statute). "Safeguarding central bank independence takes more than a series of legal provisions. Central bank independence, like any other law, needs to be continuously protected and implemented over time. This is the responsibility of the political institution" - Lorenzo Bini Smaghi, Member of the Executive Board of the ECB*, 2007 Speech. Article 108, Of the Treaty of the European Union - "neither the ECB, nor a national central bank shall seek or take instructions from Community institutions or bodies, from any government of a Member State or from any other body" This article strongly empathize the independence of ECB. And in fact it includes certain steps:

I. Functional independence - an independent central bank should be free to set its policy instrument with the aim of achieving its objective

II. Personal independence

III. Financial independence

IV. Central bank independence and prudential supervision

V. Accountability and independence- Not Arbitrariness

VI. Independence and dialogue with the government – Independence & Cooperation.

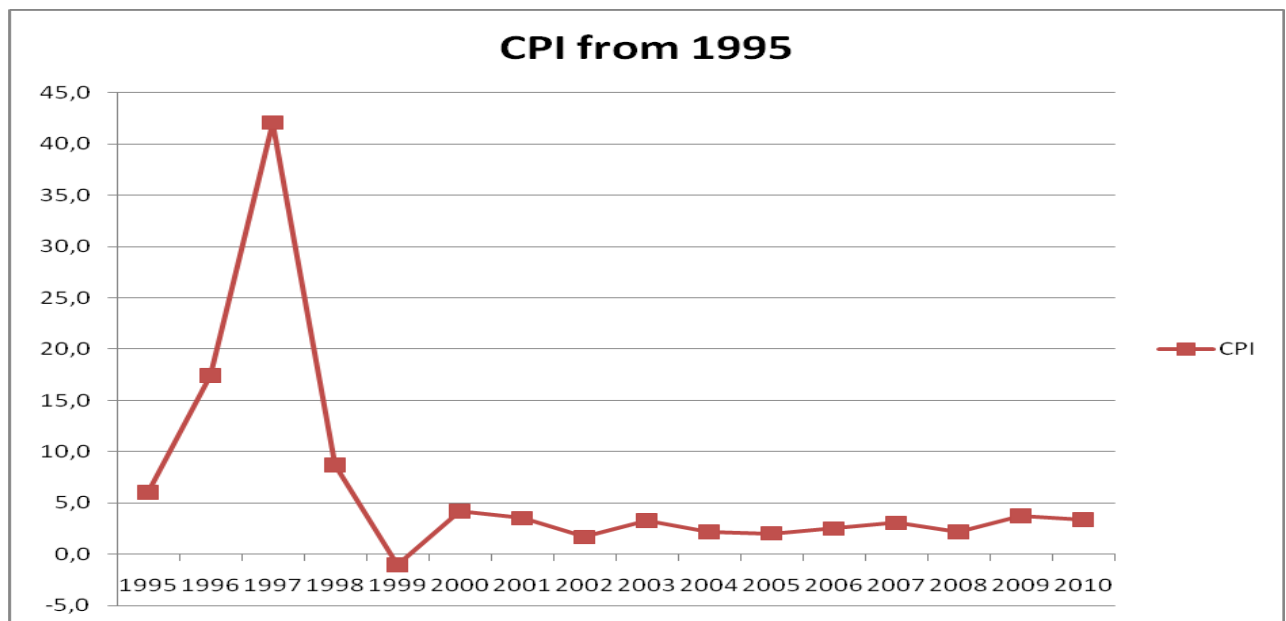
We can clearly see that the independence of ECB is much more stated and much more proclaimed than that of Fed. However our main objective is the independence of Bank of Albania. But contrary to Federal Reserve or ECB, where the measuring of independency is possible- due to their large and influential impacts, BOA's independency is hard to be measured. Regarding the measurement of independence we can use ranking - Central Banks that have final authority over monetary policy are ranked above others, where the final authority pertains to governments, cardinal measurements - questions with yes/no answers, in this type of measurement the number of yes construct the index or Cukierman Method with 6 point scale –

1. CB given final authority over issues clearly defined in the law as CB objectives.
2. Government has final authority only over policy issues that have not been clearly defined as CB goals in the case of conflict with CB.
3. In case of conflict, final decision is up to a council whose members are from CB, legislative branch and executive branch.
4. Legislative branch has final authority on policy issues.
5. Executive has final authority on policy issues, but subject to due process and possible protest by CB.
6. Executive branch has unconditional authority over policy. These get marked as 1, 0.8, 0.6,...,0.3

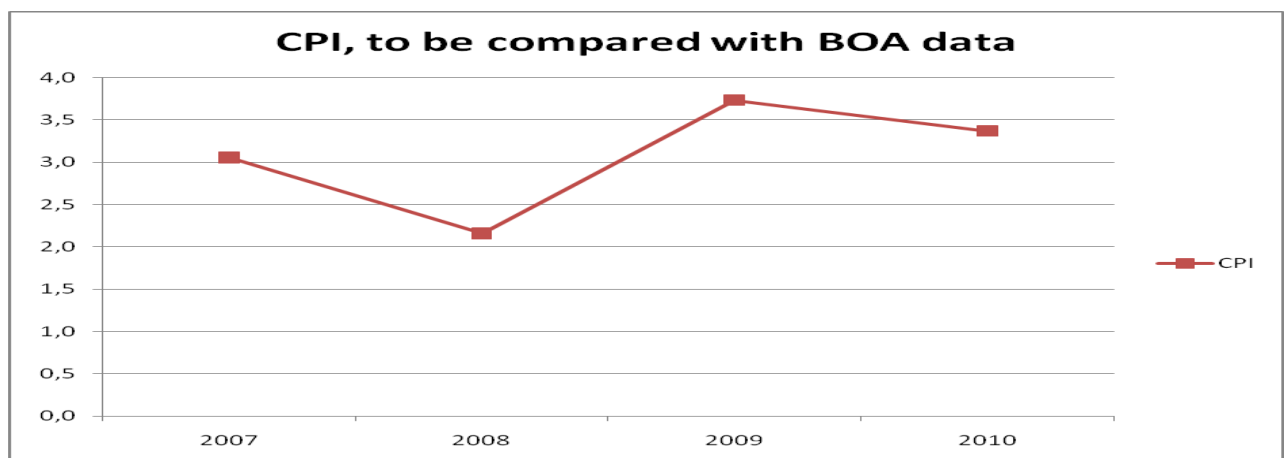
Conducting a model for bank of Albania is a difficult issue especially for conducting a regression analysis since most of the data published by Bank of Albania and INSTAT are

the same, we can detect some changes in the data of CPI – Consumer Price Index, that has to do with inflation. As mentioned above in our paper we detect a negative relation between inflation and independence of central bank. Considering the data from INSTAT and Bank of Albania we have built some graphs.

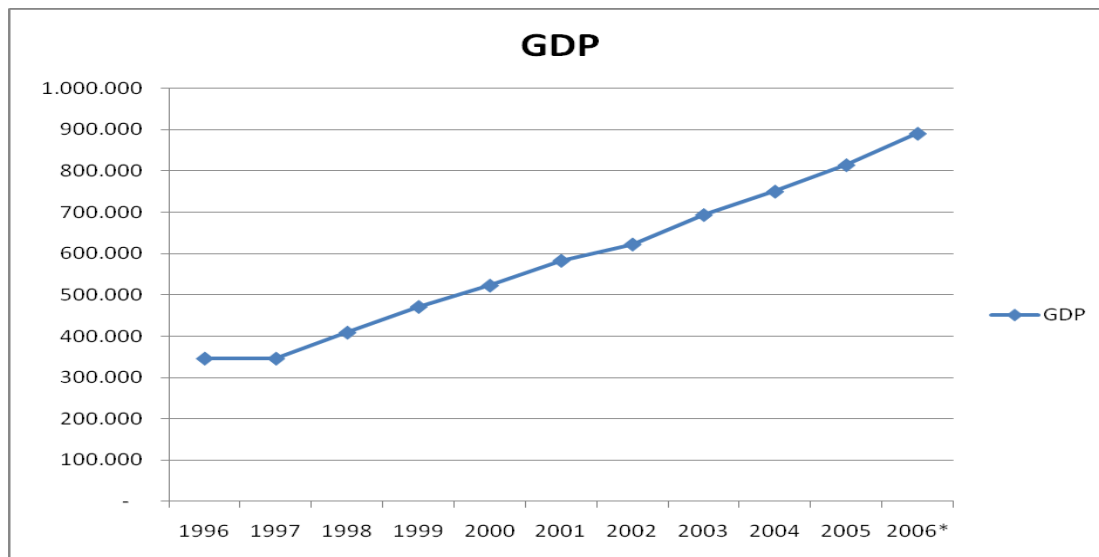
CPI from 1995:



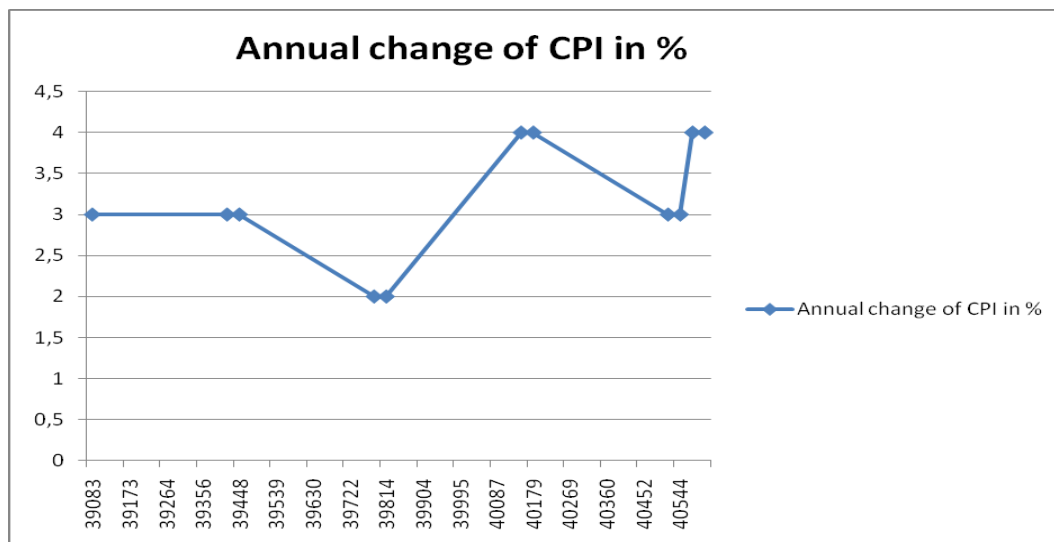
CPI to be compared with BoA data:



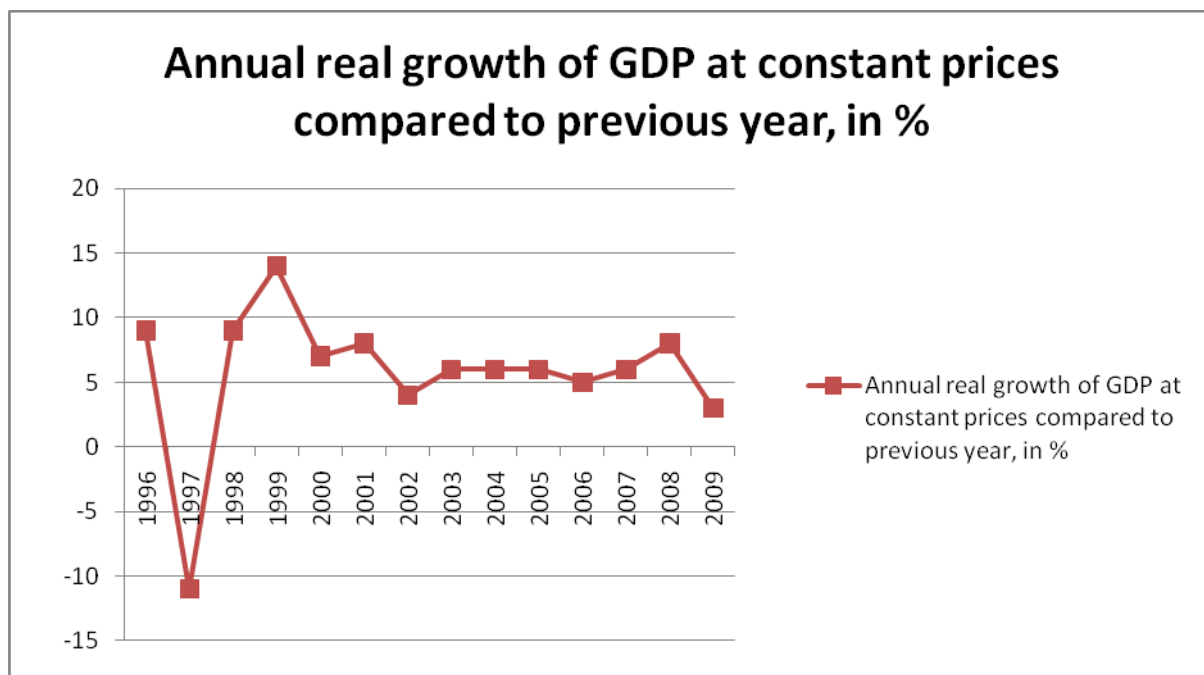
GDP of Albania from 1995:



Annual Change of CPI in %:



Annual real growth of GDP at constant prices compared to previous year, in %:



Conclusions:

My topic was conducting for the independence of Bank of Albania. But again we don't have a clear vision if the Central bank of Albania is independent or not... The importance of central bank responsibilities comes from the fact that the effects of monetary policy are very powerful for the entire economy of one country. The greater the central bank independence, the greater the responsibility

Albania is involved with the negotiation process towards the Stabilization and Association Agreement with the EU. This implies that we must have a full financial integration. On the other side even though it is an independent institution, Bank of Albania is responsible and collaborative with the Government, Ministry of Finance, Ministry of Economy and other ministries. Also the Governor of our central bank is proposed by the president of the republic of Albania. And still staying on this fact even though independent Bank of Albania was created in 1992, there have been 6 different governors until now. And in some instances their education is not proper for a governor, like the case of the current governor Bank of Albania is fully state owned, implying that all its capital is owned by the state, so regarding this fact we think that the government will try to impact the decisions of Bank of Albania since they are operating with government's money. The transparency of Bank of Albania toward the public is very disappointing. Likewise many important foreign indicators do not consider Bank of Albania as independent!

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*Informality in the Economy:
The Case of Albania
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Abstract :

In this paper is presented one of the biggest problems that agitate Albanian economy and in large-scale, which is the phenomenon of employee registration. Informal economy is turning nowadays one of the biggest disorderly problems for the economy, for the government of different countries but also for all of us. “Informal” employment escapes taxation and regulation. Such forms of employment make it difficult to manage social protection; undermine tax collection, implying either high tax rates on those in formal employment or poor-quality government services; involve unfair competition and inefficient production methods; and facilitate illegal migration. The topics that will cover in this paper are related with the first signs of informal economy in Albania, the causes that made possible the born and the increase of informality level, consequences in different directions and the solution how to get out from this bad situation that have touch our country.

Key words: Informality, Size of economy, Albania.

1. Introduction:

“The improvement of fiscal administration is considered of special importance by the government both to overcome the challenges for the country’s long-term development and European integration and to secure the financial resources that are necessary for the implementation of the GPRS. The main objective [...] of the reform of the fiscal administration will be ... [to] increase budget revenues by expanding the taxable base and reducing the informal economy ...”

Government of Albania (2001, p. 59)

Starting from a complete neglect, the phenomenon of informal economic activity has become an issue studied by researchers such as governmental and non-governmental.

The ongoing negotiations with the European Union (EU) on a stabilization and association agreement (SAA) reflect the recognition of the progress made thus far during Albania’s—at times troubled—transition. In order to advance these negotiations, strict adherence to the standards of a European pre-accession country¹ is required, politically as well as economically. With regard to the latter, Albanian policy-makers—having passed the stage of post-crisis stabilization—are now in a position to focus their energies on the more complex challenges of economic development. With regard to the latter, Albanian policy-makers—having passed the

¹ On October 21, 2002, the Council of Ministers of the European Union decided to invite Albania to start SAA negotiations; see EU (2002a,b). During the opening ceremonies of the SAA negotiations, the President of the European Commission, Romano Prodi, stressed that Albania—“a potential candidate” (Prodi 2003a)—was taking “first step down the road to Albania becoming a full member of the European Union,” which implied that the government accepted “a major commitment” in a wide range of areas, including the “completion of a market economy” (Prodi 2003b).

stage of post-crisis stabilization—are now in a position to focus their energies on the more complex challenges of economic development.

Recent problems with revenue collection, as evidenced by the consistently low revenue to- GDP ratio and repeated shortfalls relative to initial budget projections (IMF 2003a), raise the concern whether (and under what conditions) it is reasonable to expect that the realization of Albania’s ambitious development goals, including the continued maintenance of macroeconomic stability, can indeed be achieved. Subsequently, policy measures designed to increase budgetary revenues remain at the very center of any development strategy in Albania, so challenge the government to strengthen revenue collection, upgrade public services, and improve the taxpayer relations with the formal private sector. This is possible; and it has been successfully demonstrated by other, particularly smaller transition economies (e.g., the Baltic countries).

Alesina’s characterization of a government that is too small and too ineffective to tangibly improve the socio-economic environment is rooted in the rapidly growing literature on informal markets²; particularly, the seminal studies by Loayza (1997) and Johnson, Kaufmann, and Shleifer (1997), who argue that economies with large informal sectors tend to be stuck in a “bad” equilibrium with a low-quality public goods and a high degree of fiscal evasion.

Apart from the pleasure derived from the puzzle work necessary to estimate the “hidden” elements of economic activities, a large part of this literature is motivated by the attempt to identify the effects of economic informality on growth and economic prosperity.

Most researchers have found a negative correlation between these two variables³, for mainly three reasons. First, a large informal sector leads to an increase in economically non-productive activities (particularly the concealing, protecting, or detecting of hidden and illegal economic activities) and, subsequently, to a considerable waste of scarce resources (Shleifer and Vishny 1993). Second, it tends to cause a misallocation of production factors, principally because informal enterprises—unable to (fully) make use of market supporting institutions, such as police, courts, or banks—employ an insufficiently capital intensive production technology, which will make their goods and services ultimately uncompetitive (de Soto 1989). And finally, a large informal economy results in an important sum of foregone tax revenues (Loayza 1997), which—particularly in countries like Albania—reduces economic welfare as urgently required (social) infrastructure investments cannot be made, thereby holding back private-sector activities.

2. The Informal Sector and Economic Development

2.1 Defining the Informal Sector

There exists a debate taking place on the “correct” definition of the informal economy. In this paper, the term “informal economy” will be defined to comprise both “hidden” and “illegal” economic activities, of which the revenues should have been reported to the tax authorities but, for some reason, have been concealed from them—for the following reasons:

² For a survey of the corresponding literature, see, e.g., Schneider and Enste (2000a,b)

³ Notable exceptions include Cassel (1986, p. 93) or Gretschnann (1984, p. 120) who argue that informal markets represent, respectively, an “economic buffer” or a “stabilizer of last resort” that permits households and firms to more easily adjust to a deteriorating economic environment. In his empirical study, Bhattacharyya (1993) showed that the informal sector had positive effects on both consumption and investment expenditures for the U.K. during 1960–84, a point that Schneider (1998) supported analyzing German and Austrian data. Other authors, such as Asea (1996), argue that owners of informal firms tend to be greater risk-takers and, as a result, provide the economy with a higher degree of competition, thereby closely reflecting Schumpeter’s (1942) ideal of an innovative and creative entrepreneur.

First, the “hidden” economy includes activities that, apart from breaking the tax law, are principally legal, such as unlicensed microenterprises, unregistered barter trade, under-invoicing, and the smuggling of non-prohibited commodities. Thus, these types of activities are largely viewed as a problem of fiscal evasion that represents a vital challenge to economic policy making. Second, the informal sector is defined to also include those activities that, by their very nature, are “illegal”. As a result, organized (economic) crime activities⁴—which include primarily the trafficking of arms, drugs, and women are considered as well. While these represent, first and foremost, a problem of law enforcement, this definition will be used to permit subsequent studies estimating the relative size of informal activities that rely on macroeconomic data; these types of analyses would naturally encounter additional obstacles if they had to separate those activities that are, in principle, legal from those that are not. In the following, the “informal sector” will be defined as the sum of all undeclared commercial activities that, de facto, contribute to national income.

As the participation in the informal economy represents a violation of the legal norm (even if the activities are per se legal), unofficial activities tend to be accompanied by an increased level of public corruption, whereby (poorly paid) officials accept bribes in exchange for protection or other favors to the damage of the state. In recent years, a rather extensive literature has developed showing that, in a system rooted in bribery and corruption, economic incentives are distorted “as government officials and favored private individuals receive a larger share of public benefits or bear a lower share of the cost of public goods” (IMF 2000, p.130), which results in lower private investments, lower government revenues, while increasing inequality and poverty; see Mauro (1995), Tanzi and Davoodi (1997,2000), Gupta et al. (1998), and Abed and Gupta (2002), with the key arguments being nicely summarized in Tanzi (1998). The large majority of recent studies confirms the existence of a negative correlation between corruption and growth, thereby stressing the crucial importance of improved “governance” as a core element in successful economic reform programs.

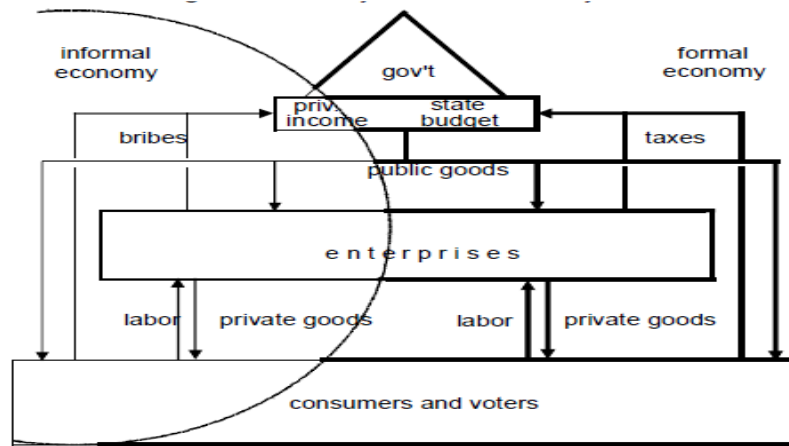
2.2 The Informality “Trap”

For a policy-maker, the most difficult aspect of reversing the trend increase in the relative size of the informal market is the confrontation of private benefits and public costs. As summarized in Figure 1, every market participant in the informal economy benefits—directly and personally—in some way: (i) individuals tend to receive higher net-of-tax salaries and are able to buy private goods and services at lower prices; (ii) firms can produce more competitively without the costly and often very time-consuming interaction with government officials; and (iii) corrupt officials and politicians receive additional private income in exchange for accommodating those participating in, and profiting from, the informal economy. By contrast, the corresponding costs are all “public” in nature. They include, for the most part, reduced fiscal revenues and, subsequently, lower expenditures on—generally valued—public goods such as hospitals, schools, universities, roads, or the continuous provision with electricity and water.

3

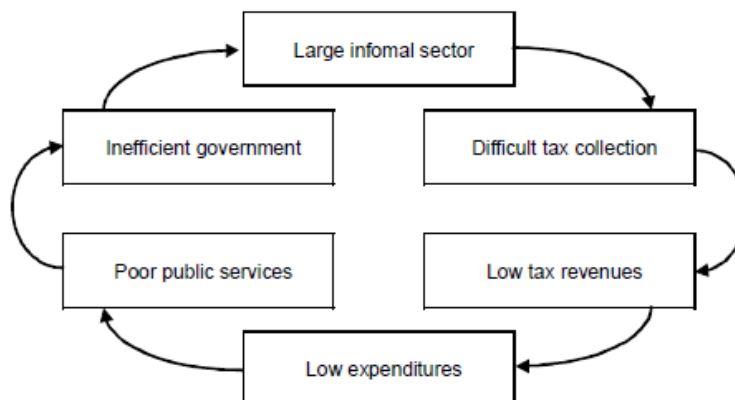
⁴ See also Altvater and Mahnkopf (2002) and Naylor (2002).

Figure 1. The Stylized Dual Economy



Typically, households, firms, and government officials understand that everyone would benefit from a more “formalized” environment, in which the degree of fiscal evasion is low and the quality of public goods high. However, due to this conflict between private benefits and public costs, no economic actor is truly prepared to “voluntarily” take the first step in the direction towards increased economic formalization. The certain reduction in private benefits derived from informal activities weighs higher than the uncertain expectation of improvements in the provision of public goods—i.e., economies that have developed a substantial informal sector tend to be stuck in a “vicious cycle” (Alesina 1999), where the large degree of informality complicates the government’s task of collecting revenues for the budget. With low tax revenues, expenditures for important public goods will be low as well, which, in turn, will be reflected in their substandard quality (thereby constraining private sector investments). With an inefficient public sector, taxpayer discipline will remain low, leaving the economy being stuck in a fiscal trap (Figure 2).

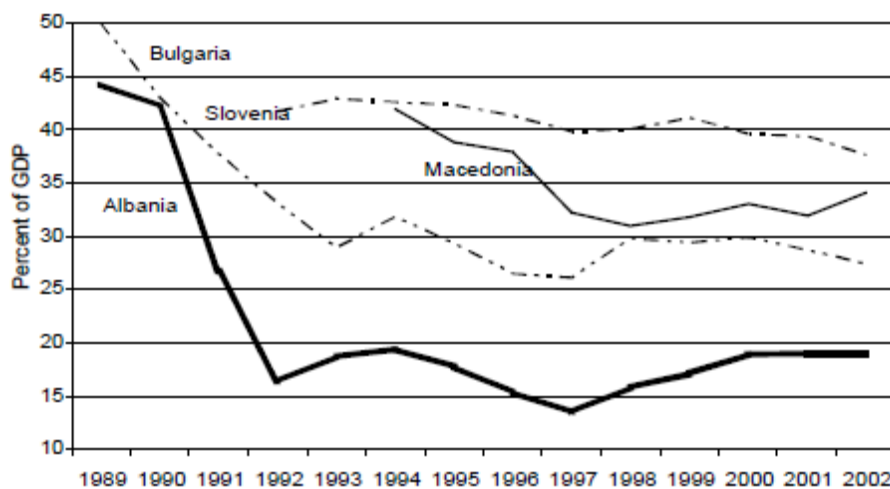
Figure 2: The Vicious Circle



3. The Informal Economy in Albania

A detailed and reliable estimation of the size and composition of Albania’s informal market—given the limited nature of data even on formal-sector activities—is, no doubt, a very challenging exercise, and further research is needed⁵. This paper will un-ambitiously restrict itself to an examination of several important macroeconomic indicators that should help to better understand the situation in Albania. As mentioned in the introduction, current GDP estimates incorporate an assessment of informal activity at about one-third of total output. Data on tax collection, however, suggest that this tentative assessment could well be on the low side. Figure 3 summarizes the key differences in tax-revenue collections among several countries in the region.

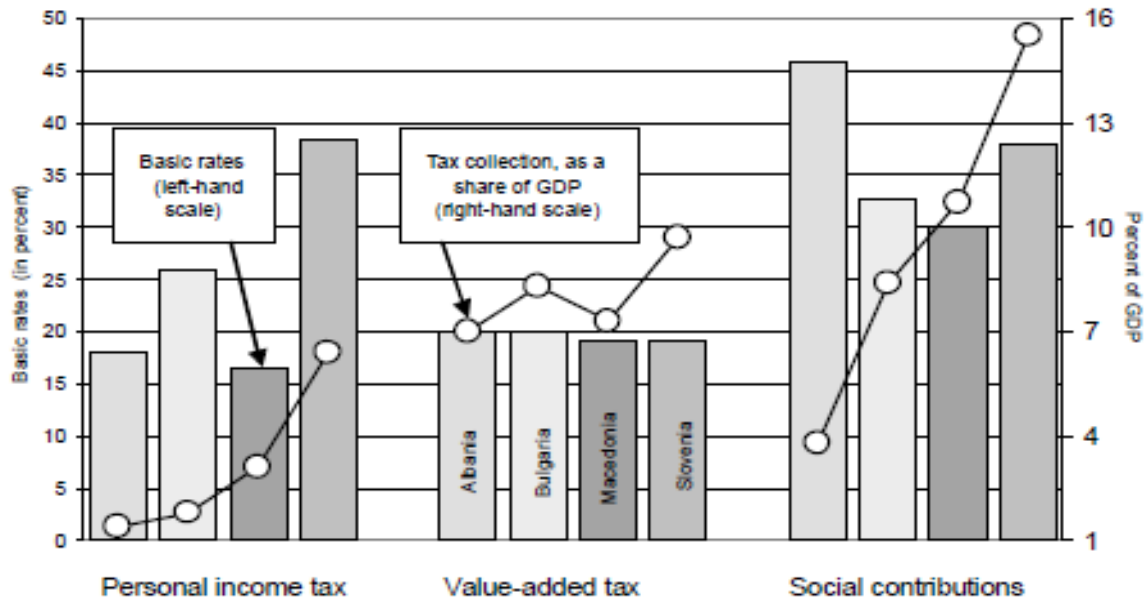
Figure 3. Tax Revenue Developments, 1989-2002



Source: Tanzi and Tsibouris (2000, p.18), and various IMF Country Reports

As Figure 4 indicates, the reason for the considerable difference in performance is not the level of tax rates levied in Albania (which are comparable to those in neighboring countries) but the difference in tax-collection efficiency.

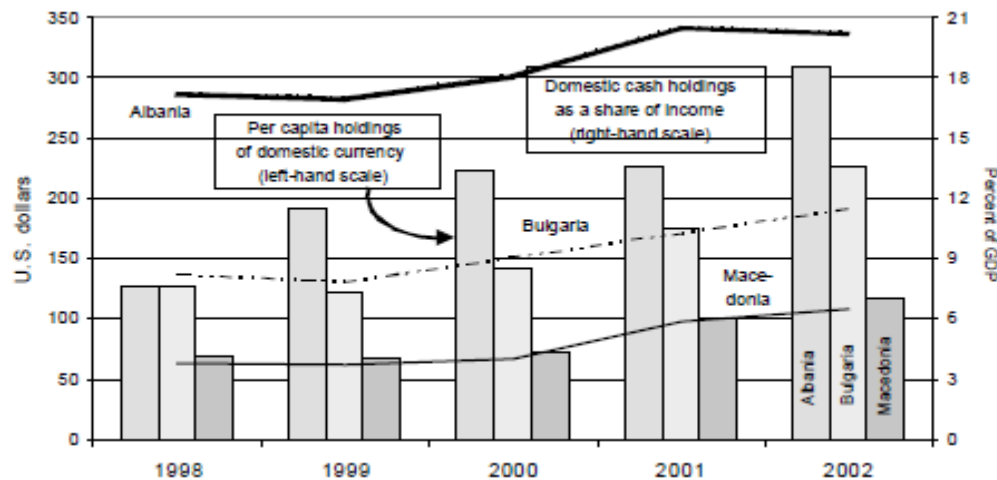
Figure 4: Tax Collection Efficiency



Source: Various IMF Country Reports

Underreporting on invoices, falsification of balance sheets, and a general weakness in (tax) law enforcement have, thus far, defined limits to domestic revenue collection and, subsequently, the government’s ability to provide public goods at an adequate level (and in a satisfactory quality). Breaking up the figures on a tax-by-tax basis (again, see Figure 4), one sees that the worst-performing tax in Albania are social-security contributions. With somewhat higher rates, Albania managed to collect about 3.8 percent of GDP in 2002, compared to Bulgaria’s 7.3 percent or Macedonia’s 10.7 percent. It is encouraging to see though that Albania’s authorities have reacted and, with the help of their international development partners, begun to devise a plan to transfer the collection of social-security contributions to the tax department, thereby allowing the social-security institute to focus its efforts on improving the targeting of entitlements. However, administrative weaknesses are only one part of the reasons explaining the large difference between Albania and its neighbors.

Figure 5: The Importance of Domestic Cash, 1998-2002



Source: Various IMF Country Reports, and FS data.

Informal economic activities tend to be cash-based (cash is anonymous), and the demand for cash, relative to overall output, is frequently used to approximate developments in the informal sector of the economy—particularly if the demand for cash increases at a pace faster than considered justified by economic fundamentals. In this context, high per-capita cash holdings and particularly an increase in the demand for cash by 3 percentage points of GDP during 1998–2002 could be taken as an indicator of such development (Figure 5). However, further—and more in depth—studies would have to (i) separate the demand for cash from the aftermath of, and the behavioral changes from, the collapse of the pyramid schemes in 1997 and the episode of heavy deposit withdrawals in early 2002; (ii) identify the relation of cash holdings and deposits in light of the large drop in real interest rates during this period; and (iii) include estimates of circulating foreign cash into the equation. Given Albania’s income level, together with the circulation of a considerable amount of foreign cash, the per capita amount of domestic cash, both over time and relative to neighboring countries, is very large and, a priori, would seem to support the supposition of an informal sector that is larger than the official estimate (and larger than those in neighboring countries). These macro data allow for a very rough and preliminary approximation of the estimated size of Albania’s informal market.

4. Conclusion

Albania’s informal sector represents a considerable share of economic activities, and it could easily jeopardize the realization of Albania’s medium-term goals of socio-economic development and European integration. While budgetary revenues, relative to the performance of Albania’s economy, is weak, formal private sector activities are discouraged by (i) strained taxpayer relations and poor public services; (ii) inadequate tax enforcement; (iii) excessive permit and licensing requirements; (iv) the existence of a competitive disadvantage relative to informal market participants; and (v) a weak public infrastructure.

In Albania's case, it is not high tax rates per se but, to a large extent, the ineffectual and discretionary application of tax laws and governmental regulations that has created the conditions under which the shadow economy is growing. Consequently, the government needs to find a way to raise public awareness of the government's increasing commitment to resolutely addressing fiscal evasion (which, in itself, should help to improve tax discipline) while enhancing taxpayer relations.

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“Determinants of Money Supply in Albania”

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Abstract

Bank of Albania conduct monetary policy, from this point of view the goal of this project is to show the determination of Money Supply in Albania. It has been done by focusing on the component of money supply during 1996-2008 years. Applying mathematical equation I have set up some correlations among different variables such are Money Base, Money Multiplier and some ratios like currency ratio, required reserve ratio and excess reserve ratio. Moreover, computing such equations and ratios I found that the main determinants of money supply in Albania were Money Multiplier and Money Base. If money multiplier increased that shift was reflected positively on money supply. In addition to that, when we conduct regression analysis for currency in circulation or M1 and Money Multiplier we found positive relationship between them. The main conclusion of this study was that money multiplier shared the highest impact on money supply.

Key words: Money Supply, Albania, Central Bank of Albania, Money Base, Money Multiplier.

Jel Classification Codes:

1. Introduction

Bank of Albania is the only institution that has absolute control over money supply and determination of money supply as one of the important part of monetary policy. In constructing this project I am based not only in the other papers and how they have developed their project but my project is based more in literature taken from Harvard University and some other western university such are "Lecture Notes on Money Banking and Financial Markets" by Pr. Peter N. Ireland Department of Economics, Boston College. So this study illustrate in more detail the explanation how to determine money supply. All of this is done based on Money Multiplier, deriving the money multiplier and the factors that determine the Money Multiplier and the relationship between those two components M1 a Money Multiplier with these ratio : currency ratio, required reserve and excess reserve ratio, for there more using also use three instruments which are part of monetary policy such are: open market operation, Reserve requirements ,the discount factor . To addition, I am based in the other study such is "The Economics of Money , Banking, and Financial Markets" by Frederic S. Mishkin with this paper I want to bring for bank of Albania another way how to determine Money Supply so in other words I can say to bring an innovation for BoA in calculating and determining the Money supply so lets be that a new alternative for BoA.

The purposes of this paper are: first is to investigate how bank of Albania determine Money supply (M1). Second is to see how much Money Supply is influenced by Money Multiplier conducting regression analysis and the last is to make compare with the other country in conducting Money Supply which is one of crucial component of Monetary policy for any central bank and the same is for Bank of Albania. Comparing their methods that they have used in determining Money Supply.

The first section is introduction and the next section of this paper is constructed as follow. Second section involves theoretical essentials which are explained some principals of how to determine Money Supply. Third section includes literature review showing the works of some other scholars how they have determine Money Supply in any country and their methodology that they have used. Fourth section shows the data that I have used and the methodology I have followed to conduct the research. Fifth section will present the Application and Results where I have tested the relationship between Money Supply and Money Multiplier using regression analysis and mathematical equations. In addition I have done mathematical calculations which help to find Money Multiplier Sixth section ends with conclusion which involves the summary of my research and some finding and suggestions.

2. Theoretical essentials

In this part of the paper firstly I will show some theoretically view in order to be clear with my explanation. We know that central bank which in this case is the Bank of Albania can control the monetary base (MB) more better than the M1 because of the Money Supply (M1) is effected by number factors that the BoA (bank of Albania) doesn't have direct control on it. Now I am gone explain some initials or short words that I have used so the first is below.

M1 represents the currency in circulation + checkable deposits.

MB (monetary base) represents the currency in circulation+ reserves.

We know that $M1 = m \times MB$ when the m is Money multiplier and is always greater than 1. We get C as desired level of currency and it is a constant fraction of checkable deposits and we can determine as C . Currency ratio (c) is constant and it is determine as $c = C/D$ (C may change but only in constant proportion to D). One part of checkable deposits is hold by banks in reserve. Banks or Commercial banks are strong required by the BoA to hold a minimum fraction in reserve which is called as the reserve requirement ratio (rr). For the excess reserve bank may choose to hold or not, so is not strongly requirement.

RR shows the required reserve held by banks. ($RR = rr \times D$, rr parameter set by the fed).

ER shows the excess reserved held by banks. $ER = e \times D$. e is constant proportion set by banks. In the end we have Total reserved (R)= $RR + ER = (rr \times D) + (e \times D)$, this equation we can write also in this form $R = (rr + e) \times D$.

2.1 Money Multiplier

Firstly, we have $MB = C + R$ after we can write in the longer from which is $MB = c \times D + rr \times D + e \times D$ and in the end we can formulate a last equation which will help as in determining the M1 or Money Supply so in the end we write : $MB = (rr + e + c) \times D$

So MB is equal with a part of deposits that it is allocated in the required reserves, excess reserves and currency in circulation. Than the above formula write in this way:

$$D = \frac{1}{rr + e + c} MB$$

We said above that $M1 \rightarrow$ is the currency in circulation + checkable deposits. So we take $M1 = C + D = (c \times D) + D = (1+c) \times D$ so $M1 = (1+c) \times D$ and we can change and note in this form:

$$M1 = \frac{1 + c}{rr + e + c} MB$$

Since we have $M1 = m \cdot MB$ also we can make a summary of all information that we have given till now and we have arrived in the end of all formulation and the important formula is as below:

$$m = \frac{1 + c}{rr + e + c}$$

2.2 Determination of Money Multiplier.

1. Changes in the required reserve ratio (r): Money Multiplier and Money Supply have negative relationship with reserve ratio.
2. Changes in the currency ratio (c): Money Multiplier and Money Supply have negative relationship with Currency ratio.
3. Changes in the excess reserves ratio (e): Money Multiplier and Money Supply have negative relationship with excess reserve ratio. Some additional information related to e ratio is: The excess reserves ratio e has negative relationship with the market interest rate. The excess reserves ratio e is positively related to expected deposit outflows.

If to analyze the factors that caused change in currency as it is told initially that we suppose that the constant currency ratio is an independent parameter in order to be more clear and more simple but here I will analyze the factor that change the currency ratio and those factor that have caused the change the currency ratio are:

- a. Change in income or wealth.
- b. Larger proportion of currency are held by people with low income.
- c. As income will increase the ratio of currency to deposits will decrease.
- d. Change in expected returns.
- e. As the interest rate on deposits increase , currency ratio falls.
- f. As the cost of acquiring currency decrease, currency ratio falls.
- g. Fears of bank insolvency for example bank panics cause currency ratio to increase sharply
- h. Increase in illegal activity cause currency ratio to rise.

Disadvantages for market interest rates:

- If money (or lek for Albania currency) held as an excess reserve has an opportunity cost equal to the interest rate it could have earned as a bank loan.
- As market interest rate rise, this opportunity costs increases and banks hold fewer excess reserves .
- Excess reserves ratio is negatively related to the market interest rates.

Advantages for expected deposits out flows :

- The main advantages of holding excess reserve is that they insulate the bank from sudden deposit outflows.
- With excess reserves banks do not have to call in loans, sell of other assets. or borrow from the BoA to cover deposits being withdrawn.
- If banks think that deposits outflow will increase they would be smart to increase their excess reserve ratio.
- Excess reserve ratio is positively related to expected deposits outflows.

Some analyzes suggest that the BoA can increase or decrease the money supply by lowering or rising the reserve ratio. Bank of Albania allows banks to classify some of their membership deposits at the BoA as required reserves. Banks have found that they need to keep extra currency in ATMs over weekends and holidays. This currency is classified as valute cash and counts toward required reserves. With these two developments, banks actually hold more reserves than the minimum required by the BoA. Something which is much important and worth to be noted here is that If rr is not binding, then any change in (rr) will have little to no effect. (its work only if we significantly increase rr).

3. Literature review

Determination of money supply is study in much country from much researcher in economy field and it is study from developed and developing country even though their financial institution such as their central bank follow and apply the same framework in determining the money supply. They conducted empirical studies on money supply and money multiplier in different countries highlighting the degree of controllability over money supply by the monetary authority, determinants of money supply, stability and predictability of money supply, and policy implications for conducting monetary policy. In more detail I will explain below with some studies which are done for this topic. So firstly studies that I have chosen is Wasti et al. (2009) has made a study concerning Monetary Policy in less developing countries for a period of 37 years, from 1971-2007 using unit root analysis, Johnson co integration technique & error correction mechanism founding that time deposits and broad money have less volatile behavior and also explain that stock of money reserve causes a large variation in money supply. They suggest so as to get good result of monetary policy the policy makers should also consider fiscal deficit in their policies because this study has clearly shown that stock of reserve money has significantly affected the money supply in the country that stock of reserve money itself effected by budget deficit. Another study for this topic is Y.C. Jao (1970) conducted the study of Proximate determinants of Money Supply in HONG KONG from 1954-1968. Here is

used the Friedman-Schwartz methodology concluding that For a Currency Board country, there are two cases in which the money supply is rigidly tied to balance of payments. One is where there is no banking system, and all money consists of “fiat money”, or to use the Gurley-Shaw terminology, “outside money” issued by the Government. The other is where there is a 100 per cent reserve requirement for the banks, so that the banking system is deprived of its ability to create money and credit.

Jamil Tahir (1996) survey and analyze the theoretical as well as empirical developments that have taken place in Money Supply and credit expansion as the main instrument of monetary policy from 1950 to 1960 all this study is based more on the Keynesian theory of effective aggregate demand which ignores the supply factor or the financial factor or on the quantity theory analysis of monetary problems of developing countries, this study is done for some developing countries such are Iraq, Kuwait, Libya and Saudi Arabia. For those country determination of money supply is arrived in conclusion that it is determined mainly by lagged money supply in Libya and also by real government expenditure and two period lagged unemployment rate in Iraq and by real government expenditure and one period lagged international reserves for Saudi Arabia. For both developed and developing countries, according to empirically studies is concluded that the effect of monetary restraint on growth takes place mainly in the short run, from all is accepted and also is proved in empirically way that unanticipated rather than anticipated money growth effect real output in developing as well as Arab countries. Also its shown that the stock of money, in this case is taken M1, is not controlled only by the monetary institution or authorities but also is influenced by the behavior of the government, the commercial banks and the public.

Oluremi Ogun, Adeola Adenikinju (1995) in this paper is study the Nigerian monetary authorities pursued an expansive monetary policy from 1970-1989 in order to accommodate both private and public sectors increasing demand for credit. In this study are used ratio and estimation techniques. In general the effects of monetary expansion of the period were rapid depletion of the country’s foreign assets and a money supply level that clearly exceeded the absorptive capacity of the economy hence, potentially threatening price stability and real output growth. In addition, an active sterilization policy would serve to reduce the effect of exogenous shocks on money supply, hence domestic economic activities. The frequent tendency of the economy towards a recession after a period of rapid growth in the external sector would thus be eliminated, or at least, significantly reduced. The last study that I have collected is Md. Ezazul Islam (2008), investigate the dynamic relationships among the money multiplier and Reserve Money components in the money supply process in Bangladesh. The empirical evidence is based on the structural vector auto regression (SVAR) model using quarterly data for the period from 1979 to 2007. According to this study the currency deposit ratio component in the multiplier model and net government borrowing and movement of net foreign asset components in Reserve Money are the major contributors to changes in money supply. The estimated impulse response and variance decomposition of money multiplier shows that currency-deposit ratio has a significance influence on money multiplier.

4. Data and Research Methodology.

4.1. Data

For this project It used collected data of M1 and M_m series from 1996 to 2008. This data consist of from M1 which is the currency plus checkable deposits also part of those data are money multiplier , currency deposits ratio , excess reserve deposits ratio and required deposits ratio all of this have been taken from several issue of “Economic Trends” or “ Report Years” of Albania published by BoA and data are calculated by me through using mathematical equation and Regression analysis.

4.2. Estimation Methodology.

In order to explain all my works and to determine the money supply in Albania which this last consist of Currency and Demand deposits also part of Monetary Base are Currency and Reserves and the last is Money Multiplier which is Reserve deposits ratio and Currency deposits ratio .To calculate all of this I have used mathematical calculation formula and in the end I have used the Regression Analysis in Excel . I have used this two tools for describing the way that the BoA determine the money supply in Albania .

Through the regression analysis I show the relationship among the Money Supply (M1) and Money Multiplier.

In order to enter those variables in excel we have to construct an econometric model. The model will be as follow:

$$\text{Model X: } a + b * M_m = M_1$$

Where we have :

M_1 = Money Supply.

M_m = Money Multiplier.

a = intercept or constant

b = is coefficient of slope line.

Identification of M_1 .

$$C+D=M_1 \quad (1).$$

$$M_1=m_x MB \quad (1.1).$$

Where : m represents Money Multiplier.

MB represents Monetary Base.

Identification of currency ratio and excess reserve ratio:

This formula $c = \frac{C}{D}$ we can write in this form $C = c \times D$ (2)

Second formula $e = \frac{ER}{D}$ we can write in this form $ER = e \times D$ (3).

Identification of Money Multiplier:

Total reserve we can write in this form

$$RR + ER = R \quad (4)$$

If we want to make any change we can write in this form $RR = r \times D$ when this last formula can change its form so we have :

$$r = \frac{RR}{D} \quad (5)$$

Now we make a substitution for RR from the (4) equation and in the end we get this formula which is:

$$(r \times D) + ER = R \quad (6)$$

Where we have that the Central Banks, in which in this case is the BoA sets r less than 1.

For Money Base we have that the

$$C + ER(r \times D) = C + R = MB \quad (7)$$

If we have an increase in the MB that goes in to currency is not multiplied, while an increase that goes to into supporting deposits is multiplied . an additional lek of Monetary base that goes into excess reserves ER does not support any additional deposits or currency.

Now we substitute the (7) equation with this equation.

$$MB = (r \times D) + (e \times D) + (c \times D) = (r + e + c) \times D \quad (8)$$

Now divide the equation above in this form in which we get a new equation which is:

$$D = \frac{1}{r+e+c} \times MB \quad (9)$$

Now let's make a summary for the all equation so firstly we have that Money Multiplier is:

Money supply is addition of Currency and the Deposits $M = D + C \rightarrow C = c \times D$ (10).

The above equation we can write also in this form which will help to construct the Money Multiplier formula.

$$M = D + (c \times D) = (1+c) \times D \quad (11)$$

Another derivation of Money Multiplier is this:

$$M = \frac{1+c}{r+e+c} \times MB \quad (12)$$

After all of those derivation and substitution we find the Money Multiplier and we write in this form:

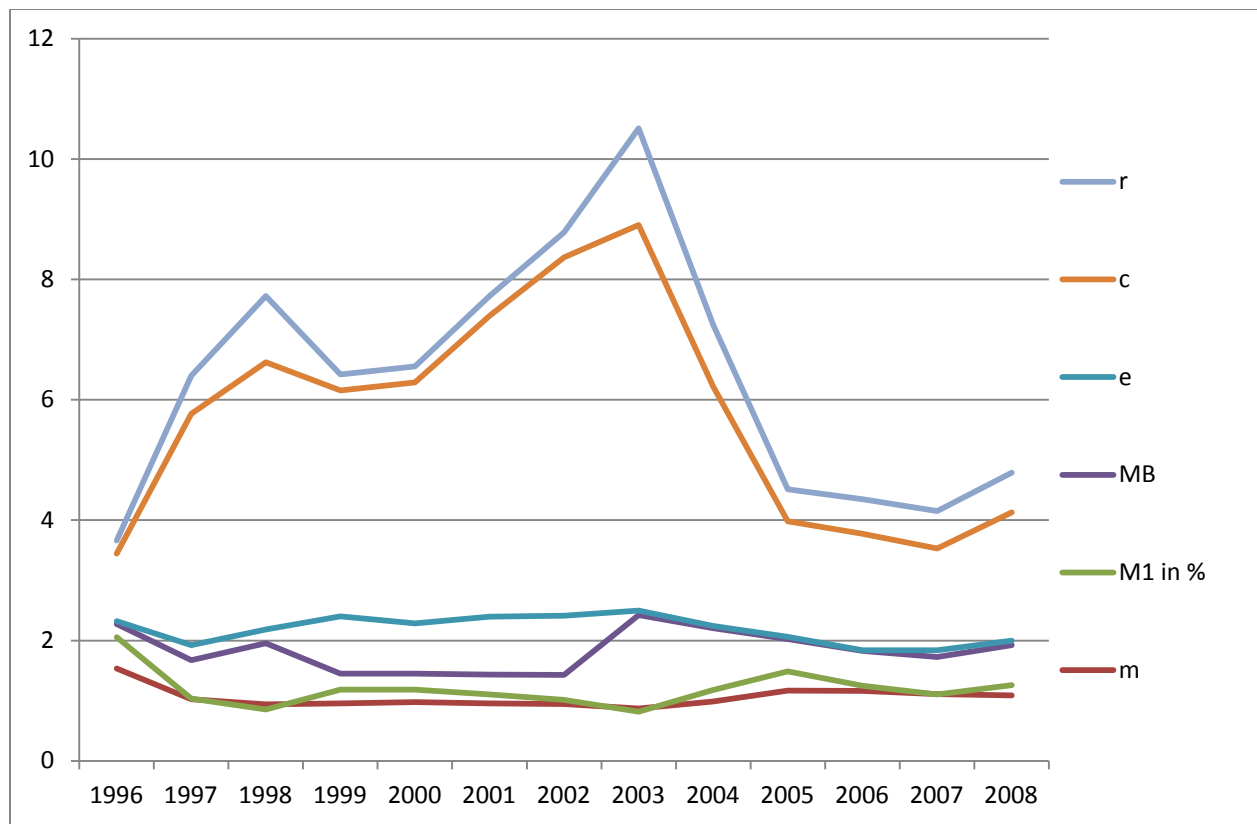
$$M = \frac{1+c}{r+e+c} \quad (13)$$

5. Application and Results.

5.1 Computing Mathematical Equations of Section 4 for year 2008.

Firstly, we have done some calculation as we see from the table and all of this calculation is based on the mathematical calculation. Some of the data are taken from the BoA such are Currency outside Banks (C), Current accounts and Demand Deposits in leks of Residents (D), Required reserve (RR), Excess Reserve (ER). And the other calculation are done by me. So lets start with first formulas:

(1) $M1=C+D$ so when C is the currency outside the banks and the D is current account and demand deposit in lek so to illustrate it let take an example, so calculate for the first year 1996 in order to understand from the other, Took C and D for the first year so $M1=90,406$ this is Money Supply for 1996. and for the other years we follow the same logic as this example. As we see from the table the M1 or Money Supply is increasing year by year. This change is done drastic after 2004 so it is double maybe this double has came as result of Demand in which those last years is increasing so fast. For all calculating all the years we can see the table on appendix.



Graph 1.

(2) Currency ratio $C = 1.122655021$ (this is for the 1996) at the same manner we continue for the other years as we can see on the appendix.

Money multiplier and money supply are negatively related with the currency ratio c . as c falls then m will rises. if the currency ratio is increased than we will have less multiple reserve ratio. All this results came from that the currency does not participate in the process of multiple deposit creation Hence, when depositors want to hold more currency, less multiple deposit creation can occur, and when depositors want to hold less currency, more multiple deposit creation can occur. As we see from table Currency ratio is increasing year by year till 2003 and after this year c is decreasing in drastic way so immediately decreasing. $M1$ is increasing year by year. Money Multiplier is decreasing little bit in 1996 and after this is stable till 2004 but after 2004 is increasing. In addition we can say that in practice for BoA is different from principle because of mostly $M1$ and c move at the same direction so have positive relationship and Mm in some year has the same direction with c and some other years has negative relationship so to conclude we can say that the Mm and c are flexible toward $M1$ and each other too.

(3) Excess reserves $e = 9605/10242 = 0.937805116$ (this is for the 1996) Money multiplier and money supply is negatively related with the excess reserve ratio (e). when e excess reserve rises m money multiplier will falls and when e falls than m rises. This is caused from that excess reserves don't participate in the process of multiple deposits creation so that when bank wants to hold more excess reserves less multiple deposits creation can happened and when bank hold less excess reserve more multiple deposit creation can occur. For excess reserve or (e) we can say that is increasing till 2004 but after this year it is decreasing so it has arrived those level

and lower than 1996 I think that this decreasing has come as result that banks (commercial banks) doesn't hold so much reserve maybe the make loan these reserve. So if I compare with M1 I can say that in some years they have positive relationship till 2004 year but after this year have negative relation so all of this is different from the principle that I mention above.

(5) Required reserve $r = 0.216125473$

Money multiplier and money supply is negatively related with the required reserve and if we have increases in required reserve ratio will have decreases in the money supply because we will have less multiple deposit expansion so lets see with graph .so as r falls rise than the m Money multiplier increases . Required reserve ratio is different from the other ratio. It is not stable. It change year by year so it is flexible and different from the principle that I mention above as we see from the table and graph mostly the move the same direction so have positive relation with each other.

Table 1.1 Data for component of Money supply.

years	M1	MB	<u>m (money multiplier)</u>	<u>e</u>	<u>c</u>	<u>r</u>
1996	90,406	0.216125	1.533	0.045972	1.122655	0.216125
1997	91,667	0.633757	1.023842	0.25363	3.839607	0.633757
1998	83,729	1.100422	0.94274	0.229796	4.435183	1.100422
1999	103,004	0.262322	0.95651	0.953849	3.753738	0.262322
2000	124,041	0.266438	0.97981	0.836606	4.000645	0.266438
2001	142,926	0.331236	0.95355	0.961066	4.996476	0.331236
2002	152,741	0.416052	0.94599	0.98138	5.953519	0.416052
2003	144,730	1.605763	0.8718	0.071037	6.407237	1.605763
2004	172,833	1.021506	0.9873	0.042206	3.975903	1.021506
2005	227,684	0.534115	1.1714	0.038602	1.918951	0.534115
2006	247,505	0.574537	1.164	0.011539	1.938338	0.574537
2007	246,575	0.618778	1.11076	0.112992	1.691632	0.618778
2008	287,696	0.662926	1.09133	0.075046	2.13176	0.662926

(4) Total Reserve $R = 11,163$ so to analyze this we have to look in table of the appendix . we conclude that the Total Reserve is increasing year by year only in 1997 and 1998 is lower because of the civil war and the economy was destroying in most of their component.

(13) Money Base (1996) $MB = 58,971,498$. If we see the table below on appendix we say that Money Base is increasing year buy year in large amount because of the (D) Current accounts and Demand Deposit in lek of resident is increasing and the ratio that I mentioned above are increasing too.

(8) Money Multiplier (1996) $Mm = 1.533$. Money Multiplier is one of the main component of money supply in determining it together with all elements that I have mentioned till now above. As we see from the table below Mm in first year is decreasing and after is stable with little bit decreasing and in the last year is increasing but with lower amounts so in general

we can say that it is stable and it is adapted related to the other changes on the other crucial components of determining Money supply.

Table 2. Relationship between M1 and Money multiplier.

Years	Money Supply M1	Percentage change of M1 (Dependent)	Money Multiplier (Independent)
1996	90,406	0.52578815	1.533
1997	91,667	9	1.0238422
1998	83,729	0.01394818	0.94274
1999	103,004	9	0.95651
2000	124,041	-0.08659604	0.97981
2001	142,926	0.23020697	0.95355
2002	152,741	7	0.94599
2003	144,730	0.20423478	0.8718
2004	172,833	7	0.9873
2005	227,684	0.15224804	1.1714
2006	247,505	7	1.164
2007	246,575	0.0686719	1.11076
2008	287,696	-0.05244826	1.09133
		0.19417536	
		1	
		0.31736416	
		1	
		0.08705486	
		6	
		-0.0037575	
		0.16676873	
		2	

5.2 Regression Analysis

The data for regression analyze for more details are presented in appendixes.

To accept the amount that are calculated from using regression analysis we firstly decide if there exist relationship between Money multiplier and M1 we should first reject:

Null hypothesis. $H_0: \beta = 0$

Alternative Hypothesis $H_1: \beta \neq 0$

We reject Null hypothesis if t-Stat is greater than t critical value for given number observations. From the table below in appendix we see that t-Stat is equal to 3.51476 and the t critical value for 13 observations equals to 2.2. So, this shows that our t- Stat $3.51476 > t$ critical value 2.2. As a result, we reject Null hypothesis and conclude that there exist relationship between M1 and Money Multiplier.

To examine the relationship between the M1 and Money Multiplier we test the model X build at section 4 .

$$\text{Model X: } M1 = a + b * Mm .$$

From table 3 on the appendix we have:

$$a = -0.60785$$

$$b = 0.707812.$$

$$\text{So : } M1 = -0.60785 + 0.707812 * Mm$$

The econometric equation indicate that, If Mm increases by 1% then M1 will increases by 0.707812. To conclude we can say that we have positive relationship between Money multiplier (Mm) and Money Supply so if Money Multiplier increase than M1, in which in this case is Money Supply for our test, so M1 will increase approximately with same amount.

6. Concluding remarks

Bank of Albania lead the money supply and is the only institution that conduct Monetary policy. Money Supply is one of instruments of Monetary Policy and Bank of Albania , by taking M1, Money Base and Money Multiplier conduct money supply in Albania. The success of monetary policy in achieving its goal depends on the degree of controllability of BoA on M1, Money Base and Money Multiplier This paper analyze determinants of money supply in case of Albania over period from 1996 to 2008 using some mathematical equation, calculation and Regression Analysis (SSPS).

The results from mathematical calculation shown that , we have some ratio such are Currency ratio, Required reserve and excess reserve ratio which play main role in determine money supply. Also the relationships between those three ratios and Money Supply , in this case we have taken M1 as Money Supply, and Money Multiplier are negative as one of those ratio increase (decrease) than M1 or Money Multiplier decrease (increase). In fact this kind of relationship between them is in principal because in reality or in practice is completely different if we compare the data between the M1 and currency ratio or the other ratio we see that in some years they move at the same direction so in some years they are positive relationships and in the other years have negative relationship. As result for Central Bank of Albania the calculation are different in practice from those in principle.

While for regression analyze we can say that we have investigate two components Money Multiplier and M1 which for our case are the main components in determining Money Supply. We have found a correlation between them according to regression analysis. In addition if Money Multiplier increase with 1 % than M1 will increase by 0.707812, so approximately will increase with the same amount. As suggestion for BoA we can recommend this way in determining the Money Supply because is easy to applied. As shortage for my paper I would like to say that, different from the other paper when they have took M2 as money supply and they have constructed different methods. Also they have used logarithm in determining money supply for their paper so for this reason my paper is not completed and has some shortage.

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7. Appendix.

Appendix A.

Table 1.Results of Mathematical calculation.

Index description	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Currency Outside Banks = C	17,990	27,627	41,906	47,815	72,726	68,324	81,336	99,236	119,091	130,775	125,191	138,099	149,682	163,272	154,967	195,832
Current accounts and Demand Deposits in leks of Residents = D	10,242	11,140	17,346	42,591	18,941	15,405	21,668	24,805	23,835	21,966	19,539	34,734	78,002	84,233	91,608	91,864
<u>M1 Aggregate (Money Supply M1= C+ D)</u>	28,232	38,767	59,252	90,406	91,667	83,729	103,004	124,041	142,926	152,741	144,730	172,833	227,684	247,505	246,575	287,696
<u>currency ratio</u> $\frac{C}{D}$	1.756492872	2.47998	2.415888389	1.122655021	3.839607201	4.435183382	3.753738231	4.000645031	4.996475771	5.953519075	6.407236808	3.975902574	1.918950796	1.938337706	1.691631735	2.131759993
Required Reserve RR	3,539	4,247	5,678	9,205	12,004	16,952	5,684	6,609	7,895	9,139	31,375	35,481	41,662	48,395	56,685	60,899
Excess Reserve ER	9,605	9,382	5,540	1,958	4,804	3,540	20,668	20,752	22,907	21,557	1,388	1,466	3,011	972	10,351	6,894
<u>excess reserves ratio</u> $\frac{ER}{D}$	0.937805116	0.842190305	0.31938199	0.045972154	0.253629692	0.229795521	0.953848994	0.836605523	0.96106566	0.981380315	0.071037412	0.042206484	0.038601574	0.01153942	0.112992315	0.07504572
Totla reserve R= RR + ER	13,144	13,629	11,218	11,163	16,808	20,492	26,352	27,361	30,802	30,696	32,763	36,947	44,673	49,367	67,036	67,793
<u>required reserve ratio</u> $r = \frac{RR}{D}$	0.345537981	0.381238779	0.327337715	0.216125473	0.633757457	1.100421941	0.262322319	0.266438218	0.331235578	0.41605208	1.605762833	1.021506305	0.53411451	0.574537295	0.618777836	0.662925629

Money Base $MB = (r \times D) + (e \times D) + (c \times D)$ $= (r + e + c) \times D$	31,134	41,256	53,124	58,971,498	89,532,212	88,578	107,685,624	126,594,798	149,888,781	161,456,689	103,183,505	175,045,466	194,349,783	212,629,361	221,984,505	263,612,934
Money Multiplier $M = (1+c)/(r+e+c)$	0.9068	0.9397	0.9927	1.533	1.0238422	0.94274	0.95651	0.97981	0.95355	0.94599	0.8718	0.9873	1.1714	1.164	1.11076	1.09133

Some illustration in order to show how are calculated formulas. (for 1996 years)

$M1\ (1996) = C+D= 47,815 +42,591 = 90,406$

Currency ratio (c) $= \frac{C}{D} =47,815/42,591=1.122655021 \ .$

Excess reserve (e) $= \frac{ER}{D} =1,958/42,591= 0.045972154.$

Required reserve (rr) = $RR/D = 9,205/42,591= 0.216125473.$

Total Reserve R=RR+ER=9,205+1,958 =11,163.

Money Base MB = (r x D) + (e x D) + (c x D) = (r + e + c) x D= (0.216125473+0.045972154+1.122655021)+ 42,591=58,971,498

Money Multiplier M = (1+c)/(r+e+c)= (1+1.122655021)/(0.216125473.+ 0.045972154+1.122655021) = 1.533

Appendix B.

Table 3. Regression Analysis date.

<i>Regression Statistics</i>	
Multiple R	0.72731
R Square	0.528979
Adjusted R Square	0.486159
Standard Error	0.118725
Observations	13

<i>ANOVA</i>					
	<i>Df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>Significance F</i>
Regression	1	0.174131	0.174131	12.35353	0.004843
Residual	11	0.155052	0.014096		
Total	12	0.329183			

	<i>Coefficients</i>	<i>Standard Error</i>	<i>t Stat</i>	<i>P-value</i>	<i>Lower 95%</i>	<i>Upper 95%</i>	<i>Lower 95.0%</i>	<i>Upper 95.0%</i>
Intercept	-0.60785	0.215256	-2.82384	0.016554	-1.08163	-0.13407	-1.08163	-0.13407
mm	0.707812	0.201383	3.51476	0.004843	0.264572	1.151053	0.264572	1.151053

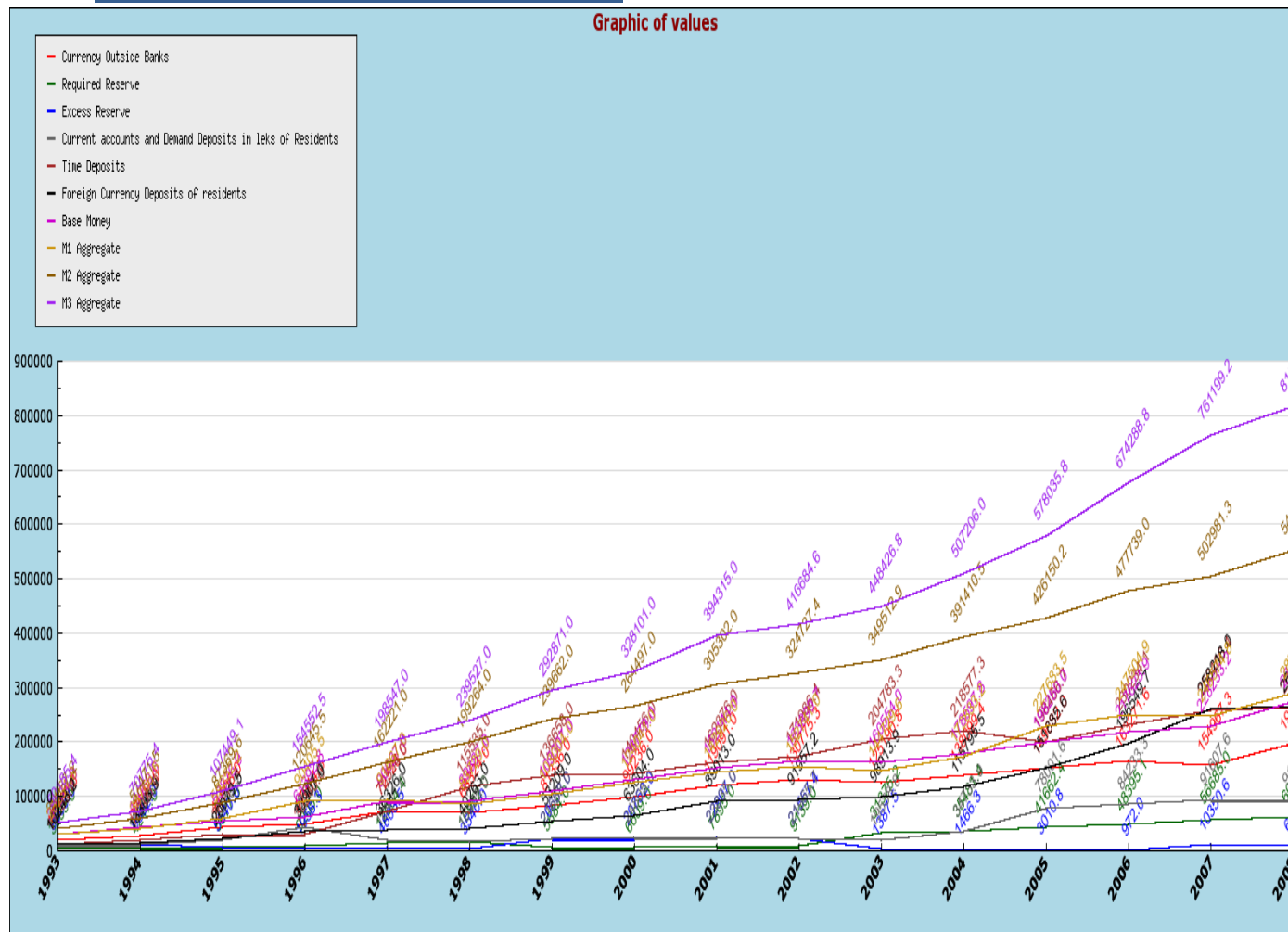
Appendix C.

Table 4. Times series database of the Bank of Albania.

Code	Index description	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
1		17,990	27,627	41,906	47,815	72,726	68,324	81,336	99,236	119,091	130,775	125,191	138,099	149,682	163,272	154,967	195,832
2	Currency Outside Banks	3,539	4,247	5,678	9,205	12,004	16,952	5,684	6,609	7,895	9,139	31,375	35,481	41,662	48,395	56,685	60,899
3	Required Reserve	9,605	9,382	5,540	1,958	4,804	3,540	20,668	20,752	22,907	21,557	1,388	1,466	3,011	972	10,351	6,894
4	Excess Reserve	10,242	11,140	17,346	42,591	18,941	15,405	21,668	24,805	23,835	21,966	19,539	34,734	78,002	84,233	91,608	91,864
5	Current accounts and Demand Deposits in leks of Residents	11,705	18,705	28,117	30,240	70,554	115,535	136,658	140,456	162,376	171,986	204,783	218,577	198,467	230,234	256,406	262,261
	Time Deposits																

6	Foreign Currency Deposits of residents	10,248	13,304	20,080	33,907	36,326	40,263	53,209	63,604	89,013	91,957	98,914	115,796	151,886	196,550	258,218	265,108			
7		30,374		42,069		53,877		61,393		90,927		89,887		109,307		128,779		152,144		163,891
Base Money																				
8		28,232		38,767		59,252		90,406		91,667		83,729		103,004		124,041		142,926		152,741
M1 Aggregate																				
9		39,937		57,472		87,370		120,646		162,221		199,264		239,662		264,497		305,302		324,727
M2 Aggregate																				
10		50,185		70,775		107,449		154,553		198,547		239,527		292,871		328,101		394,315		416,685
M3 Aggregate																				

Graph2. Taken from times series of BoA.



Inflation Targeting Albania Case

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ABSTRACT

This paper examines monetary policy in Albania during the transition period. The emphasis is on the new monetary policy regime in Albania, known as Inflation Targeting. Paper provides a review of the supposed monetary targeting regime and inflation targeting regime. In 1992 in Albania was introduced monetary policy and was established the two-tier banking system. Since 1992 until today the monetary policy of Bank of Albania (BoA) has progressed gradually into a modern design, inflation targeting regime. This paper provides a framework of monetary policy , strategies used by BoA and the challenges faced during the implementation of IT in Albania. The model enhances the channels and economic variables through which monetary policy affect the price level in the inflation targeting regime.

Key words: Monetary policy, nominal anchor, monetary targeting, inflation targeting, Albania



INTRODUCTION

Monetary policy of most central banks aims to administer money supply and interest rates to achieve price stability. Price stability is a low positive inflation so that movement in prices does not impact in the decisions made by economic agents. Bank of Albania assumed the role of central bank in 1992 and is responsible for designing and implementing monetary policy with the aim to maintain price stability. By ensuring price stability, the Bank of Albania (BoA) contributes directly to macroeconomic balances in the country, promoting economic growth, improving the standard of living, and enhancing the safety of the financial system (source: Monetary policy Document for the 2009 - 2011 period, BoA). Bank of Albania has managed successfully the decrease of inflation from 237% in 1992 to 6 % in 1996. Structure of monetary policy has changed continuously so that it could be in accordance with the newest features and the support by legal framework has increased year after year. After the collapse of pyramid schemes in 1997, Bank of Albania shifted from using direct monetary policy instruments to indirect ones attempting to bring inflation under control. After 2000 BoA announced its intention to keep inflation within the interval 2-4 % which lead to the increase in confidence of Albanian currency and the development of sound banking system. Inflation was stabilized impressively, although it sometimes has gone beyond the target due to factors that were not under the control of Bank of Albania (ex: higher bread prices, electricity and telecommunication tariffs). Bank of Albania has been formally operating under a monetary targeting regime, but BoA used as the main input in decision making inflation forecast and monetary aggregates played a supporting role. As it can be easily observed from the data in the Table-1 below. Another fact is that the actual growth rate of M3 until 2000 has diverged from its target. This raises doubts about the relative significance of the nominal anchor used in achieving low levels of inflation. Monetary aggregates are not effective intermediate target because they do not include all the necessary information about inflation forecast so like many other countries Albania moved toward an inflation targeting regime in conducting its monetary policy. Although Bank of Albania started to announce the end year objective of inflation to the public before implementing inflation targeting regime, as Mishkin (2002) argues, just reporting an inflation objective might be

insufficient to classify a country as inflation targeting. Passing from this implicit inflation target regime toward an explicit inflation target regime required some preconditions to fulfill by bank of Albania. According to IMF (September, 2005) a successful implementation of IT regime as a monetary policy requires a set of measures. The first principle to anchor inflation expectations, IT regime necessitates a fully independent central bank. The second important principle was financial system, starting from the structure to the legal and supervisory issues for ensuring an effective and soundness system. Albania needed to develop the financial markets and for doing this a collaboration channel was set with other national institutions. Bank of Albania collaborated with the Ministry of Finance and the Parliament on the legal issues for strengthening the central bank's independence. Statistics needed to become timelier and need to be improved for the purposes of policies by the central bank as well as by the government. BoA has taken several steps for making its communication policy more effective, expanding its information set and improving its inflation forecasting methodologies. In addition, the IT regime supports the maintenance of the flexible exchange rate regime. A floating regime provides Albania the opportunity to absorb the economic shocks. The value of Lek against other foreign currencies will be freely determined in the foreign exchange market by its supply and demand. The Bank of Albania will intervene in the foreign exchange market in accordance with the relevant internal regulations. In IT regime the main policy instrument is the base interest rate with the aim to influence future inflation, which is forecasted by the BoA. The monetary policy decisions are guided by the gap between the inflation forecast and inflation target. When inflation forecast for a certain number of periods is outside the target range monetary policy decision makers at Bank of Albania take decisions to close the gap. Inflation forecast play two important role in inflation targeting framework; they serve as an input into policy decision and as a communication tool to the public for the decision making.

An annual inflation rate of 3.0% is considered by the BoA as low positive inflation and appropriate for achieving a sustainable long-term economic growth in Albania. The target for inflation in the medium term is 3%, while +/- 1 percentage point is allowed. The BoA will aim at the 3.0% target midpoint. The target is symmetrical, implying that inflation outside the zone, whether above or below the target zone, is considered equally undesirable. The extended target zone ranging from 2.0% to 4.0% is called the tolerance zone. The tolerance zone is designed to

account for unforeseen shocks in regulated prices that drive inflation beyond the zone of 2.0-4.0%. The inflation target will be met in case the annual inflation rate is within the target zone. The BoA will present and comment on inflation outcomes, the actual inflation rate. The BoA will have to explain any inflation outside the tolerance. If economy suffer from temporary external shocks, the actual inflation rate may go outside from the target zone. Attempting to keep inflation within the target may cause undesirable volatility in output. Under these circumstances the BoA will aim at bringing inflation back into the target zone while trying to minimize output volatility. The inflation targeting and tolerance zone are shown in the Graph-1.

Literature Review

Inflation targeting is one of the monetary policy regimes that serves to the central bank to control inflation. A high level of inflation is costly for any economy, especially for transition countries (ex: Albania), where inflation has been more difficult to control. A significant number of developed and emerging countries have adopted inflation targeting (IT) regime, using inflation as nominal anchor for the conduction of monetary policy and the number of countries adopting IT regime is growing. One of the reasons of the high expansion of the new monetary policy has been its success in reducing the level of inflation since New Zealand adopted it for the first time in 1990. Some economists consider it as a modern strategy, not only because of its start in 1990, but also due to the role it plays in keeping moderate levels of inflation. Some economists consider the “young” age as a problem because of the risk of a non-rich experience and this raises doubts about the credibility of this new monetary policy regime. (source: Monetary transmission – Case of Albania “ Considerations on Inflation Targeting (IT)”, 07/07/2003, page 1). Adoption of an IT strategy commit countries to set as their main objective of monetary policy: price stability, so medium to long term inflation is the nominal anchor where an inflation target is set. Inflation targeting is a monetary policy strategy that encompasses five main elements:

- 1) The public announcement of medium-term numerical targets for inflation (Albania has chosen an inflation target of 3% +/- 1)

- 2) An institutional commitment to price stability as the primary goal of monetary policy, to which other goals are subordinated
- 3) An information inclusive strategy in which many variables are used , and not just monetary aggregates or the exchange rate, are used for deciding the setting of policy instruments
- 4) Increased transparency of the monetary policy strategy through communication with the public and the markets about the plans, objectives, and decisions of the monetary authorities (it includes *much more* than a public announcement of numerical targets for inflation for the following years. Reporting just numerical inflation targets or objectives for a country’s economic plan for the coming years , does not mean that these countries monetary policy strategy should be characterized as inflation targeting)
- 5) Increased accountability of the central bank for attaining its inflation objectives

(Inflation Targeting in Emerging Market Countries, Frederic S. Mishkin, NBER Working Paper No. 7618, March 2000, page 3-4)

In the present paper, the implementation and performance of inflation targeting regimes in Albania as the most efficient monetary policy regime is examined. It is hypothesized that the application of Inflation targeting in Albania as monetary strategy will have a very important role in controlling inflation or keeping it in low levels and achieving economic stability .The following literature reviews attempt to demonstrate and support the hypothesis for the Albania case.

In a research publication of Bank of Albania, done by Erjon Luci and Fatos Ibrahimi there are several advantages and disadvantages for IT regime application in Albania. Firstly monetary aggregates do not contain all the necessary information to predict future inflation, relying on a monetary targeting regime could be suboptimal. For this reason, BoA switching to an inflation targeting regime in the medium term is a better alternative. An inflation forecast, in contrast to monetary aggregates, is unrestricted in its coverage of information. Any information that could be relevant for the future inflation can be taken into account. Some of the major benefits of IT are: the broader information base it utilises, its relatively higher flexibility with regard to supply shocks, the fact that it is easily understood by the public, improved accountability etc.

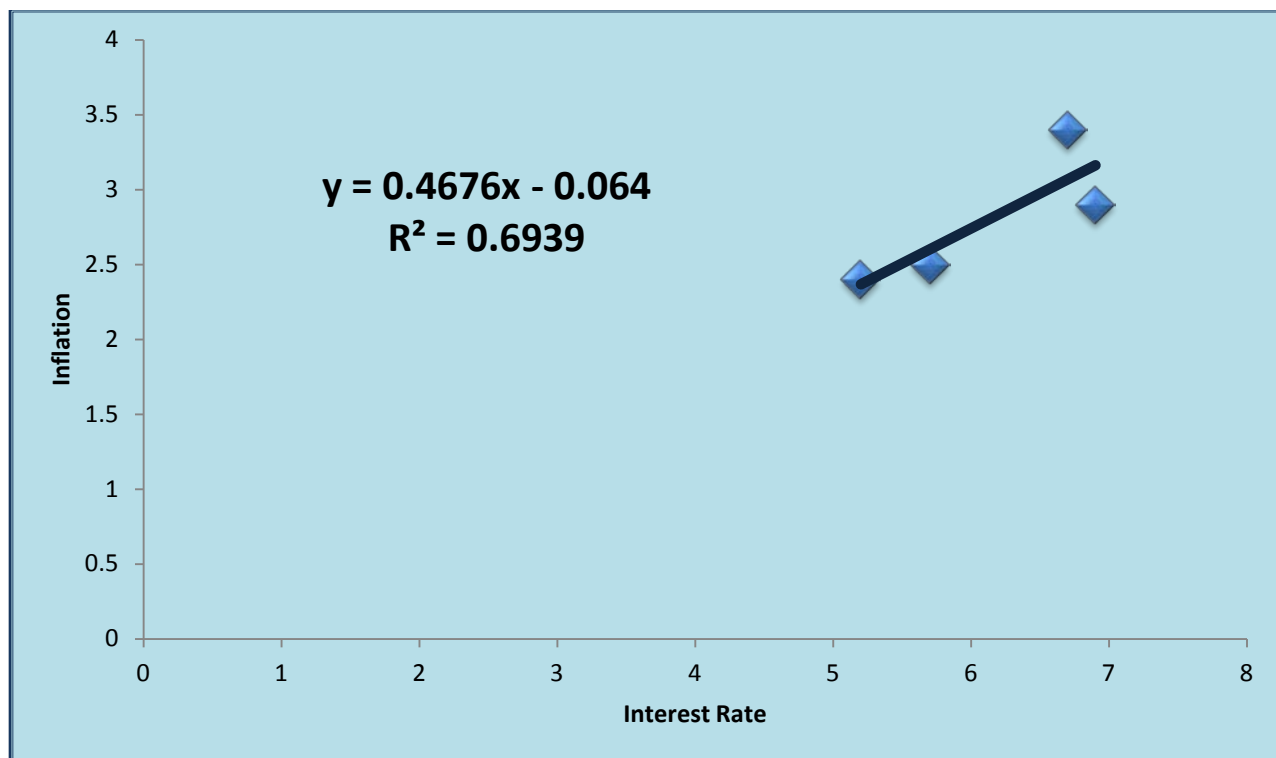
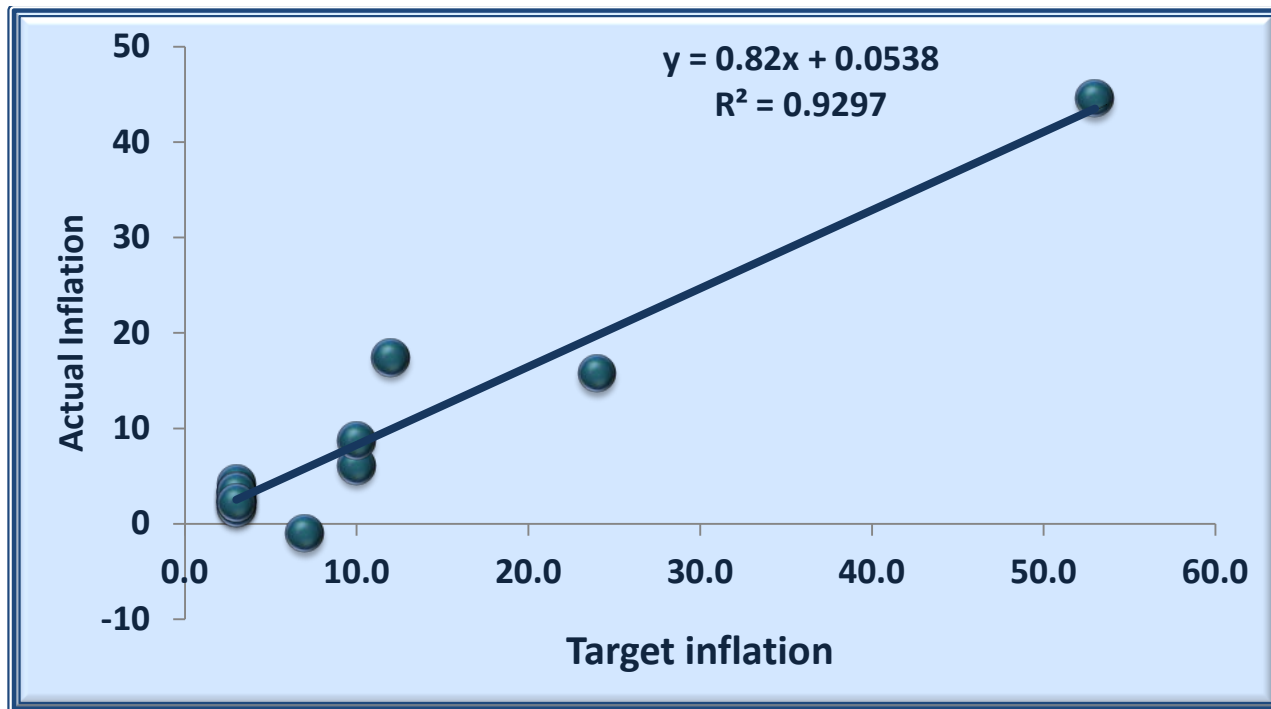
However, the adoption of an IT regime also poses several problems. The major problem for Albania is related to the increased risk on BoA’s reputation compared to regime of monetary

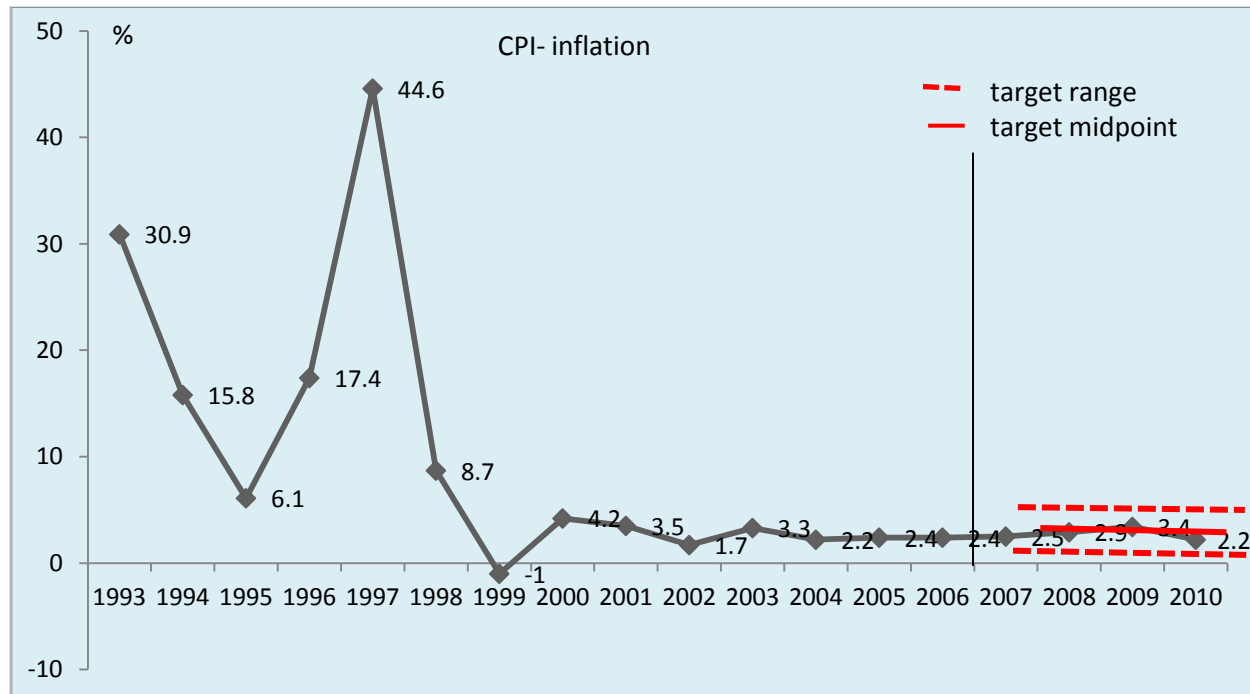
targeting. In the case of IT regime the missing of the target could be much more costly in terms of bank reputation. In recent years, BoA's reputation in terms of reaching its inflation objective around the 3 percent level has been strengthened. Some of the problems are related to BoA and some others are related to external factors. Bank of Albania main disadvantage is the statistical obstacles.

Model and Application

The model provided in this paper aims to be simple and understandable. The model aims to describe clearly the interrelationships between the main variables that influence in the monetary policy. We consider a small open economy (Albania) to emphasize some important factors in determining an inflation targeting range. The principal variables which are essential in a small and open economy, are inflation, the output gap, the exchange rate and the interest rate. In this model, if monetary policy functions properly the economy is in equilibrium in which real variables converge to their potential values, inflation converges to its target, and the other nominal variables adjust according to the inflation target. A good fit of the model with the data is important for the forecast of short to medium term, up to 3 years for inflation forecasts. While evaluating the model it should be taken into considerations that are other factors also that affect the performance of the economy. The policy instrument which Bank of Albania uses for achieving the objective is the interest rate, as the link between interest rates and inflation as the goal is tighter. Central bank chooses the interest rate based on criteria of measurability, controllability and the ability to affect the goal variables predictably. The economy faces unexpected shocks and by constantly adjusting the interest rate in response to these shocks, stable inflation can be achieved, meaning that it is possible over time to reduce the deviations of inflation from its target. As Graph-2 shows the co-movements of the actual interest rate and the inflation rate, we can obviously see that the interest rate is a major tool in reducing inflation. Monetary policy conducted by BoA has increased its transparency and also the public communication is more efficient in the new regime of inflation targeting. Credibility is more complicated due to the government intervention in the INSTAT's data of actual inflation, because they are manipulated by the government and do not show the real inflation occurred.

Bank of Albania bases its monetary policy on data taken from INSTAT and this decreases credibility since it is assumed that actual inflation many times diverges from the target midpoint and most important from target band, but referring to the data and the correlation between actual inflation and target inflation it is obvious that actual inflation has always been within the target band and the correlation is almost perfect since R square is very close to 1. It should be taken in consideration that sample consist of data both from implicit and explicit inflation targeting and also from the data of supposed monetary aggregates but which in reality was the inflation forecast which was taken in consideration. Inflation forecast is done on basis of econometric models. Monetary policy under the inflation targeting regime aims to meet objective price stability and so it can enhance macroeconomic stability that is required for the achievement of sustainable economic growth for Albania in the medium to long term. Policymakers are also concerned with the fluctuations in output and variability of the interest rate. Policymakers in collaboration with fiscal policy and other institutions within the country have aimed to keep output at its potential level, by minimizing the amplitude of the business cycle and also adjusting interest rates in response to change in conditions. Potential output is the output level when all prices and wages are fully employed. Unfortunately, potential output is not directly observed, which causes the main obstacle for the central bank in conducting the policy and this inability to observe it is called potential output uncertainty. This may create a difficulty for economic stabilization policy such as the Taylor rule, which requires reliable output gap estimates when the interest rate decisions are being made. Wrong information like output gap can mislead a central bank when choosing the target interest rate. Changes in the nominal interest rate have effect because create deviations of real variables from their trends, and these deviations affect the inflation rate. In the short run, a reduction in inflation has a real cost in terms of output and employment, their level will be below their potential level.





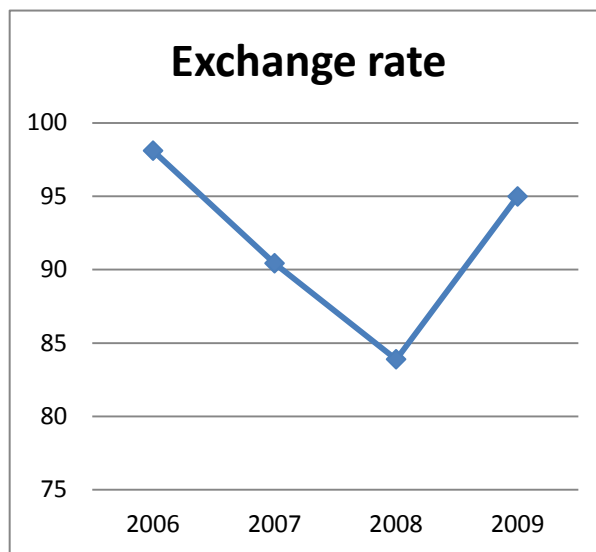
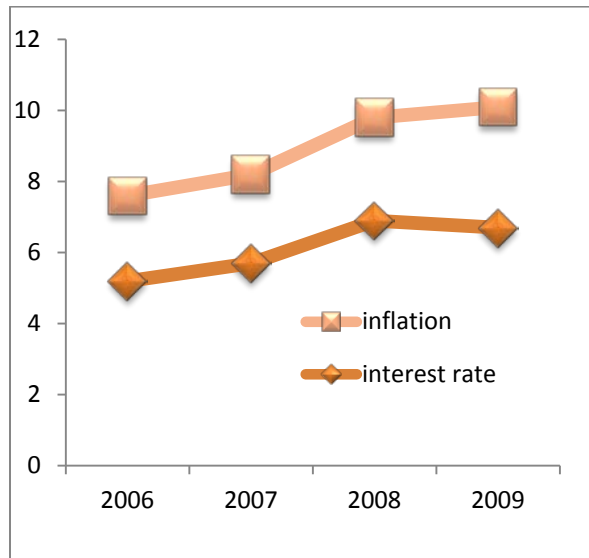


Table 1: Planned vs. actual monetary aggregates and inflation (end year, % change)

Year	MB		M3		Inflation	
	Project	Actual	Project	Actual	Desired Level	Actual Level
1993	-	-5.9	44.1	74.4	-	30.9
1994	-	-2.0	29.0	41.0	24.0	15.8
1995	-	-1.1	23.0	51.8	10.0	6.1
1996	-	2.6	22.0	43.8	12.0	17.4
1997	-	12.0	-	28.5	53.0	44.6
1998	-	14.1	23.0	20.6	10.0	8.7
1999	-	21.6	15.0	22.2	7.0	-1.0
2000	-	24.1	12.1	12.8	2-4	4.2
2001	11.4	18.1	15.4	19.9	2-4	3.5
2002	10.8	11.2	6.2	5.1	2-4	1.7
2003	-0.6	-1.9	9.5	8.3	2-4	3.3
2004	7.9	11.2	10.6	13.5	2-4	2.2
2005	5.7	-	8.3	-	2-4	-

Source: Bank of Albania

Year	Inflation targeting	Actual inflation
2006	2.0-4.0	2.4
2007	3.0	2.5
2008	3.0	2.9
2009	3.0	3.4
2010	3.0	2.2

Conclusion:

In this paper the monetary policy of a small open economy, Albania is specified. In Albania Inflation Targeting was applied in 2008-2009 and it was set an inflation target of 3% with a target band of +/- 1. Interest rate is used as a policy instrument to achieve inflation targeting. Bank of Albania controls interest rate through open market operations. Providing an inflation target band is better for achieving economic stability and the optimal value of the economic variables. Inflation targeting regime in Albania has proved in these three years to be successful since the actual inflation has been always within the inflation targeting according to INSTAT, because the real data of inflation are assumed to be higher. During this period, the Bank of Albania has expanded the range of information used in the decision-making process, increasing the transmission channels' efficiency and improving the communication with the public in both quantitative and qualitative terms. Monetary policy has made progressive steps in being an open institutions with high transparency and accountability. It assists in the anchoring of the economic agents inflation expectations to the inflation target, thus providing a direct impact to increasing the monetary policy effectiveness. Open market operations attempt to steer the short-term interest rates in the interbank market in compliance with the operational objective of the Bank of Albania. As it is obvious from the graphs interest rate and inflation have a direct relationship which shows that inflation targeting is a regime which help in maintaining a low and positive inflation. Inflation targeting has proved to be efficient in Albania in these 3 years but to see if it is adaptive for Albania long term data are a more accurate measure.

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“Inflation Targeting : The case of BoA”

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Abstract

Inflation targeting as an important part of every monetary strategy, has been defined as a stabilizer of various financial markets and as a factor giving support to the independence of the central bank. Many countries has implemented and worked in supporting the inflation targeting, but it still remains a point that there is more to be understood and done.

Albania is one of the countries that have some years that have implemented the inflation targeting method in the monetary strategy. There are strategies or plans that the bank of Albania used and implement in constructing the inflation expectations and the way in order to meet with its basic expectations.

Through the real data taken from the Bank of Albania can be observed the well targeting it has done. As being the main target of the bank of Albania, the all ways used from BOA have been successful during the last periods the main forecast of the Bank of Albania.

Keywords: Inflation targeting, BoA

1. Introduction

The basic goal for all central banks is the maintain of the price stability, there exist plenty of literature explaining the basic factors effecting the inflation. But an important role has taken the consummator expectations in the price setting process. The first theory of the rational targeting date in 1960 (John F. Muth), it's basically explained that expectations of the customer is a basic element in conducting of results which are directly related with these expectations.

Over the last 10 years inflation targeting has been as an emergence for all central banks in order to implement it in the approach to the conduct of the monetary policy. The initial adoption of inflation targeting begin with New Zeland in 1990, to continue with many other countries that consider it as an important conductor of the monetary strategy and a big support for the independence of their central banks.

Bank of Albania after analyzing the monetary theory decided to switch in inflation targeting as the first one conduct to many types of information that are not much relevant. Inflation targeting is considered as reliable and any information can be taken into account. This was mainly based on the idea that the best intermediate target of a monetary policy that aims the controlling inflation is an inflation forecast (Cukierman & Lividon 1992; Svensson 1997) Bank of Albania studied a large amount of literature in order to find the proper methodology and successful way of having the beneficial Inflation targeting regime. Most studies were based on Mishkin (1997, 2000 2002). The way from monetary targeting to inflation targeting was very risky for the BoA's reputation; because before this even though BoA's monetary targeting did not match a lot there was the situation of a low inflation. As the population does not have too much information on the relation of M3 and inflation that covered the risk of the reputation of BoA. Now a missing target for BoA is much more risky.

The aim of this paper consists on a basic analysis in which we can reunderstand the functioning of the inflation targeting methodology in the case of the Bank of Albania.

The performance of the Bank of Albania (BoA) in controlling inflation has been fulfilling the expectations. The BoA managed two disinflation processes, during 1992-1993 and 1997-1998, in a relatively short period of time and without much pressure for the economy.

CPI inflation has remained within the BoA's target margin of 2-4 % for much of the time ever since. Increased monetary stability has been reflected in increased confidence in the Albanian currency - Lek – and has helped the development of a banking system. The BoA's success in obtaining price stability is more evaluated if judged against the background of serious initial macroeconomic instabilities, the difficult political situation, the lack of institutional experience and the presence of several shocks.

2. Literature Review

Inflation targeting involves five key elements: 1) public announcement of medium-term numerical targets for inflation; 2) an institutional commitment to price stability 3) an information inclusive strategy in which not just monetary aggregates are used in making decisions about monetary policy; 4) increased transparency of the monetary policy strategy through communication with the public and the markets about the plans and objectives of

monetary policymakers; and 5) increased accountability of the central bank for attaining its inflation objectives.

With the problems encountered with monetary targeting in the 1970s and 80s, inflation targeting was adopted in a number of industrialized countries in the 1990s, starting with New Zealand in 1990, with Canada following in February 1991, Israel in December 1991, the United Kingdom in 1992, Sweden and Finland in 1993, Australia in 1994 and Spain in 1994. The case studies focus on New Zealand, Australia, Canada and the United Kingdom, from whose experience the key lessons follow.

In the mid-1990s, Leiderman and Svensson (1995) reviewed the early experience with IT, with, however, rather limited number of observations. Later studies (Bernanke et al., 1999; Corbo et al., 2001, 2002; Clifton et al., 2001; Arestis et al., 2002; Johnson, 2002, 2003; Neumann and von Hagen, 2002; Scott and Stone, 2005) inevitably afforded longer periods and more data. Overall, this evidence supports the contention that IT matters. Those countries which adopted IT, managed to reduce inflation to low levels and to restrain inflation and interest rate volatility. Bernanke (2003) suggests that *“central banks that have switched to inflation targeting have generally been pleased with the results they have obtained. The strongest evidence on that score is that, thus far at least, none of the several dozen adopters of inflation targeting has abandoned this approach”* (p. 1).

The studies that deal with the IT empirical evidence, ask a number of questions with the most pertinent being the following: first, whether IT improves inflation performance and persistence; a second aspect treated in the literature deals with the improvements in policy credibility and the ability to predict inflation under IT; a third group of studies consider whether the sacrifice ratio, i.e. the cost of lowering inflation, does not increase significantly over the period of IT implementation; a fourth range of issues stems from considering whether Central Banks' behavior change under IT regimes. Finally, the effect of the introduction of the IT new regime on the behaviour of other relevant macroeconomic variables, for example on the exchange rate, is assessed.

IT may also have an impact on the relationship between current inflation and its past history. Using univariate time series, Sikklos (1999) finds that the autoregressive coefficients show a noticeable drop in the strength of the relevant relationship for countries such as New Zealand, Canada, Finland, Sweden and Spain. Similarly, Levin et al (2004) find that actual inflation exhibits lower persistence in IT countries, and that the total variance of actual inflation is only slightly higher than the variance for shocks to the autoregressive model, whereas it is twice as big or higher in the case of non-IT countries, thereby exposing a substantial degree of propagation in the latter. They conclude that, as the variance of inflation is roughly the same in both groups, low levels of inflation persistence prevented higher levels of inflation volatility in IT countries. Uhlig (2004) takes issue with the estimation of the autoregressive model by Levin et al. (2004). He maintains that on the assumption that inflation is the sum of a trend plus noise, expected inflation should be modeled against the trend instead of actual inflation, which is just a noisy signal of this regressor. The result would lead to a downward bias, positively correlated with IT shocks. As IT countries present higher volatility, the bias would be larger for this group of countries. Finally, he recommends the use of a fully specified model including a signal-extraction-type equation.

According to the Yifan Hu study on the evidences about the Inflation Targeting, he focused on factors that might be systematically associated with a country's choice of inflation targeting as its monetary framework. It found that a number of economic condition, structure, and

institution variables are systematically associated with a country's decision to adopt inflation targeting. Low GDP growth and high real interest rates are significantly associated with the choice of inflation targeting, consistent with the view that one motivation for adopting inflation targeting is to improve overall economic performance. The evidently negative impact of inflation on the choice of inflation targeting was unexpected. The reason for the authorities' reluctance to adopt inflation targeting at a high inflation rate might come from the concern about their credibility. In fear of losing public credibility, the central bank is more likely to adopt inflation targeting when inflation rates are low, which makes the targeted inflation rate easier to achieve.

Pétursson (2004) finds that interest rates have fallen significantly more than inflation for all countries. This suggests that more weight is placed on long-run developments in expectations in IT countries, and that IT is interpreted with flexibility, considering also real and financial stability as determinants of interest rates. Increased credibility is not, however, immediate. The 'announcement' effect is shown not to be enough and only when real progress and the will by central banks to accept a temporary contraction became apparent was credibility achieved.

3. Data and Methodology

The desired features of inflation targeting framework were laid out at the Open Forum "Preconditions for Inflation Targeting in Albania" (Tirana, December 2005). The Forum supplied the BoA with valuable advice on various IT-related issues, which was reflected on our overall approach to IT as well as on our concrete actions in 2006.

Recognizing IT is a multidimensional project, the BoA set up a special internal coordinating group, named Inflation Targeting Implementation Task Force (ITITF). The idea behind ITITF is threefold. First, it serves as a forum for the discussion of theoretical and technical issues on IT. By seeking to get an early consensus on various topics, it tries to ensure the consistency of the whole project. Second, ITITF sets the agenda for the implementation of IT in Albania making sure the work proceeds on schedule. Third, it provides a framework of accountability inside the BoA. The group is chaired by the Governor, with participants being IT-relevant directors and qualified economists within the BoA. Based on a detailed and forward-looking agenda, ITITF meet on a monthly basis during the year and discuss all the issues relevant for IT implementation.

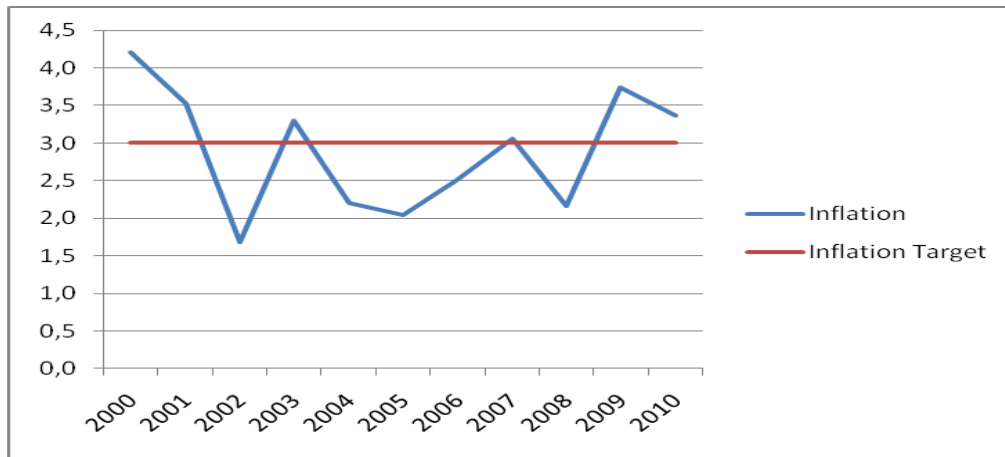
Bank of Albania works in achieving and maintaining price stability and in quantitative terms, BoA defines price stability as the keeping of an inflation rate at 3.0 percent, with a tolerance band of ± 1 percentage points. My study on this subject and mainly the case of BoA consist on the data collected from the publications of the Bank of Albania and the official statistics taken from the website of the INSTAT.

Bank of Albania has worked with many methodologies in order to have appropriate results in the inflation targeting topic. In this condition the study of their publication was the best way of having a clear idea of the ongoing of the inflation targeting in the Bank of Albania.

As I said previously I collected the BoA and INSTAT official data which are shown in the table below. We can observe the inflation rates through years from 2000 to 2010. Under the inflation rates it's shown the inflation target of Bank of Albania which is mainly 3 but with a range of ± 1 .

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Inflation	4,2	3,5	1,7	3,3	2,2	2,0	2,5	3,1	2,2	3,7	3,4
Inflation Target	3	3	3	3	3	3	3	3	3	3	3

From the data above with a simple line chart we can observe how the inflation target is approximately matched in the recent years, when also the inflation targeting policy has been implemented.



As can be observed from the chart above we can see how the inflation rate flows within the area of 3 +/- 1, mainly in the last 5 years. So it can be said that the inflation targeting of the Bank of Albania has been accomplished or reached in a good manner. The Bank of Albania has adopted inflation targeting as its future monetary policy framework. Inflation targeting has provided a better framework for integrating the increased information relevant for monetary policy decision-making and has offered a better communication tool for monetary policy.

4. Conclusions

The Inflation targeting was adopted and implemented from the Bank of Albania as an important part of the monetary policy. What I was analysing was this targeting how it has come and in need of what weak points of the Albanian economy and how did it give its primary results.

A proper conclusion about the success of monetary policy needs, however, further qualifications. Monetary policy has been conducted within a policy climate geared towards macroeconomic stability. The prudent fiscal policy pursued in this period has had a positive contribution in controlling inflationary pressures. Unlike some other transition economies, Albania has avoided fiscal problems. The budget deficit and public debt have been gradually reduced over the years.

The inflation target has been within boundaies of 2 and 4, and from the data taken and the chart given above it was very good observed how this target had been matched. Even though the studies of great profesors all over the world shows weak points of this kind of monetary policy, whic is the inflation targeting, it can be seen as in Albania this kind of policy till now has been working properly.

More has to be done in the inflation expectation which comes from different methodologies used, but it would bring basically what consumer really is asking from the Bank of Albania, how this bank is targeting the mutual point of its expectations and the consumer one and then the results would give the true result of where this policy is, and how proper it is functioning.

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Determinants of money Supply

Case of Albania

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This paper consists of Determinants of money supply in Albanian economy. The major part of it will be focused on money multiplier which is the ratio that relates the change in the money supply to a given change in the monetary base and the determinants of money supply. Here to be mentioned are: Required Reserve Ratio, Changes in the Currency Ratio and Changes in the Excess Reserves Ratio. Empirical data show that there is a positive and strong correlation between monetary base and money supply. Exactly this mathematical relationship between these two variables is given by money multiplier, the one which will be discussed in further in this paper. We will also compare Albania to neighbor countries

Key words: Money Supply, Albania

Introduction

Money Supply (MS) also known as Money Stock is the whole amount of money which is available in a country for transactions and investments in the economy. The central banks use different statistical measures to measure the forms of money that make up the money supply (MS). The monetary aggregates in the money supply have to be updated every week by the Central Bank (CB). It is generally believed that MS is controlled by the open market operations conducted by the central bank. CB controls the money supply in the economy, by checking the amount of injected liquidity and the required reserve ratio ^[1] for each unit of deposit in the banking system, but however some heterodox economists argue that the money supply is endogenous (determined by the workings of the economy, not by the central bank). MS is a very important issue because money is used in virtually all economic transactions; it has a powerful effect on economic activity. Monetary aggregates ^[2] were last revised in 1983 and the components of the MS have been the followings: M_1 : is currency held by the public to be added here travelers' checks, Negotiable Order of Withdrawal (NOW) accounts, Super NOW accounts, demand deposits, Automatic Transfer Service (ATS) accounts, and also credit union share drafts. M_2 : is the M_1 plus savings and small denomination time deposits, Money Market Deposit Accounts, and also money market mutual fund shares owned by investors. M_3 : is the M_2 plus large time deposits, large denomination term repurchase agreements (REPO's), shares in money market mutual funds owned by institutional investors.

And if we recall here the Monetary Base (MB) it is the currency in circulation plus the total reserves of the banking system as a whole. The paper is organized as follows: Firstly, the importance of the money multiplier in terms of monetary policy is analyzed. Second a simple standard model of calculating money multiplier is built. Finally, the money multiplier for Albania economy is considered further in a comparative analysis to the other economies of the region.

^[1] The reserve requirement is an amount of funds that depository institutions must hold to meet their liquidity needs.

^[2] Monetary aggregates- Broad categories measuring the total value of MS within an economy.

The link between MB and MS

The Money Supply is controlled by the central bank in each country, by Bank of Albania (BoA) in our case or by Fed in U.S. It is true that Fed has greater control over MB than it does over MS because checkable deposits are influenced by a number of factors that the Central bank can not have a direct control over them. So, we make a link between MS and MB through the following equation:

$$MS = m * MB$$

Where m , is the money multiplier, and tells us how much changes the MS for a specific change in MB. As m is always higher than 1, logically we can say that 1\$ change of MS is lower than 1\$ change in MB.

Money multiplier Model

Now let us assume that:

C = currency in circulation

D = checkable deposits (demand deposits + NOW accounts)

$MS = C + D$ = money supply (M1, but here ignoring traveler's checks)

MB = monetary base. And assume now that the desired level of currency (c) and excess reserves (e)^[3] grows proportionally with checkable deposits D . So,

$$c = \{C/D\} = \text{currency ratio}$$

$$e = \{ER/D\} = \text{excess reserves ratio.}$$

The total amount of reserves (R) is equal to the sum of required reserves (RR) and excess reserves (ER).

$$R = RR + ER$$

^[3] Excess reserves are bank reserves in excess of the reserve requirement set by a central bank. The total amount of required reserves (RR) is equal to the required reserve ratio(r) multiplied the amount of checkable deposits (D).

$$RR = r \times D$$

Substituting RR of the previous equation with $(r \times D)$, we get:

$$R = (r \times D) + ER$$

The MB is equal to currency plus reserves.

$$\begin{aligned} MB &= C + R \\ &= C + (r \times D) + ER \end{aligned}$$

Brings out the amount of the MB that is needed to support the existing amounts of currency, excess reserves and checkable deposits. A growth in the monetary base that goes into currency is not multiplied, whereas a growth that goes into supporting deposits is multiplied.

$$c = \{C/D\} \Rightarrow C = c \times D$$

$$e = \{ER/D\} \Rightarrow ER = e \times D$$

Substituting the above in the previous equation

$$\begin{aligned} MB &= (c \times D) + (r \times D) + (e \times D) \\ &= (c + r + e) \times D \end{aligned}$$

Then we divide both sides by $(c + r + e)$ and we obtain:

$$D = 1 / (r + e + c) \times MB$$

$$M = D + C \text{ and } C = c \times D$$

$$M = D + (c \times D) = (1 + c) \times D$$

By substituting we get:

$$M = 1 / (r + e + c) \times MB$$

And now we obtain the money multiplier as:

$$m = 1 / (r + e + c)$$

Numerical example

Considering the quote “Learn by practice” let us now better understand what money multiplier means by constructing a numerical example:

$$r = 0.10 \quad C = \$280 \text{ billion}$$

$$D = \$800 \text{ billion} \quad ER = \$40 \text{ billion}$$

Based on these given data we can find the c , RR , R , and MB . In this step we have just to substitute the given data in the formulas derived above:

$$c = C/D$$

$$c = \$280\text{billion} / \$800\text{billion}$$

$$c = 0.35$$

$$RR = r \times D$$

$$RR = 0.10 \times \$800\text{billion}$$

$$RR = \$80\text{billion}$$

$$R = RR + ER$$

$$R = \$80\text{billion} + \$40\text{Billion}$$

$$R = \$120\text{billion}$$

$$m = 1 + c/r + e + c$$

$$m = 1 + 0.35/0.10 + 0.05 + 0.35$$

$$m = 2.7$$

$$MS = m \times MB$$

$$MS = 2.7 \times \$400\text{billion}$$

$$MS = \$1080\text{billion}$$

Factors that determine m :

- Changes in the required reserve ratio, r

The m and the MS are negatively related to r

- Changes in the currency ratio, c

The m and the MS are negatively related to c

- Changes in the excess reserves ratio, e

The m and the MS are negatively related to e

- The e has a negative relation with market interest rate

- The e has a positive relation with expected deposit outflow

Case of Albania

As mentioned at the very beginning this paper is related to the determinants of money supply in Albania. Firstly to be mentioned is the fact that finding data about Albanian economy is hard enough and sometimes even misleading because different sources provide different information. So, we will be based on data published by public institutions in Albania, in cases of other sources it will be mentioned near the data. The money supply has also a very strong relationship with the inflation^[4]. To control the money supply, regulators must decide which particular measure of the money supply to target and when. The broader the targeted measure, the more difficult it will be to control that particular target. The M3 broad money supply in Albania totaled 939.958 billion leks (9.4 billion or 6.8 billion converted in Euro) at the end of August, up by 11.2% on the year, central bank statistics indicated. On a monthly basis M3 money supply was 2.9% higher at the end of August.

Table: 1

	End-Aug'10	End-July'10	End-Aug'09
M3 money supply	939.958	913.599	845.036
M2 money supply	588.544	586.321	567.217
M1 money supply	276.393	274.419	287.478
Monetary base	275.278	273.691	278.183

Evidence from the past suggests that there is a high degree of association between the monetary base MB and the MS. This holds true for the Albanian Economy as well, where the degree of association between the two variables is high as shown as in the below Scatter Plot and from the Summary Output Table generated through Data Analysis of Base Money and Money Supply. Data are taken from the database of monetary aggregates at the webpage of Bank of Albania: www.bankofalbania.org We will see that there has been a very strong correlation between these variables.

^[4] The more money in circulation, the less your money is worth due to inflation, higher prices.

Graph: 1

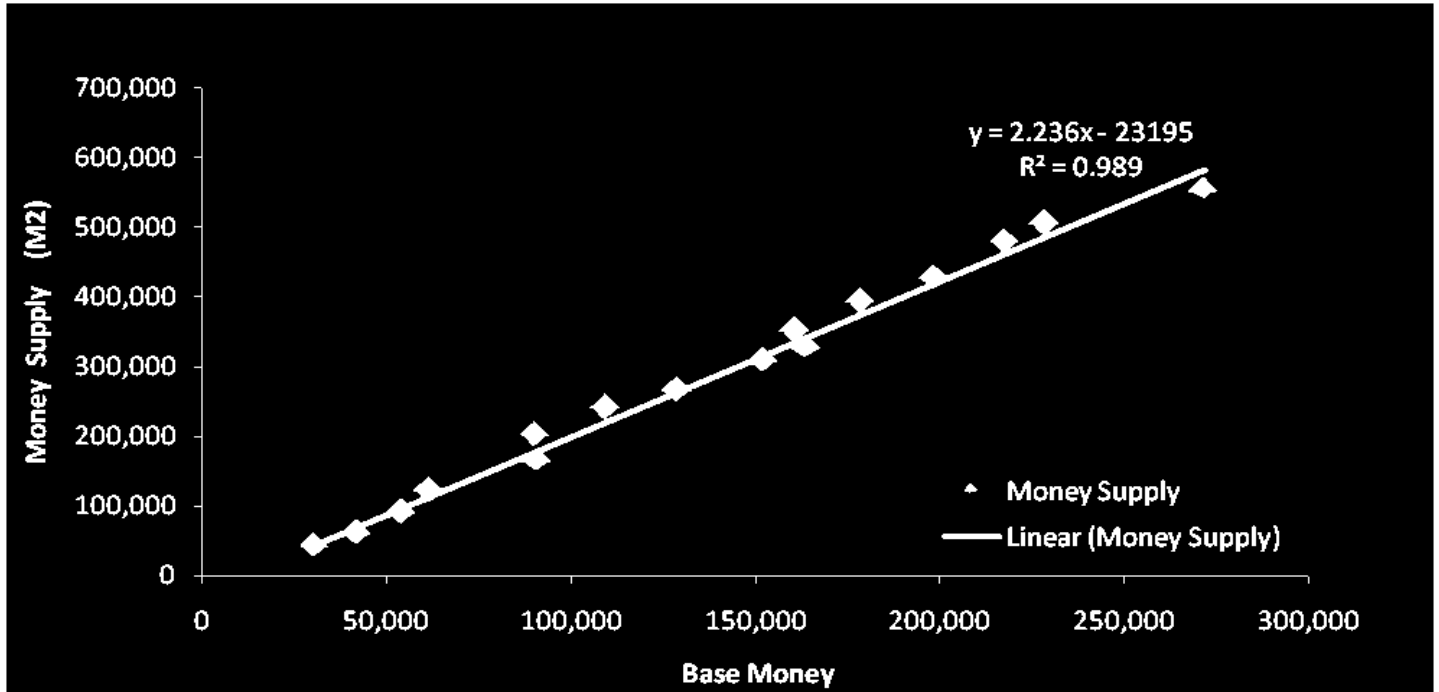


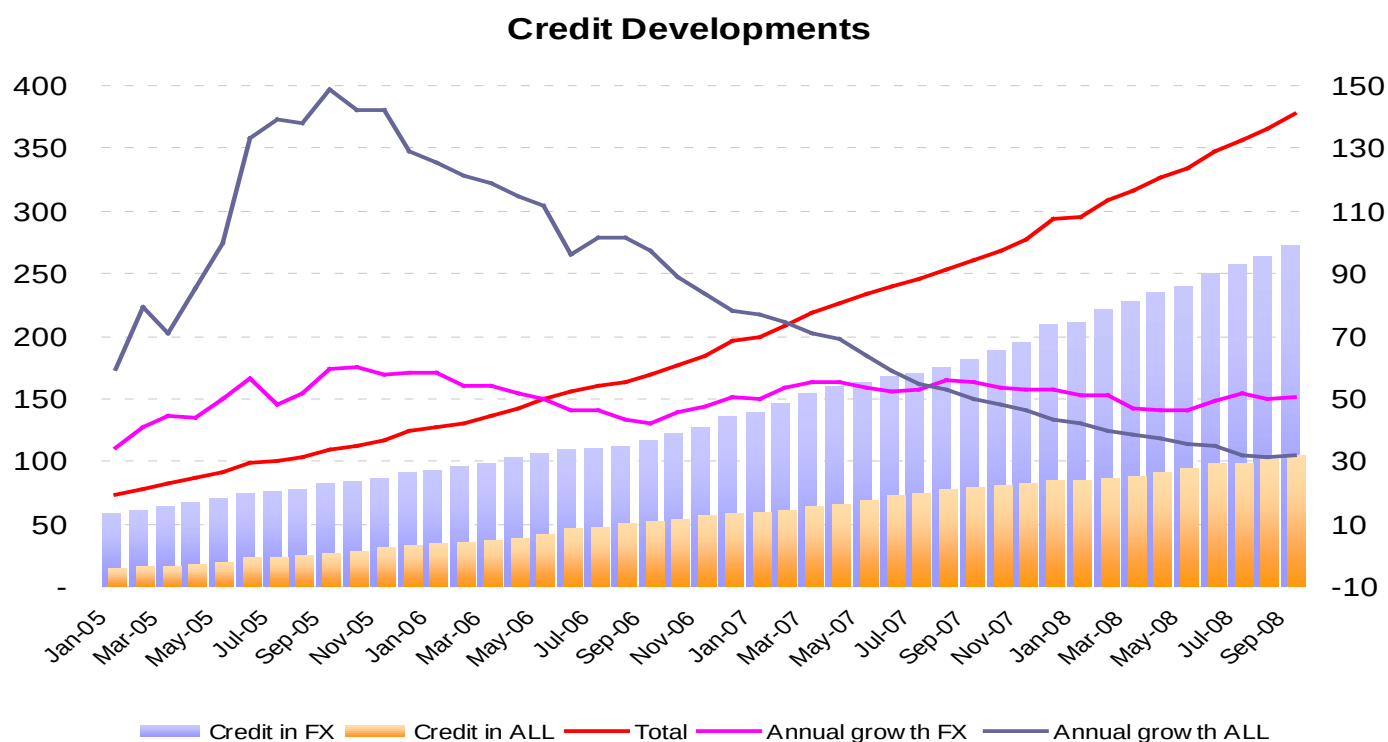
Table: 2

SUMMARY OUTPUT	
Regression Statistics	
Multiple R	0.994863387
R Square	0.989753159
Adjusted R Square	0.989021242
Standard Error	16999.45493
Observations	16

Smaller money multiplier means higher financial liquidity as one dollar of real cash has a smaller number of dollars of liabilities to serve. In simpler terms, this is printing money to support the financial pyramid so it does not run out of cash. And if Albanian economy had printed at that time an excessive amount of money the pyramids^[5] would not have collapsed. This may have been closely related to the fact that Albanians at that time did not know the current level of money multiplier. However as we are studying economics we are all aware of the very bad impacts that printing surplus money brings in the economy so this may have also been a

feedback to apply that way of preventing pyramids to collapse. From January 2005 up to September 2008 the loans given by Albanian banks has increased a lot, in details it is explained in the following chart:

Graph: 2



If the demand for credit by economic agents is high and banks decide to lend out close to the maximum allowable, money supply approximates money produced by central bank times the multipliers (assuming minimum holding of currency in the form of cash). In this case money multiplier is a strong link between money supply and money base. If banks decide to accumulate excess reserves rather than full utilization of funds to lend out

and / or if non-bank public demand for cash increases, money creation by central banks does not fully translate into money creation by banking intermediaries, thus weakening the relationship between money supply and money base. So, money multiplier does not remain constant over time and every initial liquidity injection by the BOA to the banking system affects the money supply in different time frames, depending on the performance of the aforementioned factors.

^[5] During 1996-97, Albania was convulsed by the dramatic rise and collapse of several huge financial pyramid schemes.

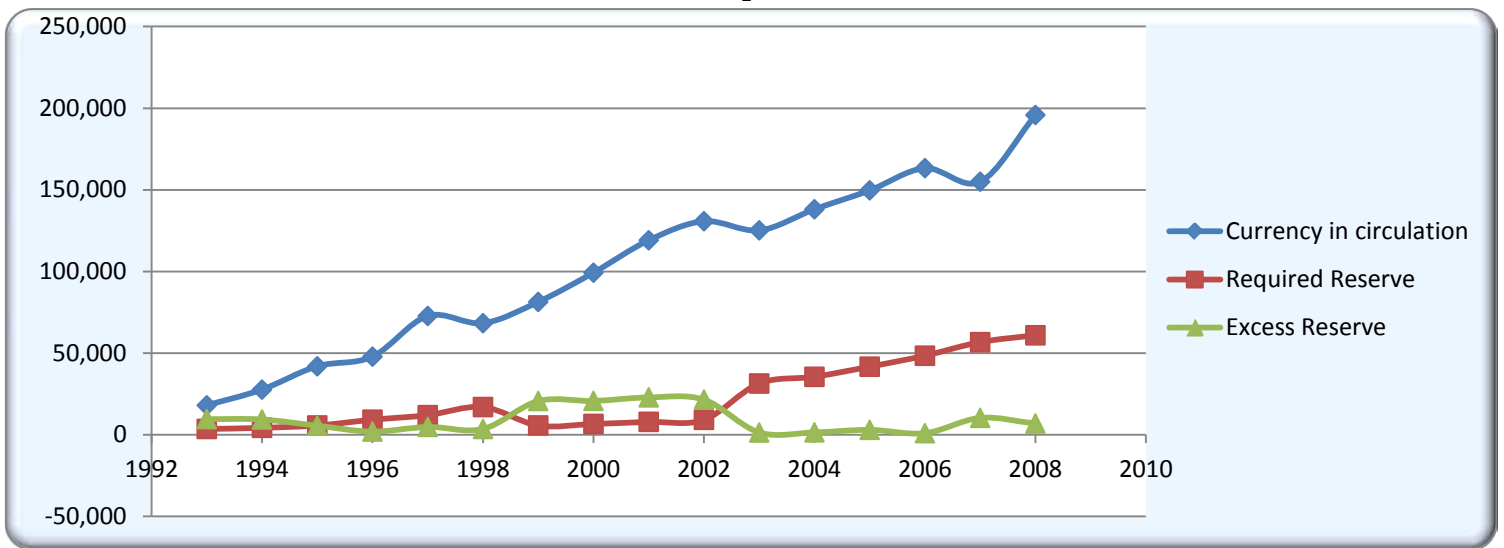
Table: 3

Periodes	C	RR	ER	D	c=C/D	e=ER/D	r=RR/D	t=T/D	m1=1+c/r+e+c
1993	17,989.80	3,539.00	9,605.00	10,242.00	1.76	0.94	0.345538	1.1429	8.777578829
1994	27,627.00	4,247.00	9,382.00	11,139.50	2.48	0.84	0.381256	1.6792	10.82738387
1995	41,906.00	5,677.50	5,540.00	17,346.20	2.42	0.32	0.327305	1.6210	11.11630445
1996	47,814.50	9,205.00	1,958.30	42,591.00	1.12	0.05	0.216125	0.7100	7.363027693
1997	72,726.00	12,004.40	4,803.50	18,941.00	3.84	0.25	0.633779	3.7249	11.15148913
1998	68,324.00	16,952.00	3,540.00	15,405.00	4.44	0.23	1.100422	7.4998	9.695417789
1999	81,336.00	5,684.00	20,668.00	21,668.00	3.75	0.95	0.262322	6.3069	20.01722832
2000	99,236.00	6,609.00	20,752.00	24,805.00	4.00	0.84	0.266438	5.6624	20.85253275
2001	119,091.00	7,895.00	22,907.00	23,835.00	5.00	0.96	0.331236	6.8125	22.04189862
2002	130,775.31	9,138.97	21,557.41	21,965.74	5.95	0.98	0.416056	7.8298	22.24464762
2003	125,190.78	31,375.17	1,387.51	19,538.84	6.41	0.07	1.605785	10.4808	11.46841369
2004	138,099.37	35,481.43	1,466.28	34,733.87	3.98	0.04	1.021523	6.2929	8.910301891
2005	149,681.95	41,662.44	3,010.78	78,001.57	1.92	0.04	0.534123	2.5444	6.550290947
2006	163,271.65	48,395.08	971.96	84,233.26	1.94	0.01	0.574536	2.7333	6.323590625
2007	154,967.29	56,684.97	10,350.65	91,607.56	1.69	0.11	0.61878	2.7990	5.538465917
2008	195,831.58	60,899.10	6,894.16	91,864.30	2.13	0.08	0.662925	2.8549	6.422468485

By considering the available data found from Bank of Albania publications and by doing some calculations we obtain the Table 3, which will help us to construct charts for the MS determinants. In above table we can find Currency in circulation, required reserves, excess reserves, demand deposits and time deposits from 1993 to 2008 in Albanian Economy.

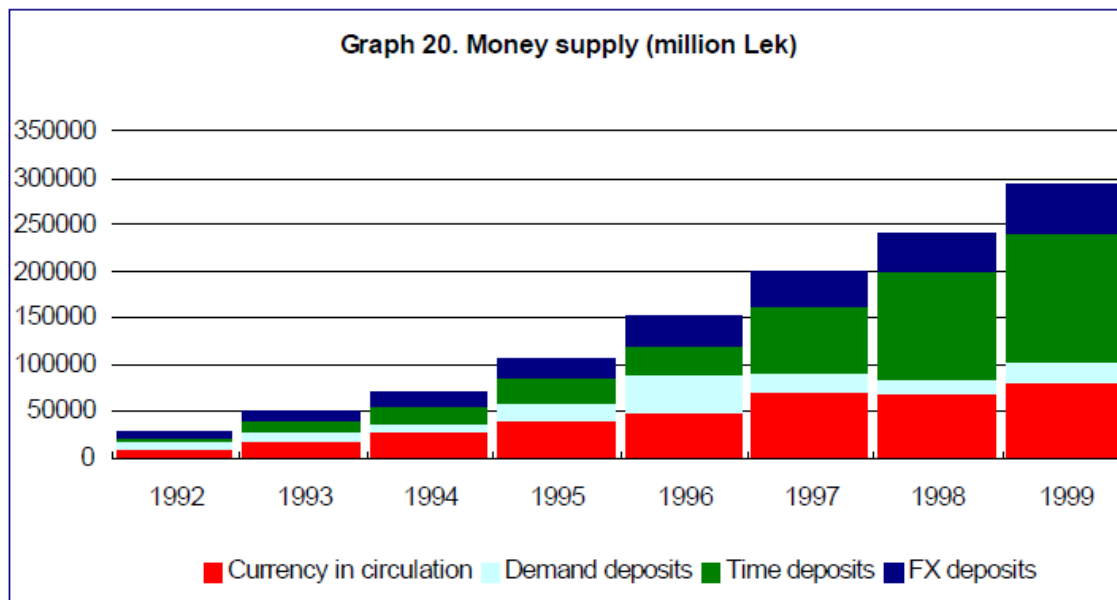
In graph 3 below we can find the Determinants of money multiplier in Albania from 1993 to 2008, and their relations. We see the relation of c, r and e from 1993 till 2008. We can see an increasing currency in circulation over years and also a required reserve having positive trend even that between years 1998 and 2002 it has declined. Excess reserve has a negative relationship with required reserves as it goes in the opposite direction of it.

Graph: 3



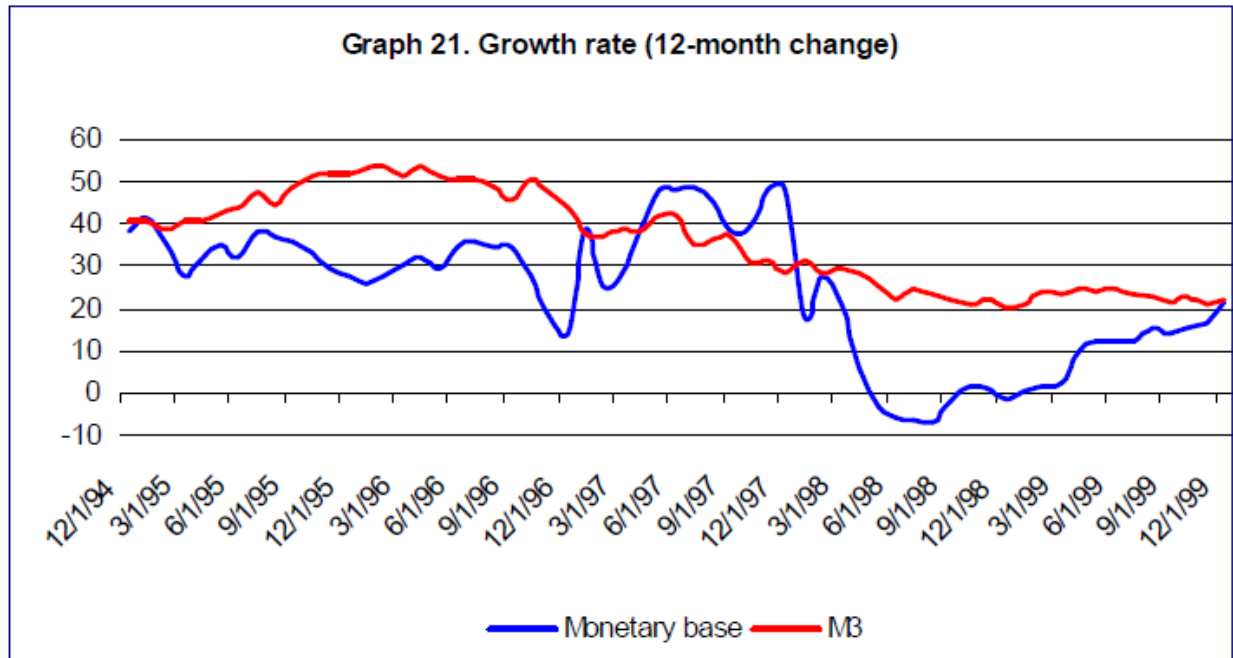
Graph: 4

Bank of Albania



Shown above money supply as share of currency, demand and time deposits from 1993 to 2008.

Graph: 5



Monetary base and money growth rate (M3) from 1993 to 2008. Monetary growth rate seems to have a downward slope whereas the monetary base has had a lot of fluctuations.

Money Multiplier in Albanian Economy as a comparative analysis with other countries in the region

Table: 4

	Money multiplier					CoB/M3					Reserve requirement ratio
	2005	2006	2007	2008	2009	2005	2006	2007	2008	2009	
Albania	3.0	3.0	3.3	3.5	3.0	25.3	23.9	21.6	19.8	24.5	10
Macedonia	4.1	4	4.3	4.3	4.2	27.7	24.9	21.6	18.7	16.7	10-13
Hungary	5.0	4.9	5.5	4.7	5.2	14	14.2	14.2	14.1	13.2	6
Croatia	4.1	4.1	4.1	4.3	4.1	9.4	9.4	9.2	9.0	5.9	14
Poland	5.7	5.7	5.5	5.5	5.6	14.5	14.9	15	14.8	14.5	3
Serbia	-	4.6	5.6	3.1	4.3	-	12.1	8.7	9.3	7.6	10-45
Source: Bank of Albania, central banks of countries in the region											

The table 4 above helps us say that in 2005-2006 money multiplier fluctuated around 3 in Albania, a relatively lower rate as compared with those of the region. After 2006 it increased gradually, mainly due to rapid money creation in the economy triggered by high banking

intermediation rate, while at the end of 2008 and on, money multiplier has shown a downward trend. Generally, high demand for liquid monetary assets is a characteristic of countries with a less-developed banking and financial system. In these countries, individuals and other non-bank agents in the economy prefer to hold significant amounts of currency in the form of cash, and banking intermediation is low. As the table shows, the countries with higher money multipliers are associated with lower currency outside banks to money supply ratios, and lower reserve requirement ratios. Hence, besides Albania, low money multipliers result even in Croatia and Macedonia. In Croatia's case, besides keeping currency outside banks on track, higher reserve requirement ratio might have impacted on comparably lower money multiplier effect. In the case of Poland and Hungary, money multiplier results higher, thus reflecting lower reserve requirement and currency outside banks ratios.

Concluding remarks:

In this paper, we aimed at revealing the importance of the control of both the monetary aggregate and the money multiplier in achieving the targeted level of money supply. This, in turn, will enable the BoA to provide price stability. In the special case of Albania, as we found by the regression analysis, MB is found to be the major contributor to the change in Money Supply. We developed a simple model for calculating $m1$ in our economy.

- An increase in r^* will decrease both $m1$ and $m2$.
- An increase in the t^* which is determined by the public time deposits will have no effect on $m1$, but will increase $m2$, as provided by our model.
- If e^* will increase, $m1$ and $m2$ both will decrease.
- A rise in c^* , will cause $m1$ and $m2$ to fall.
- Money multiplier plays a key role in monetary policy.
- Theoretically, money multiplier shows that through banking intermediation, money supply is expanded to by a multiple of monetary base.
- Money multiplier performance is subject to central bank stance, through its decisions on liquidity injection, determining the required reserve ratio and the base interest rate.
- It is also influenced by commercial banks, their decisions on the amount of lending to the economy and the liquidity held as excess reserve, as well as by the behaviour of economic agents, households and enterprises, through their demand for credit and currency outside banks.
- Money multiplier is a strong link between money supply and money base .
- However, money multiplier does not remain constant over time and every initial liquidity injection by the Bank of Albania to the banking system affects the money supply in different time frames, depending on the performance of the aforementioned factors.

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ECONOMIC GROWTH

ALBANIA CASE

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The project contributes to building the cornerstone of growth, in analyzing the theoretical growth and the empirical facts of it. It is a detailed study of how the economy survives and becomes stronger. The whole picture will be concrete for Albania. Showing how important is to value our potential and contributing to give a more vitalizing breath for our economy, linking the theory with practice and with clear strategies toward the future.

Introduction

Defining a so broad topic like economic growth in a simple project means to follow a logic of deduction, from the broader conception of growth to the most empirical ones such as the effects of the growth in the everyday life.

This would not be sufficient because “growth” means evolution, expansion, spread on newer and newer dimensions and the whole thinking would be in a continuous renewal process, it always be something to add up, something to modify or even to change the points of view.

This is how the project turns into an adventurous thinking, offering many perspectives, different ones that should be unified in the numerous brainstorming created. For sure, I have chosen to make this analysis with the intention to evaluate every color of the economic growth, every aspect of it, every signal toward the future.

Since it has color, aspects of being, and signals toward the future, it may be considered as universal issue, but at the same time a so closed reality for every day life of citizens.

I have tried to catch the essence of this infinite process toward some practical issues:

- Is economic growth a natural tendency or may be controlled or imposed?
- Which are the universal aspect of the growth in the economic, social and political context?
- Is Albania aware of its possibilities for growth?
- Which are the sources of growth in Albania?
- Has Albania possibilities for innovation?
- Do we need to build an idea of challenging growth in our economic culture?
- Do we have an adaptive institutional framework?

Keywords

- Sustained growth
- Rate of growth
- Per capita output
- Conditional convergence
- Business cycles
- Human capital
- Financial depth
- Government burden
- Public debt
- Balance of payment
- Neoclassical model of growth
- Classical model of growth
- Overproduction
- TFP, total factor productivity
- Diminishing returns
- Innovation
- Creative destruction
- FDI, foreign Direct Investments
- Endogenous and Exogenous factor in Growth
- Steady state of Growth
- Volume of trade
- Risk Diversification
- Depression

1. Origins of Growth (giving the context and the evolution of the concept of growth)

The concept of growth during times has been in a pure voyage. The conception has changed and many arguments(theoretical and empirical ones) have born.

Each of those conceptions, is build in a context and cannot be seen separately from the framework.

With the change of the economic, politic, social, human conditions it happened a renewal of conception.

Let us start with the Colonial Times, what really mattered were the government system imposed by the politics of colonization. This method was a clear cut between the poor and the wealthy countries (each of them path defined by the method of colonization)

Countries that were also helped by the strategic geographical position and factor endowments experienced limited rapid growth. The poorer colonies developed equality, broad public education, helping them to experience greater economic growth.

Industrial Revolution may be seen as a symbol of growth and the most dynamic part of the growth because of the same dynamic energy that has substituted the less efficient manual work, water and wind power. Mechanization, Transportation Infrastructure, Steel and Power Electricity were the components of the growth in the meaning of the productivity improvements. This is the most empirical spread of growth. Those processes contributed to the overproduction, a period of deflation while real wage of workers rose up allowing them to increase the production.

We are in 1920 and immediately we concentrate on the Great Depression (the opposite framework of growth) and overproduction was the reason behind it.

After the Depression, the growth started to be reseen and was helped by the increasing demand for new goods and services (phones, radios, automobiles, air conditioning)

Building of highway infrastructures contributed to post World War2nd, even capital investments and chemical industries.

We are under the period when the thought was spread throughout the well known

- Classical growth theory
- Neoclassical growth model
- Unified growth
- Creative destruction

At the heart of the classical growth theory, that is one of the leading theories of the growth stays the idea of the wealth of nations, represented by Adam Smith and David Hume. When they thought about growth, they have related it with the capacity for

growth that is specific and unique for every nation. Central to wealth was the increasing capital and agriculture as the most productive part of the wealth, while considering nonagricultural industries as sterile.

David Ricardo, another enlightened thinker, brought the idea of trade as the cornerstone of the growth. The theory is easy, integrating the trade among countries is very beneficial if one could buy more cheaply from abroad, is more profitable to make business there. Benefiting from Comparative Advantage is the key in going toward the growth.

Another impressive model is the Solow-Swan model, a very complicated model for 2 reasons

- It involves a set of relationships, labor-time, capital goods, output, investment, technological change.
- It makes also three important predictable implications, first, increasing capital relative to labor means growth, second, poor countries will grow faster because of higher return on capital and third, because of the diminishing return to capital, economies will reach a point at which any further increase in capital will no longer create growth. This is the situation called as Steady State.

The model also tries to answer to the question “how can we overcome the steady state?” the answer lies in the invention of new technology, considered as an exogenous factor. By the increasing of the technology, the steady state will improve and make stronger the growth. This has a problem in bringing in the reality, data suggests that the world has slowly increased its rate of growth. Let us discuss for another theory of growth that brought endogenous growth theory, in which economists worked to endogenize the technology by incorporating a new concept of human capital, skills and knowledge that made workers productive. Always human capital has increasing rate of returns, so there are no diminishing returns, only constant returns to capital, that is why the economies do never reach the steady state. The rate of growth depends on the type of capital a country invests in and the education of the human capital and innovation of the technology.

This theory was also conflicting with the empirical regularities that characterized the growth process over time in developed and less developed countries. A modification of the endogenous theory was made by unified growth theory, consistent with the entire process of development.

What is the big Push?

It seemed to be one of the most vital theories explaining the Dynamics of Growth (jumping from one stage of development to another through a virtuous cycle through

- Investments in infrastructure
- Education
- Private investments
- No more economic paradigms

Now we will see the essence of the Creative Destruction that has been fully considered as a new, separated theory, considering the potential of entrepreneurship, staying behind the growth and converting a new idea into successful innovation.

The creative destruction is entirely guided by the new business models, being responsible for the dynamism of industries and long run economic growth.

I have preferred to close the Origin Section of my project by wuoting a text of Alan Greenspan” capitalism expands wealth primarily by the creative destruction, the process by which thecash flow from obsolescent, low return is invested in high return cutting edge technologies”

This, also is a very good lesson of arising efficiency in economy, and turning weak points of Economy into strong ones.

In order to summarize the evolution of conception of growth over time, I will specify that by theories we have build many alternatives of growth. It is left to ask that which of them sound more real? Why do we need a so broad framework of growth? The answer lies in the second section.

2. COMPONENTS OF GROWTH

As we have seen growth seemed to be a complex reality, involving many dimensions and aspects. There are many variables or determinants of the growth, but especially we will focus on the components that have received the most attention in academic literature and in policy circles.

Conditional convergence- expresses the idea of how the initial position of the economy determines the growth rate. The conditional convergence will explain why poor countries should grow faster than rich ones because of the decreasing returns to scale. For this reason we will see this component in the light of the initial level of real GDP in Albania per capita. This is important to understand also how an economy in transition impacts the performance of the economy.

Since when we make the analysis of the growth of the economy of a country, we refer to a period of 5-10 years for many econometric estimation and forecasts. That is why this short time period implies the cyclical effects of the business cycles.

We will analyse also the output gap as growth determinant, widely used in regression analysis for growth, obtained as the difference between the potential and the actual output.

Even the output gap will offer the perspective in determining the Albanian Growth. We cannot study any growth rate separately from the so called structural policies. Structural policies can be seen as a multi area concept involving education, financial depth, international trade. Clearly, these areas are the structure and the essence of the growth are the cornerstones of building an economy.

Everything starts with education, as the process of forming the human capital, the most valuable economic asset. Human capital never depreciates, and never offers diminishing returns. It is a complement aspect of growth and without human capital, there is no long run growth.

Financial Depth, as a component of growth, should be studied in a separate section because it is crucial and leaves the traces everywhere, in whatever story of growth.

The essential points of this component are closely related to the well functioning of the financial systems

- Risk diversification
- Hedging, pooling of financial instruments
- Channeling of savings in the most profitable investment projects
- Reducing the well known principal-agent problem
- The measure is by the ratio of credit supplied to the GDP

The other component of the GROWTH is considered to be the Trade, that is closely related to the TFP or Total Factor Productivity. Since it allows countries to exploit the areas of competitive advantage and also increasing the economies of scale, increasing their TFPm by diffusing the technological innovations and managerial innovations expressing a strong positive relationship. Practically we will measure it by using the volume of trade (real exports plus imports) to the GDP that is adjusted for the size of the country.

The other important component is the government burden or the ease offered by the government. We have burden when the government discourages the private investors by heavy taxation, ineffective public programs and bureaucratic procedures.

In this framework, we will analyse also the public services and infrastructure, seen also as inputs in the production function, by improving TFP.

We will measure it by the telecommunication capacity, number of phone lines per capita.

We cannot study the growth of any country without knowing the nature and the quality of the governance, of how rights are granted and protected, of how corruption is prevented, of how contracts are enforced, of how law and order is provided.

Let us also summarize this section, so far, have made clear and we have enlightened the path that will guide us into growth evaluation, in arising conclusions and in offering possible alternatives for Albania. We have found a way to find answer to the following questions for Albania:

- How transition in Albania economy has affected the growth?
- Does Albania have a large difference between the potential and actual GDP, so does it have a large output gap?
- Does Albania have the sufficient human capital to afford and progress the growth?
- Do we have a financial market that creates good incentives for growth?

- Which is Albania volume of trade and level of openness and integration in international area?
- Do we have a well guided governance?

3. ALBANIA CASE

The most efficient way to study the progress of the economy of a country is to observe carefully the actuality, and this will be the way of analyzing Albania economy. I have collected many data for the Albanian economic indicators, taken from the every day life of Albanian citizens, later we will put them in a logical framework.

Let us start with the human capital component of the growth. Albania is distinguished for the new age people as the most vital part of the labor force and also one of the strongest point of Albanian economy is the cheap labor force. This fact should be seen in both sides. First it is a good indicator because serve as an incentive for FDI or Foreign Direct Investments, attraction, but at the same time decreases the purchasing power of the Albanian people, reducing the demand and the productive capacity. According to the result given by the Institute of Economic Studies, Albania is ranked the last of the region for the level of the average wage that is the level of 246 EUR.

This is a significant result considering the fact that Albania is under inflation, and we can say that with this level of price increase, wages in Albania have risen only by 4 EUR, an amount that does not compensate the inflation costs affecting directly the consumption and the investments. Many studies have shown that the scenario of inflation, according to the report of World Bank, states that those prices are imposed by the international area. Many foreign products have had a sensible increase in price, fact that has affected Albanian market.

30% is the increase in the general level of price causing 7.6% deficit in the balance of payments for food and energy especially, and 60% of GDP is the Albanian Public Debt. This shows how the microeconomic event of the price increase goes to the macroeconomic framework by causing the situation of disequilibrium in the balance of payments and the situation of the public debt.

The size of the Albanian Public Debt will have an important impact on the fiscal policy of Albania, having as emergency the decrease in level of subventions or other government expenditures.

Let us analyse the Albanian International Openness on the Albanian trade. I will mention for this purpose the seminar organized under the topic “ the stimulation of the exports with EFTA, European Free Trade Association) in 2010 Albanian exports were 50 million EUR from 9.3 million EUR in 2009m containing today approximately 4.2% of the total exports, reinforcing also the idea of the integration of Albania economy in the European area. This expresses a challenge for Albania economy, to direct the governance of

economic growth toward the domestic production to increase the other “Made in Albania” exports.

As we have said in order to evaluate the growth of any country, including Albania we need to see how large is the output gap or the difference between the real and the predictable output, for this reason from FMN or the International Monetary Fund I have found some data showing the economic indicators.

year	2009	2010	2011	2012	2013	2014	2015
Growth rate(%)	2.8	2.3	3.2	3.6	4.2	4.7	5
GDP(lek) Milliard	1152.59	1216.83	1294.95	1383.56	1486.3	1604.47	1735.23
GDP(usd) milliard	12.19	11.96	12.42	13.16	14.03	15.04	16.17
GDP per capita	361.785	380.049	402.436	427.834	457.834	491.219	528.610

As we can see the trend for Albanian economy is to increase year by year by reaching a 5% growth rate in 2015. Of course starting from 2011 those are predictable values that should be compared with the real ones in order to find the gap. The increasing economic conditions of Albania will affect also the most important indicator of well being and standard of living the GDP per capita that will increase positively with the increasing output.

We have mentioned above the disequilibrium that Albania economy is facing in the balance of payments, resulting in public debt and deficit. The main question arising here is” how the deficit is financed” this has big importance because expresses the financial potential of Albania to finance the debt and to cover them and the percentage needed from the foreign funds. For this purpose I have selected a table taken from Bank of Albania that expresses the balance of payment, the inside financing and the foreign one.

	2006	2007	2008	2009
Revenues Milliard leke	202.5	226.4	262.4	268.2
Expenses Milliard leke	202.3	223.3	285.9	332.6
Budget balance	0.2	4.1	-23.4	-64.5
Financing needs	-0.2	-4.4	-23.4	-64.4
Interior financing	-5.8	-6.8	-9.7	-37.5
Interior borrowing	4.6	11.8	2.7	14.3
• Treasury bills	-29.7	-20.9	-13.2	8.9
• Eurobond	0.0	-5.8	0.0	0.0

Direct credit	0.0	0.0	0.0	-3.0
Others	12.5	-31.8	-13.3	-10.6
Syndicated loan	0.0	0.0	0.0	24.6
Shares revenue	34.4	38.4	15.9	8.4
Foreign financing	5.6	2.6	33.1	26.9

As we can see Albania economy is an economy that is highly dependent on the foreign funds that is why maintaining Foreign Direct Investment is crucial to our economy. Albanian economy has adopted a tax reform that is beneficial for the investors, corruption and administrative difficulties could be discouraging for investors. As we know in order to attract foreign funds to cover the public fund, but also to expand the capital of Albania, investors will carefully evaluate the index of transaction transparency that in Albania may considerable at the level of 8.0, they evaluate the index of manager responsibility, of shareholder power respectively at 9.0 and 5.0 and the index of the investor protection that is 7.3 (according to the data taken from DOING BUSINESS IN ALBANIA) since Albania remains one of the least developed countries in Europe, a fifth of its population lives under the national poverty line and the country still suffers from lack of the appropriate infrastructure.

Considered as strong points of our economy are the strategic geographical position with ports in both the Adriatic and Ionian Sea, the presence of many natural resources, the cheap labor force, and the prospect of joining the European Union.

There are still many weaknesses that creates many boundaries for the growth, such as the dominance of personal relations over the legal procedures, competition is not completely fair, corruption exists, the taxation system also should improve to deduct the burden of the government that as I have said in the second section of my project is a component of growth.

The international openness may be closely seen in the passing of the time in order to see the level of exports, imports, the amount of deficit and the coverage ratio of the debt. Step by step the numerical data taken from INSTAT will show how integrated is the Albanian economy in the international area and which is the debt capacity of the country to respond to the deficit. Data are in million leke.

year	exports	imports	deficit	coverage
2000	37.037	157.109	-120.072	23.6
2001	44.096	190.155	-146.054	23.2
2002	47.490	210.368	-162.877	22.6
2003	54.487	225.983	-171.496	24.1
2004	62.121	236.037	-173.951	26.3
2005	85.818	262.191	-196.373	25.1
2006	77.405	299.147	-221.742	25.9

2007	97.171	376.194	-279.023	25.8
2008	112.572	438.849	-327.322	25.6
2009	102.989	430.945	-327.956	23.9
2010	20.867	62.203	-41.112	67.1

The international openness has brought also many problems such as the import of the inflation. EURO has damaged the businesses, the EURO appreciation has made more and more unsatisfied the Albanian businesses because the costs of production are strongly increased, the Albanian supply is facing a non confident consumer demand creating many difficulties for them. This may be considered as a burden for our growth since the cost of living has become more and more expensive.

In the same time we should consider a potential in our financial system especially in the commercial banks since the level of transparency offered will sharply increase and the penalizations for individuals will be smaller. Bank of Albania has recently approved the changes in the regulation in order to increase the transparency as the cornerstone of the financial system and as consequence the incentive of the economic growth. The ratio of credit given to the GDP is increasing showing that our financial market is enhancing its possibilities to finance the economy of Albania. If we can carefully see in web pages of our commercial banks. The interest rates on deposits and loans and the commissions for the services in order to reduce the informality and the consumer confidence and every three month the commercial banks should handle to Bank of Albania the necessary documents in order to make a comparative evaluation of them. I am strongly specify this as an incentive for growth since the consolidation of the financial market is highly dependent on the confidence and any reform toward transparency is a benefit for our growth.

Also searching in propertywire.com I have found something interesting from international economists, Albania and Panama are the top two locations for long term property investment according to the latest research from international analysts. In the run up to EU membership Albania is showing incredible potential for economic growth in its own right, as more and more businesses relocate there and more buy consumables from emerging market traders as part of the current massive global cost-cutting exercise, according to lead analyst Liam Bailey.

'Economic growth will generate increasing affluence within the population at large. House prices will be pushed up in line with what people can afford. This means that you can expect stable and sustained growth in Albania property prices until at least 2014, at which point, the stable democracy, and semi-established market of Albania will have a fair chance of seeing continued property price growth from then on those are the words of Liam Baile a british analyst.

Albania is becoming increasingly integrated into global production systems, which means more dependent on international trade, technology and capital and it is important for Albania to consider and adapt to. While providing a diagnosis of some of the key factors for future growth, the report does not indicate which sectors (agriculture, tourism mining, banking, etc.) should be developed, since these decisions will be taken by private investors. Instead the role of the government in this process is that of facilitator, removing the obstacles to investment and helping to provide information and institutions that private firms require to flourish.

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**CORPORATE GOVERNANCE IN DEVELOPING COUNTRIES: THE
ALBANIAN CASE**

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CORPORATE GOVERNANCE IN DEVELOPING COUNTRIES: THE ALBANIAN CASE

Abstract

Corporate governance is an important element affecting the long term prosperity of companies and a considerable part of the larger economic, social and legal environment in which firms operate. This paper is focused on what is called company's management or corporate governance with special emphasis on the Albanian practice. In the first part of this paper I will focus on the objectives and the main benefits of corporate governance to companies and countries. In the second part of this paper I will go through the development of corporate governance in Albania, by analyzing the new Albanian Company Law and its implications regarding corporate governance, and the environment in which it operates. I will try to identify some achievements made so far as well as some obstacles to further reforms.

Key Words; Corporate Governance, OECD, Albanian Company Law, NRC

Introduction

A series of events over the last decades have placed corporate governance issues as a top concern for both the international business community and the international financial institutions. Spectacular business failures such as the infamous Bank of Credit and Commerce International scandal¹, the United States savings and loan crisis², and the gap between executive compensation and corporate performance drove the demand for change in developed countries. More recently, high profile scandals, financial crises and/or institutional failures in Russia, Asia and real estate and credit crisis in the United States have brought corporate governance issues to the fore in developing countries, transitional economies, and emerging markets.³

If we refer to recent report of the OECD, the recent real estate and credit crisis in the United States, which left a lot of people without jobs; made companies to go bankrupt or cut the jobs, shut the plants and factories; plunged stocks; caused oil and real estate prices to fall; made countries to fall into recession; decreased consumer spending and raised panic among businessmen and workers, can be to an important extent attributed to failures and weaknesses in corporate governance arrangements which did not serve their purpose to safeguard against excessive risk taking in a number of financial services companies.⁴

There are a variety of definitions on corporate governance starting from broad one given by *Lynall, Golden and Hillman 2003*, who defines corporate governance as the set of mechanisms used to manage the relationship among stakeholders that is used to determine and control the strategic direction and performance of organizations.⁵

The OECD provides the most authoritative functional definition of corporate governance:

"Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and

¹ BCCI came under the radar of regulatory bodies and intelligence agencies in the 1980's due to its perceived avoidance of falling under one regulatory banking authority. A fact that was later, after extensive investigations, proven to be true. BCCI became the focus of a massive regulatory battle in 1991 and was described as a "\$20-billion-plus heist". Investigators in the U.S. and the UK revealed that BCCI had been "set up deliberately to avoid centralized regulatory review, and operated extensively in bank secrecy jurisdictions. Its affairs were extraordinarily complex.

² The **savings and loan crisis** of the 1980s and 1990s (commonly referred to as the **S&L crisis**) was the failure of 747 savings and loan associations (S&Ls aka *thrifts*) in the United States. The ultimate cost of the crisis is estimated to have totaled around \$160.1 billion, about \$124.6 billion of which was directly paid for by the U.S. government.

³ www.cipe.org/programs/corp_gov/pdf/CGHANDBOOK.pdf

⁴ The Corporate Governance Lessons from the Financial Crises, Author Grant Kirkpatrick – OECD 2009 Financial Market Trends ISSN 1995-2864 web site: www.oecd.org

⁵ Board composition from adolescence to maturity: A multitheoretic view, *Academy of Management Review*, 28: 416:431 *Lynall, Golden and Hillman 2003*, work cited in *Management of Strategy : Concept and Cases Hitt, Hoskisson, Ireland 2007 p293*

responsibilities among different participants in the corporation, such as the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance."⁶

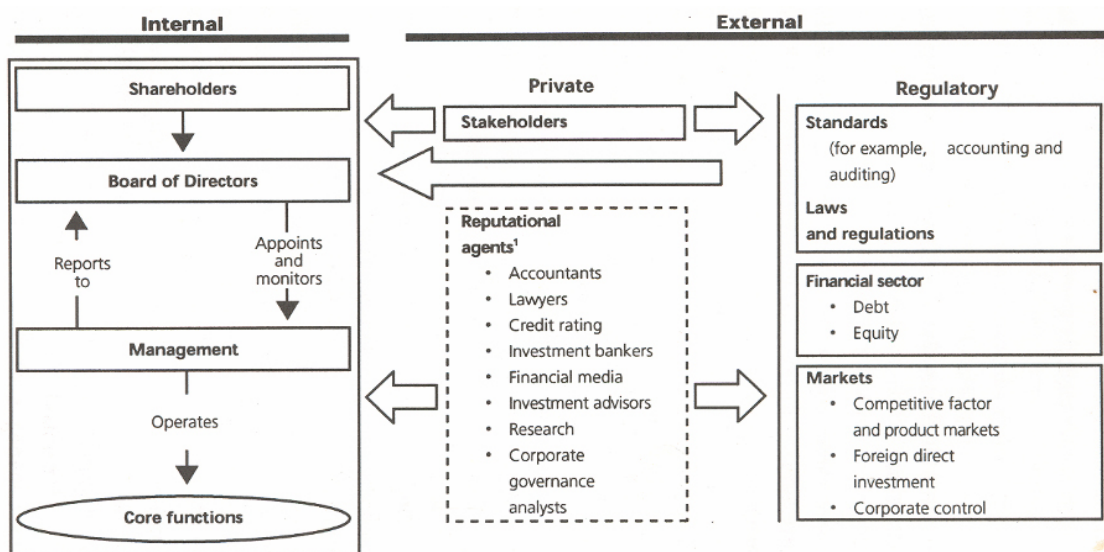
⁶ The Organization of Economic Cooperation and Development "Principles of Corporate Governance" 2004 web site: www.oecd.org, access date:02.04.2011

1.1 Objectives of Corporate Governance

In modern corporations a primary objective of the corporate governance is to ensure that the interests of top level managers are aligned with the interests of share holders. Corporate governance involves oversight in areas where owners, managers and members of the board of directors may have conflicts of interest. These areas include election of directors, the general supervision of CEO pay and more focused supervision of the director pay and the corporations' overall structure and strategic decision.⁷

Its goal is to maximize long-term shareholder value by improving corporate decision-making and performance. This involves establishing incentives and procedures that serve the interests of shareholders while respecting the interests of other stakeholders in the corporation.⁸

Good corporate governance should provide proper mechanisms for monitoring of management by the board and monitoring of the board by shareholders. Effective disclosure and monitoring will encourage management to pursue policies that provide competitive returns to shareholders, thereby encouraging firms to use resources more effectively. This in turn will help to strengthen the competitive position of the firm.⁹



1. Reputational agents refer to private sector agents, self-regulating bodies, the media, and civic society that reduce information asymmetry, improve the monitoring of firms, and shed light on opportunistic behavior.

Source: World Bank, Corporate Governance: Framework for Implementation, Overview, 1999,

www.worldbank.org, p 5

⁷ Instituting Corporate Governance in Developing, Emerging and Transitional Economies a Handbook Web site: www.cipe.org

⁸ Corporate Governance for Emerging Markets-Reform Toolkit www.cipe.org

⁹ Corporate Governance in Asia, A Comparative Perspective, Published by OECD 2001, Introduction by Joanna R. Shelton, Deputy Secretar General OECD, ISBN 92 64 18328 0 pg 11

Corporate governance can influence a firm's performance whenever a conflict of interest arises between management and shareholders and/or between controlling and minority shareholders. In the management-shareholder conflict, the agency problem manifests itself in management's low effort and unproductive investments, usually known as perquisites. In the controlling-minority shareholder conflict, controlling shareholders use their power to benefit themselves at the expense of the minority shareholders, in what is called expropriation or private benefits of control.¹⁰

Within a company, whether publicly-held or not, corporate governance provides directors the tools they need to ensure efficiency, accountability, and sound decision-making. Strengthened reporting requirements demand improved accounting procedures and stronger internal control systems, which in turn provide managers and directors the tools they need to control expenditure and gauge revenue. By increasing the transparency, quality, and regularity of financial reporting, managers can be held more accountable for the decisions they make and the performance that results. Poor performance or activities that divert company resources into non-profitable activity can be quickly identified and remedied.

1.2 How can Companies and Countries benefit from Corporate Governance?

Corporate governance helps companies and economies to attract investment and strengthens the foundation for long-term economic high performance and competitiveness in several ways. Demanding transparency in corporate transactions, in accounting and auditing procedures, in purchasing, and all the other business transactions corporate governance attacks the supply side of the corruption relationship.¹¹

Corporate governance procedures improve the management of the firm by helping firm managers and boards to develop a sound company strategy, and by ensuring that mergers and acquisitions are undertaken for sound business reasons, and that compensation systems reflect performance. Recent research has shown that countries with stronger corporate governance protections for minority shareholders also have much larger and more liquid capital markets.

2. Corporate Governance in Albania

All transition societies bear the institutional imprints of a long-lasting experience with state socialism, and they evolve into mixed economies characterized by hybrid organizational and property forms. Albania is also part of those transitional societies.¹² Cultural, political and economic norms influence the way in which a society approaches corporate governance and its

¹⁰ Competing with the Government: Anti-Competitive Behavior and Public Enterprises; Editor: R. Richard Geddes ISBN: 978-0-8179-3992-2 Pub Date: March 23, 2004

¹¹ Instituting Corporate Governance in Developing, Emerging and Transitional Economies a Handbook Web site: www.cipe.org

¹² Nee, V. and Matthews R. (1996) Market Transition and Societal Transformation in Reforming State Socialism. *Annual Review of Sociology* Vol. 22 p. 401-435

impact on board leadership, management oversight and accountability.¹³ The challenge for policy-makers is to reach an appropriate balance of legislative and regulatory reform, taking into consideration international best practice to promote enterprise, enhance competitiveness and stimulate investment. This is a key objective that the Albanian economy specialists have had in mind during the reforms undertaken in the Albanian economical system.

Albania as a country with strong centralized socialistic economy has had a historically greater government involvement in the economic activity. But with socio-economic changes after the 90-es the competition between SOE-s and private enterprises is disconcerting. Government enterprises are often endowed with government granted privileges and immunities not enjoyed by private rivals.¹⁴ Those benefits may include monopoly power, credit guarantees, freedom from paying investors an expected rate of return, exemption from bankruptcy, tax exemptions, direct subsidies, and immunity from antitrust prosecution, disclosure requirements, and other regulations. All such privileges and immunities are valuable. Those privileges give government firms an artificial competitive advantage over private rivals. By artificial, I mean that a government firm's competitive advantage is not based on economic factors such as superior management skills, more efficient technology, enhanced innovation, better labor relations, better corporate governance, or harder work. The firm's competitive advantage is an artifact of its government-granted benefits. Government firms may use their special benefits in anticompetitive ways. For example, they might use their monopoly power and other advantages to sustain prices below true economic cost in markets where they face competition. Or they might use those privileges to raise rivals' costs or preclude rivals from entering other markets. They might also leverage their monopoly power in one market into other, formerly competitive markets or engage in a variety of other anticompetitive actions.

Anticompetitive behavior by government firms is harmful. First, there is a straightforward misallocation of resources because prices are not in alignment with true economic cost. Because they are not as concerned with profits as their private counterparts, government owned firms are more willing to set price below cost and keep it there without regard to long-term losses. Second, more efficient but unsubsidized private firms will contract, not invest, or may not start.¹⁵

2.1 Types of Ownership

The Albanian Law recognizes a variety of legal forms for businesses. Because these business forms vary from each other in terms of their legal responsibilities, the list of documents required for their initial registration also varies. Each applicant must make sure he/she knows the

13 Murali, D. and Shankar Roy, K. Conflict between dominant and minority shareholders. (Wednesday, June 25, 2008) *The Hindu News Update Service*. Retrieved from www.hindu.com access date:02.04.2011

14 OECD Principles of Corporate Governance, 2004

15 Gedds, R. (2004) Competing with the government; Anticompetitive behavior and public enterprises.

type of business he/she plans to register before the start of the initial registration.¹⁶ The types of legal forms are available in the new Company Law Nr. 9901 dated 21/05/2008¹⁷.

As mentioned above, individuals (sole entrepreneurs) engaged in commercial activity must register at NRC. These individuals are recognized by the Albanian Law with the term Physical Persons. The physical persons have the right to engage in commercial activities.

The Albanian Company Law defines four types of legal entities as follows:

General Partnerships (Shoqeri Kolektive):

For the general partnerships, all partners are business partners and have unlimited and collective responsibility for the debts of the company. Creditors can sue a partner for compensation for the company's debts only after notifications directed to the company have failed. The general partnership has a name that can include the name of one or more partners, with the words "general partnership" coming before or immediately after the name.

Limited Partnerships (Shoqeri Komandite):

In limited partnerships, "limited" partners participate along with "unlimited" partners who have the status of partners in general partnerships. The "limited" partners are held responsible for the debts of the company only up to the limit of their contribution to the initial capital. This contribution cannot be in services. Meanwhile general partners have unlimited liability for partnership obligations. A limited partnership has a name that can include the name of one or more of the partners preceded by or immediately followed by the words "limited partnership".

Limited Liability Companies (Sh.p.k.) :

The limited liability companies are established by one or more partners who support losses up to the limit value of their contribution to the statutory capital. If one person sets up the company, he/she is called "sole partner". The limited liability company has a name that can include the name of one or more of the partners preceded by or immediately followed by the words "Shoqëri me Përgjegjësi të Kufizuara" or the initials "Sh.p.k.", as well as the amount of the statutory capital.

According to the current law, the minimal value of the initial capital for this type of company is only 100 ALL. The capital is divided in equal shares, whose nominal value cannot be smaller than 1.000 Lek. Otherwise, the company should be transformed into another form. Limited liability companies may be transformed into partnerships or joint stock companies; but only the General Assembly, upon majority of $\frac{3}{4}$ and approval of the last two annual financial statements can take this decision. For a Limited Liability company, the NRC may register the company without needing to see evidence that statutory capital has been paid.

¹⁶ National Registration Center http://www.qkr.gov.al/nrc/Application_forms.aspx

¹⁷ The Law no. Nr. 9901 "On Entrepreneurs and Companies" was adopted by the Parliament on April 14, 2008 and published in the Official Gazette on May, 6 2008. It entered into force 15 days later i.e. on 21/05/2008

Joint Stock Companies (Sh.a):

Joint stock companies are those companies whose capital is divided into stocks and which are established by partners who are held responsible for the losses only up to the limit of their contribution to the initial capital. The company can be established by and can have one or more partners. The joint stock company has a name, which may include the name of one or more shareholders placed before or immediately after the words "Shoqëri Aksionare" or the initials "Sh.a". The capital should also be mentioned.

There are two types of joint stock companies: with or without public offering. The companies with public offering are those whose stocks are officially registered in the stock market, beginning with the date of the registration, or those which, in order to sell any type of stocks, use the services of banks, financial institutions, stockbrokers, or publications of any type and dissemination outside the media designated for those purposes. All other joint stock companies are companies without public offering. A joint stock company must be founded with a minimum initial capital of 10 million ALL (approximately 99.000 USD or 73.000 €), if it intends to offer its shares for sale to the public, and 2 million ALL (approximately 19.800 USD or 15.000 €), if it does not. Registration at NRC for a Joint Stock Company requires evidence that the minimum initial capital has been paid in.

Strategic decisions are generally taken within the General Assembly of Shareholders, which makes decisions at regular and extraordinary meetings. Only in the context of an extraordinary meeting may the shareholders amend the company's by-laws. The management system of a joint stock company may be of two kinds: monistic or dualistic. Those companies which choose the monistic management system have a Board of Directors and Administrators having both supervising and management functions. Otherwise, those companies which choose the dualistic management system have in addition to the Board of Directors and Administrators, a Supervisory Board, which holds the supervising functions. The Board of Directors is charged with taking all basic management decisions in accordance with the bylaws of the company. It is supervised by the Council of Supervisors, which has from 3 to 21 members.

2.2 Corporate Governance Progress in Albania

There are taking place some developments on corporate governance in Albania recently, mostly related to improvements linked with *reducing of administrative barriers for business development*. The Government throughout its mandate has been working to reduce the administrative barriers for the business combined with the implementation of a number of legal and institutional reforms.

In 2005, through the AATDA-AL's initiative the "Albanian Forum on Corporate Governance" was founded as a network among nine Albanian institutions, mostly representing private sector. It has the mission of contributing towards the implementation of worldwide-accepted standards and principles on corporate governance in Albania. Certain other developments are considered the interventions on the area of training and technical assistance. A corporate governance project in the SEE region run by IFC (International Finance Corporation)

has included Albania on its field of intervention.¹⁸ It envisages a number of training sessions directed to some management boards, shareholders and other stakeholders. During the recent years IEKA (Institute of Chartered Accounts of Albania) provided training for accounts and auditors, while the AATDA-AL and Tirana Stock Exchange have been involved in a number of promotional activities, in cooperation with chambers of commerce and business organizations. The implementation of business reform measures has been driven recently by a Task Force chaired by the Ministry of Economy based on the development and implementation of the Action Plan “On the Elimination of Administrative Barriers to Investment”.

The amending of the existing legislation and regulatory framework for the commercial companies has been a positive step towards providing the market with the most modern and widely used rules and regulations in order to deal adequately with the issues of protecting shareholder rights. The Law no. 7638 “On commercial companies” (Company law) has been amended by the Law no. 9901 “On Entrepreneurs and Companies”

According to Eriona Haxhia ¹⁹, Albania introduces much more transparency with the amendment of the company law, “The most recent reform in Albania is the drafting of a new law on Entrepreneurs and Commercial Companies. A new focus lies on the Right to Information to all the shareholders about the company performance and make available to their request, annual accounts, including consolidated accounts, reports regarding the status of the company.”

2.3 Priorities for Reform

Even though we noticed that considerable progress has been done we still think that further specific efforts to promote corporate governance and reform development in the country have to be done by all the stakeholder parties. There are certain priorities that shall be considered like:

To empower the responsible structures with the authority to intervene and amend the existing legislation, like the Amending of the “Law on securities” as proposed by the Albanian Securities Commission that reflects the need for expanding the base (number) of the companies to be under jurisdiction of the Commission. To increase the capacity of the judicial system to overcome the difficulties while implementing the existing legislation. To increase the efforts towards the full adaptation of the IAS/IFRS and their implementation in the domestic system. To make medium and long term strategies towards implementing effective corporate governance practices through incorporating viable corporate governance cultures, this can only be done by the coordination of the efforts of the shareholders, management boards, academic bodies and other stakeholders. Looking for the possibility of arranging training programs and technical assistance to all stakeholders interested in good corporate governance practices.

¹⁸ www.oecd.org/dataoecd/24/19/37054432.pdf

¹⁹ Attorney, Tonucci & Partners, Albania

2.4 Main Obstacles to Progress

There exists a general good willing for further reforms in the corporate governance system; however there are several obstacles that have made major aspects of the reform process to be at the very early stages of development.

One of these obstacles is the incapacity for effective market regulators to act; the most prominent market regulator in Albania is the Albanian Securities Commission which has been acting as the only authority that has the power to deal with securities and to implement corporate governance standards only for listed companies. Tirana Stock Exchange founded as a market operator since the early 1995, is still inactive as there are no companies listed. The presence of a considerably large informal sector in the Albanian economy has led the path towards the lack of needed corporate governance culture among businesses. The limitations in the legal provisions have limited the capacity of the domestic judicial system to deal with corporate governance issues.

2.5 Implications from the new ACL

There is a question that can be raised when analyzing the ACL about whether all members (shareholders) of the company should be involved in the decision making process or if the power to act on the company's behalf should be delegated to a specialized management body whose members need not be shareholders at all?

The new Albanian Company law provides for centralized management structures in LLCs and JCSs. In contrast to the provisions regulating general partnerships and limited partnerships, members of the management organs (the administrators) are not required to be members (shareholders) of the company. *This is because often the decisions in the company have to be made in a short time and if all the shareholders have to be informed every time this would create difficulties and costs by holding meetings each time.*

Thus employing a centralized management would

- Reduce transaction costs and improve the efficiency of the company's management by reducing time.
- Permit the company to be managed by a professional, more expert group that is independent of its shareholders.
- Permit companies to raise equity capital from people who do not have any expertise in the company's business.
- Keep information costs at a minimum level and allocate them evenly.²⁰

²⁰ Bachner, Tomas. Schuster, Edmund-Philipp. Winner, Martin. The New Albanian Company Law, Interpreted according to its sources in European Law

The Principal-Agent Conflict

Delegating the decision-making to a body, whose members are not (necessarily) shareholders of the company obviously creates the risk that the management's interests collide with those of the shareholders. This potential conflict of interests is referred to as the "Principal-agent conflict", a result of the separation of ownership of the company (shareholders as principals) and the power to control the company's business (administrators as agents).

While it is in shareholder's interest to maximize the company's profits the management often seeks to maximize its remuneration and power – two aims that do not necessarily lead to the same business conduct.

This is why Company law should impose duties on managers to pay respect to their role as “agents” or fiduciaries. ACL should enable shareholders to effectively monitor the conduct of the management and restrict dealings which seem especially dangerous, such as transactions between members of the management body and the company, from the outset. In addition where decisions typically have a substantial impact on the shareholders' interests (e.g. changes of the constitution, capital increase mergers) the costs of the decision making by the shareholders can be considered a payoff, company law should require shareholder involvement in decision making.

Conclusions

There is a growing consensus among policymakers, business leaders, and the public that corporate governance is an essential tool for improving corporate performance and advancing the overall development of market-oriented democracies. The potential benefits from governance reforms in emerging markets are enormous. Establishing trusted markets with sound institutional foundations and introducing governance principles to all types of businesses will stimulate commerce, investment, and entrepreneurship. Corporate governance functions as a complete system, requiring an institutional foundation (rule of law, market institutions, and property rights), sound practices within firms, and external elements such as market pressures and appropriate regulatory supervision.

In Albania, there have been taking place some developments on corporate governance recently. The law for commercial companies has been amended and the law no. 9901 "On Entrepreneurs and Companies" was adopted by the Parliament and on May 21, 2008 it entered into force. Special emphasis has been given to improvements linked with reducing of administrative barriers for business development, improvement of the business climate and promotion of the role of the business in the process of reform. As we mentioned above with the amendment of the company law the legal framework regarding the corporate governance is adequate, but the problem is in the enforcement phase which is somehow limited. This discrepancy calls for the urgent need for more attention by policymakers, government authorities, and the other stakeholders to further reform in the area of corporate governance and capital market especially in the implementation mechanisms through reforming the judicial provisions related to corporate governance. We shall be expecting some more concrete interventions in re-organizing the capital market thus vitalizing it. However a favorable legislation is only the starting point because a corporate culture of good governance is what is needed and what must be strived to be achieved.

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"Independence of Bank of Albania"



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Abstract:

In this paper, we are going to analyze Bank of Albania and its independence. There have been debates whether central banks should be independent or not; and at what extent their claims of being independent or dependent, stand.

Our paper is going to include the current state of the central bank of Albania, and the barriers/facilities that it faces. Political reasons are a critical factor to be mentioned, because they have always played a crucial role especial to our countries reality.

Next our attention will shift toward publications regarding same macroeconomic indicators that central bank and INSTAT publish, but are however represented different form one another. This part will be backed by an analysis. This analyze will focus on the differences between these indicators.

Undertaking a stud for Albania's case creates a possibility to compare our system to foreign systems. The study becomes broader, and it is a way to understand better. The comparison will be toward Federal Reserve and European Central Bank.

Key words:

1. Central Bank independence
2. Bank of Albania
3. Inflation
4. Albanian government
5. Federal Reserve
6. European Central Bank

Introduction:

The effective functioning of the Central Bank of any country is essential to our lives since it conducts monetary policy. Due to its crucial role it is important for all of us to get a closer look of it. At the introduction of this paper we would like to introduce a brief history of Bank of Albania.

The Bank of Albania we know today evolved from the National Bank of Albania that functioned form 1925-1944, than it was transformed into the State Bank of Albania (1944-1992), indicating the hand of the communist regime even in this institution. The end of the communist regime signed a new era for the modern central bank of Albania, known as Bank of Albania (1992 until now).

Actually the first central bank institution was established since 1913 with an agreement between the Ismail Qemali government and Wiener Bank, Austrian – Hungarian Bank and the Italian Commercial Bank. But due to the bad political conditions of that era and the start of World War I this institution soon faced its end.

But the independent state of Albania again started its attempts for the establishment of a central bank that was concluded successfully in 1925 with the National Bank of Albania, still at this stage it was a bank in Albania but with foreigner's capital. Year 1925 is the first year of operation of a bank in Albania.

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Soon after the establishment of the central bank of Albania, in 1926 we have the first circulation of Albanian currency, the gold franc.

Beside the issuance of Albanian currency, National Bank of Albania during its existence also implemented the gold standard. This bank beside the issue function applied the crediting function as well.

In 1944 the cancellation of the National Bank's concession and shares was done, leading like this to the nationalization of the Bank. The State Bank of Albania was established on January 3rd 1945, being at the same time the central bank of Albania and a commercial bank. The State Bank of Albania was the central bank of a communist country implying 100 percent control by the state. Even though it was referred to it as being independent it was an important tool in the hands of the dictatorial regime in Albania.

The decline of the communist regime brought a new era even for the banking system in Albania. In the early 1990s Albania moved toward an open market economy reflecting vital changes for every aspect of life in Albania. Under this new era, on April 22nd 1992, the Bank of Albania was established by the approval of the Law No. 7559, "On the Bank of Albania". This law was review and improved further later on. Also the developments in economy, politics and every other aspect of life have developed further the functions carried out by BoA. Likewise now Bank of Albania operates in line with law no.8269, dated 23/12/1997 "On the Bank of Albania".

The Bank of Albania is a fully state owned-bank and is accountable to the People's Assembly of the Republic of Albania. The Bank of Albania is organized, run and carries out its activity through the Supervisory Board, composed of 9 members appointed by the People's Assembly of the Republic of Albania for a term of seven years, eligible for reappointment, administrators, namely the Governor and two deputy Governors, and the staff. The Supervisory Council is headed by the Governor, who serves also as General Executive Director. It maintains, in accordance with the Law "On Accounting" and the international standards, accounts and records that should at any time accurately reflect the financial position of the Bank of Albania. The founding capital of The Bank of Albania is allocated by, and is under the ownership of the government of Albania.

The Bank of Albania has relations with the banks of all levels in the republic of Albania, and with all the legislative and executive entities of the Republic of Albania enforced even further by the payment system of BoA.

The Head Office of the Bank of Albania is located in Tirana. It has 5 branches in the districts of Shkodra, Elbasani, Gjirokastra, Korça, and Lushnja. Even though its short lifetime Bank of Albania has been governed by 6 governors from 1992 up to now, correspondingly:

1. Ilir Hoti (May 1992 - September 1993)
2. Dylber Vroni (September 1993 - December 1994)
3. Kristaq Luniku (December 1994 - April 1997)
4. Qamil Tusha (April 1997 - August 1997)
5. Prof. Dr. Shkëlqim Cani (August 1997 - October 2004)
6. Ardian Fullani (October 2004 - current)

Literature review:

"There have been three great inventions since the beginning of time: fire, wheel and Central banking" - Will Rogers.

Including this statement in our paper we want to empathize the importance of central banks to our lives. For this reason many people have conducted papers regarding central bank independence, and also it is mentioned in important conferences both from government representative and from central banks governors.

First of all what is central bank independence? In fact this term is a misnomer since no economic institution can be completely free from politics. Thus we cannot conclude a unique definition for independence, however it can be explained as the freedom of monetary policy makers from the direct influence of the central government. To get a better understanding of this concept we may include two important statements: *"Independence refers to the ability of the central bank to use the instruments of monetary control without instruction, guidance or interference from the government (Henning, 1994)."* And *"On the other hand, according to Amtenbrink (2004), the three pillars of central bank governance are: i). central bank independence, ii). central bank accountability, and iii). central bank transparency."*

For a central bank to be defined as independent, it should comply with three basic conditions: First of all an autonomous central bank should have a clearly defined objective, namely price stability. Second it should have both sufficient authority (de jure and de facto) and adequate instruments to manage liquidity in the banking system to meet its primary responsibility. And last A central bank's operations should be transparent, and information should be disclosed on a regular basis so that the central bank can be held accountable for its monetary policy and inflation performance. Up to this point we created a good idea of what an independent central bank does and how it is defined but let us now turn to the importance of central bank independence. Why should we ask for an independent central bank?

This is probably the most important point of all papers conducted on central bank independence. A lot of models have been built and a lot of ideas have been discussed regarding the issue that why does a country have as a necessity the independence of the central bank? This is best explained by the inverse relation between central bank independence and the inflation. Trying to reach the primary goal of price stability a country with an independent central bank will face a stable and low inflation. But the positive impacts of central bank independence are not limited to only this fact. Independent central banks can put downward pressure to government deficit. Implying that the policies undertaken by the bank will lower the deficit gap. On the other hand an independent monetary policy may force or impose stronger fiscal discipline on government. It also contributes to long term growth.

Also the level of independence of a central bank can impact the initiations of civil wars. This is a fact not so much proclaimed but with a considerable importance because all economic, political and social achievements of a country can be downgraded to almost zero with the start of a civil war. Thus we may state with full belief that the support of an independent central bank from the government indicate that the politicians will tie their own hands in the name of the greater public good. However independence is also important for central banks themselves since in this way they can act more effectively and achieve most of the financial regulation objectives.

May 9, 2011

Taking into consideration all these positive effects of a central bank we should go out and ask for an absolutely independent central bank. But wait a minute!!! Central bank independence is not an absolute good, it has its drawbacks. So the idea of central bank independence has gone under certain criticisms. There exists a potential danger that an independent central bank will not be held accountable. Even though independence has an important impact on low and stable inflation, it is not the only macroeconomic goal. So even though we ask for an independent central bank we require some level of control to its accountability. Since monetary policy may have no long-run effect on real economic variables, but it can affect the real economy in the short run. So there is still the need of the government to keep an eye on the central banks so that they control the level to which central banks achieve their goals, and to some extent government is also needed to determine those goals. And it is a fact that we see the hand of the government in some important points regarding the life of the central bank. So first of all the governors are proposed by the president of each state, even though they are elected by the People's Assembly. Also the central banks are required to report and show all their work to the parliament every six months. And even another more important fact for Albanian central bank is that it is fully state owned.

So we may conclude with confidence that Central bank structures are chosen in a political system that reflects the nature of the polity. This can be also explained with the almost inexistence of independent central banks under dictatorial regimes. Important to mention for post-communist economies is that as soon they reached democracy all adopted or at least tried to adopt an independent central bank following the developed countries structure. And in fact there was an international consensus encouraged post communist countries to independent systems of central banks, this occurred mostly in the early 1990s. Under this international consensus it was the idea of establishing economic sovereignty. But however there was a strong uncertainty about the transition and a considerable number of states soon left behind their adoptions of independent central banks. This may be because of the fact that advanced market economies have gradually understood the importance of having low inflation and stable growth and contrary to transition economies, where every policy is taken from international advanced economies, and the impact is different because things have not gone gradually as it normally should. Thus the experience and banking culture is not a well developed one.

In fact the historical, legal, and de facto relationship between a country's government and its central bank is far very complex. Under these instances two key dimensions of independence are important: "goal independence" and "instrument independence". Goal independence stands for central bank's ability to determine the goals of policy without the direct influence of the fiscal authority. While instrumental independence refers only to the central bank's ability to freely adjust its policy tools in pursuit of the goals of monetary policy.

After having created a general idea of central bank independence, its positive and negative sides and the impact of government we will now shift our attention toward a few basic functions that independent central banks must undertake. First of all an independent central bank under normal conditions should only provide credit to the central government. While in times of financial crises that pose a serious systemic risk to financial and macroeconomic stability the Central Bank has a lender of last resort function. Under such circumstances the central bank should lend freely, against the best available collateral, and at punitive rates.

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While in even more severe economic recessions like in cases when a liquidity crises becomes a solvency crisis, the central bank does not have the resources to act effectively. Only the state, though the Treasury and its power to tax, has the resources to recapitalize insolvent financial institutions.

Now let us shift toward the main point of this paper, the central bank independence of Albania. In fact it is widely proclaimed that Central Bank of Albania is independent but papers regarding this issue are rare, and most of the people accept it as a fact. Is it really independent? This is what we are trying to find out with the conduction of this paper. Up to now we have done an introduction to many issues in order for us to have a wider view of what central bank indicates, so that we can make our conclusions regarding the title of our paper.

In fact if we open the web page of bank of bank of Albania we see in bold the fact that Central Bank of Albania is an independent institution. In fact even in the Albanian constitution we can find separate articles regarding the legal independence and the main duties of Bank of Albania. The law for Bank of Albania changed in 1996 and it states: "The Bank of Albania, within the competences defined by the Law, is independent of any other power for the accomplishment of its main objective and in exercising the tasks assigned. Every subject is obliged to respect the independence of the Bank of Albania, to not try to have influence on any member of the Supervisory Council for impinging on its obligations to the Bank of Albania, and to not interfere in the activity carried out by the Bank of Albania." On the other side According to Albanian government Bank of Albania is a dignified partner in their governing philosophy and in the counseling area. "During these years we have been engaged in observing the institutional independence of Bank of Albania, making sure that our governing policies are not in conflict with the monetary policies of Bank of Albania." And according to the governor of Bank of Albania, Mr. Ardian Fullani "BoA is a consolidated, independent, responsible, and above all, a vigilant institution. Being an independent institution, it should be at the same time, a responsible and collaborative institution, with the Government, Ministry of Finance, Ministry of Economy and other ministries, in order to achieve the main goal, macroeconomic and financial stability." I would say that the Bank of Albania independence is acquired through law", states Mr. Fullani in 2004, and he continues "We should not forget that the banking system is the most audited, the most regulated, the most transparent and where law is the most applied in Albania. The central bank is an institution not only independent, being governed by law, but also a responsible one, meaning very transparent in decision-making, policy-making and their implementation. It is important for the Bank of Albania to take decisions independently of the executive authority, politics or markets. The powerful authority that law confers to the central bank may be misused under the conditions of a formal accountability and transparency, which might cause damage to this institution, falling a prey to politics. For this reason we will always have as a principle that Bank of Albania should be an independent and accountable institution. This will be our guiding principle." Ends his statement Mr. Fullani for the Voice of America. Having included these statements from the Albanian government and the governor of Bank of Albania we want to empathize the fact that no other attempts have been done to prove the independence of Bank of Albania. The public likewise has to accept this fact as every other law written on the constitution. This absenteeism of facts can be related to the difficulty in measuring independence of Central Bank, especially that of Bank of Albania. And it also hard to

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predict its future! But regarding all the possible data we have built up a model to show its real independence and beside the results of the model we have also detected some grey areas regarding the independence of Bank of Albania.

The model:

At the beginning of this model we are going to include brief information for the Federal Reserve and European central Bank and their independence.

Federal Reserve's Independence - the greatest & most influential central bank - 1914: First of all Fed differs from all other Central Banks since it has two primary objectives, price stability and full employment. The independence of Fed has some positive and negative sides. In fact it has three shortfalls of being independent and these are; too big a responsibility - "Great evils to our country and its institutions might flow from such a concentration of power in the hands of a few men irresponsible to the people- Jackson, 1832", Fed is not democratic - "President elects members of Board of Governors, but then the bulk of Fed is elected by these members and other members of Fed branches, commercial banks & financial institutions- Mishkin" and finally Too many pitfalls - A wrong move in haste & the whole country suffers (also other countries: Butterfly effect & USA is an economy with a great impact and influence). But on the other side Fed has more advantages than shortfalls in being independent, most important ones are; Smooth Monetary Policy- Stability - (Mishkin) because it does not have to ask the Senate for every little move it makes, the Fed can instantly make open market operations whenever the economy demands, without wasting time in asking for the government's permission, Immediate Decisions to avert crisis - There seems no need to explain how slowly the government makes its decisions, Long Term Benefits - Fed can be a wonderful toy in the hands of a President hoping to be re-elected and lastly Macroeconomic Evidence - in countries where the central banks are entirely dependent upon the ruling governments, inflation is high and increasing from year to year, negative relation between inflation rates and independency. Beside the shortfalls of Fed's independence there are even some disadvantages and these are; Incorrect Decisions- probability of destruction, one man show- power concentrated, Over Confident Fed- of its powers & abilities, Practicalities- Fed can go haywire, and Subprime Mortgage Crisis, credit crisis. Considering all these disadvantages and shortfalls is it better a dependent Fed? "There is yet no consensus on whether Federal Reserve independence is a good thing [or not]." – Mishkin.

European Central Bank Independence (1998) - It is owned by other central banks of the European Union countries. "Safeguarding central bank independence takes more than a series of legal provisions. It requires, above all, a wide degree of acceptance of the principle of independence within the underlying political and economic culture of the society. Central bank independence, like any other law, needs to be continuously protected and implemented over time. This is the responsibility of the political institution" - Lorenzo Bini Smaghi, Member of the Executive Board of the ECB*, 2007 Speech. Article 108, Of the Treaty of the European Union - "neither the ECB, nor a national central bank shall seek or take instructions from Community institutions or bodies, from any government of a Member State or from any other body" This article strongly empathize the independence of ECB. And in fact it includes certain steps:

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I. Functional independence - an independent central bank should be free to set its policy instrument with the aim of achieving its objective

II. Personal independence

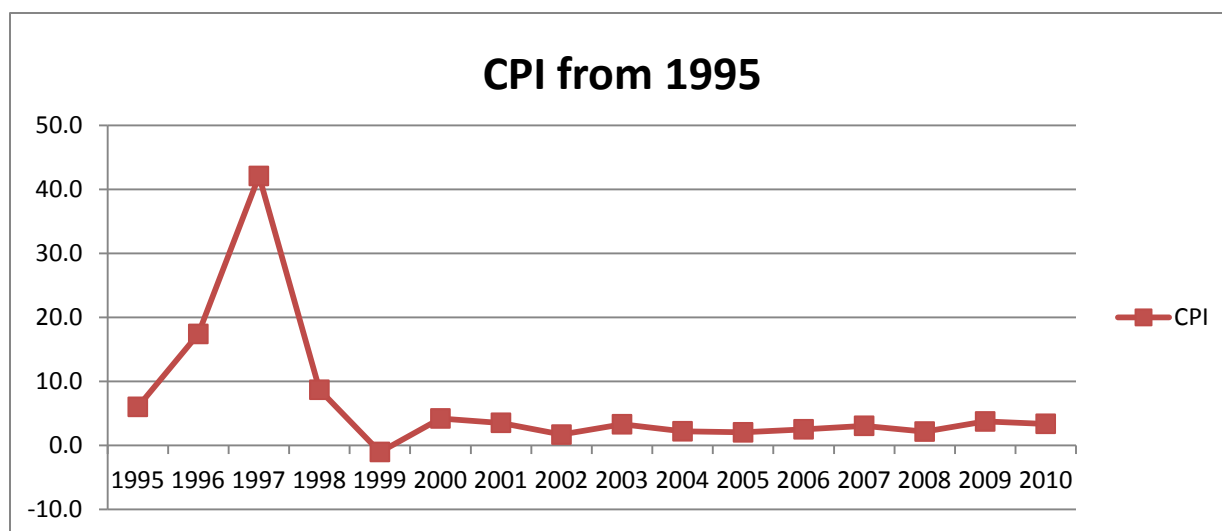
III. Financial independence

IV. Central bank independence and prudential supervision

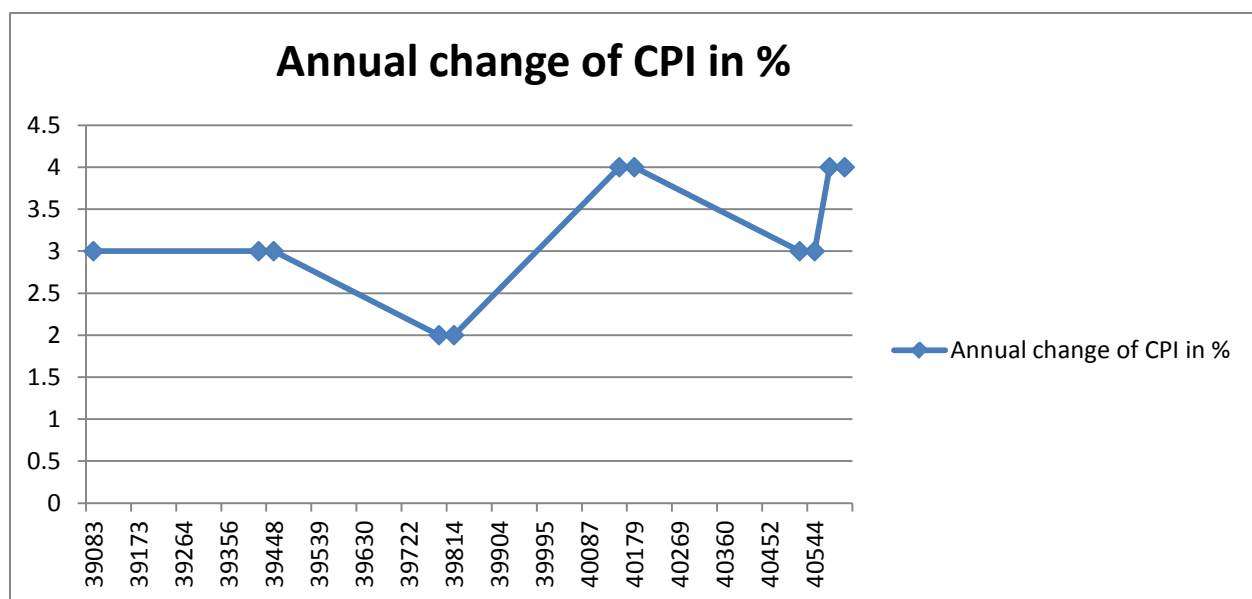
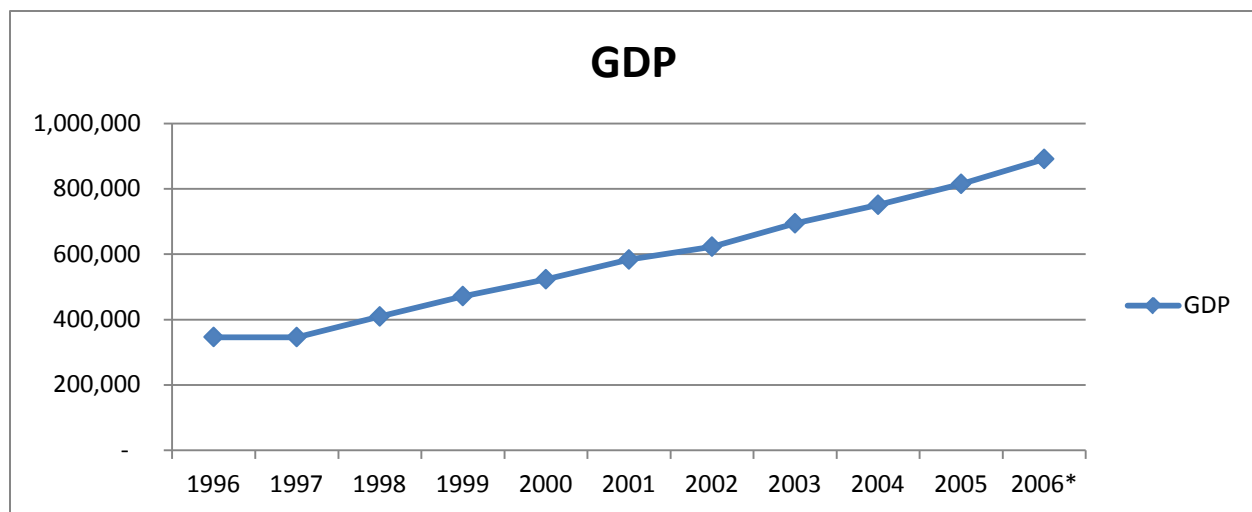
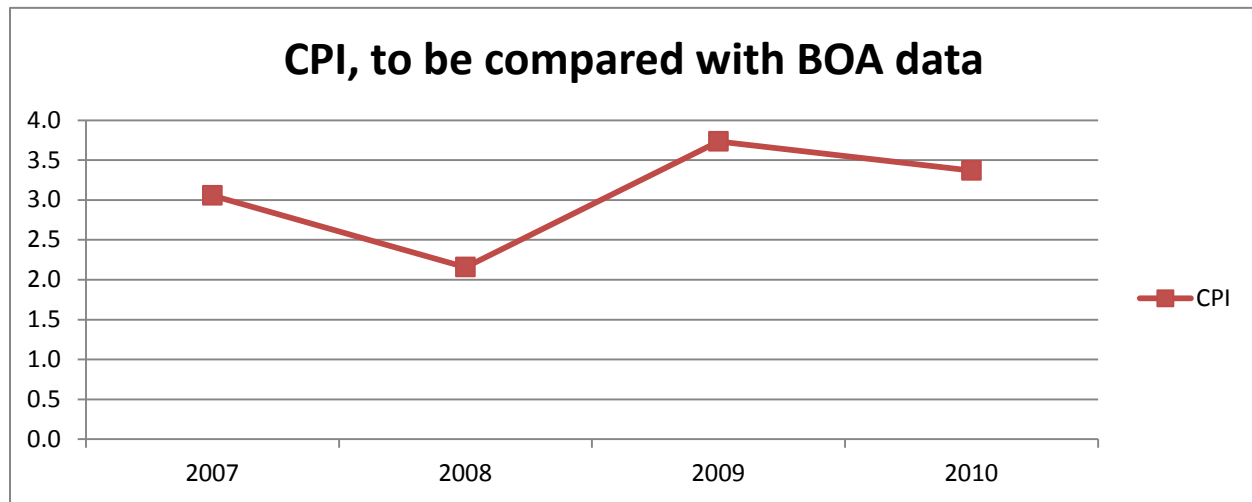
V. Accountability and independence- Not Arbitrariness

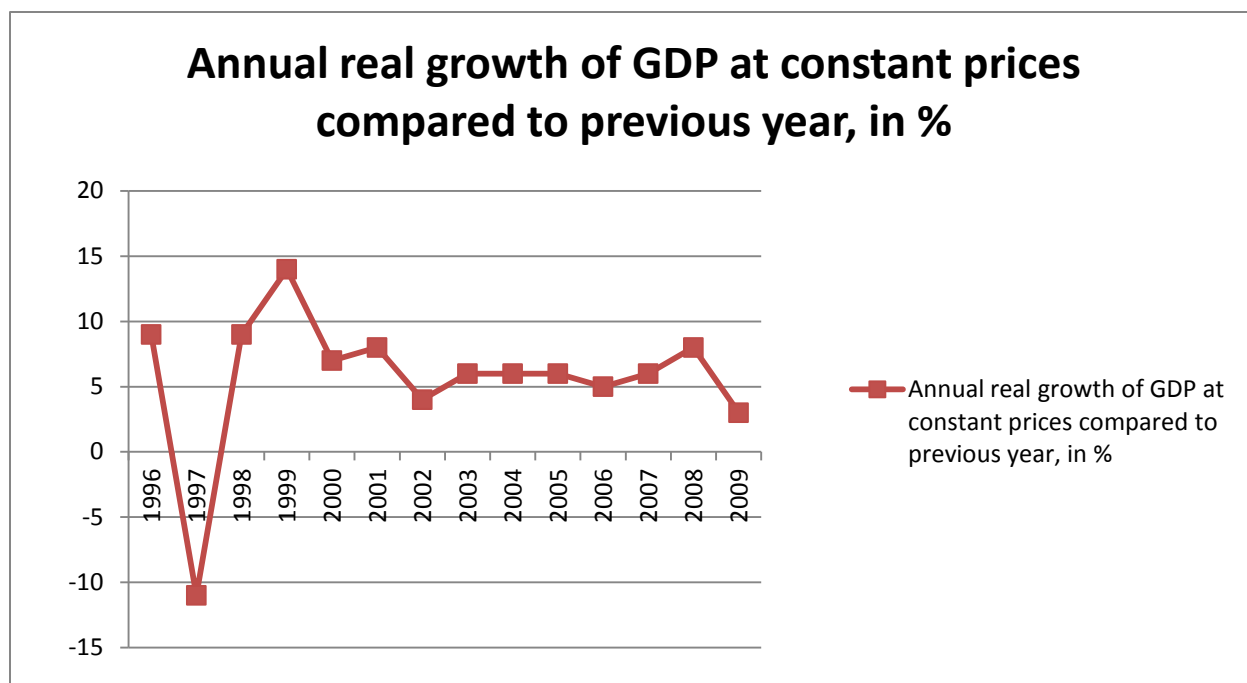
VI. Independence and dialogue with the government – Independence & Cooperation.

We can clearly see that the independence of ECB is much more stated and much more proclaimed than that of Fed. However our main objective is the independence of Bank of Albania. But contrary to Federal Reserve or ECB, where the measuring of independency is possible- due to their large and influential impacts, BOA's independency is hard to be measured. Regarding the measurement of independence we can use ranking - Central Banks that have final authority over monetary policy are ranked above others, where the final authority pertains to governments, cardinal measurements - questions with yes/no answers, in this type of measurement the number of yes construct the index or Cukierman Method with 6 point scale - 1. CB given final authority over issues clearly defined in the law as CB objectives. 2. Government has final authority only over policy issues that have not been clearly defined as CB goals in the case of conflict with CB. 3. In case of conflict, final decision is up to a council whose members are from CB, legislative branch and executive branch. 4. Legislative branch has final authority on policy issues. 5. Executive has final authority on policy issues, but subject to due process and possible protest by CB. 6. Executive branch has unconditional authority over policy. These get marked as 1, 0.8, 0.6,...,0. Conducting a model for bank of Albania is a difficult issue especially for conducting a regression analysis since most of the data published by Bank of Albania and INSTAT are the same, we can detect some changes in the data of CPI – Consumer Price Index, that has to do with inflation. As mentioned above in our paper we detect a negative relation between inflation and independence of central bank. Considering the data from INSTAT and Bank of Albania we have built some graphs.



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Conclusions:

Our topic was conducting for the independence of Bank of Albania. Even though it is so much proclaimed we still do not have a clear vision of its state, since even from the data that we gather and the graphs we created we see that only from the CPI data we can see presence of a little independence, but this is not enough to conclude whether Bank of Albania is independent or not. However we do have some important points that bring to our attention a lot of question marks for real independence of Bank of Albania. First of all now Albania is involved with the negotiation process towards the Stabilization and Association Agreement with the EU. This implies that we must have a full financial integration, so are they just covering gaps proclaiming an independent central bank? On the other side Even though it is an independent institution, Bank of Albania is responsible and collaborative with the Government, Ministry of Finance, Ministry of Economy and other ministries. Also the Governor of our central bank is proposed by the president of the republic of Albania. And still staying on this fact even though independent Bank of Albania was created in 1992, there have been 6 different governors until now, one of them had its mandate only for a period of 3 months. And in some instances their education is not proper for a governor, like the case of the current governor Bank of Albania is fully state owned, implying that all its capital is owned by the state, so regarding this fact we think that the government will try to impact the decisions of Bank of Albania since they are operating with government's money. The relations between Bank of Albania and Albanian government still do not end; Bank of Albania has to respond semi annually to the parliament. Also transparency of Bank of Albania toward the public is very disappointing. Likewise many important foreign indicators do not consider Bank of Albania as independent! But the most interesting point is that why did the law on central banks change in 1996, exactly after the conflict for the pyramidal firms between Albanian government and Bank of Albania???

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**Value Added Tax- Its importance & its impact in
Realization of the budget incomes**

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JEL Classification: H20, H25, H26, H61

I. Abstract

VAT- it is a European concept, which is implemented by a great number of countries, all over the world. According to a study of IMF, VAT is very important because it is a way to modernize the tax system and also a way of increasing resources; but this requires the VAT to be well designed and well implemented.

In this paper, we are going to focus on a general overview of the taxes and their implementation; especially in the value added tax aka VAT. It will be included the implementation of VAT in the European Union and in transition countries. The difference between the direct and indirect taxes, it is also going to be analyzed.

The second part will be about Albanian case- Albanian implementation of the VAT. How this system came in the 1990, and at what scale it is implemented. The refund of VAT it is also crucial, because as it has the pros it also has the cons (frauds and evasions). We will mention some points about the administration of VAT, being based in the legislation and define where VAT and turnover tax differ from one another.

The third part of the paper has to do with polemics and discussions about the VAT implemented. And here we will include a case study, where we have asked 30 people in our city Tirana, about the knowledge they have about the VAT.

The last part, there will be the conclusions. The aim why we chose this topic, in order to understand the importance of taxes especially of VAT; how this concept has lived through the years and the problems it has faced and still does now days.

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II. Introduction

The concept of taxes it is tightly connected to the State, the existence of the state. Taxes are a way for the government to keep the state alive. State has an important role in maintaining the public order and providing its citizens national safety and many other benefits. But where does the state find the financing to make this possible? Through many ways, where one crucial is the system of taxes. It gathers from its citizens: physical and juridical subjects, financing in order to provide the vast different services. In my opinion taxes are hugely important.

VAT- value added tax, is one of the different taxes applied. It is important because it is an equal tax, meaning that its implemented equally to all subjects, and it tries to avoid imperfections occurring. According to many studies, VAT is an important source of revenues, when comparing to the total tax revenue that a country gathers. And it has been increasing through the years.

The aim of this topic is to focus on this important element of the tax system that is part of more than 120 countries in the world, and raising about 1/4th of the world's tax revenue. How did the post-communist countries like Albania adopt this tax system and what were the benefits and problems that accompanied it.

III. General Overlook on VAT:

i. History of taxation/ VAT

The chronology starts with Egypt, where the tax collectors were called as scribes. During the times of pharaohs, it was collected the cooking oil tax. Then, in the ancient Greece, Athenians imposed a tax known as eisphora. This tax was used for special wartime expenditures, and if the war was gained this tax was refunded. Another tax applied was metoikion; it was applied to those people who didn't have both parents Athenians. The history continues with the Roman Empire, where the earliest taxes where the customs duties on imports and exports called portoria. There is the development of the inheritance and sales tax, during these times, Caesar ruling. There is seen in the expression: Give Caesar, what is Caesar's, that there was a development of a tax system. Great Britain, was also implementing taxes on land and property- during the Roman Empire. Ottoman Empire is another example of the antiquity of the tax system: HARAC Taxation. Most taxes were actually implemented in order to finance wars, and to keep under control the invaded countries. As an example there are taxes collected during the civil war in America (1861 – 1865). The income tax was firstly presented in England in 1798 for preparations for the war against Napoleon, and in Canada in 1917 during the First World War. So during the history this taxes were collected for: military reasons, to preserve the implementation and functioning of the law system and public order, protection of property, economic infrastructure, redistribution of wealth etc.

VAT was invented by the french economist Maurice Laure in 1954, but it was thought that before there was a german who had introduced it. It was firstly spread in Europe, and then in

Latin America, Brazil was the first to adopt it in 1967, and Denmark at the same year adopted it; that was the point where it began widely spread. Transition countries began adopted it only after a decade or more. Also African countries were implementing it as a policy, from 2 countries it increased to 30 in the 1990s. This development of VAT was so quick, and it was the most important event in the history of taxation. Before 50 years it was hardly known as concept, and now it is the most useful policy.

ii. Direct & Indirect Taxation:

Direct taxes – are paid directly to the Exchequer by the individual taxpayer – usually through “pay as you earn”. The same is true of corporation tax, income tax and transferring. Tax liability cannot be passed onto someone else.

Indirect taxes – include VAT and a range of excise duties on oil, tobacco, alcohol. The burden of an indirect tax can be passed on by the supplier to the final consumer – depending on the price elasticity of demand and supply for the product. (<http://tutor2u.net/economics/revision-notes/a2-macro-direct-indirect-taxation.html>)

VAT is an indirect tax, and there are arguments which are in favor of indirect taxes; of course there exist those who are against the indirect taxes.

Those who favor the indirect taxation (against direct taxation) claim that: -any change in indirect taxes is more effective in changing the overall demand for any particular good or service; - important instrument in controlling externalities (meaning making the polluter pay and internalizing the external costs of production and consumption); -the flexibility with which indirect taxes are changed when compared to direct taxes that need more time; -are less easy to be avoided by the final taxpayer; -an incentive to save (consuming less) and increasing the level of capital investment; -people have a choice with indirect taxes, while direct taxes there is no way of escaping from etc.

Those who are against indirect taxation (for direct taxation) claim that: -the distribution of wealth is less equal (unequal) because of the regressive nature of indirect taxes; -higher indirect taxes can lead to inflation; -there exists a potential loss of economic welfare (the creation of a deadweight loss of consumer and producer surplus); -higher indirect taxes lead to lower incomes, and then unable to save; -because of indirect taxes people aren't aware of the tax they are paying, and taxes fail to be transparent etc.

iii. VAT and its application:

VAT is a tax levied on each stage of production/ on all the sale of goods. It is a consumption tax, that's why it is an indirect tax. In some countries like: Canada, Australia or New Zealand this tax is also known as the goods and services tax or GST; in Japan is known as consumption tax. From the buyers point of view it is a tax on the purchase price, and the burden goes straightly to the consumer; while from the side of the seller it is a tax on the “value added” of the product or a service. Maurice Laure was the first to present this concept in 1954; but a German industrialist W. Von Siemens proposed it since 1918. The final consumers cannot recover VAT, because they are the last in the chain; in contrary to the businesses that can (input tax). So the total tax levied

in each stage of production/ in the economic chain of supply is a constant fraction of the value added by the supplier to the products. Here is an example of how VAT works:

Suppose there is supplier A that sells to supplier B, materials at the price of 200€ (excluding tax) and the supplier B sells to the consumer finished goods at the price of 500€ (again excluding tax). Now taking into consideration VAT, suppose the rate is 10 %, then the Supplier A would charge to the Supplier B 220€, in order to offset the tax, and not to be affected. The supplier B charges to the final consumer 550€, so it offsets the 20€ got from the Supplier A and the rest 30€ for the tax it has to be paid. Still, from what we see it is the final good purchased that is taxed. The last in the chain, the consumer has no where to offset the burden of the tax, and it has to afford it, if it wants to buy it. So this tax has the affect to increase price, from the supplier's perspective, to offset the tax and it ends up with increasing the price for the consumer.

VAT has these characteristics:

- ✓ It is an indirect tax- it is included in the price of the good or service
- ✓ Consumption tax- taxation of the consumption of the final goods and services
- ✓ Real taxation and not changeable- according to the incomes of consumer
- ✓ It is self declaring- meaning that all taxpayers have to declare the real amount of the production and sales it makes for a certain fiscal period
- ✓ A fractional taxation- meaning that each part of the chain offsets the ad valorem part that is responsible for...only for the final consumer it pays the whole amount
- ✓ It is not applied to the whole goods and services
- ✓ It is based on the refunds- VAT is applied on the place where it is consumed, and for exported goods it is refunded

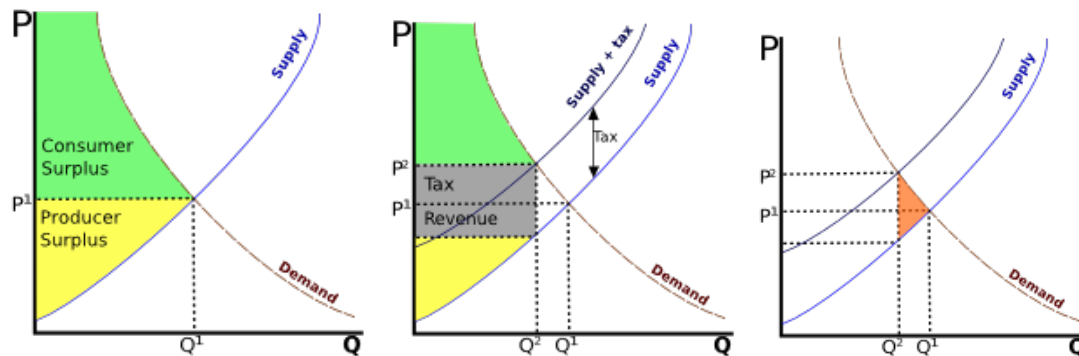
There are two types of application of the VAT:

- ✓ Invoice based, each sale or purchase should be accompanied with an invoice where the VAT is calculated
- ✓ Accounts based, it is usually used in Japan, it is not widely spread. It is like income taxation mainly, once in a year applied.

Mostly used is the invoice based, because it is easily controlled and there is the availability of the invoices. An account based is once in a year applied.

Since the VAT is an indirect tax and all the burden is of the consumer, the prices will increase for a good or service if the VAT is imposed (contrary to if the tax is not levied). So the demand will decrease, and the supply will decrease because higher costs will be for the supplier. But on the other side for the government this is a good thing, because it increases its revenues from the taxes levied. There are the graphs that explain better the situation stated: in the figure one there are no external factors, meaning no interventions from the government, no taxes (the equilibrium is in the point Q1, Social surplus is with the summation of the Consumer and producer surplus. In the second figure the government imposes a tax (VAT), and the supply decreases and the prices increase to P2, demand decreases. The tax revenue the government gets it is in the grey area. Social surplus in this case is with the summation of the part that government gets, with the

surpluses of consumer and producer. In the third figure we can see the deadweight loss, with the orange color, that is social cost because of the marginal taxes.



iv. VAT in EU & other transition countries/ Comparison:

The VAT system in European Union, it is clarified in the EU directives; the 6th directive has to do with VAT. This directive states:

- ✓ Application
- ✓ Place where it is applied
- ✓ Amount to be applied

In member states of European Union, there different rates of VAT applied; starting with minimum 15% and the maximum 25%. But there are also rates like 5%, applied in Great Britain for oil and electricity.

According to the 6th Directive there are some goods and services that the rates should not be applied such as postal services, medical services or safety; there are some goods that are excluded, but this is depended on the country and its government if it wants to exclude it (land and financial services). There are some goods and services with a 0% VAT like food, books or transportation etc.

Businesses that are in a certain location should correspond to the legislature and the regulation of the country where they are based and also where their buyers are located, for the implementation of the VAT. Before the VAT were applied at the rates at which the goods where considered as luxury goods or necessities. In France for example, in the '80s taxed at 30% cars as luxury goods, because all households started to have one or more cars as ownership. While in Britain clothes for kids are 0% rated for VAT; while the clothes for grown ups are subject of 17.5% VAT. It is a perception how the state values goods and services, depending in the current situation in the country.

For the transition countries, huge changes have occurred. Coming from a centralized economy to a market economy and then changing the whole tax system. Adopting VAT was a total reform for these countries. Almost all these countries exclude small businesses from the obligation to be registered for VAT. The limits change from country to country, but it is important to mention

that transition countries should not complicate exclusions of small businesses, rather should keep them under control to avoid being affected by inflation. According to observations:

- ✓ Bulgaria excludes from VAT medical, financial, education services, pharmaceutical products, social welfare services, gambling
- ✓ Czech Republic excludes radio and television transmissions, financial educational medical and social services, and the selling of the finished buildings
- ✓ Hungary excludes renting or selling (except first sale of residential buildings), postal and educational services, radio-TV transmissions.

IV. VAT in Albania:

i. Why VAT in a post-communist country:

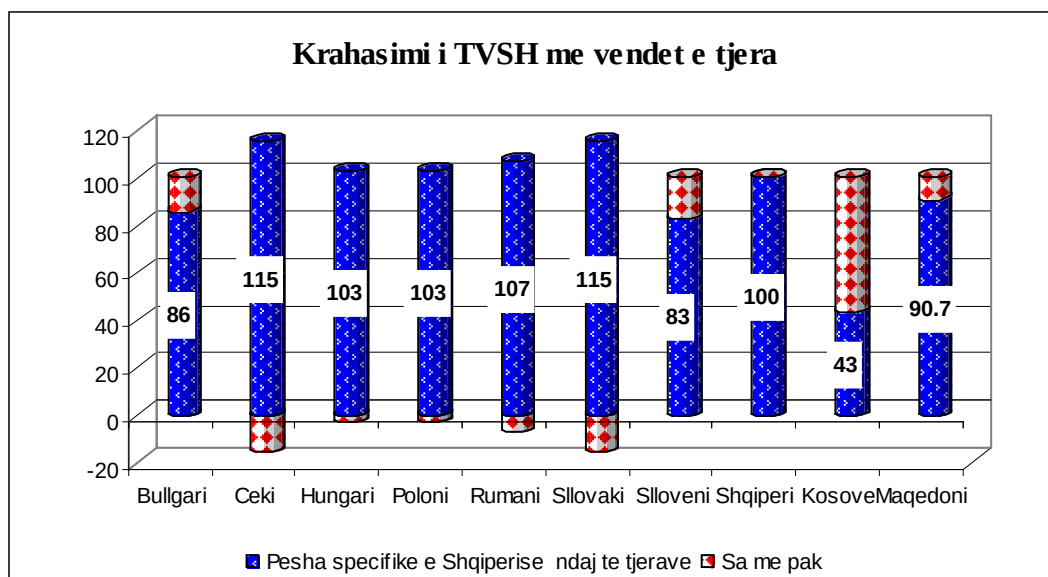
Albania, a post-communist country, in the '90s was facing a difficult situation. Passing from one system to another and changing almost everything. Without having the experience and knowledge, it was hard to adapt to the rules of the market economy- capitalism. It was seen the need of a new fiscal system, and the application of the VAT. In Albania, the VAT is mainly seen as a progressive tax, and very important for the increasing revenues of the state budget.

In Albania, VAT was firstly implemented in 1996 at the rate of 12.5%, for all the subjects that had turnovers of above 2 million lek. It was a step toward the EU. The 12.5 % was decided after negotiations with the IMF. In 1998 VAT rate increased to 20% to cover the budget deficit incurred in 1997 (with the existence of pyramid schemes).

ii. Difference between VAT & turnover tax:

In Albania, the turnover tax was substituted with VAT, in the '90s. this change was more due to the fact that many products were excluded. Excise goods were not included in the turnover tax, while VAT didn't exclude this goods. Also the physical persons were excluded from the turnover tax (tatim mbi qarkullimin), while from the VAT were not excluded, both physical & juridical persons. Investments and raw materials were included in VAT, because before in the turnover tax were not included. So a vast majority of products and services started being included in the VAT system, before were not so, in order for the state to increase its budget revenues. Revenues generated were 2.5 times bigger in the first half of 1996, than revenues got from the turnover tax applied. It is the most important source of revenues: they were 46% of the total revenues from taxes. We compete with other countries for implementation of the VAT. For the good level of VAT administration talks the fact that it is 7% of the GDP (revenues from VAT); and taxation revenues are 71 % of the budget revenues in 2009; VAT are 45% of the revenues from taxation.

Adapting this VAT system was also a way of coming closer to the European Union!



iii. Scale of Taxation of VAT in Albania:

Currently, in Albania tax rate of VAT is 20% on the taxable transactions and 0% on the exports and international services. According to the changes made to the law no. 7928 in 2008, there has been included the refunding rate of 6% to the farmers.

	TVSH	
	Standart	Reduktuar
Shqipëri	20%	-
Bulgaria	20%	-
Rep.Ceke	19%	5%
Hungaria	25%	15%, 5%
Polonia	22%	7%, 3%, 0%
Rumania	19%	9%
Sllovakia	19%	-

Slovenia	20%	8.50%
Greqi	19%	8%
Itali	20%	4.5%, 10%
Kosova	15%	-

Source: IMF

Incomes/Years	2000	2001	2002	2003	2004
Income Tax	10.5	12.2	12.2	11.9	12.7
- Personal Income Taxes	3.8	4.6	4.1	3.9	3.8
-Profit Taxes	6.7	7.6	8.1	8.0	9.0
-Taxation on small business	1.4	1.5	1.7	1.8	2.2
Taxation on Consumption	39.2	37.4	36.8	38.2	40.6
-VAT	31.6	30.4	30.6	30.8	32.0
-Excises	7.6	7.0	6.2	7.4	8.7
Taxation from International Trade	11.2	9.4	8.9	8.4	7.6
-Custom obligations	11.2	9.4	8.9	8.4	7.6
National & Local Taxations	4.9	6.2	5.9	6.9	6.8
Others non Taxatio	13.7	15.6	14.3	11.7	8.8

Source: Ministry of Finances

The scheme of international classification of the taxation system is:

- ✓ Income Taxes: personal income tax, profit tax, small business tax
- ✓ Consumption tax: VAT, excises and customs obligations
- ✓ Taxation on wealth or capital: local and national taxes
- ✓ Health and social securities contributions: social security and health security

iv. Refund of VAT/ Achilles Heel:

An advantage of VAT is that it encourages exports and expanding of investments inside the country. This thanks to refunding mechanism for the taxpayer who tend to export their products and services; and to those who are running a business in the beginning. The law favors those taxpayers who have purchased inside the country or from imports, and reimburses every month for the credit VAT that they paid when firstly purchasing. For other taxpayers of other categories, those who invest too, they start getting the reimburses only when after 3 months result in surplus of VAT credit and this surplus is above 400 thousand lek. The reimburses help in creating a better business climate and settling down conflicts.

Still actual refunding system is not totally settled. There were problems in 2009 with payments of refunding, and still there are late reimburses. The problem in Albania continues, and its dual: because taxpayers don't pay in time and also the refunding don't happen at the time when it should. It is a barrier for the development of business in Albania. There have been taken actions, legally in 2009, where are stated more clearly the rights and obligations of both: taxpayers and tax officials. So for example, if the taxpayer sends a declaration to the tax officials for refunding; the tax officials have to control this declaration and for 30 days (if everything is ok) to refund the taxpayer; in contrary the taxpayer has the right to not pay obligations for the amount it was supposed to be reimbursed.

Another problem existing is the fraud and tax evasion:

- ✓ False Complaints about refunding- creating false invoices for purchases or sales that actually have not been occurred.
- ✓ Less reported sales- evasion of VAT
- ✓ Fictive merchants- asking for refund, when all is a scheme of fraud
- ✓ National sales reported as exports- asking for refund with fake invoices
- ✓ Merchants responsible to pay VAT, but do Not pay
- ✓ Illegally imported goods, and sold without VAT- not being declared

V. Polemics and discussions about VAT:

One of the discussions in Albania is removing the VAT on imports! Legislation about VAT and fiscal system is based on foreign directives such EU & IMF, so removing VAT from imports it is like following a different path from other countries. Each country in EU applies such a tax, at the customs on imported goods and services.

Another discussion is removing VAT for exporters who buy inside the country, but this goes straightly against regulations and legislation. So the VAT has to be applied.

In order to have a good system of VAT, there should be a good control, implementation, refunding and administration. Because as system, VAT, is extremely spreading through out the countries. If used good, it is the most important instrument in gathering revenues. There are many challenges for the DPT- General directory of taxation, in order to avoid tax evasion, and frauds related to refunding. The problem with Albania is that there exists the informal economy, parallel to the formal economy, making things hard.

International organizations like IMF have suggested for DPT to make controls and auditing; to take into consideration international regulations and to be based on; to improve the information gathering and systems helping in publications (IT); to decrease the scale of VAT to 17% like the average of EU countries etc. But still it is in the hands of Albanian government following policies that are convenient to our economy, for the total benefit.

i. Case study:

This study has to do with asking a sample of 30 persons in Tirana; questions related to VAT- and the knowledge they have about this system tax. To make a conclusion if they have any idea of how fiscal and taxation happens in Albania.

The Polls were comprised of these questions:

1. Have you heard about VAT? -Yes -No
2. Do you know what VAT stands for?
3. What is the % of VAT in Albania?
4. Who does implement the VAT?

Results:

In our sample of 30 people, 15 people taken in the university; while the other 15 in the city. The students were more correct but still, for the forth question they were not correct. The first question we have these results: 30 people had heard about VAT meaning 100%. On the second questions: 16 people know what VAT stands for///53.3 %, while 14 people didn't know that/// 46.6%. To the third question 90% (27people) know the rate of VAT while 10% (3people) don't know the rate. In the fourth question 20% (6people) had no idea who implemented this tax; 20% (2people) Answered Ministry of Finances; 16.6% (5people) answered the municipality; 43.3% (13people) answered the government. Mainly the results are positive, considering the fact that that the sample is low -30

people. Still the answers from the students should have been more correct, because they were of the department banking and finance.

Generally, the culture and the total acknowledgement have been increasing, slowly.

VI. Conclusions:

Albania is a country that is developing. Through this path of development and the path of integration there are problems and challenges to face, which make it hard. Still it has managed to adapt to many systems (VAT) from the collapse of the communist system, and it was not easy.

Policies taken by the government are for the general benefit, and taxes it applies are a way to increase revenues of the budget; and then redistribute these revenues in forms of investments, improving of infrastructure and other interventions. There are some extra capitalist thinkers, who say that are not okay with the taxation policies, because it restraint the capitalist system; and the application of taxes should be voluntary. But I do not agree on this, intervention of government should be present, in order to make things be in a certain balance.

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**VADELİ İŞLEM PİYASALARINDA DÖVİZ
SÖZLEŞMELERİNE DAYALI HEDGING: VADELİ İŞLEM
OPSİYON BORSASI**

**THE HEDGING BASED ON FOREIGN EXCHANGE
CONTRACTS IN THE FUTURES MARKETS: TURKISH
DERIVATIVES EXCHANGE**

ÖZET

Bu araştırma, Spot dolar kuru getiri volatilitelerini, Vadeli İşlem ve Opsiyon Borsası A.Ş.'nde işlem gören YTL/Dolar Sözleşmelerine ait getiri volatilitesi ile karşılaştırmak ve dolar kuruna dayalı vadeli işlem sözleşmeleri ile hedging sağlanıp sağlanamadığını incelemektir. Çalışmada, spot dolar kuru getirilerine ait varyansın, zaman içinde değişmesine olanak sağlayan Genelleştirilmiş oto-regresif şartlı heteroscedastic (GARCH

ABSTRACT- Generalised Autoregressive Conditional Heteroscedastic) kullanılarak buradan elde edilen verilerle basit doğrusal regresyon analizi yapılmıştır.

Anahtar Kelimeler: USD, VOB, ARCH, GARCH, Hedging, Volatilite

This paper

Key Words : USD, TURKDEX, ARCH, GARCH, Hedging, Volatility

1. GİRİŞ

Küreselleşme olgusu sonucu, sınırların daralması, sermaye ve işgücünün mobilizasyonun sağlanması, uluslararası ekonomik ilişkilerin ve dolayısıyla rekabetin boyutunu artırmıştır. Hızla gelişen ekonomik ilişkiler ve finansal piyasalardaki değişimler, ülkeleri sürekli olarak arayışlara ve yeni çözümler üretmeye zorlamıştır. Farklı ekonomik model ve para politikaları denenmiştir. Bu modellerden biri sabit döviz kuruna dayalı Bretton Woods sistemidir. Sistemin, 1970'li yıllarda çökmesi ve esnek döviz kuru sistemine geçilmesiyle birlikte, kur ve faiz oranlarında artan dalgalanma ve belirsizlik nedeniyle, risk ve risk yönetimi kavramları önem kazanmıştır. Sağlıklı bir ekonomi için büyük önem taşıyan risk kavramı, yıllarca iç içe yaşandığı halde, son 30 yıldır yönetilmesi gerekli bir olgu halini almıştır. Riskin yönetilebilir olduğu ve yönetildiğinde ciddi kazançlar sağlayabileceği, doğru yönetilemediğinde ise çok ciddi kayıplara neden olabileceği anlaşılmıştır.

Riskin yönetilebilir olduğunu vurgulayan yaklaşım bilimselliğin ve akılcılığın bir gereğidir. Çünkü, bir ülkedeki ekonomik belirsizlik, o ülkedeki yatırım ve tasarruf kararlarını olumsuz yönde etkileyen bir süreçtir. Modern çağda, modern araç ve yöntemlerle, risk yönetimi, risk ve belirsizlik olgularını, kayıpları önleyici ve kazanca dönüştürücü, toplumun her kesimi üzerinde, ekonomik istikrarı ve güveni sağlayıcı bir etki yaratmaktadır.

Finansal Türevler (Financial Derivatives), modern risk yönetimi araçlarının en önemlileridir. Vadeli işlem piyasaları risk yönetimi ihtiyacı sonucu ortaya çıkmış piyasalardır. Vadeli işlem piyasaları, gelişmiş uluslararası piyasalara entegre olmada önemli işlevlere sahip piyasalardır. Hedging riskten korunma anlamına gelmekte, spot piyasada pozisyonu olan bir yatırımcının, fiyatların değişme riskine karşı, vadeli işlem piyasasında sözleşme alıp satarak, riskten korunmak için yaptığı borsa işlemidir.

Bu araştırmanın amacı, Türkiye'de vadeli işlem piyasasında döviz sözleşmeleri ile etkin korunmanın mümkün olup olmadığının incelenmesidir. Bu doğrultuda, Vadeli İşlem ve Opsiyon Borsası'nda işlem gören YTL/Dolar sözleşmeleri ile fiyatların düşme riskine karşı kısa pozisyonunda, dinamik

korunma yapılarak, korunma etkinliđi (hedging effectiveness) analiz edilmekte ve VOB-

Arařtırma, literatür arařtırması, arařtırmanın konusunu oluřturan veri seti ve metodoloji ile arařtırma bulguları ve sonuç bölümlerini kapsamaktadır.

2. LİTERATÜR ARAřTIRMASI

Vadeli ve spot fiyatlar arasındaki iliřki ve riskten korunma kavramları, 1970'li yıllardan itibaren geniř bir biçimde dikkat çekmiř ve deneysel çalıřmalara konu olmuřtur.

Working (1958), fiyatları etkileyen bilgi türünün çok ve çeřitli olduđunu belirtir. Kamusal kanalların yanı sıra özel kanallar aracılıđıyla, neredeyse sürekli bilgi akıřı vardır. Bu nedenle fiyat deđiřiklikleri sık olmalıdır. Erken bilgi edinme, kaynak çeřitliliđi ve bilgi türü problemleri, kar ve zararları çabuk alınan ticarete yol açar. Piyasada meydana gelen fiyat dalgalanmalarının nedeni, dünyada sürekli deđiřen bilgi ve belirsizlik olgusudur. Working yeni bilginin tesadüfi oluřtuđunu; spot ve futures fiyatlara yansıdıđını test etmiřtir.

Tomek ve Gray (1970), vadeli fiyatların spot fiyatların tahmincisi olup olmadıđını arařtırmıřlardır. Çalıřmada, forward fiyatlama modelinin gelecek spot fiyatları tahmin etme dođruluđunu etkileyen faktörlerin stoklama, yeni bilgi ve hükümet politikası olduđunu belirtmiřlerdir. Sözleřmeye konu ürünün, hasat zamanından daha ileri bir zamana stoklanabilmesi, sözleřme fiyatının spot piyasa fiyatının tahmincisi olma yeteneđini belirler ve hükümet politikalarınca belirlenen faiz fiyatları vadeli fiyatların tahmininde forward fiyatlama modelinin dođruluđunu etkiler.

Cox (1976), spot fiyat davranıřı ve piyasa bilgisi hakkında bir model geliřtirdiđi çalıřmasında, vadeli iřlemlerin bilgi etkisini arařtırmak için, altı farklı emtia fiyat serisini incelemiřtir. Her emtia için ampirik kanıtlar, vadeli iřlemlerin, yatırımcının arz-talep, piyasa bilgisini artırdıđını göstermektedir. Çalıřmada, vadeli iřlem piyasaının yeni bilgiye adapte olması ve bu durumun spot piyasaya arbitraj yoluyla transfer edilmesi durumunda, spot piyasa volatilitesinin ve piyasa etkinliđinin eşzamanlı olarak arttıđı gösterilmiřtir. Arařtırmacıya göre, Vadeli iřlemler, spot piyasanın daha etkin çalıřmasını sađlar ve vadeli iřlemlerdeki kısıtlamalar piyasa etkinliđini azaltır.

Bradford (1977), Vadeli işlem piyasalarında korunma yapmada, vadeli fiyatlar ile spot fiyatlar arasındaki ilişkiye tanımlama getirmiştir. Araştırmacı, riskten korunmada, vadeli fiyatlar ile spot fiyatlar arasındaki denge ile piyasanın etkinliği arasındaki ilişkinin önemini vurgulamıştır.

Ederington (1979), vadeli işlem sözleşmelerinin riske karşı korunmada kullanılması amacı ile kurulan regresyon modelinde korunma yapılan portföyün varyansını minimize eden korunma oranı ve korunma etkinliğinin ölçütü olan R^2 değerinin analiz edilebileceğini belirtmiş ve bir yöntem önermiştir. Korunma oranı vadeli işlem sözleşmesi fiyatındaki bir birim değişime karşı, spot fiyatında meydana gelen değişimi göstermekte ve korunma etkinliğinin bir ölçütü olarak kullanılabilir.

Modest ve Sundaresan (1983), Kansas Borsası, CME ve New York Future Borsa'larında endeks üzerine işlem gören sözleşmelerin spot ve vadeli fiyatları arasındaki ilişkiyi incelemişlerdir. Aritmetik ve geometrik endeks ile iskonto edilen vadeli fiyatların, arbitraj olanağı ile spot fiyatlara eşitlenirken; geometrik endeksle iskonto edilen vadeli fiyatların spot fiyatlara eşit olmadığını bulmuşlardır.

Howard ve D'Antonio (1984), Vadeli işlem piyasalarında korunma yaparken, korunma sadece risk minimizasyonu çerçevesinde değil, aynı zamanda risk getiri optimizasyonu doğrultusunda yapılması gerektiğini ve portföy değerinin başlangıçta alınan pozisyonun altına düşmemesi gerektiğini belirtmektedir.

Figlewski (1984), 1 Haziran 1982- 30 Eylül 1983 dönemi için, hisse senedine dayalı vadeli işlem sözleşme fiyatları ile spot fiyatları arasındaki baz ilişkisini ve riskten korunma etkinliğini incelemiş ve vadeli fiyatların ilk aylarda olması gereken teorik fiyatlardan daha düşük gerçekleştiğini, arbitraj mekanizmasının olmadığı durumlarda baz riskinin arttığını belirtmiştir. Figlewski, varyansı minimize eden riskten korunma oranının en etkin korunmayı sağladığını bulmuştur.

Brenner, Subrahmanyam ve Uno (1989), Tokyo Borsası'nda işlem gören hisse senedi endekslerine ait türetilmiş fiyatları spot fiyat olarak ve Singapur Uluslar arası Para Piyasası'nda işlem gören Nikkei Borsası endeksi üzerine işlem

gören vadeli işlem sözleşmelerini vadeli fiyat olarak almışlardır. İncelemelerinde, vadeli fiyatların spot fiyatlardan daha düşük olduğunu vurgulamaktadırlar. Spot ve vadeli fiyatlar arasındaki farkın Nikkei endeksine dayalı vadeli işlem sözleşmelerinin kısa bir süre önce işleme başlamış olması ve Japon Borsalarının maliyetlerinin yüksek olması ile açıklanabileceğini belirtmektedirler.

Kawaller ve Koch (1987), S&P 500 Futures ve S&P 500 Endeks spot fiyatları arasındaki ilişkiyi 1984-85 yılları arası dönem içinde dakika dakika analiz etmişler, futures fiyatlar ile spot fiyatlar arasında güçlü bir ilişkinin olduğunu belirtmişlerdir.

Bassembinder (1992), riskten korunma ihtiyacının esas olarak piyasada oluşan sistematik risk baskısından kaynaklandığını ve vadeli işlem sözleşmeleriyle korunma yaparken minimize edilmek istenen riskin sistematik risk olduğunu vurgulamaktadır.

Antonio ve Holmes (1995), GARCH tekniklerini kullanarak, FTSE 100 endeksine dayalı vadeli işlem sözleşmeleri üzerine yaptıkları çalışmada, bilgi ve volatilité arasındaki ilişkiyi incelemişlerdir. Çalışmada, 3 ve 6 aylık sözleşmelerin spot fiyatların tahmincisi olmadığını, bunun nedeni olarak aralarında 3 ay fark olan sözleşmelerin kendi aralarında takasının işlem hacmini arttırması olarak göstermektedirler.

Arshanapallı ve Doukas (1997), 1-30 Ekim 1987 arası dönemde, Engle ve Granger' a ait (1987) eşbütünleşme metodunu kullanarak, S&P 500 Endeks vadeli işlem sözleşme fiyatları ile spot fiyatlar arasındaki denge ilişkisinin varlığını ve spot fiyat hareketleri ile endeks vadeli işlem sözleşmelerinin dinamik ilişkisini test etmişlerdir. Çalışmada, araştırmacılar, iki piyasa arasında uzun dönemde birlikte hareket etmeye meyilli bir ilişki olduğunu göstermişlerdir.

Pericli ve Koutmas (1997), S&P 500 Endeks günlük kapanış fiyatlarını alarak 2 Ocak 1953-Eylül 1994 tarihleri arası dönem için yaptıkları incelemede, spot piyasaya vadeli işlem piyasaları ile daha çok bilgilendirilmiş yatırımcının çekildiğini, vadeli işlem piyasasının volatilitéyi azaltarak, likiditeyi arttırdığını göstermişlerdir.

Gagnon ve diğ erleri (1998), Alman Markı ve İsvi re Frangı ile Alman Markı ve Japon Yeni  zerine alternatif iki spot d viz portf y n  inceleyerek korunma performansını fayda maksimizasyonu ve risk minimizasyonu ile  l m şlerdir. Dinamik ve statik risk minimizasyon korunma stratejilerinin performanslarını karşılařtırarak, " ok para birimli riskten korunma"nın (multi-currency hedge), b y k oranda fayda maksimizasyonunu saėladıėı sonucuna ulařmıřlardır.

G len (1998), Mart 1983- Ekim 1995 d nemi i in, 1 aylık, 3 aylık ve 6 aylık NYMEX ham petrol fiyatlarını alarak, vadeli fiyatların, spot fiyatların tarafsız bir tahmincisi olup olmadıėını eřb t nleřme testleri ile arařtırmıřtır. G len, ham petrole dayalı vadeli iřlem fiyatlarının spot fiyatların keřfinde belirleyici bir etkisi olduėunu g stermiřtir.

Darrat, Rahman ve Zhong (2002), tarafından yapılan  alıřmada, S&P 500 endeks vadeli iřlem s zleřmelerinin spot fiyatların belirlenmesindeki etkisi EGARCH y ntemi ile  l  lerek, spot fiyatlardaki volatiletede vadeli iřlemlerin etkisi olmadıėı belirtilmiřtir. Vadeli iřlem piyasasındaki volatilit  spot piyasa volatilit sini etkilemezken, vadeli piyasadaki volatilit yi kısmen etkilemekte olduėu vurgulanmıřtır.

Bystr m (2003), dayanak varlıėı elektrik olan vadeli iřlem s zleřmeleri ile kısa d nem korunmada elde edilen kazan ları incelemiřtir.

Lien ve Root (2003), riskten korunma (hedge) oranının hesaplanmasının ve korunma etkinliėi  l  m n n, spot ve vadeli fiyatlar arasındaki iliřkinin doėru spesifikasyonuna baėlı olduėunu ifade ederek, vadeli ve spot fiyatlar arasındaki iliřkiyi modellemenin, optimal korunma oranının etkinliėini t m durumlarda artırmadıėı sonucuna ulařmıřlardır.

Lien ve Yang (2004), spot ve vadeli piyasalar arasındaki iliřkileri incelemiřler ve korelasyonu  l m şlerdir.

Miffre (2003), ABD piyasasında iřlem g ren on    emtia, d rt metal ve petrol, dokuz finansal vadeli s zleřme olmak  zere toplam yirmi altı vadeli iřlem s zleřmesini incelemiřtir. Metale ve finansal enstr manlara dayalı vadeli s zleřmelerde risk primi ortaya  ıktıėını belirterek, normal backwardiaton teorisinin uygulanabileceėini vurgulamıřtır. Emtia vadeli s zleřmelerinde ise,

kısa pozisyonda riskten kaçınanların arzı ile uzun pozisyondaki riskten kaçınanların talebi karşılaşmakta olduğunu ve aralarında risk transferinin olmadığını vurgulamaktadır.

Bae, Kwon ve Park (2004), Kore piyasalarında endeks vadeli işlem piyasasının spot fiyat volatilitesine ve piyasa etkinliği üzerine etkisini ölçtükleri çalışmalarında iki yöntem izlenmesi gerektiğini vurgulamaktadırlar. Bunlardan birincisi; vadeli işlem piyasası açılmadan önce ve açıldıktan sonra spot fiyatlardaki volatilitenin karşılaştırılmasıyla ve İkincisi ise, spot fiyatlardaki volatilitenin, vadeli işlem piyasalarında işlem gören ve görmeyen araçlarda karşılaştırılmasıyla ölçülmesidir. Araştırmacılar, ikinci yöntemi uygulayarak olay araştırması metodu ile, Ocak 1990- Aralık 1998 döneminde piyasayı incelemişlerdir. KOSPI-200 Endeksine dayalı vadeli işlem sözleşmelerinde yaptıkları araştırmada, vadeli işlem sözleşmelerine konu olan endeksin spot piyasa volatilitésinin ve işlem etkinliğinin daha yüksek olduğunu bulmuşlar ve vadeli işlemlerin spot fiyatlardaki volatilitéyi arttırdığı sonucuna ulaşmışlardır.

Lien (2004), optimal korunma oranı ve korunma etkinliği üzerindeki spot ve vadeli fiyatlar arasındaki ihmal edilmiş eşbütünleşme ilişkisinin etkilerini araştırmıştır.

Laws ve Thompson (2005), Ocak 1995- Aralık 2001 dönemi için, LIFFE' de işlem gören FTSE-100 VE FTSE-250 vadeli işlem sözleşmeleri ile korunma etkinliğini incelemiş, korunma etkinliğinin, sistematik riske ait varyansın minimize edilmesi olarak tanımlanabileceğini belirtmiştir.

3. ARAŞTIRMANIN DİZAYNI

Riskten korunma üzerine geliştirilmiş teorilerin en önemlileri "Geleneksel Hedging Teorisi" ve "Portföy Hedging (Riskinden Korunma) Teorisi"dir.

Geleneksel hedging teorisinde yatırımcılar para piyasalarındaki durumlarına göre, nominal değerleri birbirine eşit ancak işaretleri zıt vadeli işlem pozisyonu alarak korunma sağlarlar. Geleneksel teoride spot ve vadeli fiyatların genellikle aynı yönlü hareket ettiği ve böylece hedge edilmiş kazancın mutlak değerinin, hedge edilmemiş kazançtan daha az olacağı kabul edilmektedir. Geleneksel teoriye göre, vadeli ve spot fiyatlar arasındaki fark

olarak tanımlanan bazdaki değişim sıfır olduğunda mükemmel hedging (korunma) gerçekleşir. Geleneksel teoride spot ve vadeli fiyatların birlikte hareket ettiği ve vadeli işlem piyasasında elde edilen kar ya da zararın, spot piyasada elde edilen zarar ya da karla telafi edilebileceği kabul edilir (Ederington, 1979: 162).

Portföy Riskinden Korunma (Hedging) Teorisi'nde ise, spot ve vadeli işlem piyasalarına ilişkin portföyler birbirinin yerine geçen araçlar olarak görülmezler, bunun yerine; spot piyasadaki yatırımların (X_s) sabit olduğu kabul edilir ve bu portföyün ne kadarlık kısmının hedge edileceğine karar verilir. Portföy riskinden korunmak için, spot ve vadeli yatırım içeren portföyde yer alan hedge edilmiş vadeli yatırımların miktarının saptanması gerekmektedir.

Portföy riskinden korunma teorisi, "Korunma Etkinliği" ölçümünü sağlar. Riskin azaltılması hedger tarafından belirlenen hedge rasyosuna bağlıdır. Vadeli işlem piyasalarının riski azaltmadaki potansiyeli, korunmasız (unhedged) bir portföydeki risk ile hem spot, hem de vadeli yatırım içeren korunmalı (hedged) bir portföyün minimum riski ile kıyaslanarak ölçülebilir. (Ederington, 1979: 163).

3.1. Veri Seti

Çalışmada, amaca uygun olarak, Usd-TL sözleşmelerinin 04.02.2005-11.12.2009 tarihleri arasındaki fiyatlar alınmıştır. Bu tarihler arasındaki, "döviz dayalı vadeli işlem (YTL/Dolar) sözleşmesi"ne ait uzlaşma fiyat verileri, Vadeli işlem ve Opsiyon Borsası A.Ş'den temin edilmiştir. Yine aynı tarihler arasındaki, spot piyasadaki (Interbank Döviz Piyasasındaki), dolar kuruna ait fiyat verileri Reuters ekranından temin edilmiştir. Tablolarda yer alan "vobusd", "döviz dayalı vadeli işlem (YTL/Dolar) sözleşmesi"ne ait uzlaşma fiyatlarını temsil ederken; "usd" de spot piyasadaki dolar kuruna ait fiyatları temsil etmektedir.

3.1.1. Veri Setinin Oluşturulması

Vadeli fiyat serisi, 6 aylık sözleşmelere ait uzlaşma fiyatlarının, en yakın bir sonraki vadedeki sözleşmenin, mevcut sözleşmedeki açık pozisyon sayısını geçtiği tarihten devam edilerek oluşturulmuştur. Bunun nedeni, açık pozisyon sayısının, fiyatı en iyi yansıtan gösterge olmasıdır. Spot fiyat serisi, aynı tarihler için dolar alış fiyatları kullanılarak oluşturulmuştur.

3.1.2. Getirilerin Hesaplanması

Vadeli ve spot fiyatlar yukarıda açıklandığı gibi oluşturulduktan sonra logaritmik getirileri hesaplanmıştır. (getiri= $\log_{pt}/\log_{pt-1}$)

3.2. Araştırmanın Yöntemi

Literatürde volatilité ölçümünde kullanılmış farklı ekonometrik modeller mevcuttur. Bu yöntemler arasında basit aritmetik ortalama, tesadüfi yürüyüş (Random Walk), hareketli ortalama (Moving Average), üstel düzeltme (Exponential Smothing) modelleri yer almaktadır. Son yıllarda ise, volatilité ölçümünde, oto-regresif şartlı heterosedastisite (ARCH- Autoregressive Conditional Heteroscedastic) modellemeleri kullanılmaktadır. İlk kez 1982 yılında Engle tarafından ortaya konulan modellemelerin, diğerlerine üstünlüğü, şartlı varyans değişim değerlerini yakalamada daha başarılı olmalarıdır. Finansal zaman serilerinin varyansları zaman içinde değişme gösterirler. Engle şartlı hata varyansının modellenebileceğini göstermiştir.

ARCH modellemeleri lineer değildirler ve normallik varsayımında incelenmezler. En popüler ARCH modellerinden biri olan GARCH, Bollershev (1986) tarafından geliştirilmiştir. Bu çalışmada, spot döviz kuru getiri volatilitesi ile dövizde dayalı vadeli işlem sözleşmeleri getirilerinin volatilitetisinin ölçümünde GARCH (1,1) kullanılmıştır.

Çalışmada, kullanılan verilere dayalı zaman serileri oluşturulduktan sonra, fiyatların durağan olup olmadığı test edilmiştir. Bunun için, E-views 5.0 paket programı kullanılmıştır. Fiyatların durağan olmadığı görülünce birinci derece farkları alınarak seri durağan hale getirilmiştir. Tüm serinin, yatırımcının, bir sonraki en yakın vadedeki sözleşmenin açık pozisyon sayısının, mevcut sözleşmedekini geçtiği tarihten itibaren, mevcut sözleşmedeki pozisyonunu kapatarak, bir sonraki sözleşmede pozisyon aldığı ve bunun tüm seri boyunca böyle devam ettiği varsayımı altında regresyonu hesaplanmıştır. Regresyondaki beta katsayısı, korunma oranı olup, R^2 değeri, korunma etkinliğinin açıklayıcı gücü, yani, spot fiyatlardaki değişimin ne kadarının, vadeli fiyatlardaki değişim tarafından açıklandığının ölçüsüdür.

Çalışmada, incelenen zaman serilerinin durağanlık testleri için, "Genişletilmiş Dickey- Fuller (ADF)" testi kullanılmıştır. ADF testi aşağıdaki regresyon denklemini gerektirmektedir.

$$\Delta Y_t = \alpha + \gamma Trend + \rho Y_{t-1} + \sum_{i=1}^k \delta_i \Delta Y_{t-1} + \varepsilon_t \quad (1)$$

ADF testi, yukarıdaki regresyon denkleminde $\rho = 0$ olup olmadığını test etmektedir. H_0 hipotezi ($\rho = 0$) reddelirse, Y değişkeninin orijinal seviyesinde durağan olduğu, H_0 hipotezinin kabul edilmesi halinde ise durağan olmadığı tespit edilmiş olur. Orijinal seviyede durağan olmayan bir zaman serisinin durağanlığı bulununcaya kadar devresel farkları alınır. Dönemsel gecikme sayısı (denklemden “k” ile ifade edilmiştir). Gecikme uzunlukları belirlenen denklemlerin ADF-t istatistiği McKinnon (1990) kritik değerleri karşılaştırılarak, değişkenin test edilen seviyede durağan olup olmadığı belirlenir.

GARCH (1,1) spesifikasyonu aşağıda denklem 2’de görüldüğü gibi yazılabilir. Modelde, hata ve volatilité değerleri için sadece bir dönem önceki gecikme değerleri kullanıldığı için GARCH (1,1) olarak tanımlanmıştır.

$$Y_t = \alpha_0 + \sum_{i=1}^p \gamma_i Y_{t-i} + \sum_{i=1}^q \alpha_i \varepsilon_{t-i} + \varepsilon_t \quad (2)$$

$$\varepsilon_t / I_{t-1} \approx N(0, h_t)$$

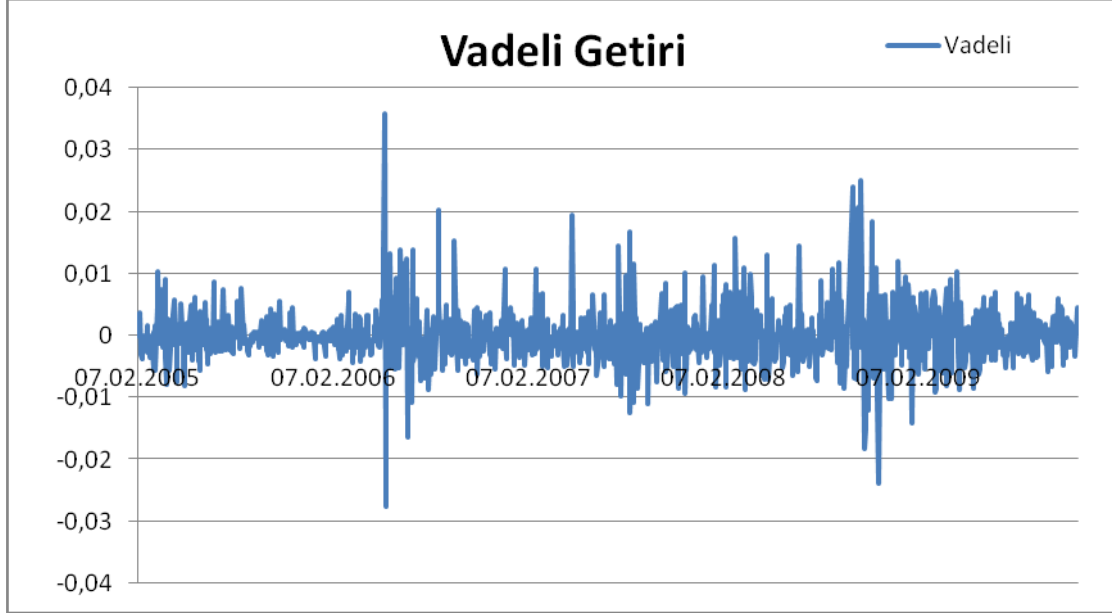
$$h_t = \text{var}(\varepsilon_t) = \beta_0 + \beta_1 \varepsilon_{t-1}^2 + \beta_2 h_{t-1} \quad (3)$$

Y_t , ilgili değişkeni, Y_{t-i} , Y_t ’nin gecikmiş değerini, γ ve β ’lar tahmin edilecek popülasyon parametrelerini, ε_t hata terimini, I_{t-1} t-1 zamanındaki bilgi setini ve h_t şartlı varyansı göstermektedir. (3) nolu denklemde yer alan koşullu varyans, getirilerde meydana gelen beklenmeyen şokların gecikmeli değerleri ile belirlenmektedir. Yani, koşullu varyans, beklenmeyen hata terimlerinin (şokların, sürprizlerin) karesine bağlı fonksiyondur.

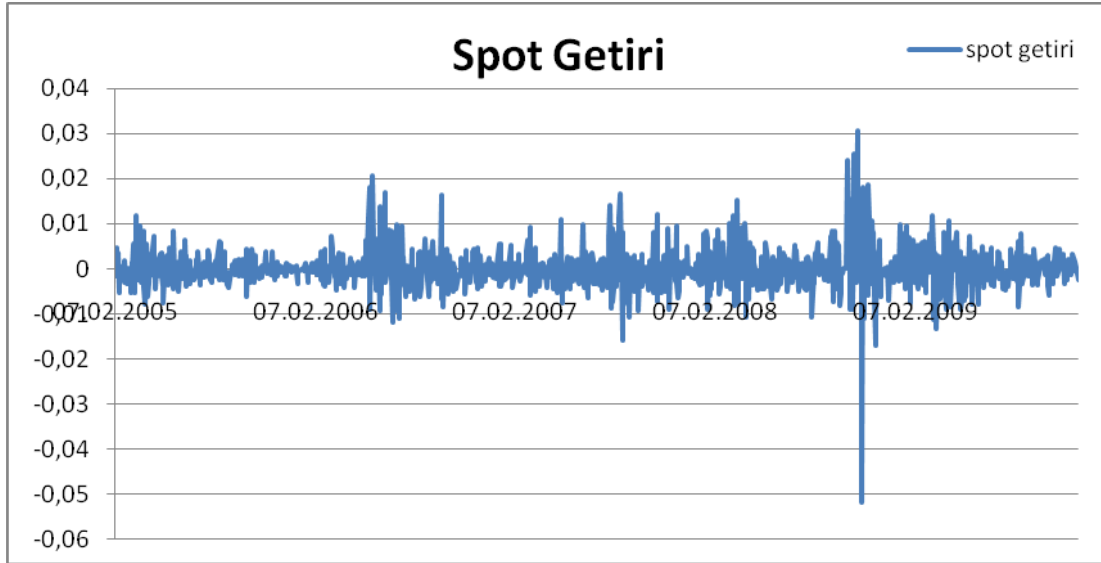
Spot döviz kurunun koşullu varyansı bağımlı, YTL/Dolar vadeli işlem sözleşmelerinin koşullu varyansları bağımsız değişken olarak alınarak, aşağıdaki denklem kurulmuştur.

$$Y_{S_i} = \beta_0 + \beta_1 f_i + \varepsilon_i \quad (4)$$

**Grafik 1: YTL/Dolar Vadeli İşlem Sözleşmesi Getiri Volatilitesi
(07.02.2005-01.12.2009)**



Grafik 2: Spot USD Kuru Getiri Volatilitesi (07.02.2005-01.12.2009)



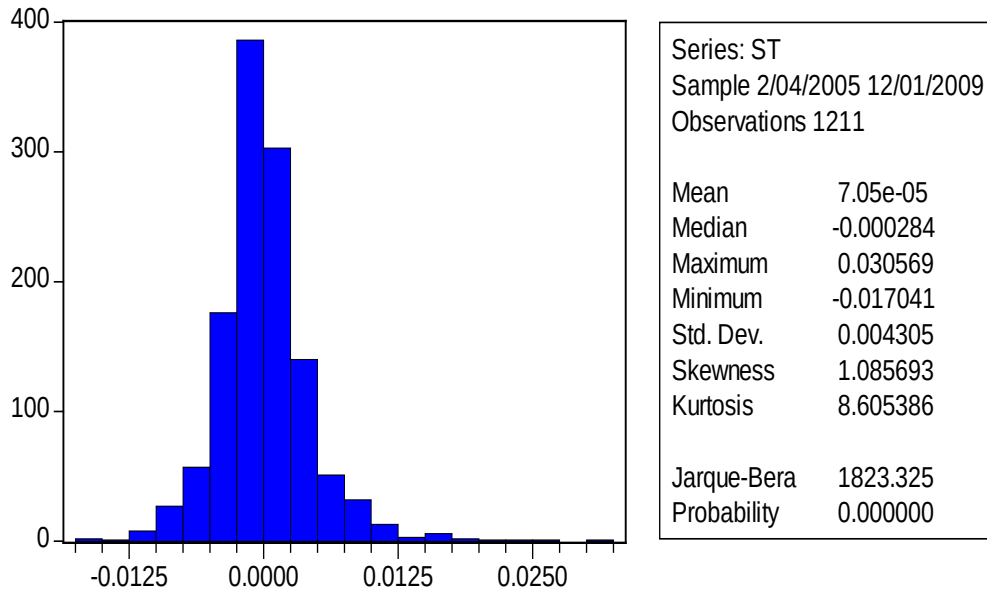
Yukarıdaki grafiklerde daha açık görüldüğü gibi, YTL/ Dolar Vadeli işlem sözleşmesi ve Spot USD kuru getirilerinden oluşan serilerde sapmalar gözlenmektedir. Serilerin durağan olmadığı açıkça görülmektedir. ADF testi ile serilerin durağanlığına bakılarak durağan olmadığı görüldüğünden birinci devresel farkları alınmıştır.

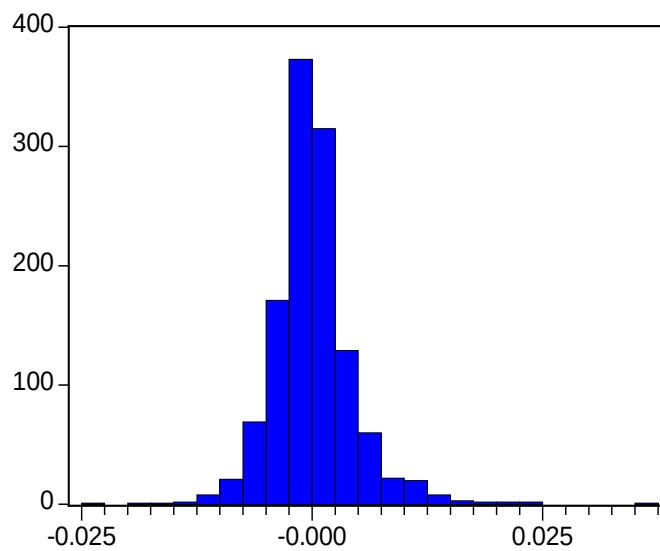
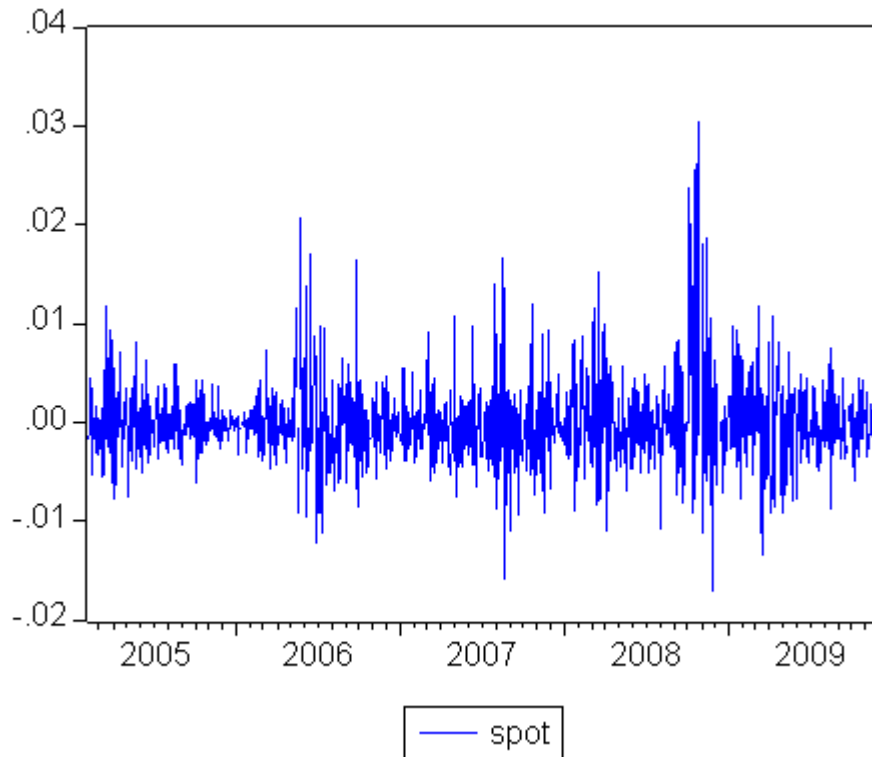
Yukarıdaki grafiklerde daha açık görüldüğü gibi, YTL/ Dolar Vadeli işlem sözleşmesi ve Spot USD kuru getirilerinden oluşan serilerde sapmalar

gözlenmektedir. Serilerin durağan olmadığı açıkça görülmektedir. ADF testi ile serilerin durağanlığına bakılarak durağan olmadığı görüldüğünden birinci devresel farkları alınmıştır.

4. ARAŞTIRMA BULGULARI

Zaman serilerinin logaritmik getirileri hesaplandıktan sonra, zaman yolu grafikleri oluşturulup, outlier değerlere karşılık gelen iki tarih çıkarılarak, zaman yolu grafikleri tekrar oluşturulmuştur. Yeni seriler üzerinden araştırmaya devam edilmiştir. Bu amaçla, tam ve kısmi otokorelasyona bakmak için, Korelogram tabloları ve Augmented- Dickey Fuller (ADF) testi kullanılarak, değişkenlerin durağanlıkları incelenmiş ve durağan oldukları görülmüştür. Tüm değişkenler için ADF test sonuçları, McKinnon %1 kritik değerlerinden büyük olduğu gözlemlenmiştir.

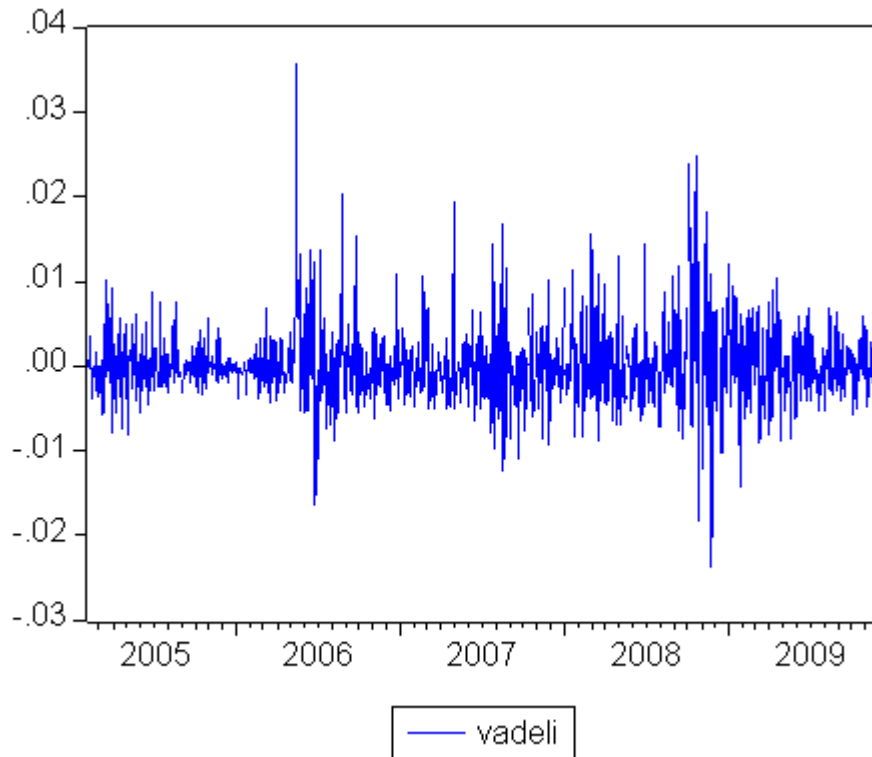




Series: VA
Sample 2/04/2005 12/01/2009
Observations 1211

Mean	5.07e-05
Median	-0.000312
Maximum	0.035784
Minimum	-0.023821
Std. Dev.	0.004489
Skewness	1.123148
Kurtosis	10.11987

Jarque-Bera	2812.464
Probability	0.000000



Vadeli ADF Kesmeli

Null Hypothesis: VADELİ has a unit root

Exogenous: Constant

Lag Length: 0 (Automatic based on SIC, MAXLAG=22)

		t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic		-31.04865	0.0000
Test critical values:	1% level	-3.435541	
	5% level	-2.863720	
	10% level	-2.567981	

*Mackinnon (1996) one-sided p-values.

Augmented Dickey-Fuller Test Equation

Dependent Variable: D(VADEL_)

Method: Least Squares

Date: 02/01/10 Time: 19:06

Sample (adjusted): 2/08/2005 12/01/2009

Included observations: 1210 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
VADEL_(-1)	-0.888072	0.028603	-31.04865	0.0000
C	4.55E-05	0.000128	0.354567	0.7230
R-squared	0.443835	Mean dependent var		3.70E-06
Adjusted R-squared	0.443375	S.D. dependent var		0.005984
S.E. of regression	0.004465	Akaike info criterion		-7.983500
Sum squared resid	0.024082	Schwarz criterion		-7.975073
Log likelihood	4832.017	F-statistic		964.0187
Durbin-Watson stat	2.004776	Prob(F-statistic)		0.000000

Vadeli ADF Kesmeli ve Trendli

Null Hypothesis: VADEL_ has a unit root

Exogenous: Constant, Linear Trend

Lag Length: 0 (Automatic based on SIC, MAXLAG=22)

	t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic	-31.03650	0.0000
Test critical values:		
1% level	-3.965649	
5% level	-3.413530	
10% level	-3.128813	

*MacKinnon (1996) one-sided p-values.

Augmented Dickey-Fuller Test Equation

Dependent Variable: D(VADEL_)

Method: Least Squares

Date: 02/01/10 Time: 19:07

Sample (adjusted): 2/08/2005 12/01/2009

Included observations: 1210 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
VADEL_(-1)	-0.888089	0.028614	-31.03650	0.0000
C	9.86E-06	0.000257	0.038332	0.9694
@TREND(2/04/2005)	5.88E-08	3.68E-07	0.159900	0.8730
R-squared	0.443847	Mean dependent var		3.70E-06
Adjusted R-squared	0.442926	S.D. dependent var		0.005984
S.E. of regression	0.004467	Akaike info criterion		-7.981868
Sum squared resid	0.024081	Schwarz criterion		-7.969228
Log likelihood	4832.030	F-statistic		481.6333
Durbin-Watson stat	2.004785	Prob(F-statistic)		0.000000

Spot ADF Kesmeli

Null Hypothesis: SPOT has a unit root

Exogenous: Constant

Lag Length: 0 (Automatic based on SIC, MAXLAG=22)

	t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic	-33.18405	0.0000
Test critical values:		
1% level	-3.435541	
5% level	-2.863720	
10% level	-2.567981	

*MacKinnon (1996) one-sided p-values.

Augmented Dickey-Fuller Test Equation

Dependent Variable: D(SPOT)

Method: Least Squares

Date: 02/01/10 Time: 19:08

Sample (adjusted): 2/08/2005 12/01/2009

Included observations: 1210 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
SPOT(-1)	-0.953819	0.028743	-33.18405	0.0000
C	6.86E-05	0.000124	0.554532	0.5793

R-squared	0.476871	Mean dependent var	-6.56E-07
Adjusted R-squared	0.476438	S.D. dependent var	0.005948
S.E. of regression	0.004304	Akaike info criterion	-8.057102
Sum squared resid	0.022373	Schwarz criterion	-8.048675
Log likelihood	4876.547	F-statistic	1101.181
Durbin-Watson stat	1.998084	Prob(F-statistic)	0.000000

Spot ADF Kesmeli ve Trendli

Null Hypothesis: SPOT has a unit root

Exogenous: Constant, Linear Trend

Lag Length: 0 (Automatic based on SIC, MAXLAG=22)

	t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic	-33.17894	0.0000
Test critical values: 1% level	-3.965649	

5% level	-3.413530
10% level	-3.128813

*MacKinnon (1996) one-sided p-values.

Augmented Dickey-Fuller Test Equation

Dependent Variable: D(SPOT)

Method: Least Squares

Date: 02/01/10 Time: 19:08

Sample (adjusted): 2/08/2005 12/01/2009

Included observations: 1210 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
SPOT(-1)	-0.954104	0.028756	-33.17894	0.0000
C	-4.92E-05	0.000248	-0.198450	0.8427
@TREND(2/04/2005)	1.94E-07	3.54E-07	0.548341	0.5836

R-squared	0.477001	Mean dependent var	-6.56E-07
Adjusted R-squared	0.476135	S.D. dependent var	0.005948
S.E. of regression	0.004305	Akaike info criterion	-8.055698
Sum squared resid	0.022367	Schwarz criterion	-8.043057
Log likelihood	4876.697	F-statistic	550.4223
Durbin-Watson stat	1.998023	Prob(F-statistic)	0.000000

ARMA YAPILARI

Modeller	ARMA
Parametreler	(2,3)
C	6.99E-05
ϕ_1	0.515887
ϕ_2	-0.961637
θ_1	-0.475004
θ_2	0.940947
θ_3	0.071711
R^2	0.024222
HKT	0.021877
AIC	-8.072067
SIC	-8.046769
Log Likelihood	4885.564
F Olasılığı	0.000018
^a 0.01 düzeyinde anlamlıdır. ^b 0.05 düzeyinde anlamlıdır. ^c 0.1 düzeyinde anlamlıdır.	

Arch LM TESTİ

ARCH Test:

F-statistic	46.37232	Probability	0.000000
Obs*R-squared	44.72932	Probability	0.000000

Çizelge 2. GARCH(1,1) Modelleme Sonuçları

$$\sigma_t^2 = \alpha_0 + \alpha_1 \varepsilon_{t-1}^2 + \beta_1 \sigma_{t-1}^2 + \gamma * VA$$

Modeller	GARCH
Parametreler	(1,1)
C	-0.000266
ϕ_1	-0.096477
ϕ_2	0.823359
θ_1	0.103240
θ_2	-0.865661
θ_3	-0.042882
α_0	0.128713
α_1	0.851106
β_1	0.000239 ²
R^2	-0.032275
HKT	0.023144
AIC	-8.446384
SIC	-8.400004
Log Likelihood	5116.839
^a 0.01 düzeyinde anlamlıdır.	

ARCH LM TESTİ

ARCH Test:

F-statistic	0.627051	Probability	0.428595

Obs*R-squared	0.627764	Probability	0.428177

EPOKA UNIVERSITY

PAPER: LABOR MOBILITY AND MIGRATION: CASE OF ALBANIA

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PREPARED BY: GRISIDA BAKALLI (gbakalli@epoka.edu.al)

OUTLINE:

1. Abstract

2. Key words

3. Introduction

4. Literature review

- Reasons why Albanians migrate
- Effects of migration in the Albanian labor market
- What are some major benefits from the effect of migration in the Albanian economy?

5. Data and research methodology

- Human capital investment
- How is the current migration flow from Albania to the European countries?

6. Conclusion

7. References

1. ABSTRACT

In the following paper, I am going to discuss and analyze the transition of Albania from a closed economy and society to a more open one with the fall of the communism, to open borders and the large flow of people across the Albanian borders. There will be also shown some major points about labor mobility and migration, a phenomenon that is very common in the last twenty years in Albania. Firstly I am going to discuss the reasons why people or Albanians are pushed to take the decision to leave their home countries and migrate to more developed ones in search of better jobs and better life opportunities. In this paper it is going to be included the current level of migration and at what phase it has arrived until now from twenty years past. Also I am going to analyze the internal migration and labor mobility of people. What are some of the “push and pull” factors that have mostly influenced migration. What are its effects in the labor market and the most important one which are the benefits that arrive from migration.

2. KEY WORDS

- Labor mobility
- Migration
- Albania
- Labor market

3. INTRODUCTION

Since the fall of the communist system, in Albania , migration has been the most important political, social and economic phenomenon and it has also been dominating in the every day life of the Albanians in the last twenty years. Since 1990, a major part of the population which is approximately one fifth of the total population has left the country and lives abroad in search of better life opportunities. As this large number of people left Albania, the population has decreased by 4 percent. Migration has been the most common livelihood strategy in our country and it is an important issue to escape unemployment and other economic difficulties that were felt in our country during the transiton to a market economy.

The International Monetary Fund in 1997, reported that : “The turbulent economic and political climate in the aftermath of the demise of communism fueled mass migration, 15 – 20 percent of the labor force left the country migrating to neighboring countries mostly in Greece and Italy.

Naturally, after observing these facts there come some major questions: who emigrated and what impact did these emigrants have on the Albanian economy? We are going to give the answer to this crucial question in the following points.

4. LITERATURE REVIEW

- **Reasons why Albanians migrate.**

Albania is a country that in the past years has experienced dramatic changes and because of this it has been transited into a more open market economy. The mobility of Albanians, internally and internationally plays an important role in household level strategies to adopt with the economic hardship of transition and it is the single most important political, social and economic phenomenon in post communist Albania.

The initial economic downturn that was followed with the change in government led to the largest surge of Albanian migration in recent times with 300,000 people leaving the country from March, 1991 to 1992 (Piperno, 2002; Pastore, 1998).

While the economical and political situation was stabilized after 1992, migration was reduces and as a consequence inflation dropped to less than 10 percent in 1995 from a high percentage of 226 which was in 1992 also unemployment fell from 28 to 12 percent and annual real GDP growth went to approximately 9 percent from -7.2 percent from 1993 to 1996.

But the most important period for the down turn of the Albanian economy were the years 1996 to 1997 when the collapse of national pyramid saving schemes occurred and they sparked another flow of international migration. The pyramid schemes occurred because of a weak formal credit system and a thriving informal market unregulated by the government.

The country fell into a total collapse as the army and police lost control over the people and foreign national were evacuated (Jarvis, 1999). Thousands of Albanians left the country starting from Vlora which was the centre of the pyramid collapse and then they were spread throughout the country until March 1997.

Some economists have focused that the decision of Albanians to migrate is based on wage and unemployment differentials. For risk averse workers, destination employment probabilities may be a more important determinant of migration than wage rates at least in the short run (Treyz, 1993 and Hatton, 1995).

In 1996 the monthly earnings of full time workers in Albania were approximately \$200 as it was compared to over \$ 1800 in Greece and \$ 2600 in Italy. Starting from this major differences and also the close borders with Greece and Italy have created the vast migration flows of Albanians to these countries.

Migration decisions of Albanians in the early transition appear to be economically rational, reflecting the differential reward of working abroad and the relative cost differences across potential migrants.

(Albanian Emigration: Causes and Consequences Nevila Konica and Randall K. Filera)

Migration also focuses on geographical differences in the demand and supply of labor markets. Regions which have a shortage of labor relative to capital are characterized by a high equilibrium wage, whereas regions with a large supply of labor relative to capital are faced with low equilibrium wage.

Consequently this wage differential causes a migration flow from low wage to high wage regions. (Prof.Dr.Gungor Turan, Epoka University, Department of Economics)

- **Effects of migration in the Albanian labor market.**

Here it is examined the relationship between emigration by members of a household and labor force participation of the members of that household who remain behind in Albania. By offsetting impacts on labor force participation of the remaining members in a household. If a domestic earner is lost in the household will increase the work by others.

Emigrants and natives are perfect substitutes in production, which means that emigrants and natives have the same types of skills and are searching for the same type of jobs. (Ehrenberg and Smith, 2009 : 340 - 342; Borjas, 2008: 181- 184; McConnell et al., 2003 287 – 293; Borjas, 1994: 1667 – 1717).

While the emigrants enter the labor market, supply curve will decrease and total employment will increase and wages will be reduced. Consequently, emigrants “take jobs away” from natives by decreasing the native wage and convincing some native workers that it no longer worthwhile to work.

If emigration is increased the economy will reduce the wage and employment of native born workers.

If two groups are complement in production, if the number of emigrants will increase the marginal product of natives will also increase. To explain more this fact, some natives who did not find a profitable work in the past, now will see the higher wage rate as an additional incentive to enter the labor market and consequently the native employment will also increase.

- **What are some major benefits from emigration in the Albanian economy?**

In accordance to some survey evidence, over half of migrants working outside Albania were sent back which is used for consumption. (Kule, et al., 1002: 235). Many migrants are contributing to the maintenance of their families and are the major source of income for some families which keeps them out of poverty. (DeSoto et al., 2002: 90, 99). Some of these incomes are used for small scale income generating activities and the impact may be small but they increase the living standards of their families and have an aggregate contribute to the overall benefits of migration.

The remainder of the money sent to Albania is saved or invested. Migrants save up to half of often very low earnings (Gedeshi, 2001: 14). A major part of them are target savers Puri and Ritzema, 1999: 18), who intend to invest their savings in specific projects in Albania.

5. DATA AND METHODOLOGY

I will focus the development of this section based on three models which are human capital investment, neoclassical approach and the size and structure of emigration flows from Albania.

1. Human capital investment:

A migration research was introduced by Sjaastad which became the most influential and widely used model, in which is treats migration as an investment decision of an individual and views the migration of workers as a form of human capital investment. (Borjas, 2008 : 322) workers calculate the value of the employment opportunities available in each of the alternative labor markets, net out the costs of making the potential move, and choose which ever option maximizes the net present value of lifetime earnings. Individuals which depend on their skill levels calculate the present discounted value of expected returns of their human capital in every region, including also the home location. Migration

occurs, if the returns, net of the discounted costs of movement, are larger in a potential destination region than the returns in country of origin. Every individual evaluates the returns and costs in a different way, depending on personal characteristics such as age, gender and schooling. (Bauer and Zimmerman , 1995 1995: 15)

The net present value of migration is calculated using the equation (McConnell et al., 2003:279; Ehrenberg and Smith, 2009:325; Borjas, 2008:322) .

$$V_p = \sum_{n=1}^N \frac{E_2 - E_1}{(1+i)^n} - \sum_{n=1}^N \frac{C}{(1+i)^n} - Z$$

V_p = present value of net benefits

E_2 = earnings from new job in year n

E_1 = earnings from existing job in year n

N = length of time expected on new job

i = interest rate

n = year in which benefits and costs accrue

C = direct and indirect monetary costs resulting from move in the year n

Z = net psychic costs (psychic costs – psychic gains)

Explanation of the equation: if V_p is greater than zero, implying that the expected earnings gain exceeds the combined monetary and psychic investment costs, the person will migrate, if, conversely, V_p is smaller than zero, the person will remain in his or her present job and location. All else being equal, the greater the annual earnings differential ($E_2 - E_1$) between the two jobs, the higher will be the present value of the net benefits (V_p), and the more likely it will be that an individual will migrate.

2. How is the current migration flow from Albania to the European countries?

The major part of Albanian contemporary migration over a short period of time as the country faced from total closure to large – scale out migration, makes Albanian migration as a specific case. It is described as a “ new migration order” and a “ laboratory for the study of migration and development”. Counting in these features, the after 1990 Albanian migration is a new type of international migration.

Barjaba suggested an Albanian model of emigration in 2000 which has the following characteristics:

- It is intense which means that Albania has a rate of migration much higher than any other eastern country.)
- It is largely economically driven like a “survival migration”
- Irregularities play a major role which means that there are a major number of undocumented migrants
- Displays lots of to and fro movement
- It is being a dynamic issue and is growing at large steps especially as regards new destinations and routes of migrants (Vullnetari 2007 : 40)

In our days an estimation of 25 percent of the total population or 35 percent of the labor force has migrated. A number of 900,000 emigrants of our country have mainly migrated in Greece and Italy and the remaining part in the western European countries, US and Canada.

In 2000 the Albanian Department of Emigration in collaboration with the Albanian Ministry of Labour and Social Affairs estimated that in 1999 there were 800 000 albanians living abroad (Barjaba 2000), from which 500 000 in Greece and 200 000 in Italy and the remaining in other European countries and in north America .

The Albanian Census (INSTAT 2002) published an estimated net loss due to emigration of more than 600 000 from 1989 to 2001 which is calculated by the census residual method (calculating net emigration as the residual if inter censal population change, minus the net difference between births and deaths.) here it is excluded short term migration of less than one year's duration and much migration to Greece which is temporary.

The Albanian Government has published in 2005 that the number of Albanians outside the country is approximately over one million (Government of Albania 2005 : 36)

Source: Barjaba (2000) and Government of Albania (2005)

COUNTRY	1999	2005
Greece	500,000	600,000
Italy	200,000	250,000
USA	12,000	150,000
UK	5,000	50,000
Germany	12,000	15,000
Canada	5,000	11,500
Belgium	12,000	5,000
Turkey	5,000	5,000
France	2,500	2,000
Austria	1,000	2,000
Switzerland	2,000	1,500
Netherlands	2,000	1,000
TOTAL	742,500	1,093,000

The increase of 350,000 in the number of Albanian migrants between 1999 and 2005 means that they have been migrated during these years. These figures show that there have been a shift in the importance of various destination countries. Although Greece and Italy remain the main receiving countries, other destination such as USA, UK and Canada have become attractive to an increasing number of Albanian emigrants. (Vullnetari, 2007:35-36).

The high number of Albanian migrants have remained high as a consequence of some factors as poverty and unemployment. The unemployment rate has remained high. These mostly economic hardships have at different points combined with episodes of political instability to boost migration flows. This was especially true in the period 1997 – 1998, when labor migration was coupled with forced migration. (Barjaba 2004).

Table: characteristics and education levels of permanent migrants

Non – migrants	Migrants
0,69	0,35
36,6	31,5
9,8	10,1

9,23	8,36
11,08	10,12

Source: Azzari and Carletto 2009

This table shows us some further evidence of some contrasts and introduces new variables into this analysis. Permanent migrants are younger, male and more educated than the average adults left behind. Migrants come from larger households which as a result of migration are now smaller. The larger number of less educated individuals are migrating in recent years. Educational levels of migrants have remained stable over the years, at levels above the rest going to Greece and Italy and originating from other parts of Albania. (Azzari and Carletto 2009:8-9)

6. CONCLUSION

After discussing and analyzing the major influence that migration has had in the Albanian economy I can say that migration is a very common issue that is being developed massively in our country since the fall of the communist system in 1990 when a major part of the Albanian population left their country in search of better life as they were stuck for more than 40 years in a country with closed borders where migration was forcibly prohibited. As our borders were opened to the world, Albanians found their opportunity to see a better life with better perspectives. A major number of our population migrated to our neighboring countries like Greece and Italy when they found shelters and new jobs with greater economical incomes.

The policies of EU are giving an importance in the legal and institutional asymmetry in the global migration system. In our country, migration is seen as an economic and social phenomenon but to the countries where Albanian migrants go it is seen as a risk to public safety. Due to EU increasingly restrictionist policies, the flow of regular migrants from Albania to neighboring countries is currently declining in low levels. (Barjaba 2004)

Migration has also had a major impact on wages and employment levels with the skill levels of the migrants and labor demand in the EU. If we have an increase in the number of Albanian emigrants the marginal product of the EU natives will increase and the wage rate will also increase and the EU natives are in search of new jobs and consequently the employment level will increase.

As we analyzed in our models, the Albanian government published that a major part of the Albanian population outside our country is approximately one million which is a high level for our country.

The Albanian migrants are giving to our country some major benefits which have a high impact in the Albanian economy because the major part of the emigrants work and save to maintain their families in Albania.

The estimations made in the models clearly show that potential number of migration is high due to possible accession of Albania to EU. Considering the number of potential migrants I can say that the public fears concerning the occupation of the European labor markets especially in Greece and Italy by the Albanian emigrants which is very high.

As a result I can say that migration in our country is being decreased as Albania is more open to Europe and other countries but still the number of migrants remains really high in the other countries. The government is following policies to reduce this number and to give the Albanian better job and life opportunities to live in Albania and to give to our people a higher income level.

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PROACTIVE APPROACH FOR THE IMPACTS OF FRAUDULENT FINANCIAL INFORMATION ON ECONOMIC DECISION

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Abstract

In the last decade today's world has been affected by frauds and manipulation of the financial information. An investment decision based on false financial information causes the investors to suffer losses as was experienced in Enron and WorldCom cases. For this reason financial information manipulation is as important as other types of manipulations and must be prevented so that the investors make a rational decision. Financial information has, certainly, an important positive or negative effect in economic decisions. Positive or negative effects of financial information on economic decisions depend on reliability of the financial information.

Keywords: Financial Information, Fraudulent, Manipulation, Decision

Introduction

In recent years the financial information manipulation has been debated by many economists and researchers especially in the developed countries all over the world. If we look at the negative effects of manipulated or fraudulent financial information on the economy it seems this issue will be debated for many years. In the literature for the financial information has been given several names: earnings management, big bath accounting, creative accounting, income smoothing and window dressing. In order to manipulate the financial information have been used these technics using the flexibility of the Accounting Standards.

The collapse of Enron has caused about \$70 billion lost in market capitalization which is devastating for significant numbers of investors, employees and pensioners. The WorldCom collapse, caused by alleged financial statement fraud, is the biggest bankruptcy in the United States history. (Zabihollah Rezaee, 2005) Loss of market capitalization resulting from the reported financial statement fraud committed by Enron, WorldCom, Qwest, Tyco, and Global Crossing is estimated about \$460 billion.

Fraud detection is among the highest priorities for the accounting profession and standard setters (PCAOB 2003, 2007, 2008). The transparency, reliability and accurate information allow users of the financial information such as investors, creditors to make intelligent decisions. "Audited financial statements provide the foundation for securities markets. Audited financial statements allow investors to make decisions on whether to buy, hold, or sell a particular security" (SEC, 2002a). "Accurate information also improves the quality of markets by allowing markets to discover the true price at which specific securities trade" (SEC, 2002b). Fraudulent financial reporting has become a very problematic issue which damages today's economy. As technological developments and expectations of people have caused the inevitable changes in the economic structure, whilst trying to provide the maximum benefit with limited resources.

Financial scandals, indisputably, in recent years, have significant importance in the financial world. These scandals have shaken the confidence of the investors. And effects of these scandals have been felt, are being felt and will be felt all over the world. The recent reported financial statement fraud and resulting decline in the stock market show the importance of the quality of financial reports and audit functions as well as the understanding of what may have caused the occurrences of accounting scandals (Zabihollah, Rezaee, 2005). Scandals which took place in the beginning of the 20th century brought us the quality of financial reports and credibility of audit functions. Collapses of these big companies have raised the concern of whether the accounting standards are sufficient for producing the quality of financial information.

Financial information manipulation mainly stems from the desire to influence the possibilities of wealth transfer between the various stakeholders. Active investors should be informed in time, and, properly and correctly in capital markets. The requirement of being informed is also important and necessary for money markets which consist of other financial system. However, investors' intentions of buying securities and taking decisions are based on financial information which is presented too, so this requirement of being informed is increasing the importance of financial information.

Why companies manipulate the financial information and commit the fraud in financial situation? Who benefits from the manipulated information and fraudulent financial situation? What kinds of reasons force the manipulators to commit the fraud and manipulate the financial information? If the all financial information's fraudulent can be detected? If the financial losses can be calculated in real economy? If is there any measurement which have been taken by governors to prevent the manipulation in the financial information? All these kind of questions have asked before and are being asked today. In this paper we will try to answer to these questions and find some solutions to satisfy the readers.

Causes and Effects of the Manipulation of the Financial Information

In today's conditions, rivalry in business is at a high level and the desire of companies to present the financial information of company is rationally approached. Capital markets in which there are many companies pass the information to the investors through reports which present the activities of the companies and these reports help the investors to provide necessary funds. Companies acting this way need means and an intermediary in order to present the financial situation. Some of the causes for manipulation the financial information have been detailed below.

Weakness Structure of the Company's Management

Any weakness structure of the company management leads the manager to manipulate the financial information to show the company's financial situation better than it is. Why the management structure is so important for any company and why the weakness structure of the company's management can be the reason to manipulate the financial information According to the Dechow, Sloan and Sweeney (1996),

- CEO's influence on the board is measured as follows: a) CEO chairs the board in about 64% of the control firms. b) The CEO belongs to the founding family in 26%

of the firms. So the result is that Board members are at the same time general directors and top manager.

- Most of the general directors are chairman of the board at the same time.
- Most of the general directors are founders of the company at the same time
- There are not independent audit committee in the most companies
- Shareholders from outside have not important share in the company

According to the Koch, the financial information can arise from organizational structure of the company. So we can say that the weakness management structure of the companies can be the reason for manipulation of the financial information.

Managers' Interests and the Partnership Structure of the Companies

Behind of the financial information manipulation can be the managers' interests. Managers' interest can affect the strategic decision for the company. Normally any decision is based on interests. Especially senior managers are aware of their interests and can keep their own interest for the first point on decision. Much more, that senior managers' decisions for a strategy A or B are not (solely) based on an abstract strive for 'profit-maximization' of 'efficiency' (or whatever is portrayed as 'the interest of the organization') but on what they regard personally as in their interest. Arens and Loebbecke (2000) define fraudulent financial reporting as: "intentional misstatements or omissions of amounts and disclosures in financial statements to deceive users." Managers are always the manipulators in financial information manipulation whereas mainly the other investors are the manipulators in other types of manipulations. According to some economists;

- Managers act for increasing their own interests
- Dividend ratio is the norm to determine the stock price causatively
- Managers' interest depends directly on the stock price of the company

Studies made by investigators indicate that companies are most likely to have fraudulent financial reporting perpetrated by top managers. These reasons above trigger the managers to manipulate the financial information in order to make stable profit. Besides this, efficiency and the size of the company is also an important factor.

Inadequate Internal Control System

The aim of the independent audit committee is to monitor the financial reporting process which must produce the accurate, reliable financial information. Of course this monitoring process does not mean that the audit committee should stay all day in the company while controlling the accounting records. Inadequate internal control system is considered as an important cause for the financial information manipulation. Inadequate internal controls over financial reporting and accounting practices could lead to errors, which could adversely impact ability to assure timely and accurate financial reporting. On the other hand every public company must have the internal control department according to its size and should employ the experienced people who can control if the financial reports have been produced accurately and reliable.

That is why Managers invest in internal controls, in part, to prevent and detect fraud. Because these controls are costly, and fraud prevention and detection are difficult, these controls are generally incomplete (Ernst & Young 2007). Consequently, managers and academics recognize that employees who become aware of wrongdoing such as fraud can

play an important role in its early detection (ACFE, 2006). We can get some investigation results from the survey done by the Association of Certified Fraud Examiners (ACFE) 2010 Report to Nation. These surveys also express the importance of the weaknesses of the internal control system. According to the survey the respondents have been asked to identify which of several common issues they considered to be the primary factor that allowed the fraud to occur. The answer was as follow; a lack of internal controls, such as segregation of duties, was cited as the biggest deficiency in 38% of the cases. In more than 19% of the cases, internal controls were in place but were overridden by the perpetrator or perpetrators in order to commit and conceal the fraud. Interestingly, even though hotlines are consistently the most effective detective control mechanism, and even though less than half of the victim organizations had a hotline in place at the time of the fraud, a lack of reporting mechanism was the control deficiency least commonly cited by the CFEs who participated in study.

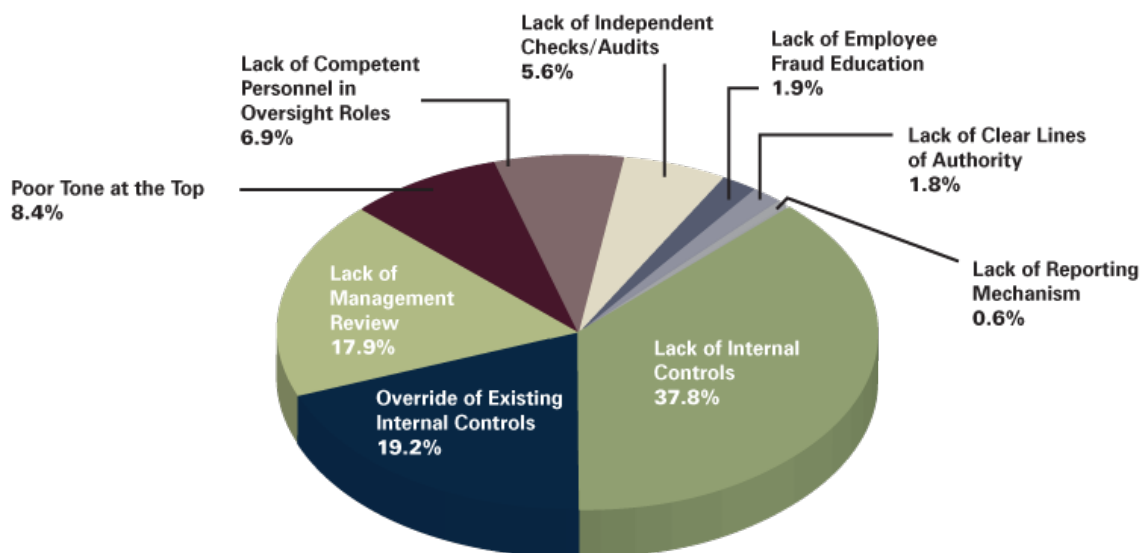


Figure 1: Primary Internal Control Weakness Observed by CFEs

Figure 1 shows the difference between organizations according to their sizes. As we see in the chart that 47% of the small business do not have any internal control. But the number 33.7% is rather big for larger companies. Lack of internal controls shows the factor most contributed to the fraud. Small business do not override because there is nothing to override.

Figure 2 shows the difference between organizations small and more than \$1 million. How the weaknesses of the internal control contribute to fraud.

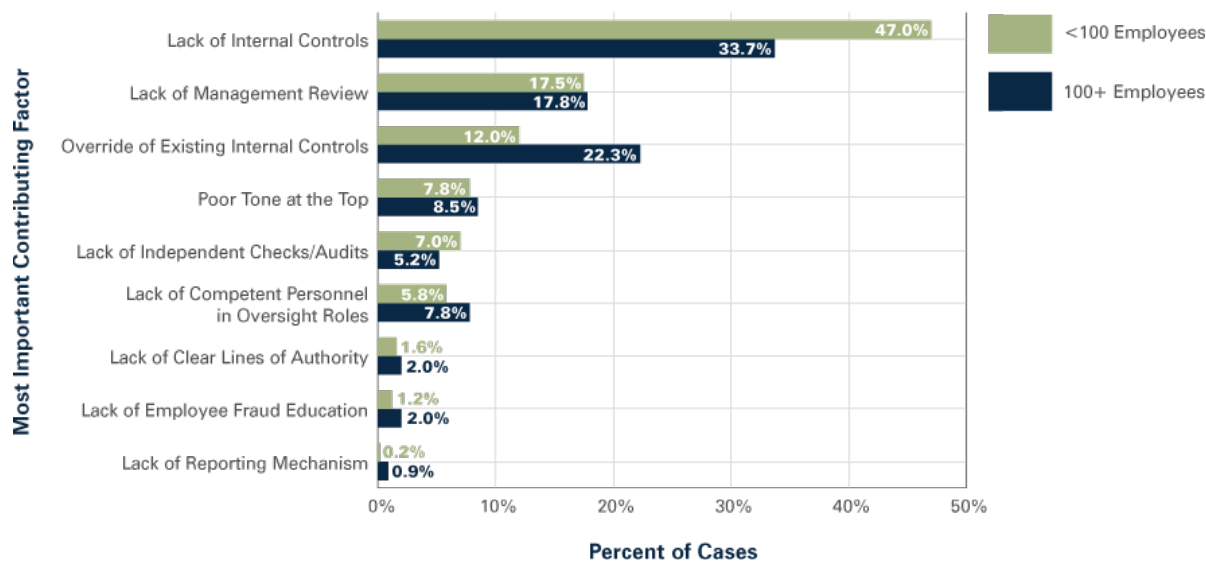


Figure 2: „Primary Internal Control Weakness by Size of Victim Organization”

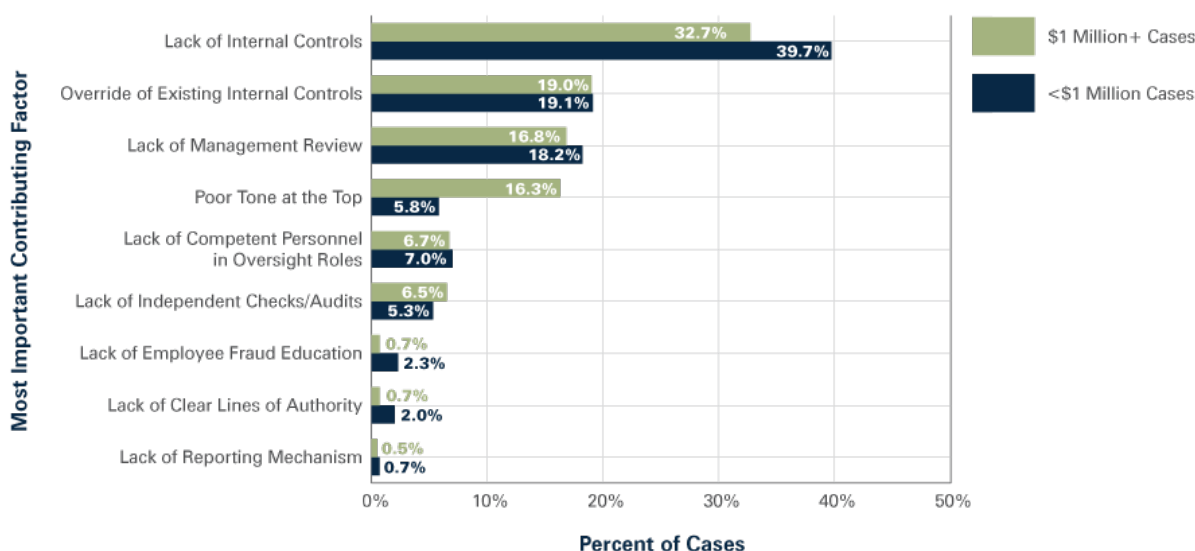


Figure 3: „Primary Internal Control Weakness in Largest Cases”

Accrual Accounting and the Flexibility of the Accounting Standards

Generally Accepted Accounting Principles (GAAP) relies on accounting accruals to provide earnings information that is useful in business decision-making. Dechow and Skinner (2000) both emphasize that fruitful areas for future research is to first, identify firms whose managers practice earnings management and focus on their managerial incentives. Second, document the magnitude and frequency of specific accruals and accounting methods used to manage earnings. The impact of discretionary accruals on the information content of earnings is subject to debate. On the one hand, these manipulations could enhance the value-relevance of reported earnings by communicating a manager’s private information regarding future profitability. On the other hand, the flexibility inherent in GAAP may result in opportunistic behavior that distorts reported earnings. To date, empirical research on managerial discretion and earnings informativeness has been

indirect and mixed, and the information effects of discretionary accruals in particular is relatively unexplored (Subramanyam, 1996).

Accounting principles have an international or national standard to produce the financial reports in regular and understandable mode by everyone. But as a matter of course every rules or laws can be flexible in order to adopt more easily. But ,indisputably' there are some arguments in favor of accrual accounting and some against for accrual accounting. Models of non-discretionary accruals, i.e. Accrual models, are widely used by financial analysts to assess the level of discretionary accruals, an important indicator of earnings management practices, and, more importantly, a significant predictor of stocks returns (Hirshleifer, 2009). Actually, one of the main reasons why accrual models have generated such attention in the finance literature is precisely the fact that the residuals of accrual equations carry valuable information about stock returns.⁴

Fraudulent and Manipulated Financial Information

The term fraud is defined in some dictionaries as follows; *an act using deceit such as intentional distortion of the truth of misrepresentation or concealment of a material fact to gain an unfair advantage over another in order to secure something of value or deprive another of a right. Fraud is grounds for setting aside a transaction at the option of the party prejudiced by it or for recovery of damages.* But on the other hand the term fraud has been by scholars too as follows; *in legal terms, fraud is a generic category of criminal conduct that involves the use of dishonest or deceitful means in order to obtain some unjust advantage or gain over another. In business terms, fraud is sometimes difficult to define as it extends, for example, from conduct as trivial as an employee having an extended lunch break without permission, to large-scale misappropriation of funds by a company accountant involving many millions of dollars.*

Certainly the definition may differ from person to person and from country to country but the common thing of fraud is dishonesty. Starting from the definitions we examine the problem with some real evidence.

The recent reported financial statement fraud and resulting decline in the stock market show the importance of the quality of financial reports and audit functions as well as the understanding of what may have caused the occurrences of accounting scandals (Zabihollah Rezaee, 2005). Today's one of the biggest problems we face is fraudulent in the financial situation. According to the Association of Certified Fraud Examiners (ACFE, 2008) the cost of fraud is difficult to quantify for a number of reasons: 1- not all fraud is detected; 2- of that detected, not all is reported; 3- in many fraud cases, incomplete information is gathered; 4- information is not properly distributed to management or law enforcement authorities; and 5- too often, business organizations decide to take no civil or criminal action against the perpetrator (s) of fraud.

In the survey done by Association of Certified Fraud Examiners (ACFE, 2010) given details in the "Report to the Nation on Occupation Fraud and Abuse" 2010 booklet have been declared the loss because of the fraudulent. In the survey has been asked the question to provide his or her best estimate of the percentage of annual revenues that the typical organization loses to fraud in a given year. The median response was that the average organization annually loses 5% of its revenues to fraud. The ACFE committee applying this percentage to the 2009 estimated Gross World Product of \$58.07 trillion would result

in a projected total global fraud loss of more than \$2.9 trillion. But we should note that this estimation is based only on the opinions of 1,843 anti-fraud experts, rather than any specific data or factual observations; accordingly, it should not be interpreted as a literal representation of the worldwide cost of occupational fraud.

As we see above the subject „fraudulent” must be considered carefully by audit experts and should be prevented as much as possible. Otherwise the negative effects of the manipulated financial information will be bigger than previous year. This given example is just for U.S.A. but for the rest of the world cannot pass over. But we should note that the financial statements fraud is the least common but most costly form of fraud among cases investigated in the surveys.

Fraud can inflict significant damage at community, organizational or individual level and the potential consequences of fraud for organizations can be strategic, legal, financial or operational. Therefore, it must be an important issue for organizations. (Lucian Vasiua, Matthew Warrend and David Mackay, 2003)

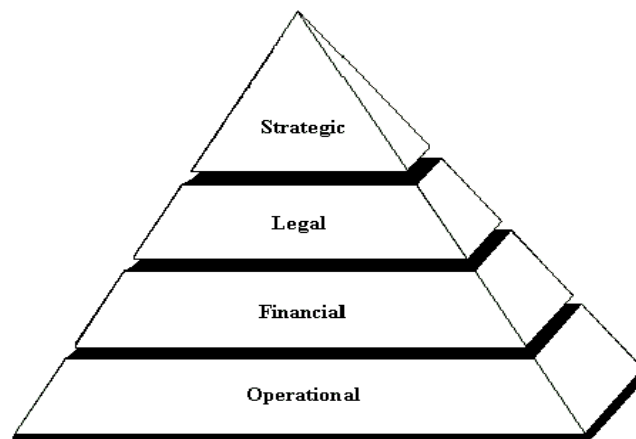


Figure 4: Pyramid of potential consequences of fraud for organizations

Fraudulent in financial situations

Fraud consists of knowingly making material misrepresentations of fact, with the intent of inducing someone to believe the falsehood and act on it and suffer a loss or damage (Louwers, 2007). Every country specially developing and developed countries suffer from fraudulent and manipulated financial information. The losses from manipulated financial statements rather bigger than other types of fraud as corruption, asset misappropriation. The cost of fraudulent and manipulated financial information cannot be calculated. But some investigations show how big negative effect of the fraudulent has on real economy and undisputable because of fraud all people is effected all over the world.

An investigation study made by Committee of Sponsoring Organizations of the Treadway Commission in U.S.A. searching the „Fraudulent Financial Reporting” between 1987-1997 years has declared some of the more critical insights. They are;

- The companies committing fraud generally were small, and most were not listed on the

New York or American Stock Exchanges.

- The frauds went to the very top of the organizations. In 72 percent of the cases, the CEO appeared to be associated with the fraud.
- The audit committees and boards of the fraud companies appeared to be weak. Most audit committees rarely met, and the companies' boards of directors were dominated by insiders and others with significant ties to the company.
- A significant portion of the companies was owned by the founders and board members.
- Severe consequences resulted when companies committed fraud, including bankruptcy, significant changes in ownership, and delisting by national exchanges.

The study above shows that audit committees should be stronger and the audit committees should not have any connection with the company members. If the founders of the company are members at the same time, it may encourage the directors to commit the fraud more easily. Committing fraud in the financial situations may bring to the company some benefit for short-term but consequences may be worse as bankruptcy, changes in ownership and delisting by national exchanges.

Preventing the fraud is also costly work for the companies or government agencies. As explained in section 1 the causes of fraudulent play an important role to commit the fraudulent in the financial situations. Al Capone's bookkeeper once said that he can steal more with a pencil than ten men with machine guns—the situation is much worse today, with computers that have increased the speed, the possible scope of criminal acts and the difficulty to investigate such crimes (Lucian Vasiua, Matthew Warrenband and David Mackaya, 2003). Furthermore, money in electronic form are much easier to steal: while US\$1B in \$100 bills occupies about 15 cubic meters, and in gold would weigh about 65 tons, in electronic form is just 32 bits plus some application-dependent headers.(Parker, 1998)

Financial Losses Caused by Manipulated Financial Information

Detecting fraud is difficult because those engaging in fraud generally attempt to conceal their behavior, fraud is not a predictable event, and auditors often have limited experience detecting fraud (Nieschwietz, 2000). It is very difficult to calculate the cost of the fraud losses. ACFE „Report to Nation-2010” also expresses the danger on this issue. ACFE declares that „there is no way to precisely calculate the size of global fraud losses, the best estimate of anti-fraud professionals with a frontline view of the problem may be as reliable a measure as we are able to make. In any event, it is undeniable that the overall cost of occupational fraud is immense, certainly costing organizations hundreds of billions or trillions of dollars each year.

According to the ACFE researches there are three main types of fraud; asset misappropriations, corruption and financial statement fraud. Asset misappropriations fraud committed to steal or misuses an organization's resources. Corruption schemes involve the employee's use of his or her influence in business transactions in a way that violates his or her duty to the employer for the purpose of obtaining a benefit for him- or herself or someone else. Financial statement fraud schemes are those involving the intentional misstatement or omission of material information in the organization's financial reports. Common methods of fraudulent financial statement manipulation include recording

fictitious revenues, concealing liabilities or expenses and artificially inflating reported assets.

These three types of fraud have been illustrated in charts. As we see in the chart that the asset misappropriation is most frequent but least costly form of fraud besides the financial statement fraud is less frequent but most costly form of fraud. Corruption is in the middle of two fraud types.

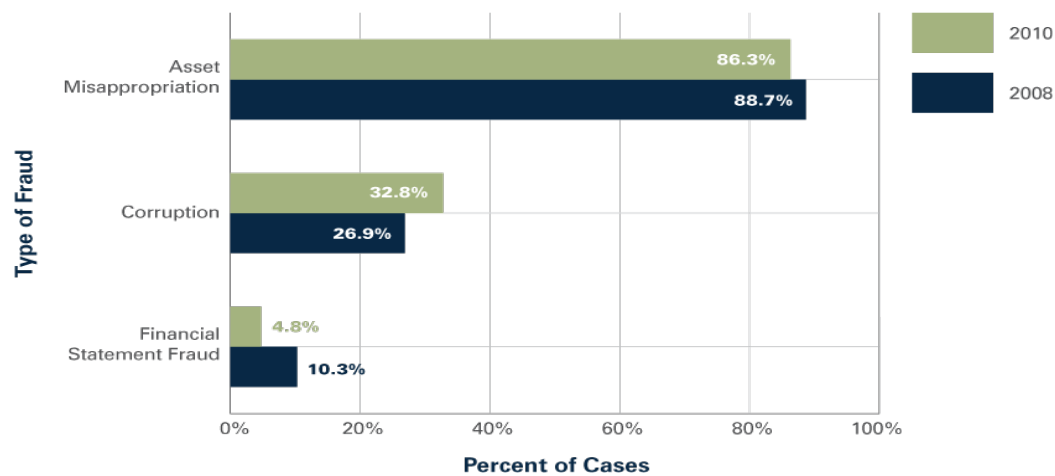


Figure 5: Occupational Frauds by Category — Frequency

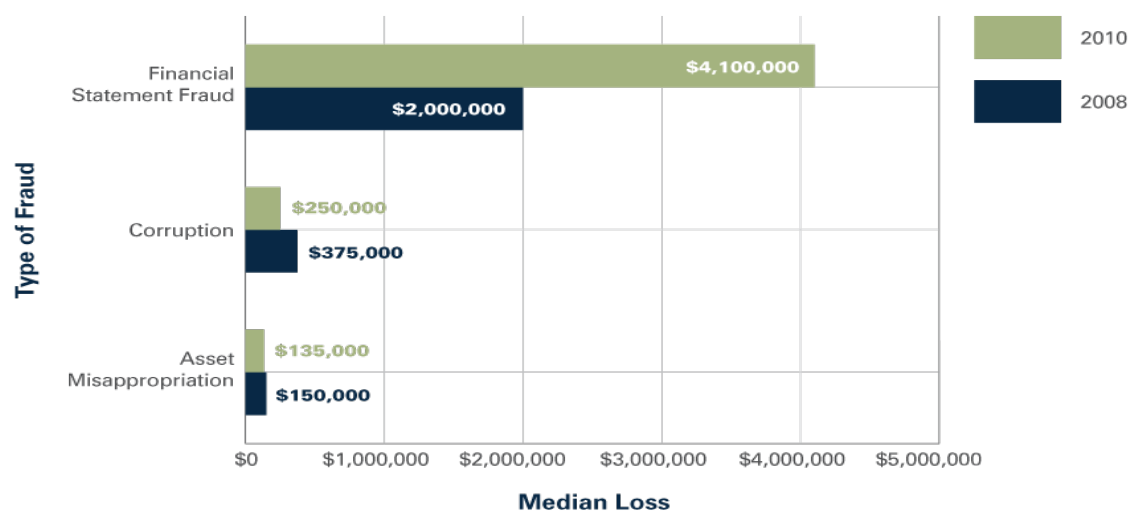


Figure 6: Occupational Frauds by Category — Median Loss

As indicated in charts above although the percentage of cases of financial statement fraud decreases in 2010 against 2008 but the losses increased significantly. So this situation raises the question that something should be done in order to prevent the financial statement fraud. Otherwise financial crisis will be inevitable and the financial system will be fatal. On one hand the flexibility is the method unblocking the economically development on the other hand flexibility of the accounting standards encourage the perpetrators to manipulate the financial information but the flexibility of the accounting standards should not misused in order to gain for short-term.

Social effects of fraud or manipulated financial information

Fraud is a serious social and economic problem that adversely affects a broad range of stakeholders, including audit committee and board members, top managers, employees, auditors, creditors, shareholders, and pensioners (Dyck, 2007). Effects of fraud have been debated by financial world from point of economy. But nobody can pass over the social problem of fraud.

Expected function from taxation is to achieve the economic aims with taxes. In this situation the taxation laws have to be applied completely and correct. On the other hand, presenting the financial situation accurately the informal economy is being obstructed. Persons who evade tax can use the funds as they wish. This situation cause unfair competition and the consequences of evasion tax may affect the government plans.

Indisputable fraud has a negative effect on every human being. We can classify few consequences:

- Economic decline due to direct physical damage
- Economic decline due to losses suffered by publicly used services such as transportation, police and fire departments
- Indirect economic losses endured by prominent corporations due to losses suffered by their clients
- Physical injury or death to innocent victims caught in the middle of a scam gone wrong
- Emotional and psychological burdens placed on the fraud victims

The impact of such theft can also have a social impact on the organization. It can allow the organization to lose the confidence of the stockholders of the organization. It can also contribute to a loss of confidence in the organization by its advertisers. The negative publicity from the media can also impact how the organization is perceived and supported by the local, national or international community in which the organization operates as well as the customer base of the organization. The cumulative effect on all of the negative circumstances may also have a major impact on the organization's total reputation and stock value which could in some cases can lead to the closure of the business or an unprecedented loss of revenue (ACFE, 2007). Due to the losses in the organization it can also have an impact on the confidence of the local, state or national economic conditions based on the size of the business affected by corporate fraud (ASIS, 2007). Fraud has a negative impact on individuals, organizations, and communities. It can divide families and small communities and also has ramifications for society as a whole.

CONCLUSION

The fraud is a global problem. Managers are responsible for committing the fraud in financial information. Managers' interests are playing very important role to manipulate the financial information. Company's management structure should be strong and transparent. If in any company general director is the chairman or founder of the company at the same time, so the manipulating the financial information is inevitable. Internal control system makes the financial information more confident. According to the investigation is made by ACFE express the importance of the weaknesses of the internal control system. Lack of the internal controls shows the factor most contributed to the fraud. In the last decade preventing the fraud in the financial information and manipulated financial information is an important issue. Preventing the fraud is also costly work for the companies or government agencies. As indicated in the charts the financial losses are significant and should be taken measures to prevent the fraud. Otherwise the losses will cause to collapse the real economy as experienced before. Accuracy, transparency and reliability of financial information will give the opportunity to investors to make the correct decision on their investments. Otherwise the allocation of resources will not be efficient.

Nowadays there is no developed country without an accounting and audit system. Not only national financial results but also international financial results have to show the single aspect which is called reliability. Accurate, robust, reliable and real financial reports are provided only with audit. Reliable information has become more important as the community grows and gets more complex. From the investors' point of view, the main measurement of the investments which have been made or planned is, obviously, reliable information. If disclosed information is not reliable so decision makers cannot take measured decisions on issues. Interest groups require the financial information explained to them and need that financial information to reflect the reality. Decision makers have to investigate if the disclosed information is reliable or not. The usual method is to take advice from an independent person. Integrity, accuracy and impartiality of the audited and verified information are considered to be reliable information in the decision process.

To protect the assets which belong to investors against risks, so to provide the confidence in the capital market is quite important. Otherwise, because of the losing the confidence in the capital market will not contribute to the growing of the economy of the countries. Committing fraud in the company and presenting an erroneous financial situation will damage the companies. Every fraud and error has a cost to the economy. The consequences of fraud and errors are that sources are not directed to the necessary and most productive areas in the economy, so allocation irregularities appear in the economy. Fraud and errors committed in financial reports lead the users of financial information to make decision wrongly, thereby not allocating resources correctly, and because of this companies could be sanctioned by official authorities. Also investors who invest on the stock exchanges will be affected by errors in the financial information. Investors will be encouraged to invest in unproductive areas and this will have the cost to the economy. Companies would like to get a profit in the short period, but this ambition could lead to fraud and errors being committed in the financial information and consequently these companies could be dragged bankruptcy. Unless this ambition of companies ends there will not be any stability in their economy. Any fraud or errors could trigger the committing of other fraud in the financial situation. If we look at the statistical numbers there is no period in which the fraud or errors were not detected.

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Paper Title: 2008 Economic Crisis Analysis
(The Macroeconomic Approach)

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Abstract

Recent economic crisis started from the American Housing. In 2005, the price of housing started to grow and for gaining more profit, the banks inclined to housing and provided applicants with lots of facilities. With the burst of price bubbles, intense reduction of prices occurred in the housing market and the loan recipients did not have any motives to repay their loans. Therefore, the credit- providing and official organs that had given lots of facilities to the housing sector faced crisis. This recession rapidly spread to other economic sectors and shortly infected Europe and Japan, and also influenced other countries with respect to their dependence on America's economy.

This paper, with an approach to macroeconomics and IS-LM model, analyzes the recent crisis.

Key words: Economic crisis, Macroeconomics, IS-LM Model, America Economy

Introduction

In 1776, Adam Smith (1723-1790) the British economist, simultaneous independence of America published his great economics book, *Wealth of Nations*. Nowadays we know Adam Smith as the father of modern economics. It is true that Smith established modern economics but some other nearly economists like John Maynard Keynes and Friedman revolted in economics. It is marvelous that every revolution in economics is following an economic crisis.

All over the economic history of the world, Recessions, Depressions and economic downturns have been experienced. In the economics sources, there are several theories about economic economic fluctuations which are developed during the past centuries. Economists like Schmpeter (Schmpeter, 1939) are arguing that business cycles can be predicted, but some others like Mankiw (Mankiw, 1997) and Romer (Romer, 2006) are saying no. Karl Marx (1818-1883), great German economist and sociologist believed in that recessions and economic crisis are the nature of the capitalism economic system.

It is natural that after any great crisis – strategic crisis, political or economic – new theories will be submitted. The Great Depression that was one of the world's largest downturns in economic history, inspired John Maynard Keynes to develop his revolutionary theory. He argued that, economy can be recovered by boosting consumer spending. The Great Depression was overcome by several Keynes inspired economic programs and simulation between 1933 and 1935.

Most of economists are comparing recession of 2007-2009 with the Great Depression. Some researchers like Even and Feldman (2009) assert that the current crisis, at least from the financial viewpoint is considered the worse since 1929. Recent crisis started from the American Housing. It rapidly spread to other economic sectors and shortly infected Europe and Japan, and also influenced other countries with respect to their dependence on American's economy. At this paper we want to illustrate that how the recent crisis started and how solved. And whether new theories are necessary or not?

Model

What is crisis?

Crisis is one of the serious processes of the actual risk. Every security threat contains "potential" and "actual" process. Potential process of the security threat involves "tension" and "challenge" and actual process includes "warning", "risk" and "crisis" (Figure 1).

Figure 1:

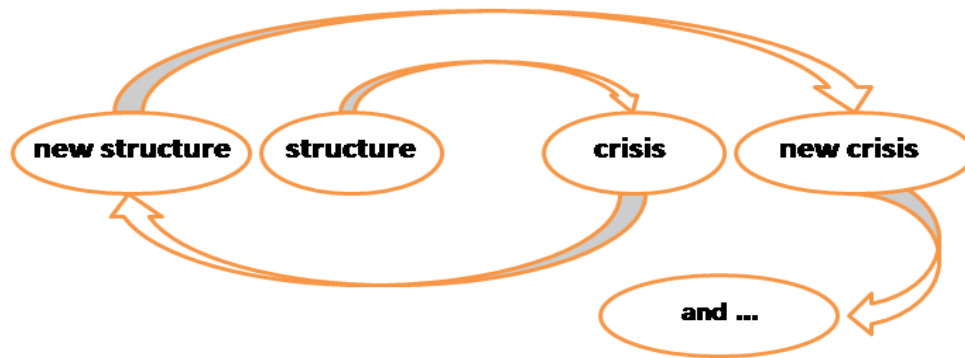


Security Threats Stages

Crisis is a very important concept in discussions of economics science, political and strategic and has many examples. In the economic field, it involves rapid and dramatic rise of prices, production expanded reducing, sharp rise of unemployment, a sharp reduction in income, sharp reduction in the value of securities and etc. In the political field, it contains social revolts increasing, developed gap between government and citizens and in the field of strategic, crisis has examples such as military and coercive regime dealing with social groups or neighboring countries and other countries. So, when the word of "crisis" is used, it means that the security threat is in the last process its existence.

Structural change is considered as one of the main consequences of the crisis. After emergence of the crisis, if there dos not be any measure to its roots and to make decisions about structural changes, crisis re-emergence should be expected. Necessity of structural changes is to prevent similar crises repetition or other crises. Crisis lead to new theories and also these theories create new structures. So, theories are result of crises and on the other hand, they are facing to the theoretical and practical challenges and crises. It is clear that theoretical challenges affects to new structures and newer structures occur. So, this process is continuous and permanent (Figure 2).

Figure 2: Crises and Occurring New Structures are Continuous and Permanent



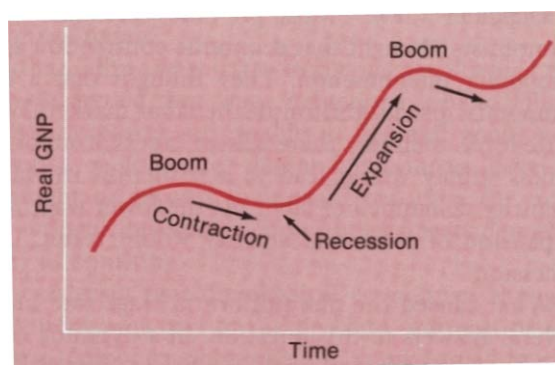
Economic fluctuations and business cycles

In 1776, Adam Smith (1723-1790) by publishing his great economics book, *Wealth of Nations*, established Modern Economics. But from creation of capitalism economic system Recessions and Depressions and economic downturns have been experienced. Karl Marks (1818-1883), great German economist and sociologist believed in that recessions and economic crises are the nature of the capitalism economic system. Economists as Schumpeter (Schumpeter, 1939) are arguing that business cycles can be predicted, but some others like Mankiw (Mankiw, 2007) and Romer (Romer, 2006) are saying no. There is no doubt, however, that the Great Depression was one of the world's largest downturns in economic history. It inspired John Maynard Keynes to develop his revolutionary theory. He argued that economy can be recovered by boosting consumer spending. The Great Depression was overcome by several Keynes inspired economic programs and stimulation between 1933 and 1935. Several recessions and economic downturns had occurred since then. There is little doubt that, the relevance of Keynesian economics is being questioned during every economic downturn in the previous century. A result of that is the rather influential works of authors such as Fausto Vicarelli and Paul Krugman. In 2007 new recessions started. Many economists are comparing recession of 2007-2009 with the Great Depression. Many governments have already adopted fiscal stimulus plans and lowered interest rates as close to zero (Funa, University of Ljubljana, 2009).

Economic fluctuations are referring to the business cycle, which occur over longer periods and cover periods of economic expansion and economic stagnation. Usually, these fluctuations are measured by the growth of real GDP (gross domestic product). As the term implies, a **business cycle** is a period of up and down motion in aggregate measures of current economic output and income. Figure 1 illustrates a hypothetical business cycle. When most businesses are operating at capacity level, the real GNP is growing rapidly, and the unemployment is low, **boom** condition exists. Boom conditions result in a high level of economic activity. As aggregate business conditions slow, the economy begins the contraction phase of a business cycle. During the contraction, the sales of most business will fall, real GNP will grow at slow rate perhaps decline, and unemployment in the aggregate labor market will raise. When economic activity is low and unemployment is

high, these conditions are referred as a **recession**, or if they are quite serious a **depression**. After the recession reaches bottom and economic conditions begin to improve, the economy begins an expansionary stage. During the expansion phase, business sales will rise, GNP will grow rapidly, and the unemployment rate will decline. The expansion blossoms into another boom. But the boom will eventually peter out and turn to a contraction, beginning the cycle anew (Figure 3) (Gwartney, 1976). Schumpeter also proposed four types of business cycles, which however did not enjoy much support. These four types are called; Kitchin inventory cycle (period of 3 to 5 years), Juglar cycle (period of 7 to 11 years) which is usually taken as the business cycle, Kuznets cycle (period of 15 to 25 years) and Kondratiev wave (period of 45 to 60 years) which is sometimes as well referred to as long technological cycle (Funa, University of Ljubljana, 2009).

Figure 3



Business Cycle

Economic crisis of this kind usually entail two components, a financial crisis and a real economic crisis developing in its wake. The financial crisis stems from a failure in the functioning of the financial system. It is manifested in tremendous monetary losses, in the crash of financial institutions, in the loss of trust in the system, and in low financial supply (a slowdown in the flow of money). The lack of financial oxygen causes increasingly more companies to cancel projects and lay off workers. At the same time, the blow to private savings on the capital market and the loss of employment security cause the public to reduce spending on goods and services. Thus the real economic crisis is created, expressed in a sharp downturn of consumption and product, a rise in business bankruptcies, a reduction in the nations' income from tax revenues, a sharp increase in unemployment, a rise in poverty, and so on. (Shmuel Even and Nizan Feldman, 2009)

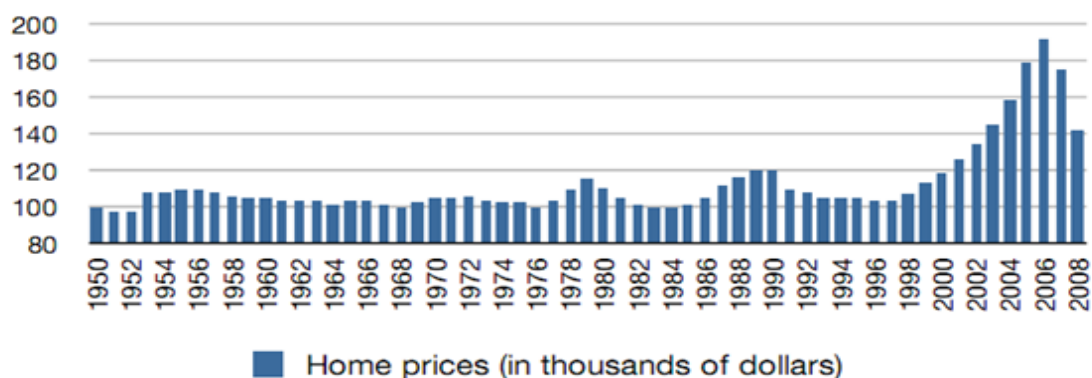
How did the recent crisis start?

After September 11, 2001, recession was predicted in America (Gharib, 2008). Economic researchers such as Rathkopf argue that more attention to the terrorism and less to the finance and economy is the main reason of the current economic crisis (2008). In the years before the crisis, the Federal Reserve's expansionary monetary policy reduced interest rate.

It seems that this policy was adopted in front of economy and market horror after the event September 11, 2011. Policy "a house for every American" that was a policies of the American President of that era with interest rate decline and international geopolitical risks increased real assets prices such as land, building, precious metals (including gold and silver), industrial metals and even oil.

Figure 4 illustrates home prices situation from 1950 to 2008. The average annual investment return from 1950-2000 was less than one-half of 1% per year, after adjusting for inflation. The home price index was set to start at 100 in 1950. So, a \$100 investment in a home in 1950 was worth \$104 in inflation-adjusted in 1997.

Figure 4

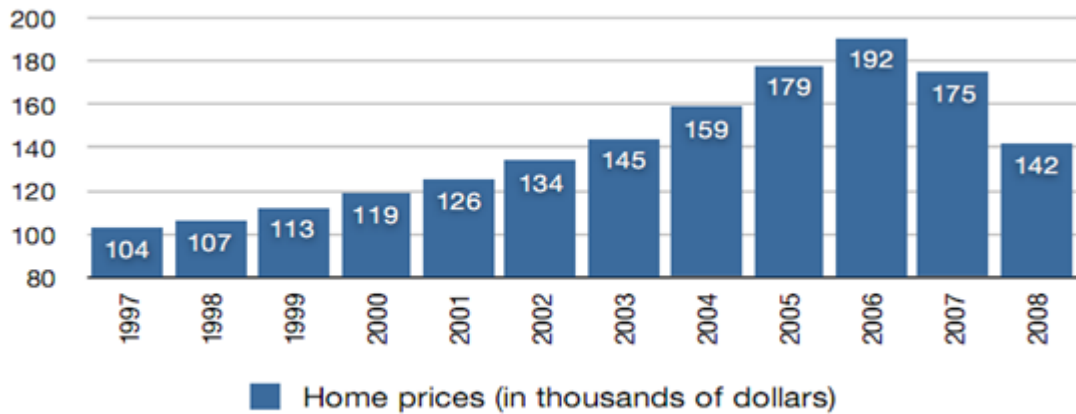


The history of housing as an investment

Source: USA Today According To Economist Robert Shiller, Yale University

In economics, it is axiom that every economic institution and firm (such as banks and credit and finance foundations) wants to maximize own profit. So banks and financial foundations invested in housing for gaining more profit. Housing banks reduced down payments from 30% of whole home price to 10% and thirty years loan rates from 5% to 3% such that after three years, they can adjust interest rate to the subprime mortgage loans and daytime interest rate. Housing Banks in lending to customers to greedy more profits did not observe criteria relating to customers financial ability and their repay power because if they were not able to pay their loans, banks could take ownership of their homes and through this gain more profits.

Figure 5

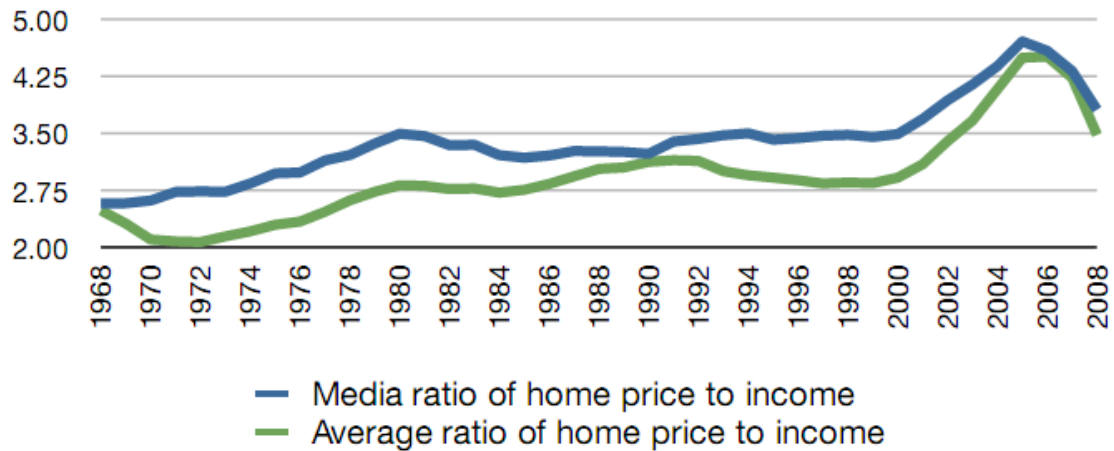


the Bubble Decade

Source: USA today according to Economist Robbert Shiller, Yale University

The housing bubble began in 1998, peaked in 2006 and burst in 2007 (Figure 5).

Figure 6



Home Prices as a Multiple of Income

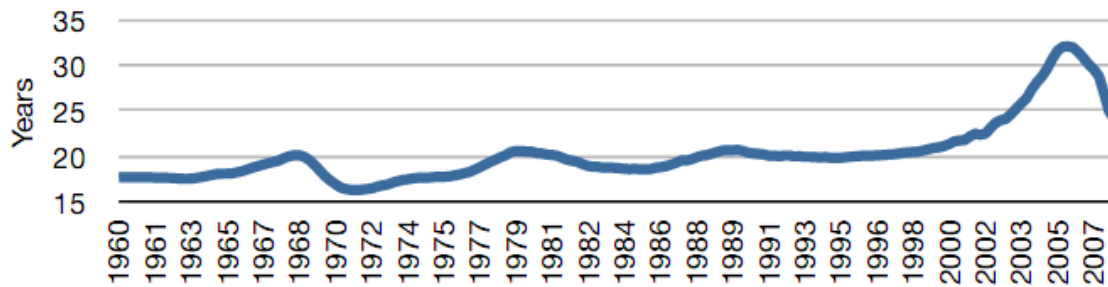
Source: USA Today, according to Census Bureau, A&P/Case-Shiller Home Price Indices

How far can home prices fall. A long way, if prices return their traditional level. Historically, home prices have been equal to about three times average household income. In 2005, they peaked at 4.5 times income (Figure 6).

Economists also measure home prices based on how much it would cost to rent the house. Historically, homes cost about 20 times what it would cost to rent the home for a year. A house that rents for \$10,000 a year – about \$830 per month – would be worth about \$200,000.

In 2005 and 2006, home prices peaked at unprecedented levels – 32 years' worth of annual rents. In other words, a house that could fetch \$830-a-month in rents was selling for \$320,000, far above traditional value of \$200,000. As shown in Figure 7 (Dennis Cauchon, USA Today).

Figure 7



Home Prices as Multiple of Annual Rent

Source: USA Today according to Economist Morris Davis, University of Washington

The traditional 20% down payment became a thing of past during the housing boom, especially for first-time buyers. In 2007, 45% of first-time buyers used "no money down" loans, a mortgage that essentially did not exist before the late 1990s. Millions also obtained adjustable-rate mortgages (ARMS) that offered low interest rates at the beginning but later re-set at much higher rates, causing homeowners' monthly payments to soar.

Table 1: How did prices get so high in the first place?

Median downpayment	1989	2007
All buyers	20%	9%
Repeat buyers	23%	16%
First-time buyers	10%	2%

Source: USA Today According To National Association of Realtors

Table 1 shows down payments that homebuyers used in 2007 compared with 1989. It illustrates that banks took a great risk than before.

A typical bank puts about 9% of its money into its business, a leverage ratio of 11-to-1. Lehman Brothers, the failed investment bank, have a leverage ratio of 30-to-1, meaning it borrowed and invested \$30 for every \$1 of the company's own money. During the housing

boom, home buyers leveraged small down payments into big mortgages to buy more expensive houses than they could otherwise afford.

Levergages increased the risk to the homeowners and borrowers. Just as important, it magnified profits. The investment return on a home depends on the amount of equity, not the purchase price. Some homeowners doubled and tripled their investment every year during the housing bubble, a tribute to the power of leverage. Small down payments, low interest payments, adjustable-rate mortgages and interest-only payment options made buying a home affordable to low-income people who had previously rented. A rising tide of easy lending made the \$1 million McMansion and the \$750,000 beachfront condominium hot commodities. New homes got bigger and more expensive across the board. The largest growth came in homes costing \$200,000 to 300,000. Sales of inexpensive homes plummeted after 2002 as high-risk mortgages proliferated.

Customers thought that if after three years interest rate increased and they could not pay their loans, they can sell their houses thus they can gain more profits. After first three years, bank for covering loan risks, increased interest rates from 3% to 5% and even 7%. In front of this, borrowers who were not able to pay loans, decided to sell their houses. According to high interest rate, they did not find customer. So home prices start to fall and the bubble burst.

By bursting the bubble, borrowers did not pay their loans and banks faced to empty houses. Thus banks failed one after another and crisis spread to other parts of America economy and recession started.

The Economic Crisis around the World

According to David Rathkopf (Rathkopf, 2009) these 13 countries probably will damage: Mexico, Pakistan, Ukraine, Turkey, Egypt, Iran, Russia, Venezuela, Argentina, Indonesia, Philippines, China and North Korea. During the crisis, ILO anticipated that global unemployment levels could reach from 29 million to 59 million in 2009¹ (ILO and GMG, 2009).

Given the dominant economic position of the United State in the global economy, the US economic crisis that started in 2007 impacted both developed and developing economies and the panic situation that has prevailed since then has affected both credit markets and trade flows and consequently, has caused global recession (Akhtar Hassain, 2009). Figure 3 shows the movement of real GDP in the United States in period the beginning of the year 2007 and until the beginning of the year 2009. The shaded areas indicate the period of U.S. recession that started in December 2007. Once the recession started, the real GDP was at about 11,640 billions of chained dollars. The curve demonstrates slow growth and rather stable GDP until August. According to BEA (Bureau of Economic Analyses) GDP decreased at annual rate of about 5.5% during the first quarter of 2009 (Funa, University of

¹ refer to the GMG and ILO Fact Sheet on the Impact of the Economic Crisis on Immigration Policies.

Ljubljana, 2009). From the start of 2008 until April 2009 unemployment in the United States shot up from 4.9 to 8.9 percent. In May 2009 the number of those who claimed unemployment benefits reached a peak of 6.66 million. In March 2009, 130,831 bankruptcies were declared in the United States – a rise of 46 percent compared with March 2008 and of 81 percent compared with March 2007. From the beginning of 2009 until the middle of April, 25 banks failed in the United States, compared with 25 for all of 2008, and three for 2007. As a result of the crisis in the large economic sectors, the situation of other countries has worsened as well, and some have required assistance from the International Monetary Fund. In the first quarter of 2009 GDP in the US dropped 1.6 percent (compared with the previous quarter). Other developed countries are experiencing a dramatic economic low. In Germany, for example, in the first quarter of 2009 the GDP dropped 3.8 percent (compared with the previous quarter); in Italy, 2.4 percent; in Britain, 1.9 percent; and in France, 1.2 percent (Shmuel Even and Nizan Feldman, 2009).

Responses to the Crises around the World

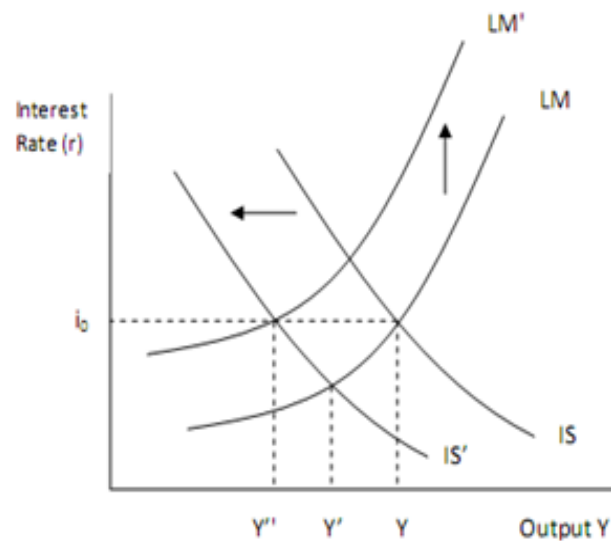
In response, following the advice of the IMF in particular, many developed and developing countries have implemented discretionary fiscal and monetary measures to revive their recessionary economies (Akhtar Hassain, 2009).

Monetary policy²

According to Economist Richard Swain (Swain, 2009, University of Sydney) the sharp decrease in consumer spending and business confidence that resulted from the financial crisis, reflected by falls in real personal consumption of 3.8% (3rd Qtr 2008) and 4.3% (4th Qtr 2008) for the United States economy, led to significant shift to the left of The IS curve in an IS-LM model. The result in the short-run was a substantial decrease in output and if the target interest rate had been maintained, output would have declined further to Y'' as shown in figure 8.

² Monetary Policy includes Conventional Monetary Policies and Non-Conventional Monetary Policies. Non-Conventional Monetary Policies collectively known as quantitative easing. At this paper we emphasis Conventional Monetary Policies.

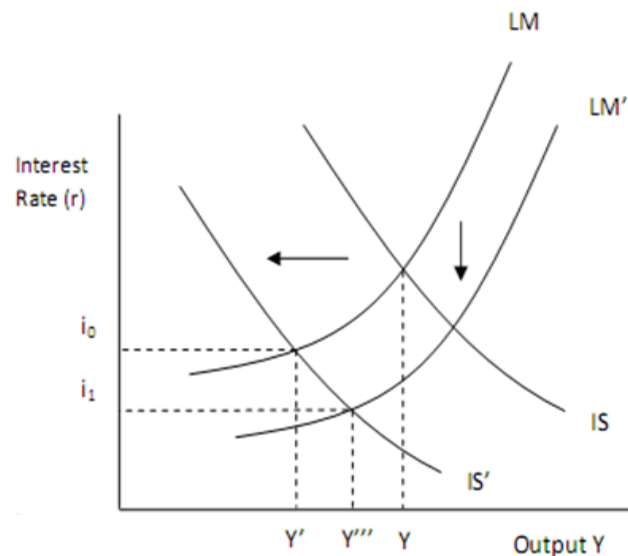
Figure 8



Conventional monetary policies have been pursued in a co-ordinated effort to stimulate growth and stabilise the the global financial system with Central Banks cutting their policy interest rates dramatically since September 2007. For example, the Federal Reserve (0-0.25%), the Bank of Japan (0.1%), the Bank of England (0.5%) all reduced their policy rate targets to near zero.

By reducing real interest rates the Central Banks helped stimulate domestic demand through the six channels of the transmission mechanism. In Australia, the Reserve Bank of Australia (RBA) increased liquidity in the overnight cash market through numerous open-market purchases thereby lowering the interest rate through a downward shift of the LM curve. This helped offset the leftward shift of the IS curve, encouraging the maintenance of output levels at Y''' in the short-run as indicated in figure 9.

Figure 9



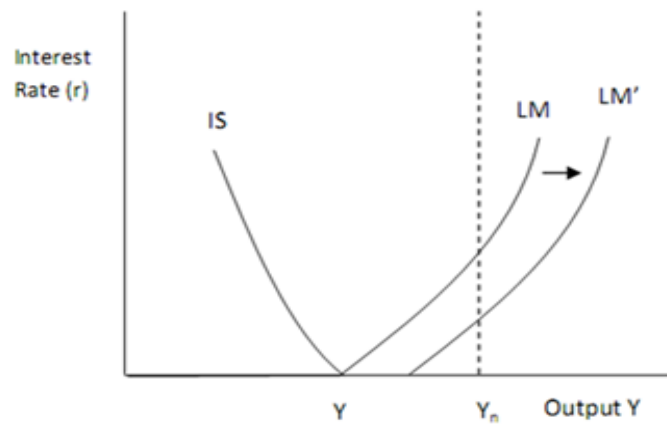
The expansionary measure was also appropriate because the interest rate cuts countered the upwards pressure on real interest rates from an upwards shift of the LM curve due to increased risk aversion and risk premiums helping maintain investment and output levels. For example, the RBA's 100 basis point cuts in December 2008 and February 2009 were very appropriate due to the reluctance of Australia's domestic banks to reduce interest rates because the breakdown of credit markets caused an increase in term premia and credit and liquidity spreads.

Fiscal Policy

Governments around the world have enacted expansionary fiscal policy to mitigate the impact of the economic crisis. The United States Government has responded with a number of spending initiatives worth 1.1% of GDP to stimulate aggregate demand. Other governments have also responded in kind, with the UK, French, German and Japanese governments passing discretionary spending initiatives worth 1.5%, 1.3%, 20.% and 2.5 of domestic GDP respectively whilst in Australia, a \$42 billion Economic Stimulus Plan including targeted cash payments of \$8.7 billion and \$12.2 billion in December 2008 and February 2009 and a \$22bn nation building plan has been implemented.

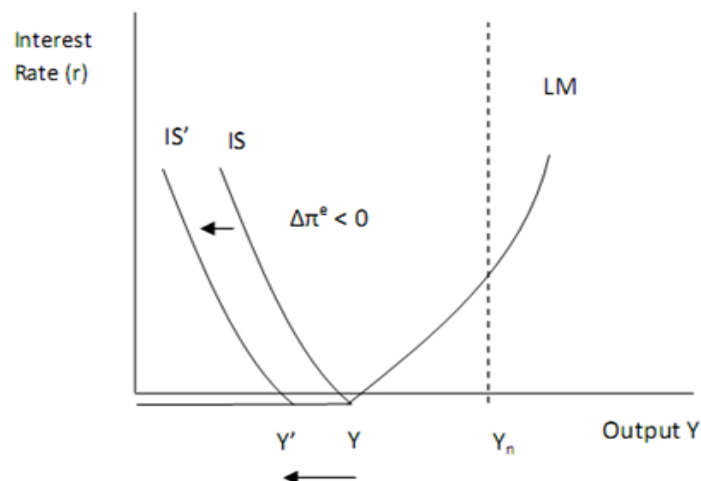
Such spending initiatives were appropriate if not vital. The first reason is that an increase in net government spending leads to a rightward shift of the IS curve implying higher output. Secondly, the appropriate use of traditional monetary policies led many countries to fall in to a liquidity trap where monetary policy can not stimulate investment further. The reason is once nominal interest rates are near zero any change in the money supply shifting the LM curve downwards will have no effect on output as shown in figure 10.

Figure 10



Moreover, the situation implies that output is below the natural level of output meaning a downwards revision of inflationary expectations. This posed a significant risk to economies as an increase in deflation when nominal interest rates are zero increases the real interest rate by Fisher's equation³. The higher interest rate then shifts the IS curve and hence the AS curve left and down respectively, placing an economy in a vicious downward cycle as shown in figure 11. Thus, the fiscal expansions adopted were appropriate to avoid deflation, the consequence of which were seen in the major economic problems in Japan in the 1990s.

Figure 11



³ $r = i - \pi$; where r - real interest; i - nominal interest rate; π - inflation rate.

Expansionary fiscal policies have been implemented successfully to avert any onset of a liquidity or deflationary crisis and increase aggregate demand emphasising the appropriateness of the fiscal responses. For example, fiscal expansions were used successfully between 1950-1970 for demand management in Australia and a budgeted deficit of \$4.6 billion after the 1982-83 recession helped the economy recover. In 1989-1990 a fiscal expansions contributed to Australia achieving growth of over 3.5% throughout the 1990. Moreover, fiscal expansions in the United States in 2001 reduced both the duration and extend of the recession following the Tech bubble burst and pump-priming measures by the Japanese Government helped stimulate a stagnant domestic economy in 1999, whit real GDP growth rate reaching 0.6%.

Conclusion

This recession showed however economic theories are developed, new theories are necessary, at least in the financial sector. Moreover, relationship between economies of countries increases risks and threats; when a great economy like American economy is facing a crisis, it is not only for that country. It could be global. So, new theories in international finance and economics are predicted.

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Outline

Topic: Applying the IS-LM Model for the Albanian Economy

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Abstract

- ⦿ This paper discuss IS/LM model, invented by John Hicks, has been used from 1937.
- ⦿ The IS/LM model stands for “Investment/ saving equilibrium”/”Liquidity preference /Money supply equilibrium” and the curve describe the type of actions that government can use to influence inflation and unemployment.
- ⦿ The paper also discusses the factors that influence the interest rates and explains that they have both positive and negative effects.
- ⦿ On the horizontal axis represents the national income or real gross domestic product GDP
- ⦿ On vertical axis represents the interest rate, r .
- ⦿ IS curve is used to represent the equilibrium in the product market (the total spending=economy’s total income)
- ⦿ The explanation of this curve is that every level of interest rate will generate a certain level of planed investment, which are mainly related to the level of savings.
- ⦿ Another explanation of the curve is that a higher level of income is needed to produce a higher level of saving at a given interest rate.

Literature Review

The IS-LM model

The **IS/LM model** (Investment Saving/Liquidity preference Money supply) is a macroeconomic tool that demonstrates the relationship between interest rates and real output in the goods and services market and the money market. The intersection of the IS and LM curves is the "General Equilibrium" where there is simultaneous equilibrium in both markets.

The **IS/LM** model was born at the Econometric Conference held in Oxford during September, 1936. Roy Harrod, John R. Hicks, and James Meade all presented papers describing mathematical models attempting to summarize John Maynard Keynes' *General Theory of Employment, Interest, and Money*. Hicks, who had seen a draft of Harrod's paper, invented the **IS/LM** model. The model is presented as a graph of two intersecting lines in the first quadrant. The horizontal axis represents national income or real gross domestic product and is labelled Y . The vertical axis represents the real interest rate, i . Since this is a non-dynamic model, there is a fixed relationship between the nominal interest rate and the real interest rate.

The point where these schedules intersect represents a short-run equilibrium in the real and monetary sectors (though not necessarily in other sectors, such as labor markets): both the product market and the money market are in equilibrium. This equilibrium yields a unique combination of the interest rate and real GDP.

The IS-LM model is represented by two curves, an IS-curve and an LM-curve. The two curves reside on a graph with output (Y or GDP) on the horizontal axis and the real interest rate r on the vertical axis, although since the rate of inflation is assumed fixed, the nominal interest rate i is often used instead of r . Each curve represents a set of equilibrium conditions. It is important to note that the two curves are not supply and demand curves, even though one slopes down (the IS-curve) and the other slopes up (the LM-curve), giving the impression that it is a supply and demand diagram.

The IS-curve

For the IS curve, the independent variable is the interest rate and the dependent variable is the level of income (even though the interest rate is plotted vertically). The **IS** curve is drawn as downward-sloping with the interest rate (i) on the vertical axis and GDP (gross domestic product: Y) on the horizontal axis. The initials **IS** stand for "Investment and Saving equilibrium".

but since 1937 have been used to represent the locus of all equilibria where total spending (consumer spending + planned private investment + government purchases + net exports) equals an economy's total output (equivalent to real income, Y , or GDP).

To keep the link with the historical meaning, the **IS** curve can be said to represent the equilibria where total private investment equals total saving, where the latter equals consumer saving *plus* government saving (the budget surplus) *plus* foreign saving (the trade surplus).

The **IS** curve is defined by the equation

$$Y = C(Y - T(Y)) + I(r) + G + NX(Y),$$

where Y represents income, $C(Y - T(Y))$ represents consumer spending as an increasing function of disposable income (income, Y , minus taxes, $T(Y)$, which themselves depend positively on income), $I(r)$ represents investment as a decreasing function of the real interest rate, G represents government spending, and $NX(Y)$ represents net exports (exports minus imports) as a decreasing function of income (decreasing because imports are an increasing function of income). In this equation, the level of G (government spending) is presumed to be exogenous, meaning that it is taken as a given.

The IS-curve is a set of points representing the equality of the supply and demand for goods. It is written, initially as: $Y^S = Y^D$. The main action is on the demand side. First, the definition of demand: $Y^D = C + I(i) + G + NX$,

where C is consumption, $I(i)$ is investment demand, G is government spending and NX is net exports. The remainder of the demand function is an exposition of these components, an exposition that embodies many subtle assumptions.

Consumption function: $C = A + b(Y - T)$,

where T = total taxes, b = Marginal Propensity to Consume (MPC), and A = autonomous spending. Typically, the MPC is near 0.75.

This consumption function says that aggregate consumption is guided by current net income ($Y - T$). If net income is zero, some (autonomous) consumption will still occur, because individuals will not allow themselves to starve. However, for each dollar of extra net income, only fraction MPC is spent on consumption; the remainder is saved. (This consumption function and the marginal propensity to consume derive explicitly from Keynes's (1936) treatise, *The General Theory of Employment, Interest and Money*.)

Key assumptions on the consumption function:

1. Current net income is all that matters.
2. Future income does not matter.
3. Savings and wealth do not matter.
4. Future taxes do not matter.

Investment function: $I(i)$ As i rises, $I(i)$ falls--investment is a decreasing function of the interest rate.

The little i is for the nominal interest rate. More properly, the real interest rate should be included. However, inflation is assumed to be unchanged throughout any duration that the

model applies to. If inflation is fixed, real and nominal interest rates differ by a fixed constant, so they can be used interchangeably in the analysis.

Key assumptions:

1. The principal determinant of investment is the current interest rate.
2. Future needs for capital are of secondary importance.
3. The interest rate i in $I(i)$ is the same one that monetary policy affects.

The LM-curve

For the LM curve, the independent variable is income and the dependent variable is the interest rate. The LM curve shows the combinations of interest rates and levels of real income for which the money market is in equilibrium. It is an upward-sloping curve representing the role of finance and money. The initials **LM** stand for "Liquidity preference and **M**oney supply equilibrium". As such, the LM function is the set of equilibrium points between the liquidity preference or Demand for Money function and the money supply function (as determined by banks and central banks).

Each point on the LM curve reflects a particular equilibrium situation in the money market equilibrium diagram, based on a particular level of income. In the money market equilibrium diagram, the liquidity preference function is simply the willingness to hold cash balances instead of securities.

Two basic elements determine the quantity of cash balances demanded (liquidity preference) and therefore the position and slope of the function:

- 1) Transactions demand for money: this includes both (a) the willingness to hold cash for everyday transactions and (b) a precautionary measure (money demand in case of emergencies). Transactions demand is positively related to real GDP (represented by Y , and also referred to as income).
- 2) Speculative demand for money: this is the willingness to hold cash instead of securities as an asset for investment purposes. Speculative demand is inversely related to the interest rate. As the interest rate rises, the opportunity cost of holding cash increases - the incentive will be to move into securities.

The LM-curve represents the set of (Y, i) pairs where equality holds between money demand and money supply: $M^S = M^D$.

The money supply is the nominal money stock, M , divided by the price level, P . That is,
 $M^S = M/P$.

Money demand, according to this model, is positively related to income and negatively related to the interest rate. An increase in the interest rate lowers money demand, according to the argument, by making bonds more attractive.

Policy with the IS-LM model

The policy analysis consists of (1) figuring out which curves is affected, (2) shifting it in the correct direction, (3) figuring out what happens to i and Y based on the graph shifts, and finally (4) figuring out what happens to C , Y , N and I . The rule of thumb is that if i goes up, I goes down and vice versa. If Y goes up then C and N both go up, and vice versa for decreases in Y . Consumption increases with Y because of the consumption function: $C = A + b(Y - T)$. Labor input N increases with Y because $Y = F(K, N)$, where K is the capital stock (and is assumed to change very little over the business cycle). To increase output Y , labor input must be increased.

The standard policy actions effects are:

1. Tight money (reduction in M/P) raises the interest rate and reduces Y , C , I and N .
2. Loose money (increase in M/P) reduces the interest rate and raises Y , C , I and N .
3. Tight fiscal policy (reduce in G) reduces Y , C , N and i . Raises I .
4. Loose fiscal policy (increase in G) raises Y , C , N and i . Reduces I .
5. Tight fiscal policy (increase T) reduces Y , C , N and i . Raises I .
6. Loose fiscal policy (decrease in T) raises Y , C , N and i . Reduces I .

Criticism of the model

1. Is it a short-run or long-run model?
 - A. It seems to be a short-run model because:
 - The price level P is assumed to be unchanged (when M changes).
 - Taxes and spending are assumed to operate independently. An increase can occur in G without a corresponding increase in T . In the long-run, spending and taxes need to be in balance.
 - Consumption does not depend on long-term taxes and income.
 - A. However, it also seems to be a long-run model.
 - Investment does not depend on short-term blips in the interest rate--only sustained changes have an effect on investment.
 - The multiplier effect of consumption does not operate instantaneously.
- A. The price level is not determined in the model. Price level determination can be "tacked on," but the model gives no clue about how this should be done. Normally, this kind of objection would not be a major problem, for all models leave the determination of many variables out. However, with the IS-LM model, the magnitude of the price level determines the position of the LM-curve. Its position is essential. The IS-LM model does not show how the real wage is determined, but that is not a problem with the model (it is a short-coming, not a problem) because the real wage is not needed in the model to determine other variables.

2. The shocks that the model attempts to counteract are not built into the model itself. Thus, if a slump in investment is a problem, because it leaves employment levels too low, we should know why investment is slumping before we go about counteracting it. It might be the case that a reduction in investment is desirable because the capital stock is currently too high. We should not resist desirable outcomes even if they appear painful. (By contrast, the means by which a pollution tax can correct an externality problem can be demonstrated in a standard supply and demand diagram by graphing the marginal cost curves with and without the pollution costs.)

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4. Since the IS-LM model is for short-run analysis, it should never serve to guide policy. A driver of a car may want to know that a clockwise turn of the wheel will direct the car to the right (a short-run response), but directions to a motorist should depend mainly on where the destination is. The long-run plan should govern the short-term decisions.

5. Finally, the money supply in the IS-LM model is poorly defined. Is it money base, M1 or M2 or M3? The choice makes a big difference because M2 and M3 are governed largely by bank lending practices whereas money base is governed largely by open market operations.

6. A short-run model, as the IS-LM model seems to be, is most definitely not what should guide policy

Model

The model we used to make our analysis is regression analysis which is mostly used in case when you have to make modeling and analysis about several analysis, in our case we had to make analysis about four different variables: investment, savings, liquidity and money. Since the ISLM model is a two market model, the first one is the goods market and the second one is the money market, and in every case separately there is always one independent and one dependant variable.

In the case of the goods market we built the IS curve which shows the relation between the real output and the interest rate. But before we go the the IS curve we have to see the relation between the interest rate and the investment level and also at the same time the relation between the interest rate and net export.

As we previously said there has always to be on independent variable and one dependant variable. In the case of the interest rate and investment relation , the interest rate is the independent variable and the investment is the dependent one, which simply how that the investment level is a function of interest rate.

Secondly we have the combination of the real output and the interest rate in order to built the LM curve but in this case we use the money market and not any more the goods market. We have to emphasize also that in this case we use the nominal interest rate and not any more the real interest rate. In this case also the independent variable is the interest rate and the dependent variable is the output level.

If we refer to the regression analysis it is mostly used to make predictions and forecasting by using the given data. Albania is a special case and because the variables are not affected only by one factor we can not make exact predictions about the future. The forecasting process is also complicated because the givens published by INSTAT are not in accordance to each other.

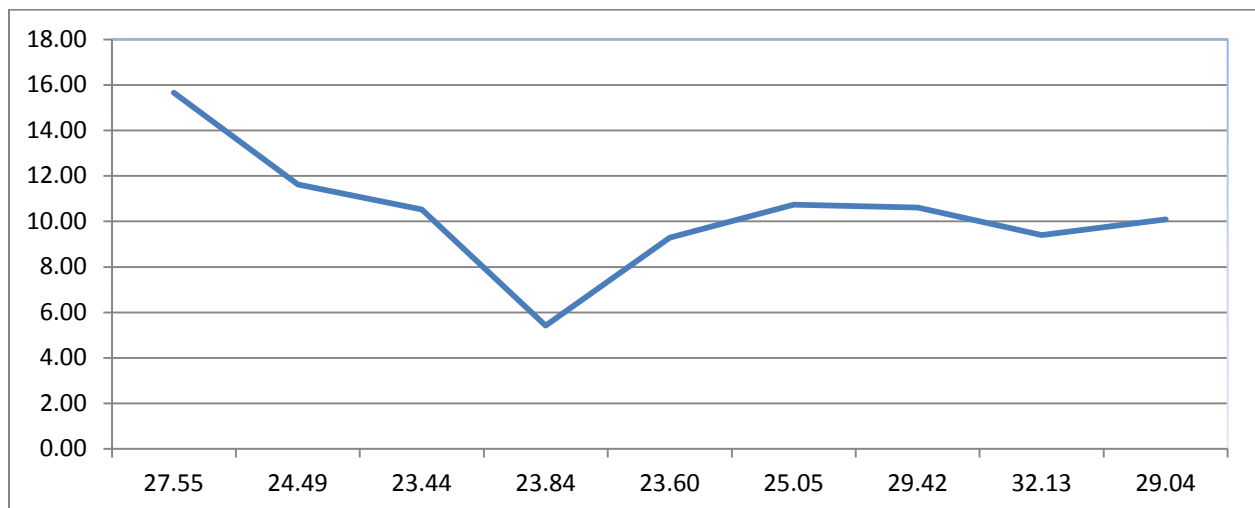
Analysis

Generation of IS Curve

- Interest Rate and Planned Investment Spending
- Interest Rates and Net Exports

Interest Rate and Planned Investment Spending

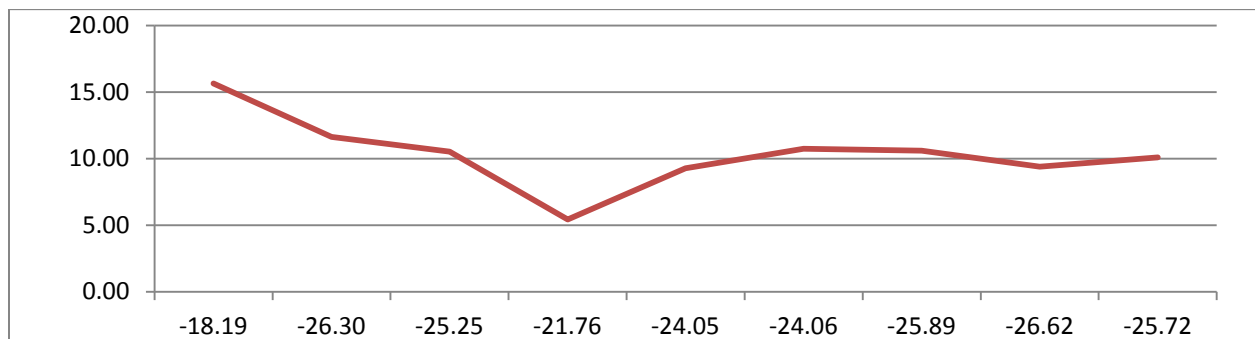
- When the interest rate is high, the planned investment spending is low.
- When the interest rate is low, the planned investment spending is high.
- The planned investment spending will be affected also in case when the company has surplus of fund, because instead of investing in physical assets it could purchase a security.



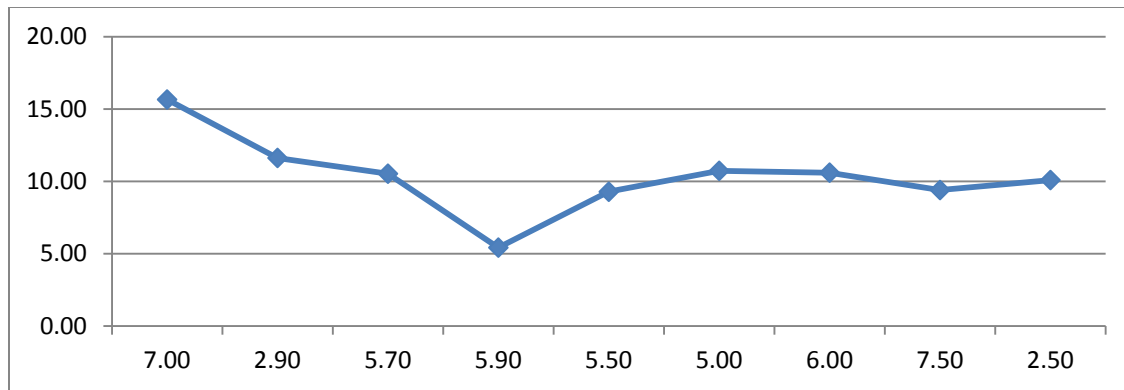
Interest Rates & Net Exports

- ⦿ When the interest rate rises in Albania, the Albanian Lek assets become more attractive relative to assets on foreign currencies.
- ⦿ Increase in demand for Albanian assets will rise the exchange rate.
- ⦿ The higher the value of Lek, which is the result of the increase in the interest rate, makes domestic goods more expensive than foreign goods, so the net export level will be decreased.
- ⦿ At a low interest rate, the exchange rate is low and net export will be high. At a high interest rate, the exchange rate will be high and net export are low.

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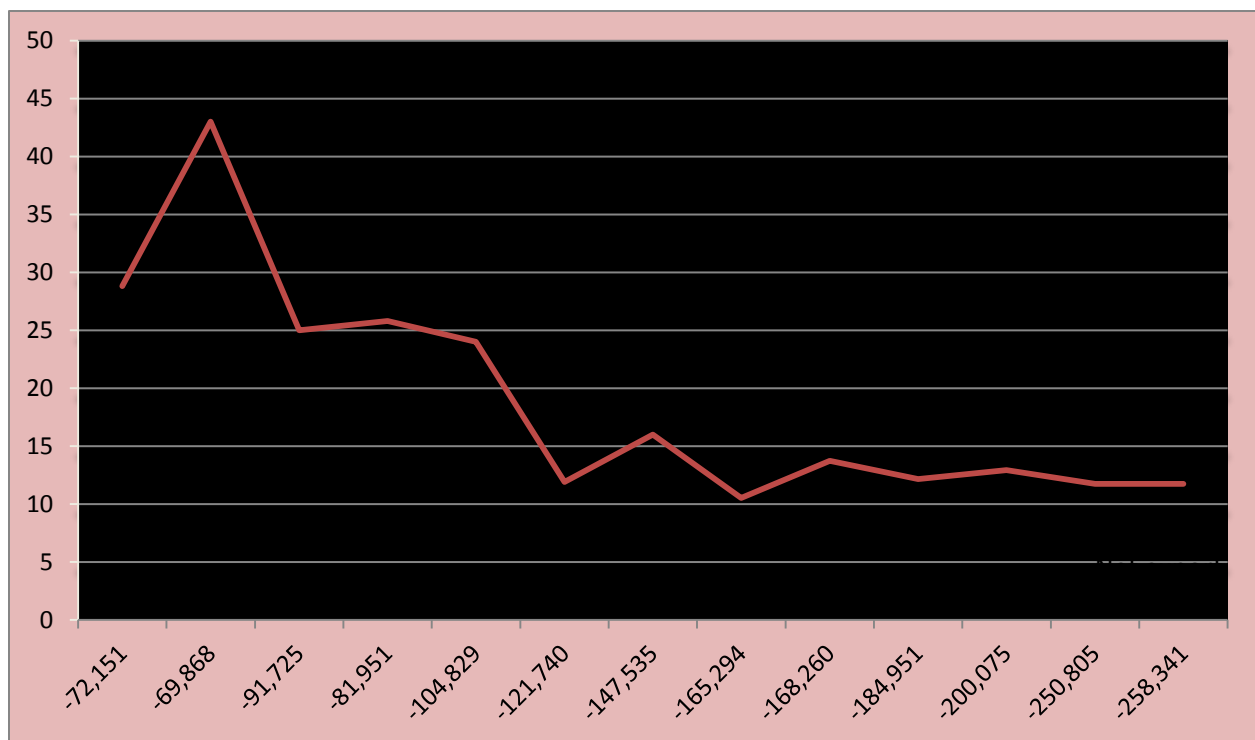


When the interest rate rises in Albania, the Albanian Leka assets become more attractive relative to assets on foreign currencies. Increase in demand for Albanian assets will rise the exchange rate. At a low interest rate, the exchange rate is low and net export will be high. At a high interest rate, the exchange rate will be high and net export are low.



Shows the level at which the total quantity of goods produced equals the total quantity of goods demanded. Describe the point at which the good market is in equilibrium. As the interest rate rises, planned investment spending and net exports falls.

If the economy is located at the area to the right of the IS Curve, it has excess supply of goods. If the economy is located at the area to the left of the IS Curve, it has excess demand for goods.

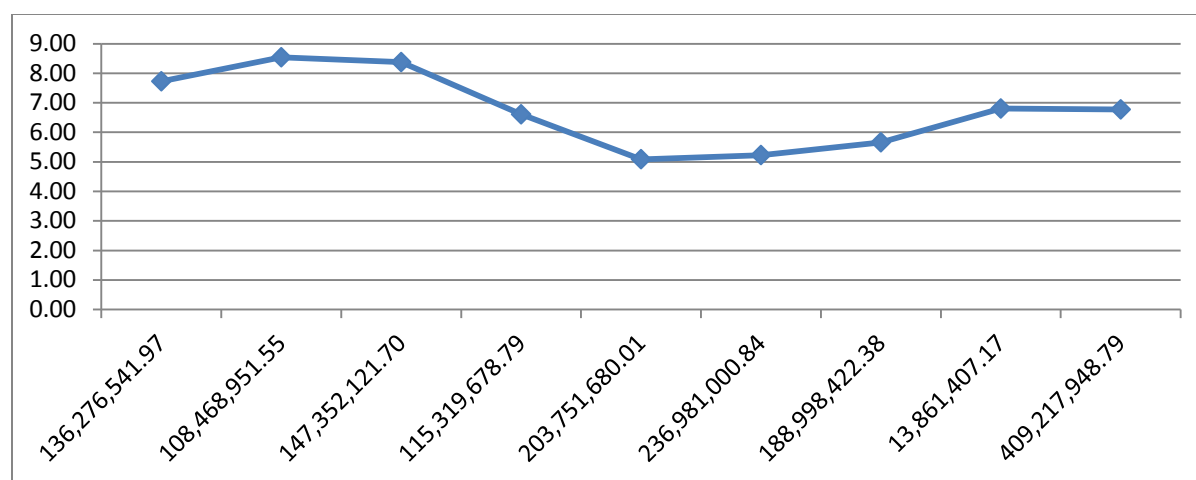


- ⦿ If the economy is located at the area to the right of the IS Curve , it has excess supply of goods
- ⦿ If the economy is located at the area to the left of the IS Curve, it has excess demand for goods.

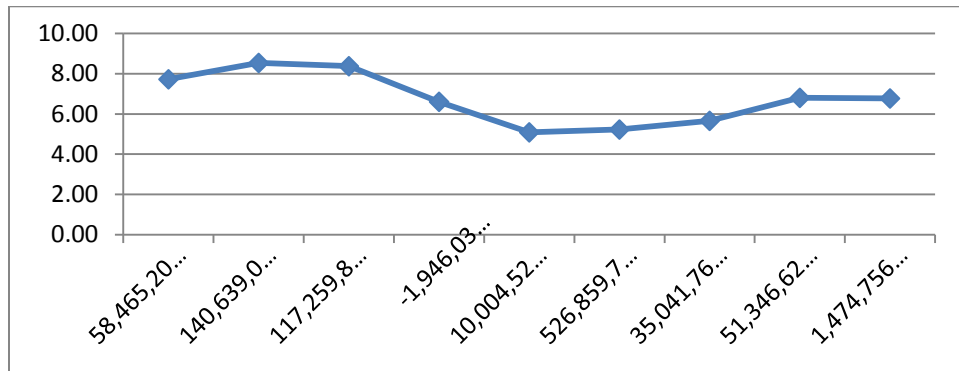
Money Market (LM curve)

LM side of IS-LM model deals with the equilibrium in money market where quantity of money demanded equals the quantity of money supplied. Money demand is derived depends on two sources transaction demand and speculative demand while money supply is set or regulated by Central Bank of Albania by using its policies in order to keep under control the quantity of money in circulation. The quantity of money demanded is positively related to income and negatively related to interest rates. In analyzing this model for LM side it is taken into consideration the nominal interest rates because nominal interest rates affects the individual portfolio decisions of holding bonds or money. The opportunity cost of holding money is the interest rates we will earn by investing in other assets such as bonds or other financial securities. So if interest rates decreases, the opportunity cost decreases which means that we will earn more by holding these money than by investing them in other assets and consequently the demand for money increases because people now want to hold more cash and there is the opposite when the interest rates increases, the opportunity cost increases which means it is costly to hold money and demand for money decreases because it is earned more by investing these money in other assets.

According to income level there is a positive relationship when income level increases the demand for money increases and when the income level decreases the quantity of money demanded decreases too. More income means that society is wealthier and they want to hold more assets now and it is known that money is a kind of assets. So their portfolio consist of more money and less bonds which means that they sell bonds. Selling bonds lowers the bonds price by increasing the interest rates. More income also means that the transactions increases because people include themselves in more financial activities (buying, selling etc) and so the demand for money increases too. There is the opposite when income level is reduced so people are less wealthier, they are included in fewer transaction activities, and the quantity demanded for money is reduced. People want to hold more bonds compared to money and they buy bonds by increasing the bonds' prices and lowers the interest rates.



In the horizontal axis there is quantity of real money balances and in the vertical one is the interest rate. The datas are starting from 2001 till to 2009. Money supply is fixed because is determined by Cental Bank of Albania.



In the horizontal axis is the aggregate output and in the vertical one are the interest rates starting from 1996 till to 2009.

The opportunity cost of holding money is the interest rate we will earn by investing in other assets (bonds). If interest rate increases than the opportunity cost increases and the demand for money decreases. The opposite when interest rate decreases.

Conclusions

We may say that it is a model , and as every model which has its own limitations and also considering the fact that sometime with the givens about Albanian data it is not functional. Models were mostly used in the times when there were no explanations and most of the factors which may affect the variables were kept constant. Referring to the Albanian data we may say that the economists can not give an exact stamen about the effects of stabilization policies on the gross national product. We focused more on the role of the investment in the stabilization process and we can say that the role of the interest rate is very important. The IS-LM model shows the importance of the negative effect of investment to the interest rates, and as a consequence of tis there will be limitations on the expenditure and saving policy. What we can say is that in most of the cases the factor that makes one policy weak may at the same time make one other factor strong enough to be applied. Since there is a negative relationship between the interest rates and investment , it shows that this policy is not functional, but instead of this combinations of many balanced stabilization policies may be very functional.

**Preared by: Kriselda Sulcaj
Lorena Hoxhaj**

THE ROLE OF THE FEMALE EDUCATION IN ECONOMIC GROWTH: A CASE FOR TURKEY

“...The reason of the failures of our society is being indifferent to our women and neglecting them. ...In this case, if some (men) work while others (women) stand still it means that that society is paralyzed. ...Therefore, if science is necessary for our society these should be learned by both men and women at the same level.”

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Abstract

Education is one of the most important fundamental factors that affect economic growth. Either by individually or as a society, education develops people's talents, skills, creativity, productivity, imagination, knowledge in any branch and also advances in technology. With all those critical points in hand, education has very important effect on both social and economic progress in Turkey by increasing the welfare of the society. In this context, the aim of this study is to examine whether there is a long-term relationship between human capital and economic growth using yearly data covering the period 1980-2009. The relationship between human capital and economic growth will be analyzed by using Engle-Granger causality test, Johansen co-integration approach and VAR models.

Key words: Human Capital, Economic Growth, Time Series.

JEL Codes: I21, J24, C22.

1. INTRODUCTION

In general human capital, in particular education is one of the pillars of the economic and social structure. Therefore, education plays a critical role in the transformation in the economic life, in other words in increasing the level of prosperity. Its strategic importance makes education the most important investment good. This issue is also handled in the economic literature in details.

The contribution of investing in human to economic growth dates back to A. Smith. Although A. Marshall and M. Friedman followed A. Smith with their studies, these studies haven't been integrated until 1950's (Becker, 1993, p.392. With the technological developments in 1960's, investment in human gained importance and human capital theory was developed by T.W. Schultz (1961) and Denison (1962) and included in the economic literature. In the research made by T.W. Schultz and Denison, it was emphasized

that education improved the skill and productivity capacity of labor force and thus contributed to an increase in national income.

This theoretical frame formed by T.W. Schultz and Denison and work of Becker (1964), Nelson and Phelps (1966) and Mincer (1974) increased interest of human capital in academic literature and gained new impetus with internal growth models beginning from the mid 1980's. Generally, these work handle human capital which is shaped by various informal learning types such as formal education and learning by doing (kinesthetic) and learning by seeing (visual) as an indicator of individuals' productive capabilities. Within this framework, while on one side human capital represents the information individuals have, on the other side it is an indicator of individuals to learn from other individuals and adaptability to changing conditions. Intrinsically, it emphasizes that since traditional production factors such as Internal Growth models, labor force, capital and soil have diminishing returns they couldn't form dynamic of growth, instead information which as increasing returns (human capital) is the gripping power of growth. (Romer, 1986 and 1990; Rebelo, 1991; Cheng and Hsu, 1997; Grammy and Assane, 1996; Lucas, 1998; Barro, and Sala-i-Martin 1995)

Other than the researches which aim to find the contribution of human capital to economic growth many researches aim to test the relation between the economic growth and education. Although strong and positive relation has been determined between human capital indications and growth in many researches, in some researches (Denison, 1962; Barro, 1991; Mankiw, Romer and Weil, 1992; Gregorio, 1992; Tallman and Wang, 1994; Piazzola, 1995; Ranis, Stewart and Ramirez, 2000; Webber, 2002; McDonald and Roberts, 2002; Wilson, 2003; Martin and Herranz, 2004), the number of which are too limited, no relation between human capital and economic growth was identified. It is seen that empirical studies on Turkey about the subject had been conducted. Studies by Güngör (1997), Saygılı (1998), Ergen (1999), Canpolat (2000), Taymaz (2001), Çoban (2003), Kar and Ağır (2003), Bozkurt and Doğan (2003), Kar and Taban (2003) and Demir, Üzümcü and Duran (2006), In the work made about the subject, education expenditures and schooling rates were used as an indicator of human capital . It is identified that there is a positive relation between these indicators and growth.

Although there is no consensus about the effect of human capital on economic growth in literature, it is widely believed that theoretically human capital has a positive effect on growth.

The main goal of this study is to analyze for Turkey sample the relation between education and economic growth, on which theoretical and practical studies were conducted. The study aims to test relation between woman education and growth in Turkey by benefiting from Cobb-Douglas production function for 1990-2009 periods by using new and comprehensive variables by using annual data. Beyond this general goal, growth structure of Turkey's economy would be analyzed within the frame of education indicators and then empirical resolution would be found for Turkey sample. In this study, growth structure of the Turkish economy would be studied within the frame of education indicators and later empirical analysis would be made within the frame of Turkish sample.

2. DEVELOPMENT OF WOMAN EDUCATION IN TURKEY

Although women form a big part of the population of the world and Turkey, they aren't represented at the same rate in the economic activities. Not benefiting adequately from

knowledge and skills of this population, which forms potential labor force according to human resources usage.

Although education of women wasn't taken into consideration in growth plans in history for a long time, today has an important place generally in all modern states. Women taking more effective role in economy have become an indispensable necessity for developing economies. Especially in Western states and developing Asia, in order to increase the participation of women in economy, the governments made many legal regulations and proposed institutional changes (Doğar, 1998, p.13-18).

When we look at Table 1, which shows correlation between the education level of women and developmental level, it is seen that there is a linear correlation between the education levels of women and the welfare of countries.

Table 1. Educational Attainment by Sex

Region (no. of countries)	Year	Population age 25 & Over			Population age 25 & Over		
		Average school year		Gender ratio (A/B, %)	Average school year		Gender ratio (A/B, %)
		Females A	Males B		Females A	Males B	
Developing Countries (73)	1960	1,16	2,39	48,5	1,46	2,63	55,7
	1980	2,20	3,97	55,9	2,74	4,37	62,5
	2000	4,03	5,74	70,2	4,33	5,92	73,2
Developed Countries (23)	1960	6,74	7,23	93,3	6,87	7,26	94,7
	1980	8,39	8,98	93,5	8,65	9,09	95,2
	2000	9,55	10,06	94,9	9,53	10,01	95,3
Transition Economies (11)	1960	6,70	7,80	85,9	7,01	7,95	88,2
	1980	8,21	9,20	89,2	8,5	9,36	90,7
	2000	10,01	9,87	101,5	9,89	9,44	104,7
World (107)	1960	4,28	4,96	86,4	4,31	4,98	86,7
	1980	5,27	6,31	83,6	5,42	6,43	84,3
	2000	6,18	7,28	84,9	6,13	7,19	85,9

Source: Barro, Robert J. ve Lee, J.W. (2001). "International Data on Educational Attainment: Updates and Implications," Oxford Economic Papers.

What is the situation of women in Turkey, who forms more than half of the population, about education which is so important for social development, economic growth and welfare? Although throughout the world the participation of women in labor force increases and the gap between the men and women decreases, it is remarkable that there is a reverse trend in Turkey. One of the most leading reasons that women participates in labor force at low levels as %26 is that women can't reach education adequately.

Education seriously affects the participation rates of women and men to labor force. As indicated in address-based population registration system (ABPRS) in 2009, in our country %12.2 of women aren't literate and in order to get rid of this worrying situation economically as soon as possible and reach %100 literate rate as stated in Pekin commitments in 2000 considerable improvements were achieved in recent years in Turkish Education System. In 1997 compulsory primary education was raised from 5 years to 8 years, in 2005 compulsory secondary education was raised to 4 years and in 2009 the share

of the budget allocated to education in GDP raised from %2,30 to %2,51 (Ministry of Education, 2008-2009). To strengthen vocational and technical training comprehensive projects were actualized with EU support. All these developments are highly positive incentives to increase the quality of education and schooling ratio however, for the economic adaptability to the increasing competition environment and to train qualified people more comprehensive reforms should be applied in the area of education because in Turkish economy stable growth will be actualized with the contribution of the more educated and working women. In last 20 years, progress of women in education and working life has given a new dynamism to the economy. Therefore, economy will be rescued from its one step forward to step back rhythm with the help of the progress of women in education and working life. (Table 2)

Table 2. Schooling Ratio by Level of Education, Labour Force Participation Rate and Economic Growth Rate

Year	Schooling Ratio (%)						Labour Force Participation Rate (%)	
	Primary Education		Secondary Education		Higher Education			
	Males	Females	Males	Females	Males	Females	Males	Females
1995	76,23	65,55	44,05	33,21	10,57	8,07	77,8	30,9
2000	95,28	99,58	48,49	39,18	13,12	11,38	73,7	26,6
2005	92,29	87,16	61,13	51,95	20,22	17,41	70,6	23,3
2006	92,25	87,93	60,71	52,16	21,56	18,66	69,9	23,6
2007	98,53	96,14	61,17	55,81	22,37	19,69	69,8	23,6
2008	96,99	95,97	60,63	56,3	29,4	25,92	70,1	24,5
2009	98,47	97,84	67,55	62,21	29,83	26,34	70,5	26

Source: <http://www.tuik.gov.tr/isgucuapp/isgucu.zul>,
http://www.tuik.gov.tr/VeriBilgi.do?tb_id=14&ust_id=5

3. ECONOMETRIC METHODS AND DATA SET

3.1. Econometric Methods

Since time series data were used in this study primarily data set should be tested for stationarity. When time series analysis are used in econometric analysis you can encounter dummy regression problems occurring in instable time series put forward by Granger and Newbold (1974). There can be significant correlation between series due to strong tendencies in the same way or same trend. To understand whether this correlation is real or dummy the level of stationarity of the series should be determined. There are different test methods for unit root test, however stationarity properties of the series has been researched with Augmented Dickey-Fuller (ADF) (1979-1981) unit root test used commonly in application. ADF in general is stated as follows in the following form (Sevüktekin and Nargeleçekenler, 2007, p.321-323):

$$\Delta Y_t = \beta_0 + \beta_1 t + \delta Y_{t-1} + \sum_{i=1}^n \beta_i \Delta Y_{t-i} + u_t \quad (1)$$

In the related equation, ΔY_t denotes first difference of the variable, t general tendency variable, ΔY_{t-1} lagged difference term. The basic reason of taking into consideration the lagged difference terms to provide consecutive independency of the error term. Accordingly, to obtain a reliable result by ADF test and not to cause consecutive dependency problem in the estimated variable AIC was utilized to determine the optimal lagging number denoted by “n” in the equation (Lutkepohl, 1990, p.53-78).

Depending on ADF test result if the series are not stationary at the same level they are made stable at the same level by taking their differences. In case the series are not stationary at the same level or not stable it should be tested if there is co-integrations before taking their differences. Although the series are not stationary if their linear component is stationary there is co-integration in the variables of the model and directly original data can be used in the model without taking their differences. Otherwise, if there is no co-integration among the series they can be used in the model after taking their differences until the series are made stationary (Enders, 1995, p.469-470). The lack of co-integration means there is no long term equilibrium among the variables (Karaca, 2003, p.247-255; Siregar ve Rajaguru, 2002). In this study, Johansen- Juselius co-integration method was used from Engle and Granger (1987, p. 251-276), Johansen (1988, p. 231-254) and Johansen-Juselius (1990, p.169-210) co-integration tests used in the determination co-integration relation between series used.

Johansen (1988), and Johansen-Juselius (1990) have developed a maximum likelihood testing procedure on the number of cointegrating vectors which also include testing procedures for linear restrictions on the cointegrating parameters, for any set of variables. Two set statistic and the maximum eigenvalue test statistic, are given here. For the null hypothesis that there are at most r distinct cointegrating vectors, the test statistic is

$$\lambda_{trace}(r) = T \sum_{j=r+1}^n \ln(1 - \lambda_j), \quad (2)$$

where λ_j 's the $n - r$ smallest square canonical correlations between Y_{t-k} and ΔY_t corrected for the effects of the lagged differences of the Y_t process. The maximum ratio or the maximum eigenvalue statistic for testing the null hypothesis of at most r cointegrating vectors against the alternative hypothesis of $r + 1$ cointegrating vectors, is given by

$$\lambda_{max}(r) = -T \ln(1 - \lambda_{r+1}) \quad (3)$$

Some econometric software may not produce this last statistics, but it can be calculated by the first one as follows,

$$\lambda_{max}(r) = \lambda_{trace}(r) - \lambda_{trace}(r + 1) \quad (4)$$

Johansen (1988) argues that, λ_{trace} and λ_{max} statistics have non-standard distribution under the null hypothesis, and provides approximate critical values for the statistic, generated by Monte Carlo methods.

After long term correlation is determined among the series causality relationship and the direction of the causality should be put forward between the series. In econometric models we can talk about the dependency of a variable to other variables but this dependency does not mean that there is absolute causality between these variables (Akkaya ve Pazarlıoğlu, 1998, p.177). To determine the direction of the real causality relationship several causality tests are used, however Granger Causality Test was used in this study for application

simplicity and for some of the inferences in its result. But in case there is no co-integration relation between the time series used in the study, since the standard Granger Causality test will not be Vector Error Correction Model (VECM) will be used to determine causality analysis instead of VAR (Vector Autoregressive) Model (Granger, 1988, p.199-211).

Error-Correction Model is used to make a distinction between the long term equilibrium and short term dynamics and to determine short term dynamics. If the variables are cointegrated there must exist an error-correction representation that may take the following form (Gujarati, 2006, p.726-730):

$$\Delta Y = \beta_0 + \sum_{i=1}^n \beta_{1i} \Delta X_{t-i} + \sum_{i=1}^n \beta_{2i} \Delta Y_{t-i} + \beta_{3i} ECT_{t-1} + \varepsilon_i \quad (5)$$

$$\Delta X = \alpha_0 + \sum_{i=1}^n \alpha_{1i} \Delta Y_{t-i} + \sum_{i=1}^n \alpha_{2i} \Delta X_{t-i} + \alpha_{3i} ECT_{t-1} + \varepsilon_i \quad (6)$$

where ECT_{t-1} is the residuals of long-run (cointegrating) relationship and β_{3i} and α_{3i} are the error-correction coefficients. The inclusion of error-correction terms in equations (5) and (6) introduces an additional channel through which Granger causality could be detected. According to Granger (1988), the error-correction models produce better short-run forecasts and provide the short-run dynamics necessary to obtain long-run equilibrium. However, in the absence of cointegration, a vector autoregression (VAR) in first-differences form can be constructed. In this case, the error-correction terms will be eliminated from equations (5) and (6). If the series are cointegrated, then the error-correction models given in equations (5) and (6) are valid and the coefficients β_{3i} and α_{3i} are expected to capture the adjustments of ΔY and ΔX towards long-run equilibrium, while ΔY_{t-i} and ΔX_{t-i} are expected to capture the short-run Dynamics of the model.

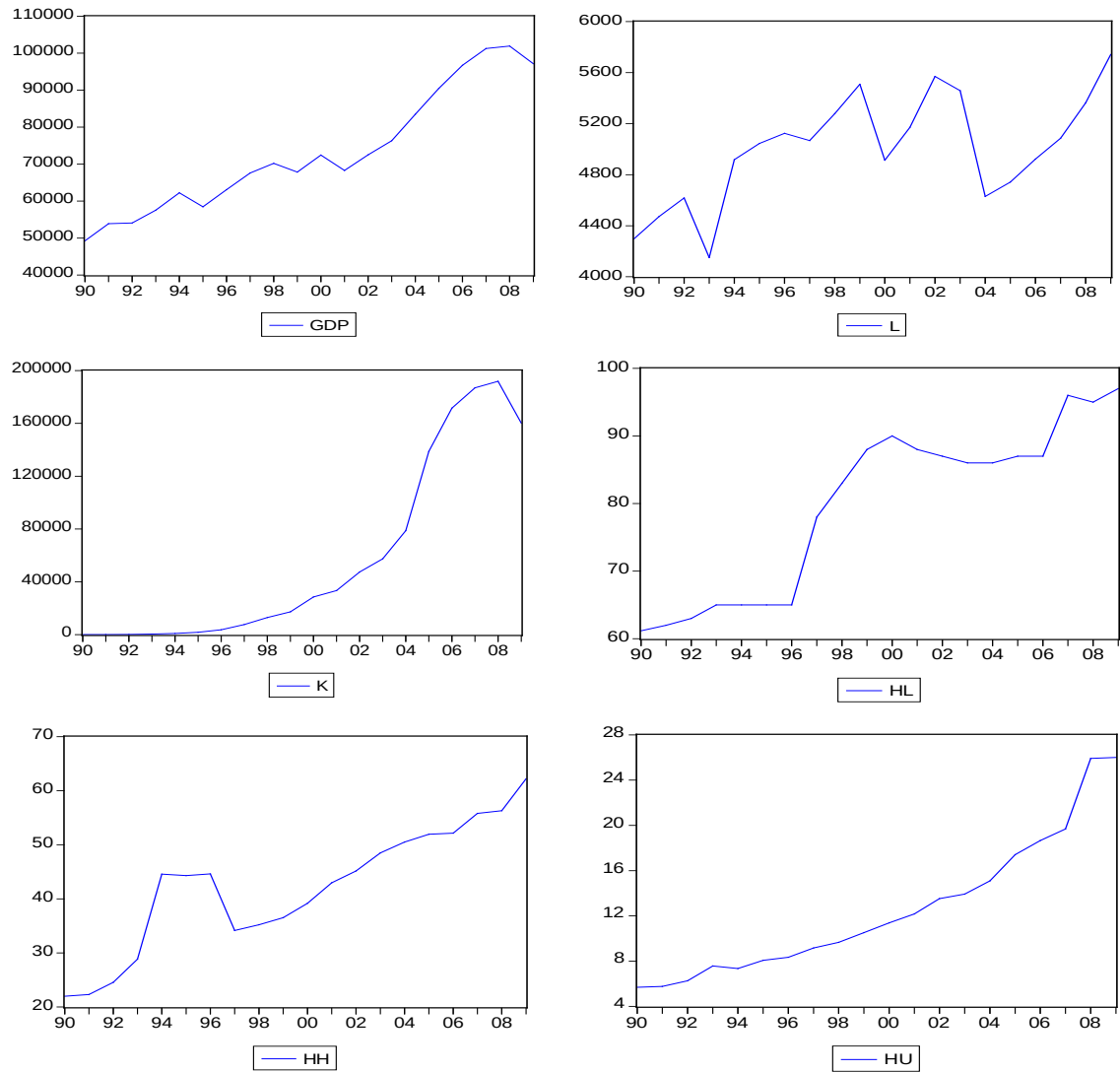
3.2. Data

The variables used in this study of human capital and economic growth of Turkey are real gross domestic product (LGDP), gross fixed capital (LK), female labour force (LL), less than high school education ratio (LHL), high and vocational high school education ratio (LHH), higher education education ratio (LHU), compulsory education was expanded to 8 years dummy variance (DUM1) and economic and financial crisis dummy variance (DUM2). The variables in model are used logarithmic. The sample period covers annual data from 1990 to 2009. Those variables are obtained from Turkish Statistical Institute and State Planning Organization website.

In Table 3, the variables are used in the model and in figure 1 variables in model are given time series graphic. In Figure 1, all the variables observed to have a stable structure.

Table 3. Variables Used in the Model

Dependent Variable	
LGDP	GDP (In Purchasers' Value, At 1987 Prices, in Millions of TL)
Independent Variables	
LK	Gross Fixed Capital (in Millions of TL)
LL	Female Labour Force (Thousand Person, 15+ age)
LHL	Less than High School Education Ratio (Females) (%)
LHH	High and Vocational High School Education Ratio (Females) (%)
LHU	Higher Education Ratio (Females) (%)
DUM1	Compulsory Education was Expanded to 8 Years Dummy Variance
DUM2	Economic And Financial Crisis Dummy Variance

**Figure 1. Time Series Graphic of Variables**

3.3. Empirical Results

All the variables in this study are tested for stationarity using the Augmented Dickey-Fuller test statistics. The results are presented in Table 4. Table 4 shows that all variables are non-stationary in their original levels of series, but stationary in their first difference level of the series at 5% level of significance.

Table 4. Augmented Dickey-Fuller Unit Root Tests for Turkey

Variables	ADF Test Statistic		Result
	Level	1st Difference	
LGDP	-1.9607 (0)	-4.4794 (1)	I(1)
LK	-0,6794 (4)	-6.0807 (1)	I(1)
LL	-2.5278 (0)	-5.2517 (1)	I(1)
LHL	-1.7597 (3)	-6.0757 (0)	I(1)
LHH	-3.5548 (1)	-5.8816 (0)	I(1)
LHU	-2.4969 (0)	-6.6505 (3)	I(1)

Note: Significance level at 5% and 1% critical values are respectively -4.80 and -3.79. Lag lengths are given in parentheses.

The results indicate that all variables chosen for the purpose of this paper are stationary of I (1). The next step is to check the optimal lag length, for this purpose the Akaike information criteria is used. The optimal lag length is turned to be one.

According to the optimum lag lengths are determined. The other step involves applying Engle-Granger two-stage cointegration procedure and Johansen-Juselius cointegration test to check whether stationary variables are cointegrated.

Firstly, the Johansen-Juselius cointegration test has been performed for the variables and the results of this test which has been presented in Table 5 below.

Table 5. Johansen Cointegration Tests Results

Hypothesized No. of CE(s)	SIC	Eigenvalue	Trace Statistic	0,05 Critical Value	Max-Eigen Statistic	0,05 Critical Value
None*	1	0.205	54.702	47.856	28.909	27.584
At most 1	1	0.141	25.792	29.797	19.244	21.131
At most 2	1	0.038	6.5484	15.494	4.8890	14.264
At most 3	1	0.013	1.6594	3.8414	1.6594	3.8414
At most 4	1	0.011	0.9203	1.9871	0.4229	2.2871
At most 5	1	0.009	0.4443	0.8642	0.0137	0.0029

Note: Trace test and max-eigenvalue test indicate 1 cointegrating eqn(s) at the 0.05 level.

* denotes rejection of the hypothesis at the 0.05 level.

Two criterion, Trace statistics and Eigen value are used for cointegration test at 5% level of significance which are presented in Table 5. Result shows that there is one cointegrating

equation for GDP, investment, labour force, females human capital. Results of cointegrating equation show that there is positive relationship for females human capital and economic growth. From Table 5 above, we see that the likelihood ratio test indicates one cointegrating equation at 5 % significance level. This result show that Johansen-Juselius cointegration test imply a long-run association between females human capital and GDP series for Turkey.

$$\begin{aligned} \text{LGDP} = & 18.44 + 0.03\text{LK} - 0.64\text{LL} + 0.72\text{LHL} + 0.18\text{LHH} + 0.36\text{LHU} + 0.20\text{DUM1} - 0.01\text{DUM2} \\ & (0.315) \quad (0.008) \quad (0.012) \quad (0.002) \quad (0.003) \quad (0.127) \quad (0.069) \\ & [-2.089] \quad [79.093] \quad [58.642] \quad [-63.432] \quad [-102.50] \quad [-1.602] \quad [-0.229] \end{aligned}$$

This equation shows that if there is 3 percent, 64 percent, 72 percent, 18 percent and 36 percent change in real gross domestic product due to 1 percent change in labour, capital, less and high school education ratio, high and vocational high school education ratio and higher education ratio, respectively. These results are significant at 5 percent level of significance. There is positive relationship between female education and real gross domestic product.

Since there is cointegration between the variables, the final step is to test for the direction of causality using the vector error correction model. The presence of a cointegrating vector allows for the use of a vector error correction (VECM) model to test causality. The empirical results of the estimated error-correction (VECM) models and the Granger causality test are presented in Table 6 and in Table 7, respectively.

Table 6. Vector Error Correction (VEC) Estimates

LY	LL	LK	LHL	LH	LU	D1	D2
1.302	0.102	0.866	0.076	0.419	0.500	0.043	0.003
(0.032)	(0.057)	(0.031)	(0.014)	(0.038)	(0.053)	(0.071)	(0.001)

Note: Values in parentheses show standard error values.

Table 7. Results of Granger Casuality Tests

Null Hypothesis	F-Statistic	Probability
LK does not Granger Cause LGDP LGDP does not Granger Cause LK	3.69679 5.56281	0.05863 0.04289
LL does not Granger Cause LGDP LGDP does not Granger Cause LL	1.16508 1.46560	0.34243 0.26670
LHL does not Granger Cause LGDP LGDP does not Granger Cause LHL	6.34168 1.07531	0.01196 0.36969
LHH does not Granger Cause LGDP LGDP does not Granger Cause LHH	9.66991 0.11711	0.00268 0.89042
LHU does not Granger Cause LGDP LGDP does not Granger Cause LHU	5.03122 1.20872	0.01707 0.33003

Table 7 is show that there is uni-directional casuality between less than high school education ratio, high and vocational high school education ratio and higher education education ratio and real gross domestic product. It is shown that there is bi-directional

casualty between capital and gross domestic product, but labour do not Granger cause gross domestic product.

CONCLUSIONS

In this study, in Turkey relationship between female education level and growth has been tested with using data from 1990 to 2009 annual data. The econometric model is used bi-directional logarithmic. In this study, firstly, the series has become causality by the ADF unit root testing. Then the long-run relationship between the series is determined by whether the Johansen cointegration test.

Female education as a human capital indicator, with cointegration results that indicate there has been a positive relationship among them in the long-run. Whereas the results of cointegration demonstrate the direction of causality, with the help of causality test when the level of female education increases, there has been bi-directional causality between GDP and females education. Despite, to check the size of the effect of used parameters on GDP, VAR model is tested. Female education is affecting GDP in short time like one year. Because there has been time lags between starting education, graduating, finding a job, earning salary and increasing wealth. Additionally error correction and Granger causality test gives supportive result that increase in women education level affects economic growth positively.

Turkey's economy to stable growth will be realized rapidly rising level of education and contribution women in working life. Women's developments in fields of education and employment in the last 20 years will bring new dynamism to economy in next 10 years. A two-forward-one back rhythm of economy will be saved with the support of women in education and working life.

In summary, existing evidence indicates that improving the level of education of females will lead to higher economic development. In addition to this, the combination of all of these variables will lead to better positions of women in the society with higher wealth. As a result, there is a positive correlation between female education and economic development in Turkey. To have a sustainable economic growth, it is also necessary to give great importance to education of female in Turkey.

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Albania: A country with a High Human Development

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Abstract

This paper evaluates Albania's Human Development post communism regime and nowadays. What's the meaning of a 0.719 HDI in 2010? Is it a good indicator or not? Is Albania on the right path to development? To answer this questions Albania's economic development is compared to countries sharing comparable HDI and historical metamorphosis. Accordingly, this paper compares Albania to two other former communist countries: Macedonia and Bulgaria; being the case that Bulgaria lags behind Albania which lags behind Macedonia in terms of HDI. To insight more on the topic, the HDI is broken down and all of its components are analyzed separately. This way, addressing concerns over the oversimplification of HDI due to many other complexities hidden in its components. To conclude, the paper explains the standing of Albania behind Bulgaria and above Macedonia, even though having a GNI per capita lower than the two. Its position is explained mainly by its higher life expectancy to birth and mean years of schooling due to the increase in the number of students finishing high schools and increase in the number of the private universities nowadays.

Keywords: *Albania, UNDP, human development, HDI, historical events, former communist countries, GNI per capita, life expectancy, schooling, criticism*

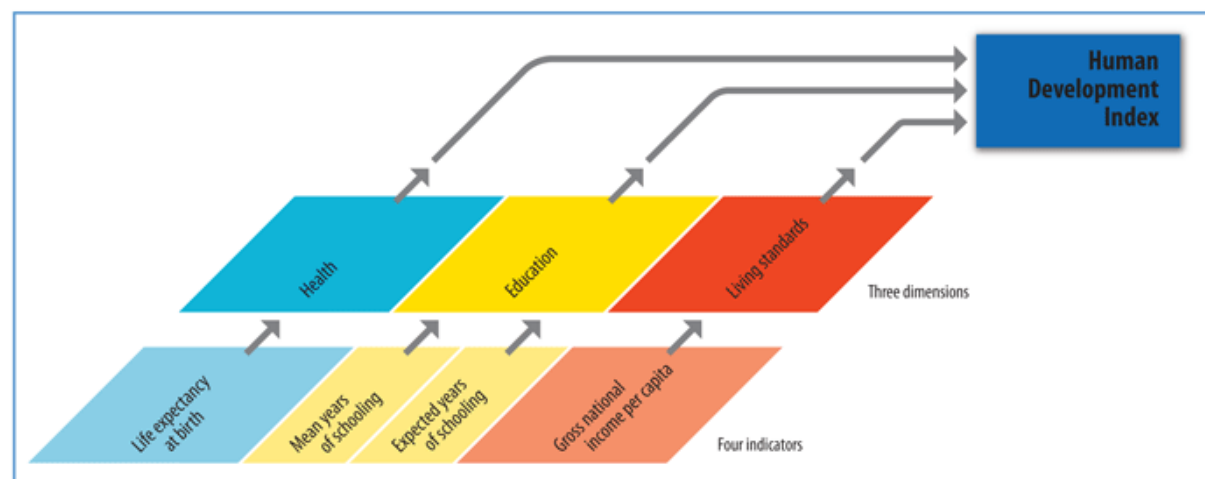
JEL classification: J10, I20, O15, P3

1. Introduction

1. A. HDI and its components

The Human Development Index (HDI) was proposed for the first time by United Nations Development Program (UNDP) in its *Human Development Report 1990*. It is a composite indicator of development levels, which attempts to rank all countries on a scale of 0 (lowest human development) to 1 (highest human development). The HDI is based on the three so-called deprivation indicators or end products of development: health as measured by life expectancy at birth, education as measured by weighted average of adult literacy (two-thirds) and mean years of schooling (one-third), and living standards as measured by real GDP per capita adjusted for differing purchasing power parity of each country's currency. Prior to the introduction of this index, human development was explained by taking into account separated measurements thus, the breakthrough of this index was the creation of a single index which was to serve as a frame of reference for both social and economic development. Setting a minimum and a maximum for each dimension, called goalposts, it shows where each country stands in relation to these goalposts, expressed as a value between 0 and 1.

The HDI—three dimensions and four indicators



Note: The indicators presented in this figure follow the new methodology, as defined in box 1.2.

Source: HDRO.

Figure 1. Components of Human Development Index

The UNDP classifies countries with HDI less than 0.5 as “low human development”, countries with HDI between 0.5 and 0.8 as “medium human development” and countries with HDI at least 0.8 as “high human development countries”. However in the list published by UNDP in 2010 in its official site, countries with HDI less than 0.475 are classified as “low human development”, countries with HDI between 0.475 and 0.675 as “medium human development”, countries with HDI between 0.675 and 0.785 as “high human development” and countries with HDI at least 0.785 as “very high human development countries”.

Based on analysis of HDI trends in 93 countries for the period 1970-2007 the poorer countries see a faster increase in their HDIs than richer countries – mainly attributable to drops in child mortality rates (through expanded public health programs and better medical

care) and increases in literacy. (Klugman, J., Scott, 2009).

1.B. Calculation of HDI for Albania

Since when it was introduced, calculation of the HDI has undergone a number of changes. The index has been simplified during this period and today it is calculated relatively in a straightforward manner. To calculate these indices, minimum and maximum values (goalposts) are chosen for each indicator. Performance is expressed as a value between 0 and 1 applying the general formula:

Dimension index = actual value – minimum value / maximum value – minimum value

Then, HDI is calculated as a simple average of the 3 indices.

Table 1. Goalposts for HDI indices (2010)

Indicator	Observed maximum value	Minimum value
Life expectancy at birth (years)	83.2 (Japan, 2010)	20.0
Mean years of schooling (years)	13.2 (United States, 2000)	0
Expected years of schooling (years)	20.6 (Australia, 2002)	0
Combined education index	0.951 New Zealand, 2010)	0
Per capita income (PPP \$)	108,211 (United Arab Emirates, 1980)	163 (Zimbabwe, 2008)

Source: From United Nation Development Program, *Human development report 2010*.

Albania's HDI in 2010 was 0.719, ranking the country number 64 in total, standing under countries with high human development.

Table 2. Main human development indicators of Albania (2010)

Indicator	Values
Life expectancy at birth (years)	76.9
Mean years of schooling (years)	10.4
Expected years of schooling (years)	11.3
GNI per capita (PPP 2008 US \$)	7,976

The life expectancy index measures the relative achievement of a country in life expectancy at birth. It is calculated using a minimum value of 20 years and maximum value of 83.2 years. These are the observed maximum value of the indicators from the countries in the time series, 1980–2010. The country's life expectancy at birth, which in Albania in 2010 was 76.9 years, is subtracted by the minimum value of 20 years and then the result is divided by 83.2 years minus 20, or 63.2, which represents the range of life expectations expected over the previous and next generations. For Albania, with a life expectancy of 76.9 years in 2010, the life expectancy index is 0.9.

$$\text{Life expectancy index} = \frac{76.9 - 20}{83.2 - 20} = \frac{56.9}{63.2} = 0.9$$

The education index measures the country's relative achievement in both adult literacy and

combined primary, secondary and tertiary gross enrolment. According to the old methodology, first indices were calculated separately for each than they were combined to create the education index, with two-thirds weight given to adult literacy and one-third weight to combined gross enrolment. In its 2010 Human Development Report the UNDP began using a new method of calculating the HDI that eventually affected the education index. It is now calculated using the mean years of schooling in a country (years that a 25 years old person or older has spent in schools) and expected years of schooling (years that a 5 year old child will spend with his education in his whole life). Mean years of schooling are estimated based on duration of schooling at each level of education. Expected years of schooling estimates are based on enrolment by age at all levels of education and population of official school age for each level of education. The indicators are normalized using a minimum value of zero and maximum values are set to the actual observed maximum values of the indicators from the countries in the time series, that is, 1980–2010. The education index is the geometric of two indices. For Albania with mean years of schooling of 10.4 years and expected years of schooling of 11.3 years, the education index is approximately 0.69.

$$\text{Mean years of schooling index} = \frac{10.4 - 0}{13.2 - 0} \approx 0.7879$$

$$\text{Expected years of schooling index} = \frac{11.3 - 0}{20.6 - 0} \approx 0.5485$$

$$\text{Education index} = \frac{\sqrt[2]{0.7879 * 0.5485} - 0}{0.951 - 0} = 0.69$$

The income index is calculated using adjusted GDP per capita (PPP US\$). International dollars rather than U.S. dollars are used because of evidence that the purchasing power of U.S. dollars is greater in poor countries than it is in rich countries. Cheaper services in poor countries are a major reason why the purchasing power of dollar is greater in poor countries. This component serves as a surrogate for all the dimensions of human development not reflected in a long and healthy life and in knowledge. The HDI uses the logarithm of income, to reflect the diminishing importance of income with increasing GNI.

$$\text{Income index} = \frac{\ln(7,976) - \ln(163)}{\ln(108,211) - \ln(163)} = 0.5988$$

Finally, HDI composite index is calculated using geometric mean of the 3 indices calculated above.

$$\text{Human Development Index} = \sqrt[3]{0.9 * 0.69 * 0.5988} \approx 0.719$$

The United Nations Human Development Index has made a major contribution to improving our understanding of what constitutes development, which countries are succeeding (as reflected by rises in their HDI over time), and how different groups and regions within countries are faring. Combining social and economic data, HDI is a broader measure of development performance of countries and so sometimes serves as a signal for countries unveiling the areas in need of improvement. However, there are some valid criticisms, which will be discussed later.

2. Communism in Albania and comparison of HDI components to Bulgaria and Macedonia

Human development performance of the socialist system, despite its beneficial outcome for the 'working masses', had little in common with actual human development. It met basic needs in education, health, and living standards. Under the socialist system development approaches were missing two major components of human development – freedom and agency (Ivanov and Peleah, 2010).

While all countries experienced declines in income, rising unemployment and increased inequality in the 1990s, by 2008 most countries had reached or surpassed their pre-transition levels of income per capita, and unemployment and inequality had declined or at least stabilized.

The report *Human Development in Eastern Europe and the CIS since 1990* argues that if human development is defined as 'the process of enlarging people's choices', then the collapse of the communist system across Eastern Europe and the former Soviet Union twenty years ago might be viewed as one of the most significant steps towards advancing human development in the twentieth century. Communism restricted individual choice in a vast number of ways reducing the individual satisfaction and motivation to work. Yet under communism most countries more than adequately provided for the basic needs of the population and most countries enjoyed a rising standard of living in the postwar period. In the 1980s over a quarter of the world's population lived under the Communist regime and Albania, even though a small country couldn't be an exception. It experienced a really harsh communism regime of a Stalinist-style (centrally planned economy). It nationalized all industries, transformed foreign trade into a government monopoly, brought almost all domestic trade under state control, and banned land sales and transfers. The communists' reforms were aimed at squeezing large landowners out of business, winning peasant support, and increasing farm output to avert famine. Under the Agrarian Reform Law, which redistributed about half of Albania's arable land, the government confiscated property belonging to absentee landlords and people not dependent on agriculture for a living. The few peasants with agricultural machinery were permitted to keep up to 400,000 square metres of land; the landholdings of religious institutions and peasants without agricultural machinery were limited to 200,000 square metres and landless peasants and peasants with tiny landholdings were given up to 50,000 square metres, although they had to pay nominal compensation.

The Fall of communism in Albania started on december 1990 with the students demonstrations. It was since than that the liberalization of freedom to travel abroad was provided. Efforts were begun to improve ties with the outside world. About 5,000 men and 450 women were executed under the rule of Enver Hoxha. 34,135 People were jailed, and 1,000 died in prison. Many families are still looking for remains of their executed relatives. Health care has experienced a steep decline after the collapse of socialism in the country (as also seen in the graph below), but a process of modernization has been taking place since 2000. As of the first decade of the 21st century, there were 51 hospitals in the country, including a military hospital and specialist facilities. Albania has successfully removed diseases such as malaria.

Life expectancy is estimated at 77.43 years, ranking 51st worldwide, and outperforming a number of European Union countries, such as Hungary and the Czech Republic (CIA – *The World Factbook 2010*, Life Expectancy ranks). The major causes of death are circulatory disease followed by cancerous illnesses.

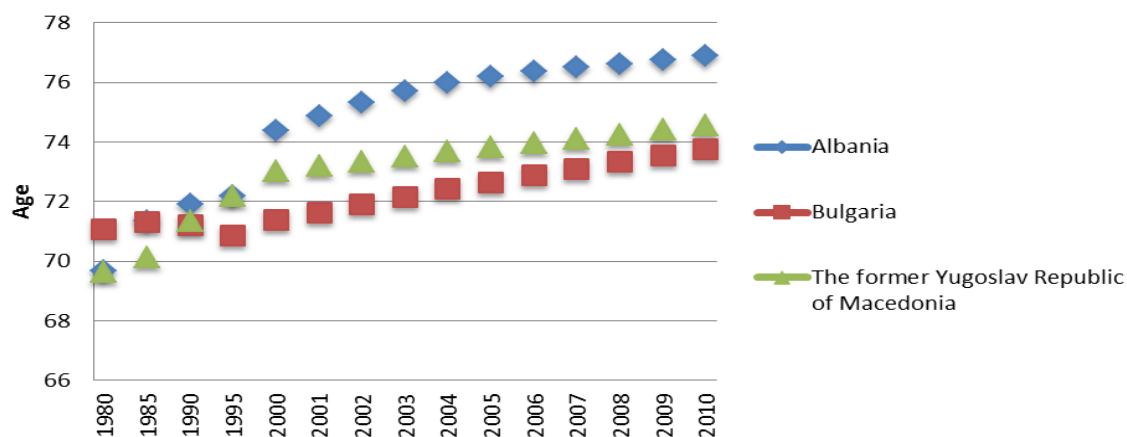


Figure 2. Life Expectancy of Albania, Bulgaria and FYRM (1980-2010)
(Data from UNDP website)

As seen in the graph, Albania's life expectancy has been rising at a higher rate as compared to other two prior-communist countries, Bulgaria and the Former Yugoslav Republic of Macedonia.

Life expectancy in Bulgaria is 73.4 years (CIA – The World Factbook 2010, Life Expectancy ranks), which is below the European Union average even though it has a developed medical system. An interesting fact is that it has 181 doctors per 100,000 people, which is above the EU average.

Albania's illiteracy rate was around 85% before the Communist regime. Schools were really scarce between World War I and World War II. In 1944, when the Communist regime gained control, it gave high priority to the wiping out of illiteracy. There were introduced a number of strict regulation; anyone between the ages of 12 and 40 who could not read or write was mandated to attend classes to learn. Since then the country's literacy rate has improved remarkably. Today the overall literacy rate in Albania is 98.7%, the male literacy rate is 99.2% and female literacy rate is 98.3% (CIA World Factbook: Albania, 2010). With large population movements in the 1990s to urban areas, the provision of education has undergone transformation as well. The University of Tirana is the oldest university in Albania, founded in October 1957.

Even though the literacy rate of Albania is slightly higher than that of Bulgaria, the former traditionally had high educational standards and its students rate second in the world in terms of average SAT Reasoning Test scores and I.Q test scores according to MENSA International (OUTSOURCING TO BULGARIA – Danmarks ambassade Bulgarien, 2010) According to CIA Factbook 2010 the literacy rate of Bulgaria is 98.2%, approximately the same for both sexes.

On the other side Macedonia has a relatively low literacy rate of 96.1%. However an interesting fact is that the United States Agency for International Development has underwritten a project called "Macedonia Connects" which has made Macedonia the first all-broadband wireless country in the world. The Ministry of Education and Sciences reports that 461 schools (primary and secondary) are now connected to the Internet. In addition, an Internet Service Provider (On.net), has created a MESH Network to provide WIFI services in the 11 largest cities/towns in the country.

According to the INSAT data (Institute of Statistics of Republic of Albania) the main characteristics of the Albanian education in the last years are:

- Increased number of pupils attends Professional and Technical schools and profiling in two directions natural and social after some of successful testing years of General schools in upper secondary level of Education:
- Increased number of new entrants on Tertiary level of Education – particularly on full time system in due to fulfill the enormous requests of pupils ends upper secondary level.
- Improvement of schools and curricula
- Opening of non-public – private universities. Have a quickly growth of non-public institutions in number and on enrolments, particularly on main town of Albania. Total number of enrolments in all level of Educations on year 2005 was about 769,6 thousand children, pupils and students altogether; Enrolments on non-public institutions consists of 4,3% of total, presenting an increase of 1% more than year 2003 and 2,3% more than 2001.

In last year, 31 % of students studies in social, economics and law sciences. Another positive trend in tertiary education in Albania is the increase in number of non-public institutions. Even though enrolment in universities has increased mainly in non-public, the government has a lot to do in order for these universities to offer high levels of education. The tertiary education still suffers problems of modernization and liberalization in its efforts to acknowledgement and evaluation of Albanian University Diplomas as well as implementation of Bologna Process. An education trend during the transition consisted of a decline in gross enrollment rates for basic and secondary education. Overall basic education enrollments declined from over 90 percent prior to the transition to 88 percent in 1997. Secondary enrollment rates in 1989 were 79 percent, and they fell to roughly 40 percent by 1997. Albania, however, has joined the Education for All (EFA) Fast Track Initiative, being one of the 18 countries invited.

Mean years of schooling in Albania are higher as compared to Bulgaria and Macedonia. In Albania it is around 10.3 years whereas in Bulgaria the mean years of schooling is 9.9 years and 8.1 years in Macedonia. This is a promising number considering the fact that Albanian population is considered relatively young: Its average age is 32.5 years old, for men is 32.1 years old and for women 33 years old.

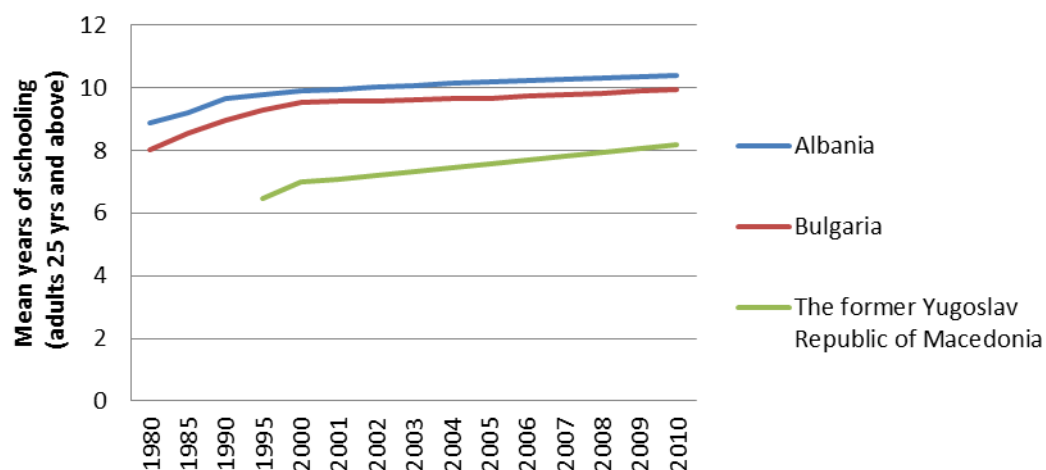


Figure 3. Mean years of schooling of Albania, Bulgaria and FYRM (1980-2010)

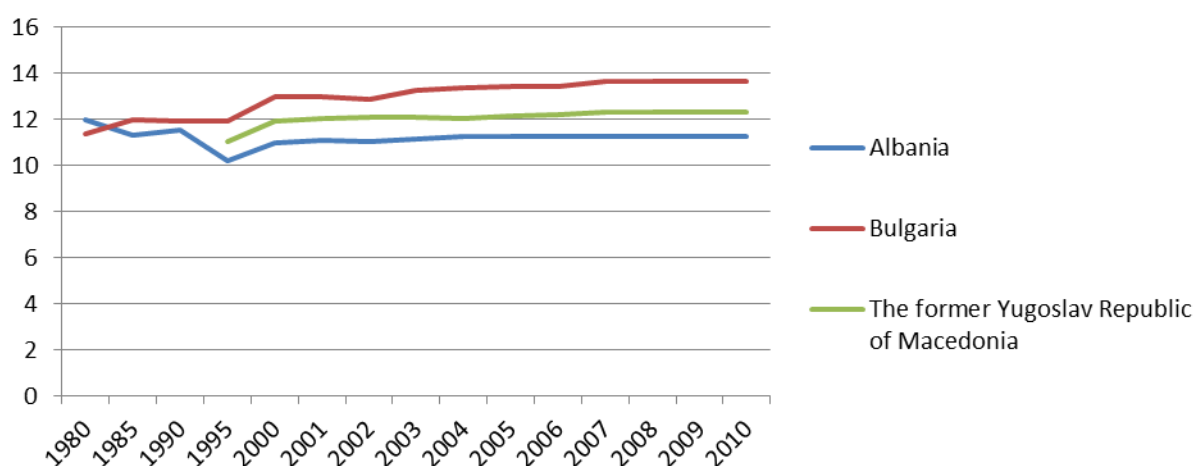


Figure 4. Expected years of schooling of Albania, Bulgaria and FYRM (1980-2010)

Albania remains a poor country by Western European standards. Its GDP per capita (expressed in PPS—Purchasing Power Standards) stood at 26 percent of the EU average in 2010. However, Albania has potential for economic growth, as more and more businesses relocate there and consumer goods are becoming available from emerging market traders as part of the current massive global cost-cutting exercise. Albania, Cyprus and Poland are the only countries in Europe that recorded economic growth in the first quarter of 2009. International Monetary Fund (IMF) predicted 2.6% growth for Albania in 2010 and 3.2% in 2011. Its low GNI per capita is the main reason why Albania stands behind Bulgaria in means of human development whereas the positive health indicators and high life expectancy are its main features for standing before Macedonia. Even though Macedonia reports higher GNI per capita, Albania has a higher HDI due to its better education and health indices.

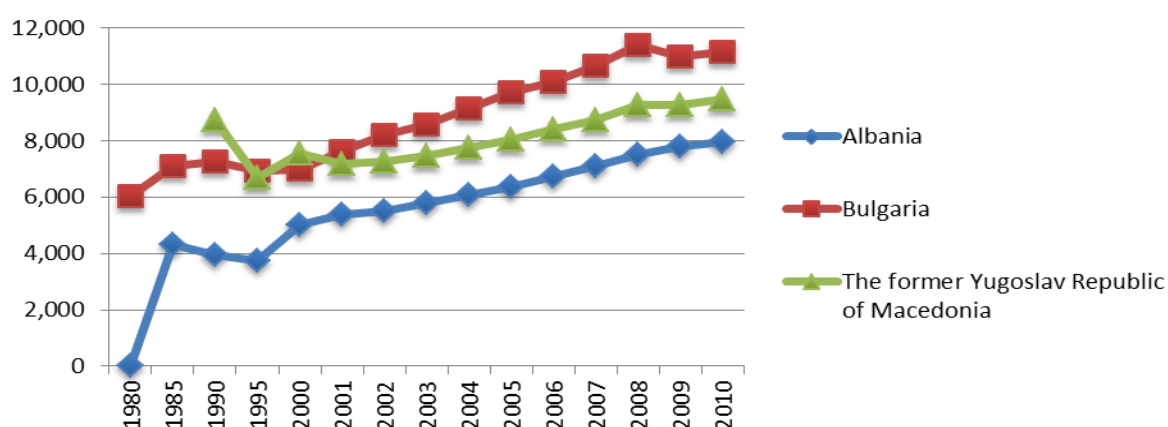


Figure 5. GNI per capita(constant 2008 PPP US\$) of Albania, Bulgaria and FYRM (1980-2010)

Table 3. HDI rank (UNDP 2010)

HDI rank	Human Development Index (HDI)							HDI rank		Average annual HDI growth rate			HDI improvement rank ^a
	Value							Change		($\%$)			
	1980	1990	1995	2000	2005	2009	2010	2005–2010	2009–2010	1980–2010	1990–2010	2000–2010	1980–2010
48 Latvia	0.651	0.679	0.652	0.709	0.763	0.769	0.769	–2	0	0.55	0.63	0.81	71
49 Montenegro	..	..	..	..	0.755	0.768	0.769	–1	0	..	..	..	..
50 Romania	..	0.688	0.674	0.690	0.733	0.764	0.767	1	1	..	0.54	1.06	..
51 Croatia	..	..	0.690	0.720	0.752	0.765	0.767	–2	–1	..	..	0.63	..
52 Uruguay	..	0.670	0.691	0.716	0.733	0.760	0.765	0	0	..	0.67	0.67	..
53 Libyan Arab Jamahiriya	..	..	..	..	0.726	0.749	0.755	3	1	..	..	..	..
54 Panama	0.613	0.644	0.672	0.703	0.724	0.751	0.755	4	–1	0.69	0.79	0.70	54
55 Saudi Arabia	0.556	0.620	0.649	0.690	0.732	0.748	0.752	–2	0	1.01	0.96	0.85	21
56 Mexico	0.581	0.635	0.660	0.698	0.727	0.745	0.750	–2	0	0.85	0.83	0.73	38
57 Malaysia	0.541	0.616	0.659	0.691	0.726	0.739	0.744	–2	1	1.06	0.94	0.73	19
58 Bulgaria	0.649	0.678	0.678	0.693	0.724	0.741	0.743	–1	–1	0.45	0.46	0.69	82
59 Trinidad and Tobago	0.656	0.660	0.662	0.685	0.713	0.732	0.736	1	1	0.38	0.54	0.71	84
60 Serbia	..	..	..	..	0.719	0.733	0.735	–1	–1	..	..	..	..
61 Belarus	..	..	..	..	0.706	0.729	0.732	1	0	..	..	..	..
62 Costa Rica	0.599	0.639	0.668	0.684	0.708	0.723	0.725	–1	0	0.63	0.63	0.59	68
63 Peru	0.560	0.608	0.644	0.675	0.695	0.718	0.723	4	0	0.85	0.87	0.69	41
64 Albania	..	0.647	0.633	0.670	0.700	0.716	0.719	–1	0	..	0.52	0.70	..
65 Russian Federation	..	0.692	0.644	0.662	0.693	0.714	0.719	3	0	..	0.19	0.82	..
66 Kazakhstan	..	0.650	0.620	0.614	0.696	0.711	0.714	–1	0	..	0.47	1.51	..
67 Azerbaijan	..	..	0.563	0.597	0.655	0.710	0.713	16	0	..	..	1.77	..
68 Bosnia and Herzegovina	..	..	..	..	0.698	0.709	0.710	–4	0	..	..	..	..
69 Ukraine	..	0.690	0.644	0.649	0.696	0.706	0.710	–3	0	..	0.14	0.89	..
70 Iran, Islamic Republic of	..	0.536	0.576	0.619	0.660	0.697	0.702	10	2	..	1.35	1.27	..
71 The former Yugoslav Republic of Macedonia	..	..	0.634	0.660	0.678	0.697	0.701	1	–1	..	..	0.61	..
72 Mauritius	0.525	0.602	0.631	0.657	0.685	0.697	0.701	–2	–1	0.96	0.76	0.64	28
73 Brazil	..	..	..	0.649	0.678	0.693	0.699	0	4	..	..	0.73	..

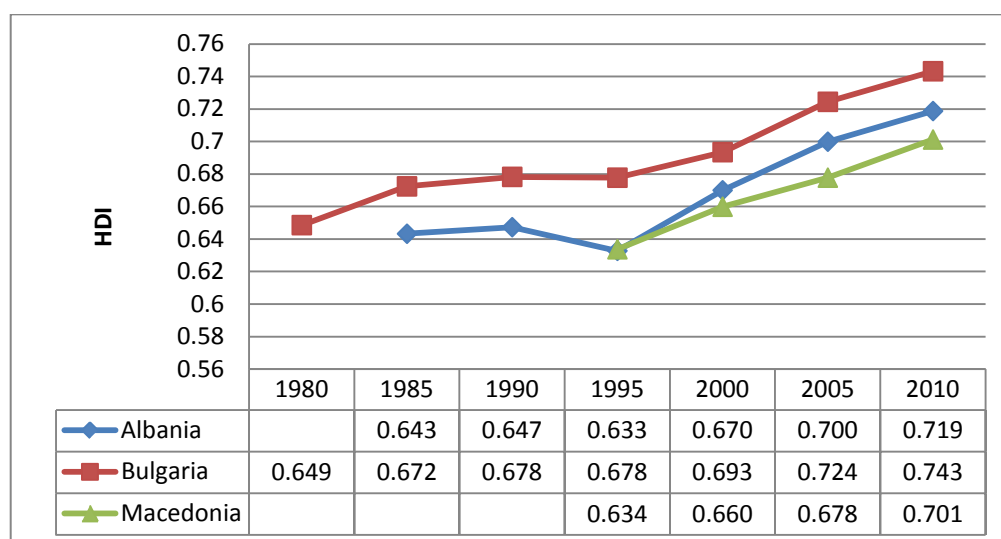


Figure 6. HDI of Albania, Bulgaria and FYRM (1980-2010)

3. Criticism of HDI

Even though HDI, when used in conjunction with traditional economic measures of development greatly increases our understanding of which countries are experiencing developments and which are not, it has some valid criticism. Economic development is a complex notion and there are many other indicators which should be taken into consideration that HDI doesn't as inequality or poverty.

For example in the presence of valuable functioning, such as people living long, being literate and having middle per capita income; does not prevent the overwhelming biasing effect of the high level of inequality in different aspects of the society. This leaves a high

percentage of the population without any chance to develop their capabilities and live as a full human being and eventually questions the notion of development.

Economist Bryan Caplan has criticised the way HDI scores are produced; each of the three components is bounded between zero and one. As a result of that, rich countries effectively cannot improve their ranking in certain categories, even though there is a lot of scope for economic growth and longevity left. "This effectively means that a country of immortals with infinite per-capita GDP would get a score of .666 (lower than South Africa and Tajikistan) if its population was illiterate and never went to school." He argues, "Scandinavia comes out on top according to the HDI because the HDI is basically a measure of how Scandinavian your country is."

A few authors have proposed alternative indices to address some of the index's shortcomings. However, of those proposed alternatives to the HDI, few have produced alternatives covering so many countries, and that no development index (other than, perhaps, Gross Domestic Product per capita) has been used so extensively – or effectively, in discussions and developmental planning as the HDI. There has been one lament about the HDI that has resulted in an alternative index: David Hastings, of the United Nations Economic and Social Commission for Asia and the Pacific published a report geographically extending the HDI to 230+ economies, where the UNDP HDI for 2009 enumerates 182 economies.

However certain attempts has been done to come up with an adjusted more valid HDI disaggregating a country's overall HDI to reflect income distribution, gender, regional and ethnic differentials, as presented in the recent UNDP reports. Eventually, we are now able to identify not only whether a country is developing or not but also whether various groups within that country are participating in that development.

4. Conclusion

Human Development Index is a composite statistic which is widely used by UNDP to rank countries by level of "human development" and separate "very high human development", "high human development", "medium human development", and "low human development" countries. This index has been used by the United Nations Development Programme for its annual Human Development Reports since 1990. The motive to come up with a composite measure of human development was to convince the public, academics, and policy-makers that they can and should evaluate development not only by economic advances but also improvements in human well-being. Despite the difficulties to capture the full complexity of human capabilities in a single index, HDI by a single number would shift the attention of policy-makers from concentration on economic to human well-being. So the breakthrough of this index is that it focuses not only in economic development using only GDP per capita but also in social development (health and education). Its 3 combined dimensions are: a long and healthy life measured by life expectancy, access to knowledge measured by mean years of schooling and expected years of schooling and a fair standard of living measured by GNI per capita in international dollars.

During the last 10 years Albania has experienced expansionary as well as recessive economic trends, accompanied by changes in education, healthcare and social protection systems; during which time the World Bank provided support for improvement in these fields. The country program under the Human Development umbrella aims to address the innumerable challenges that touch on the fundamental aspects of human capital development and individuals' well-being. Its HDI has experienced an over average

increase due to Albania's high and increasing life expectancy, high and increasing mean years of schooling and remarkable growth rates which have led to increasing GNI per capita. A bright future is ahead but still Albania, to maintain and increase the level of development, has to work in certain fields such as: infrastructure, quality of education, inequality among genders and living conditions in the rural which leave much to be desired. However, even though a small country with a struggling history background, Albania has a bright future ahead. The living conditions are improving day by day after the 50 years under communism regime which, have left their marks on this small country. Compared to its two neighboring countries, Bulgaria and Macedonia, two other former communist countries, Albania lags behind Macedonia by far in terms of HDI and it is soon approaching Bulgaria. Macedonia is facing problems with health dimension (lower life expectancy than Albania) and access to education. Besides the fact that Bulgaria has the highest GNI per capita among the 3 countries, it has the lowest life expectancy signaling problems in health conditions of the Bulgarian population. On the other side Bulgarians have a really good access to education and higher living standards compared to Albania and Macedonia.

HDI is widely used to measure the accomplishments of basic needs of a country's population and to compare countries worldwide. Constructing such a measure, helps to set goals such as Millennium Development Goals (MDGs) which were adopted in 2000 by UNDP focusing on eradication of poverty and other human development goals by 2015. They acknowledge the multidimensional nature of development and poverty: an end to poverty requires more than just increasing incomes of the poor. Still HDI has its drawbacks. There are many economists which, criticize the HDI in different aspects. They mainly focus on its simplicity of measuring the human development as there are many other indicators which should be taken into consideration such as: income distribution, gender, regional and ethnic differentials. Even though a country may experience development through increasing HDI it may be the case that only a group of its population is better off but the definition of development is broader than that; it is the increase of living conditions and opportunities for the whole population without an increase in inequalities or poverty. However, the UNDP 2010 Report introduces three new indices to capture important aspects of the distribution of well-being for inequality, gender equity and poverty: Inequality-adjusted Human Development Index (IHDI) which adjusts the Human Development Index (HDI) for inequality in distribution of each dimension across the population, Gender Inequality Index (GII) which reflects women's disadvantage in three dimensions: reproductive health, empowerment and the labor market, Multidimensional Poverty Index (MPI) which identifies multiple deprivations at the individual level in health, education and standard of living. Eventually, measuring human development remains a challenge in the future.

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INFLATION AND NOMINAL INTEREST RATES

ALBANIA

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Abstract:

This paper analysis the inflation and nominal interest rates in Albania. It shows how inflation is kept low in Albania and the reasons behind its high levels during some years and whether there is a possible relationship between nominal interest rates and inflation in Albania. With our data from the tables and regression analysis we will see this, more properly.

Keywords: inflation, nominal interest rates, correlation

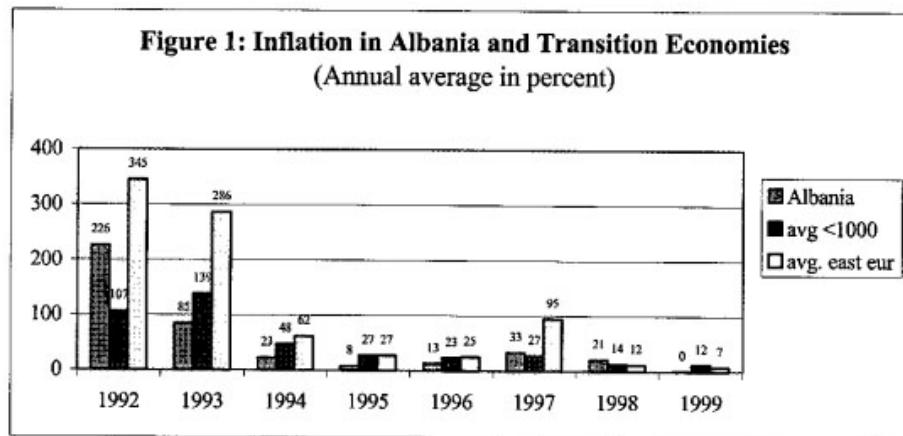
INTRODUCTION

The changes in prices and nominal interest rates are two important subjects when analyzing the macroeconomic conditions of a country. Inflation can have different consequences in an economy both positive and negative. Albania has been a country that generally has kept inflation at low levels. Far as we know one of the main macroeconomic objectives is to maintain price stability, and that is why keeping a low inflation level is very necessary. The paper follows with inflation analysis from years 1992, at the second part nominal interest rates follow and at the end we will see whether there exists a good line of fit between these two variables by our scatter plot analysis.

PART I

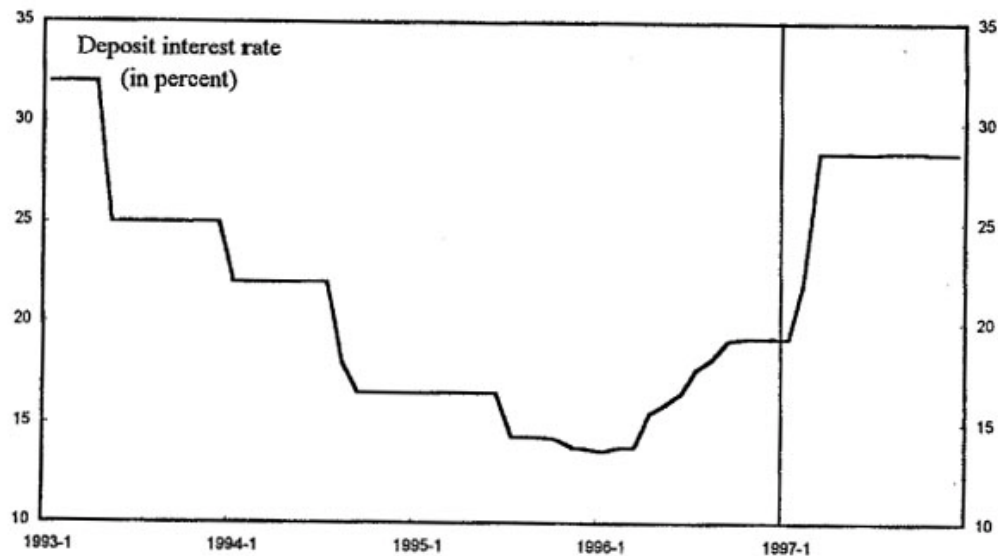
We will see that inflation in Albania recently has been too low compared to that of years 90's. Albania has rapidly increased its GDP growth and falling inflation, through strong efforts on market reforms. Albania is an economy in transition so how it can manage to keep its inflation level low?

The increase in inflation on years 1996 and 1997 to 12.7 and 33.2 respectively did not follow any later because the inflation decreased every year. In 1992 inflation had increased by more than 200% (226) because on these years the country exited from Central Economic Planning. Then inflation decreased a lot due to economic stability. At years 1996 and 1997 it increased



to 12.7% and 33.2 % respectively due to pyramid schemes which pressured inflation at higher levels at year 1996 where inflation was 13 %. Then the following year after the pyramids, where many people had put their savings, collapsed, inflation went to highest level at 33%. However through monetary tightening and due to an increase in real interest rate to approximately 16% inflation reduced to about 20%. From table 1 the avg <1000 represents all the other transition economies that keep their inflation below 1000% during this period. Whereas avg. east eur represent the east European transition economies. And at figure 1 there is a comparison between Albania inflation and these other transition economies.

This performance of Albania's economy can be explained also in terms of its output. Increase in labor costs increase inflation rate. Many other transition countries whose output was merely based on industry sector faced higher inflation than in Albania. Albania's output was mostly influenced by agriculture than industry. After the fall of the central planning regime in years 90s many agricultural properties were rapidly privatized so most of their families produced themselves this part of output. At the agricultural sector the farmers were self employed that's why labor costs were flexible. The industrial sector was small enough to have a great effect by their labor costs (employees who in this case were not self employed- so their labor cost was small enough to have effect)



PART II

By its definition we know that nominal interest rate is the interest rate without adjusting for inflation. The nominal interest rate is the interest rate that we all know, and hear at everyday life. It is the interest rate that the banks have for our saving or time deposits. So real interest rate is equal nominal interest rate minus expected rate of inflation. The real interest rate tells you about your purchasing power on how much it will rise at the future.

Year	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Inflation Rate	226	85	22,6	7,8	12,7	33,2	20,6	0,4	0,1	3,1	7,8	0,5	2,3	2,4	2,4	2,9	3,4	2,3
Deposit Interest Rate	18,5	27,3	19,8	15,3	16,8	27,3	22,6	12,9	8,3	7,7	8,5	8,4	6,6	5,1	5,2	5,7	6,8	6,8
Real Interest Rate	-65.5	-39.7	-10.7	13.3	-3.5	-12.2	-11.9	16.4	17.0	15.7	11.6	10.5	5.4	9.3	10.7	10.6	9.4	10.1

As we can see from the above table in Albania nominal interest rate (deposit interest rate) has increased to 27.3 % and then it followed a decrease until year 1997 where it increased up to 27.3 %, by thus decreasing the money demand, because at higher interest rates opportunity cost of holding cash had a negative effect on money demand.

However, the period of democratic transition in Albania has been more difficult and longer than the predictions, which was confirmed by the deep economic crisis of the years 1997-1998. This crisis was accompanied by a sharp decline of economic indicators; inflation reached 40%. Albanian Lek depreciated by more than 30 %, and the budget deficit was 30% of the GDP. From local and foreign research the main factor driving behind the 1997 crisis was the weak institutional development carried out in four to five years of transition.

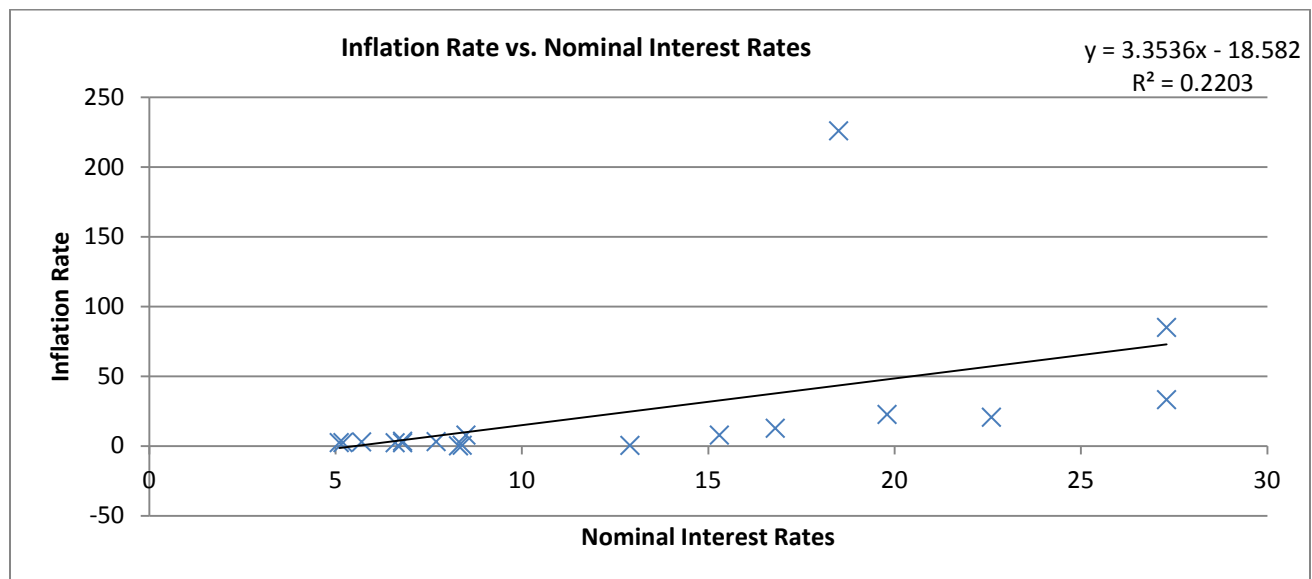
Nominal interest rates have decreased a lot on the latest years but a further decrease of them would be a good way to increase competition and as a consequence also the prices of the goods and services offered to consumers. So

as e conclusion we may say that the Albanian economy has passed the down phase of years 1997, 1998 and 1999 but it still needs a lot of work in order to be classified as a country with a stable economy.

PART III

“In statistics, correlation and dependence are any of a broad class of statistical relationships between two or more random variables or observed data values.”

In our case we will study the relationship between inflation rate and nominal interest rates in Albania. The basic regression equation is $(y) = a + bx$ where x and y are our two variables (in this case inflation and nominal interest rate), b is the slope of the regression line, a is the intercept point of the regression line and the y axis. By using excel the following correlation and line of fit is observed.



Our R^2 square value ($= 0.2203$) is far away from 1 so it is not a good line of fit. Our line of best fit is not close to the points so there isn't a strong positive correlation between our data. So from years 1992 to 2009 there isn't any **STRONG** positive correlation between nominal interest rate and inflation.

CONCLUSION

From 1992 to 2009 Albania has undergone transition and by having so it has influenced a lot different economic indicators. Inflation for example in 1992 was at highest levels but then it decreased due to the change from a centrally planned economy to a market economy. Except the crisis of 1997 where inflation increased substantially, it then has been at low levels which can also be attributed also to the agricultural sector where Albania was based most. Also nominal interest rates have decreased each year, but a further decrease of them would be good in order to increase competition also the prices of the goods and services offered to consumers. After observing the correlation between inflation and nominal interest rate there is weak evidence for an existing dependence between these two variables. The coefficient of determination R^2 showed that it was far away from 1 meaning that our line didn't fitted well so there isn't a strong relation between our independent and dependent variable.

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2011

MIRJAN ZAJAKU

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**Thesis:Albanian Living Standart
Measurement Survey in 2008**

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OUTLINE

1.INTRODUCTION

2.DATA METHODOLOGY

3.CONCLUSION

4.REFERENCES

Abstract

Living standards measurement is the main key of the economy of each country, and Albania as other countries has its standards of living, Standards of living measurement survey of year 2008 is an attractive topic for each of us, but mostly at me. Albania as a developing country, coming from a communist regime after 1990s, is passing through a deep transformation process passing from a socialist and centralized economy to a public economy where the free market economy rules are applied. Objectives of this study are to analyze the living standards of Albania for year 2008 and compared with previous years also compared with neighbor countries which are at the same level of Albania.

Keywords: living standards, Albania

1. Introduction

Over the past two decades, Albania has been seeking to develop the framework for a market economy and more open society. It has faced many internal and external challenges because of the low income levels and the lack of the infrastructure also rapid collapse of output and inflation rise after the shift in regime in 1991. Another important point is the pyramid crisis in 1997 and the social and economic shocks accompanying the Kosovo crisis in 1999. Unless all these obstacles Albania has made notable progress in creating conditions conducive to growth and poverty reduction. From the investigation is concluded that the population poverty is reduced from 25% to 18% in year 2002 to 2005. This increase in income is seen in standards of living of Albanian citizens.

The National Strategy for Development and Integration (NSDI) lays out the vision and strategy for developing Albania's economy for the period they are designed to cover. It is concentrated toward sustaining high growth, reducing poverty and putting Albania on the path to European integration.

The Living Standard Measurement Survey (LSMS) is the main source of data for monitoring the expected outcomes. It collects the information from the household with a questionnaire which is divided in two visits with a 14 day lag and a dairy as well as a community and a price questionnaire. The possibility of conducting parallel facility surveys in the sampled areas is being explored. The household questionnaire will contain information both at the household and individual levels, and its contents will be modeled according to the specific purposes and policy questions agreed upon in the course of a process which will involve the participation of both domestic and international data users. The community questionnaire contains information on community infrastructure and access to services. Finally, a price questionnaire is generally added to allow for adjustments in regional differences in the cost of living.

The way that how the people live or let's say living standards are very important. From the birth all of us have necessities, with necessities I understand not only the commodities which are indispensably necessary for the support of life, but whatever the customs of the country renders it indecent for creditable people, even the lowest order, to be without. The first thing that comes in my mind is mobile phone, which I think that is not a necessary of life. As we know that in past times like in old Greece, people have not used mobile phone, but nowadays it is connected so much with our lives.

Related to this I have read 'The wealth of nations' by Adam Smith (1776), which I decided to mention at the beginning of this work because it enlightens the necessity, even for the classical economic theory, of considering the concept of human well being in a multidimensional way. The relevance of material aspects of life is important in affecting happiness and satisfaction, but evaluation of wealth is such a complex issue that it requires more than a simplistic attitude towards any kind of analysis.

The capability approach of Amartya Sen (1997), but also the works of Kahneman and Tversky (1979) constitute a different attempt to describe concepts such as instrumental freedom, empowerment and human security.

Evaluation of both well being and quality of life is then surely correlated with that of poverty, so that the definition of such a broad concept becomes a very difficult issue.

To our knowledge, there is no country where the geographic dispersion of poverty is homogenous. This is why some countries put in place politics that target regions where the incidence of poverty is high. To justify such policies, it would be useful to know whether the region itself is a determining factor of poverty or whether the joint distribution of demographic characteristics is to blame. This problematic has already been addressed for Bangladesh by Ravallion and Wodon (1999). In their work, the authors first estimate an econometric income model. They then proceed to use this model and average demographic household characteristics to simulate poverty indices for various regions.

In this work I will concentrate my attention on the standards of living of Albanian people and trying to find some multidimensional indicator in order to provide more information than simple measures based only on money. I will then compare our standards of livings and the development and growth with our neighbor countries like Macedonia. The object of my paper is to highlight the economic situation of Albania and may be, why not to suggest something in terms of policy making. To use or not to use a multidimensional indicator can actually provide very different pictures of the same society and, therefore, it can suggest completely different interventions aiming at solving a specific problem.

I will simply try to demonstrate the indicators that why economy has problems or why the welfare is not so acceptable.

The paper is structured as follows. Firstly is the introduction including the literature review, an overlook from other papers. And later following by a brief portrait of Albania. Third part is the comparison of Albanian welfare with neighbor countries like Macedonia. But firstly having a look in the situation of Albania, taking in consideration context like GDP, GDP Growth, GDP per capita, Imports, Exports etc. The final section is a brief conclusion of all my job, what I have concluded and may be some suggestion

1.2 A picture of Albania

Albania is a Balkan country sharing borders with Greece, Macedonia, Montenegro and Kosovo, with a population over three million people. The past of Albania has been turbulent because of the Communist regime but in early 90's the fall of the Communist party that had been in power for 46 years left the country in economic, political and social turmoil. At that time a quickly recession ensued. Since then, the economy has known good growth with an average real GDP growth of 4.3% between 1990 and 2001. There was however a strong recession between 1996-1997 due essentially to the crash of pyramid schemes which affected those with small investments (Jarvis, 2000). The great number of Kosovo's refugees in 1999 along with the events of September 11th also slowed growth which has, since 2002 stabilized around 5%. It's worth noting however that in 2005, Albania posted the lowest per capita GDP of all the occidental Balkan countries (2,518 USD in current dollars).

Before its political transition, the agricultural sector represented more than 35% of the GDP, employed over 50% of the workforce and consisted of about 40% of its exports. Today, the GDP's structure by economic activity is as follows: 24 % agriculture, 24.9% services, 13% industry, 12.1% transport and communications and 8.1% construction. Even with these levels growth, Albania is still one of Europe's poorest countries. An important informal economy coupled with an insufficient communications and electrical infrastructures are among the many hurdles Albania faces as an emerging economy (CIA, World Fact Book). Furthermore, Albania is considered a small country exporting essentially agricultural products yet is a big importer of machinery, manufactured products, food goods, textiles and chemical products. This situation deteriorates its current account balance which represents 23.2% of the GDP, this after an increase of 41.5% between 2004 and 2005.

Albania has just been publishing official results since the beginning of the 90's even without complete data which was made available in 2002. The Living standards measurement survey, which initiated in 2002 allowed information on household spending as well as living conditions to be collected. Now was seen a clear picture of poverty from this data. Using an absolute poverty line which was calculated with Ravallion and Bidani's (1997) basic needs approach; about a quarter of Albanian households are living under the poverty line. When looking at inequality, even though Albania is poorly classed in terms of its position on the human development index (HDI) for South-Eastern Europe (72/177 in 2005), it is still classed among the countries with the lowest levels of inequality when considering consumption expenditure.

2. Modeling living standards in Albania

Current literature suggests many methods for modeling the living standards of a country but in my paper I will compare the living standard of Albania with neighbor countries like Macedonia. There are many determinants to take in consideration but I will take most important ones. The first I think is GDP which is related to the economy of a country also in the welfare of the population. But also the GDP per capita shows the performance of a country. Other determinants that I am going to use are inflation, exports, imports, etc.

As I mentioned before the first one is GDP, and from the information collected I have found the **GDP** of Albania from 1990 till 2008. In the table below, table 1 are all the components that I will study

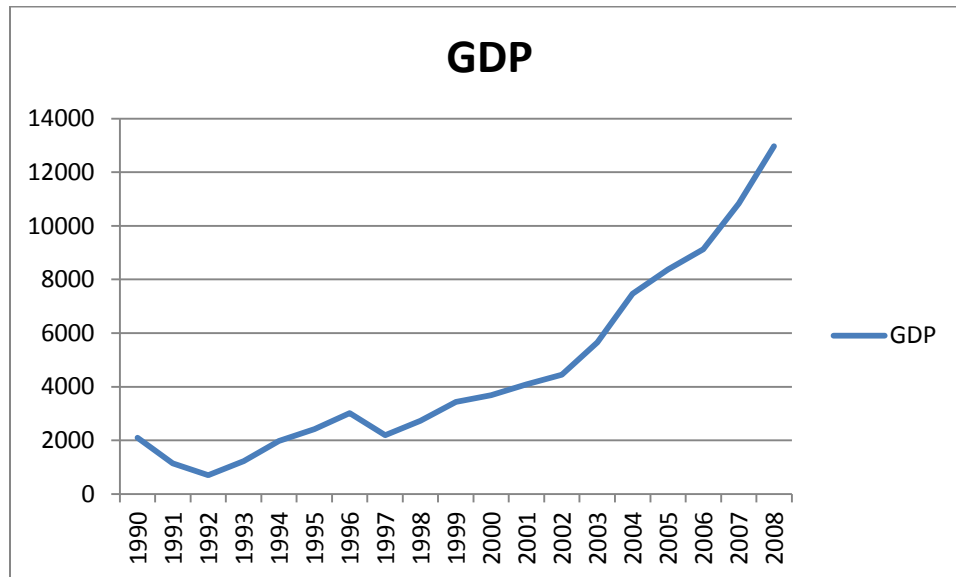
Table 1

Year	GDP (in millions \$)	Exports	GDP growth	GDP per capita	Inflation and consumer prices
1990	2101	14.8%	-9.57%	638	
1991	1139	7.2%	-29.58%	346	
1992	709	11.4%	-7.20%	217	226%
1993	1228	15.4%	9.60%	381	85%
1994	1985	11.3%	8.30%	625	22.5%
1995	2424	12.4%	13.30%	773	7.8%
1996	3013	12.3%	9.10%	970	12.7%
1997	2196	10.4%	-10.20%	711	33.1%
1998	2727	10.7%	12.70%	886	20.6%
1999	3434	17.2%	10.10%	1118	0.4%
2000	3686	19.1%	7.30%	1201	0.05%
2001	4091	20.5%	7%	1332	3.1%
2002	4449	20.4%	2.90%	1446	7.7%
2003	5652	20.6%	5.70%	1831	0.5%
2004	7464	21.5%	5.90%	2408	2.3%
2005	8376	22.2%	5.50%	2692	2.4%
2006	9132	25%	5%	2925	2.37%
2007	10834	28.4%	6%	3458	2.93%
2008	12968	29.5%	7.50%	4125	3.35%

Beginning with GDP we can see that in 90's it has been 2.101 billion dollars. This is the first year that I have started my studies but if we have a look at the GDP growth, it is -9.57%, which means that in this year our GDP has fallen. Referring to the next year we can see that it has dropped down more, it has been decreased by 29.58%. Also following the other year is in again decreased but has than past years. This happened because of the change of regime, from communism to capitalism. Year 1993 has been a year with a positive increase. The economy started to go in the right way with high increases in GDP. This happened till 1997, because this

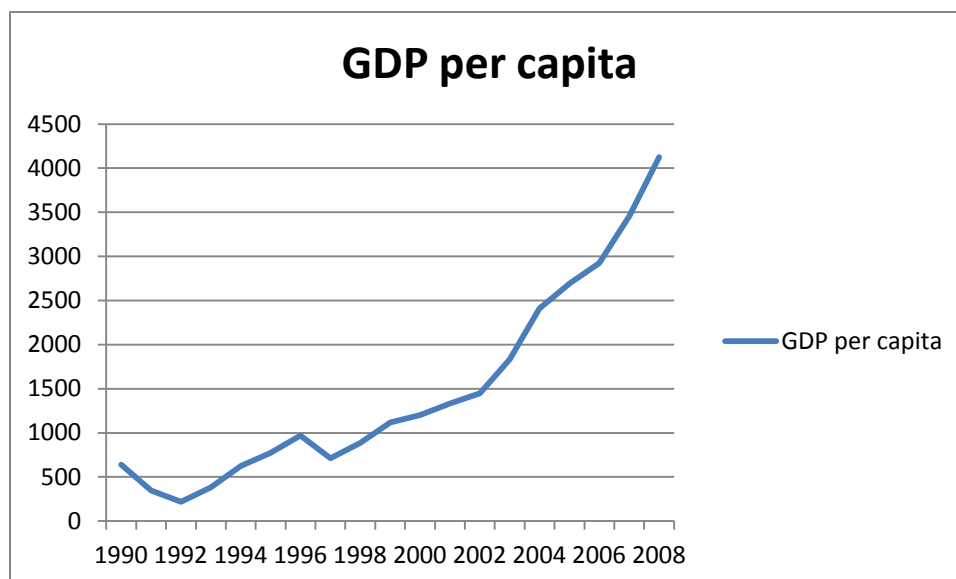
year was a terrible situation for the economy of Albania, because of pyramidal firms the economy was destroyed. The GDP was decreased till -10.4 %. After this year as always in economy that after the recession a boom may happen, also for Albania was the same thing. In 1998 to 2000 Albania had high increase in economy and GDP. After 2000 the economy has had an increase in straight way, just sometimes like 2002 when it has a small increase because of the crises that had U.S. To better show that I will make it in a chart line.

(Amounts in millions \$)

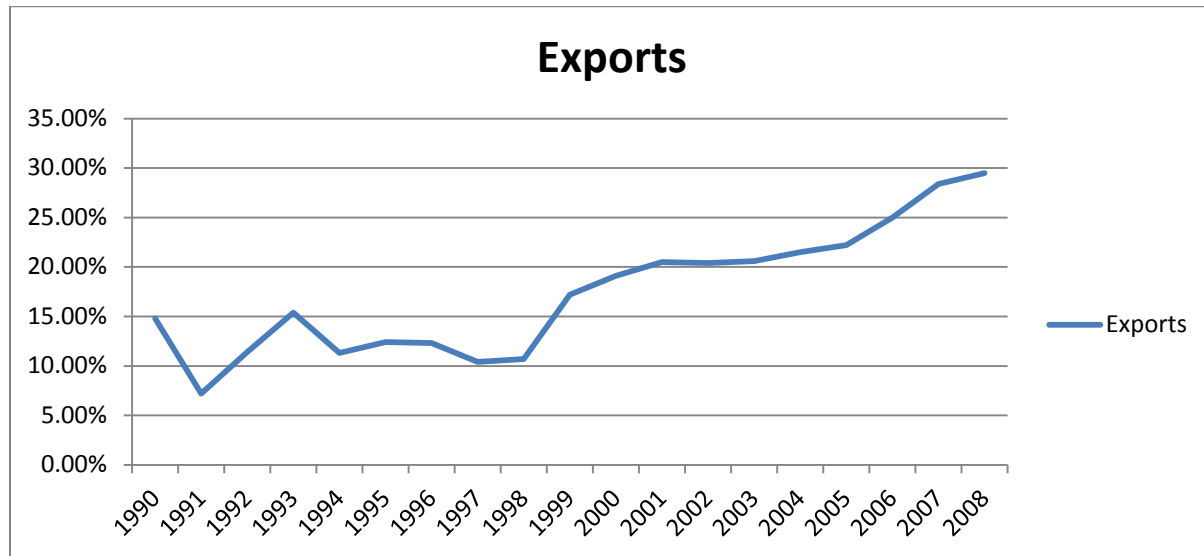


All what I explained before are better seen in that graph.

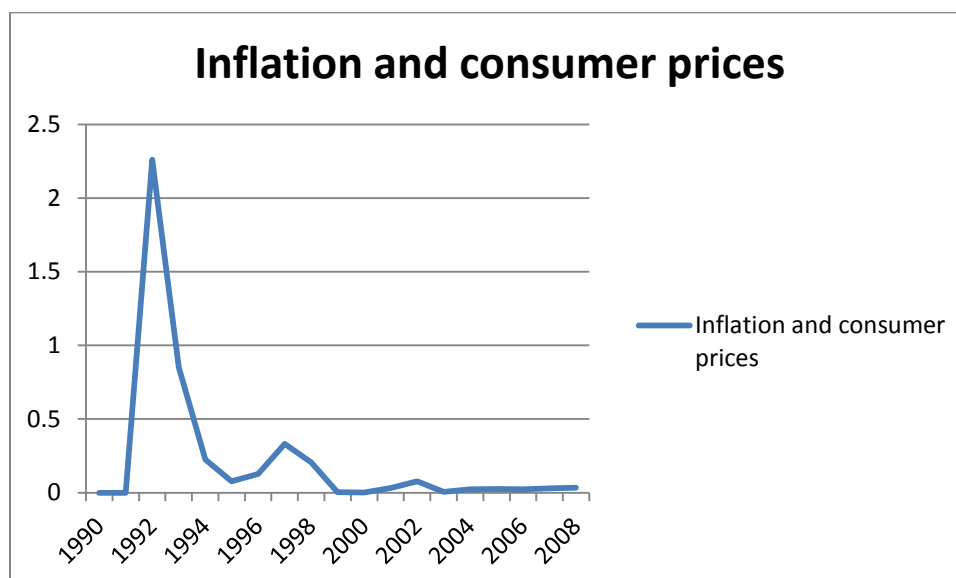
GDP per capita. It's is related with GDP. It also had the same decreases as GDP, firstly in the 92's and later on in 97's. It is batter seen in line chart.



Exports. Exports are also important indicator in the living standards calculation of a country. If the exports are high also the welfare will increase. Having a look to the Albania situation in this 19 years we can see that in the 90's Albania had a small amount export because of the communist regime. It was increased year by year and till 2008 the exports are doubled. Batter I will illustrate in a line chart.



Inflation and consumer prices. This indicator is also very important, which starts immediately with a terrible percentage in 90's. In year 1992 was the highest inflation in the history of Albania, this happened because of the devaluation of the Albanian Lek. These year till 1997 has been the worst for Albanian economy. In 99's it was decreased a lot, it reached 0.4 in this year. It continued like that for three years but in 2002 as the other indicators has changed also the inflation changed and was increased till 7.7%. After that the inflation continued normally and a small volatility. The line chart below that I had prepared shows it better.



This was an overlook about situation of Albania from 1990 to 2008. But is that situation good or bad, or compared with neighbor countries, is it going the same with them or not. For that reason I have chosen to compare our situation with Macedonia's situation. They are neighbor countries but their histories are not the same with ours. The change of the regime is made in different years but let's see the comparison of economies in general manner. Firstly let's build tables of their data, starting with Macedonia.

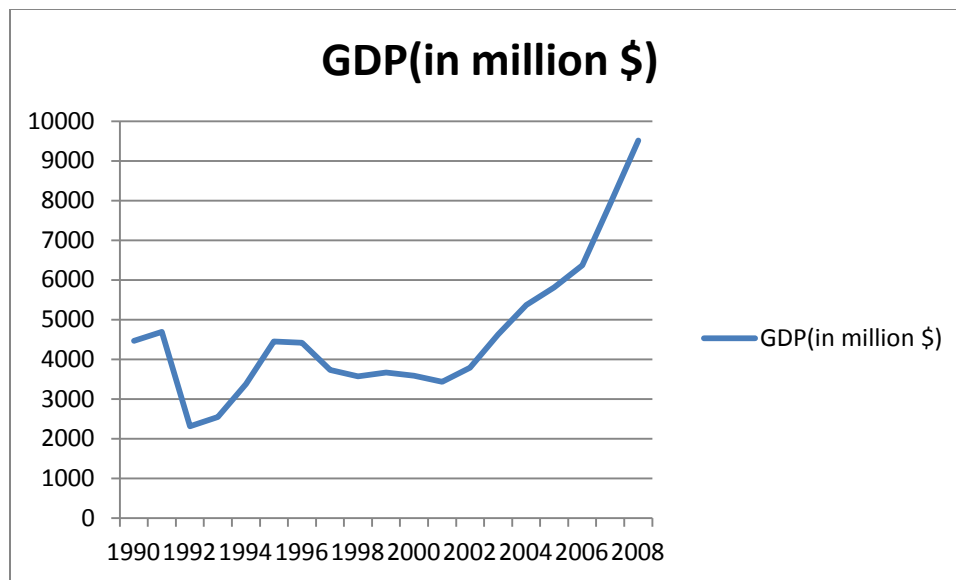
Macedonia

Year	GDP(in million \$)	GDP growth	GDP per capita	Exports	Inflation
1990	4471		2342	109%	
1991	4694	-6.17%	2441	102%	
1992	2316	-6.56%	1197	91.3%	
1993	2550	-7.46%	1311	84.8%	
1994	3381	-1.75%	1730	82.2%	126.5%
1995	4449	-1.11%	2266	82.6%	16.3%
1996	4422	1.18%	2240	86.4%	2.4%
1997	3735	1.44%	1882	85.7%	1.2%
1998	3571	3.37%	1790	84.5%	0.5%
1999	3673	4.33%	1833	86.9%	-1.2%
2000	3586	4.54%	1783	100.4%	6.6%
2001	3436	-4.52%	1702	102%	5.1%
2002	3791	0.85%	1873	104.2%	2.3%
2003	4629	2.81%	2282	103.3%	1.1%
2004	5368	4.08%	2641	104.1%	0.9%
2005	5814	4.10%	2856	94.4%	0.16%
2006	6373	3.95%	3127	89.4%	3.2%
2007	7921	5.9	3883	88.3%	3.6%
2008	9517	4.80%	4662	90.5%	7.2%

Having a look to the data of GDP, it is seen that Macedonia has had the same problem with us in 90's till 95. The difference is that our decrease in GDP is higher than the Macedonia's decrease. Also our problem was solved faster, two years before Macedonia. In 1997 it does not had the same problem with us. In 2001 as in the case of Albania it has also the same problem. The GDP was decreased, and I think that is the same factor also for that country.

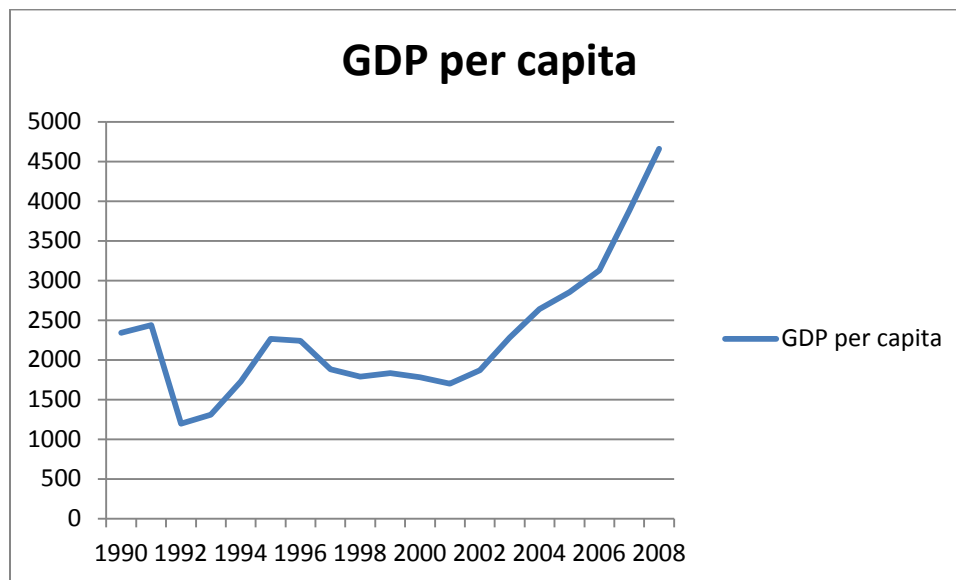
Related to the GDP per capita, it is easily seen that Macedonia has had a higher GDP per capita till 2000. But after this year Albania has started to increase it approximately the same with Macedonia and in the year 2008 they are nerly the same. It is important to mention that Macedonia's GDP is lower than ours but GDP per capita is higher than ours. I think this is an important case. In this situation the welfare of Macedonia people is better Albania population.

Let's have the line charts of this two components.



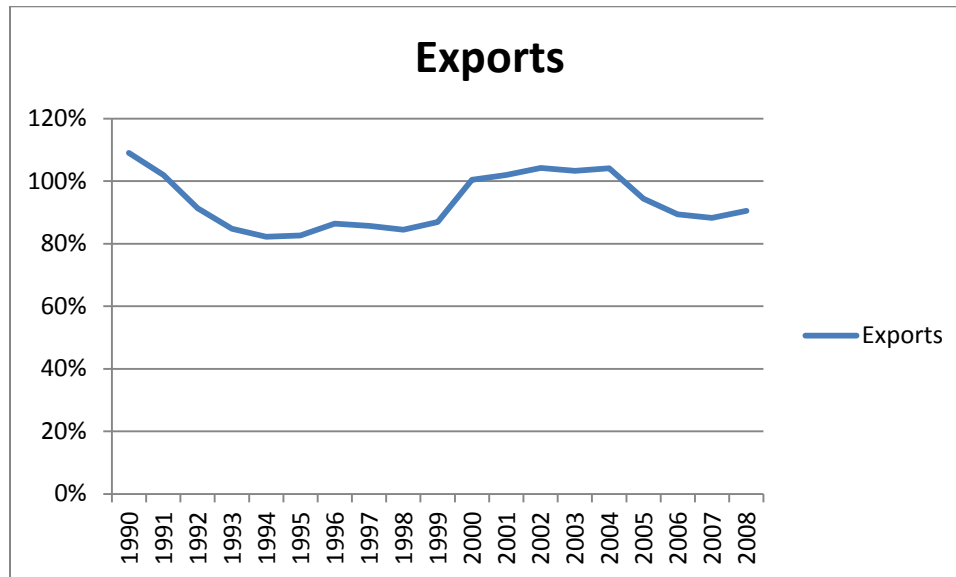
It seems like the GDP of Albania, the shape of the graph, just latest years Macedonia has a higher growth rate of it.

Now let's see the GDP per capita



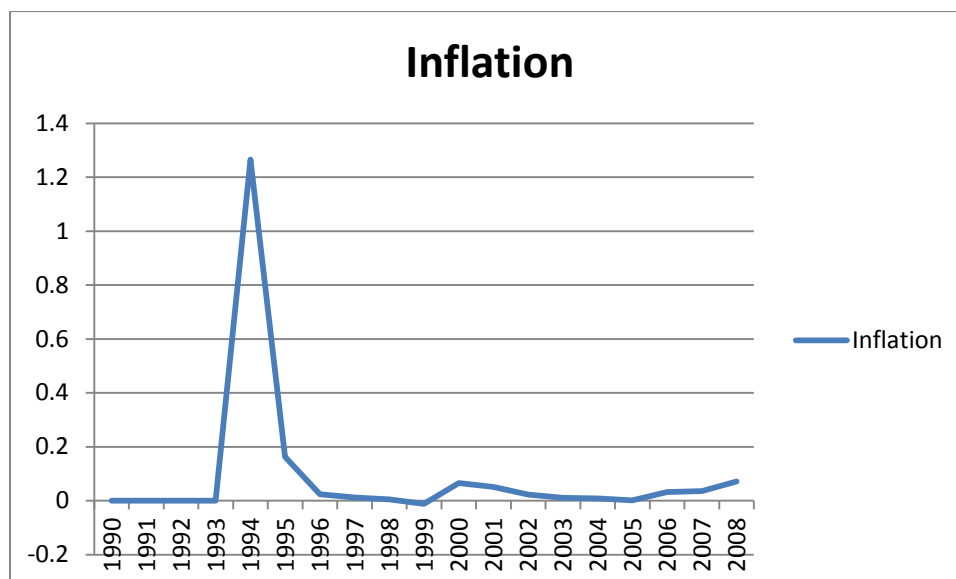
Now I am going to pass to the other components like exports. In Macedonia is the opposite situation from Albania. This country has export in high amounts, starting from year 1900 it has exports of 94%. It's exports were slow down in years 1993 to 1994, which went to 80 % but

generally we can say that Macedonia is an exported country. Compared to Albania these exports are very high. I am drawing the line chart of it.



As it is seen that the best times for Macedonia export are from 2000 to 2004. Later year have an decrease of exports.

Now let's pass our attention to the last component which is inflation. I am showing above the line chart of Macedonia inflation.



The inflation in Macedonia was high in 1994, in difference with Albania that had high inflation in 1992. Also the inflation of Albania was two times more than Macedonia's inflation. In 1997 when Albania had a high inflation, in Macedonia it goes not happened. In last years the Macedonia's inflation is higher than Albania's inflation.

3. Conclusion

Albania has passed very difficult situation in politics and economy, since these two are related with each other, they also has indicated each other. Firstly starting with the 90's when the Albanian Lek was devaluated a lot. In this moment Albania economy was destroyed and passed in a deep recession. But after this recession, the boom came. Another shock for Albania economy was the year 1997 when the pyramidal firms stole the money of people. All these things that has happened in Albania has indicated the welfare or the standards of living of people. Compared with it's neighbor country, Macedonia, it is developed a lot. Just to remember that Macedonia had more higher GDP per capita, but nowadays we are arriving them. Albania is a developing country and has many problem yet, firstly with politics and also with economy, because they are related. In general I can say that Albanian people has worked a lot to increase their standards of living. Our economy is growing but there are also many problems. The unemployment is in high rate in Albania. In the beginning of my paper I said that I may be suggest something, and now I want to say that my suggestions are that government must decrease the number of unemployed people because the unemployment hurts the economy of a country. Also the exports must be increased because nowadays is a perfect time for Albania to export because the Lek is devaluated, and this helps a lot exports. The monetary policies in Albania must be changed in some cases, for example in the case of small businesses. I want to remind that all this are my opinions.

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Labor market, education and the skills needed in the industry; Comparison between Macedonia and Albania

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Abstract

Macedonia and Albania are both located on Balkans peninsula and, as a second world countries, they share some similar problems concerning labor market, EU integration, economic development, corruption, health and etc. In one modern country's economy, nothing can be seen linear or from only one perspective. Sharing experiences, transfer of the knowledge are essential for policy improving and country progress.

If there are some country spheres which are more universal among many countries that is industry and calibration of the education as an engine for gaining knowledge, skills, industry growth, market and personal development, wellness and so on... Only few aspects of state market economy are questioned in this work. One of them is education, labor market and skills needed for future employment.

Few questions are arising for both countries. Can the education policies answer the market needs? Are the students equipped with necessary skills for tomorrow's work? What is the influence of the industry to the education policies? What can be done? What are the skills which the employers are looking for?

Keywords: labor market, skills, market needs, education

Introduction

"Happy families are all alike; every unhappy family is unhappy in its own way"
Leo Tolstoy

We can hardly say that there is “happy” family i.e. happy country. All countries are having their own problems, somewhere there smaller, for example: Norway, somewhere there are more than essential for living, for example: Sudan.

Since 1991, during the years of independence Macedonia really struggles with different issues, as many other countries, respectively and Albania. Macedonia and Albania as neighboring countries are in many ways alike. In the last 20 years both countries had made huge steps in social, economic and political development. Transition from planned to market economy, and the political transition from authoritarian to democratic political system. All European and world institutions which are internationally oriented share same opinion that Western Balkan countries will need to continue their intensive and systematic efforts in the economic, social sphere and especially to focus on the speed of the reforms in all the areas. Few of these steps are international oriented programs like achieving Millennium Development goals, creating National programs and strategies for different

areas like energy, transport, education, FDI, involving in educational exchange programs like Erasmus, Tempus, Comenius, Leonardo da Vinci and etc.

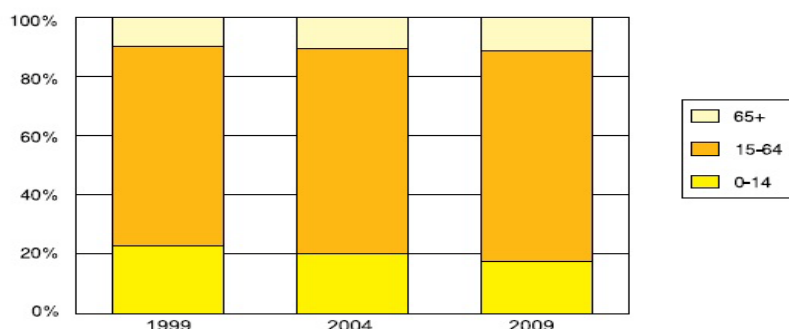
Now, we are living in very fast changing and dynamic time, and it is very hard to follow all the information about global trends in industry and markets. So, adjusting the education to industry needs is a real challenge for every country. Therefore, there is a need of very strong and long term relationship. This relationship is among three (3) sides. Among government, regional and local authorities on one side, public and private schools, especially universities and vocational schools as providers of skilled labor on the other, and private, business sector as an engine of economic growth and well-being as a third partner in this relationship.

There are many statistical analysis and data about education in Macedonia and Albania, and the whole region known as Western Balkans. Statistical data and analysis are really important forces that can contribute in a great measure to country's economy, but the most important aspect is to create strategy and to make decision that is based on the provided data provided from the above mentioned triangle, and not to forget to mention that there is a need of a vision where do we want to be and want we want to become. In this work, the author will be using only secondary sources of information.

Demographics

According to National statistical agency, Macedonia in 2009 has 2 052 722 inhabitants, with natural growth of the population around 1.5%. In last 12 years, there are significant changes in age structure of the population. In the period from 1999-2009, the part of young people (0-14 years) is decreased from 22,8% to 17.7%, and the part of elderly people (65+) is increased from 9.8% to 11.6%.¹(Graphic 1) From this data we can presume that Macedonian population is ageing and that active working population will be decreasing. Additional problem is emigration abroad of highly skilled labor from Macedonia. Complicated political situation in last 12 years is just contributing to emigration of young people in a search for a better future and is an another reason for changed age structure of the population,

Graphic 1, Age distribution 1999 - 2009



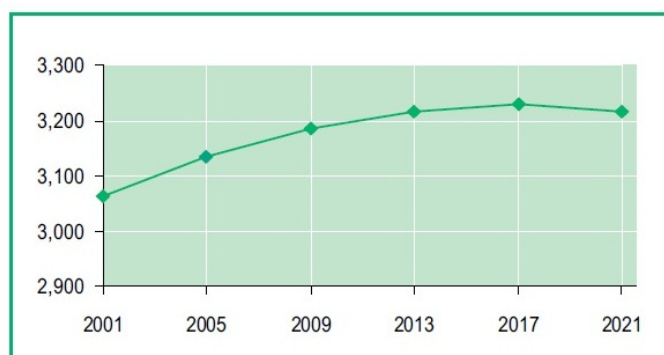
In Macedonia, territorial distribution of the population is showing significant disproportion. There are 34 cities in the country and 57.8% of total population is living in the cities, leader is Skopje with 20.5% and is still growing. Many of the villages are

¹ Makedonija vo brojki, 2010, str. 10

completely depopulated (141 from 1728) or they have very small number of inhabitants with elder people²So, there is another migration happening, from small villages to the cities, mainly in Skopje. According to the results of Janeska's research, "the permanent emigration of the highly educated cadres from Macedonia in the nineties of the last century reached very large proportions. It was consisting of young couples, persons with tertiary education in the area of technical and natural sciences, as well as young teaching and research staff from particular faculties".³One of the objectives of one country is keeping the best and offers them conditions and opportunities for success. It's hard to say that Macedonia is doing this well. I couldn't find data about projections for near or further future how the territorial and age distribution is going to be, but from this numbers the future of labor market is not too bright for Macedonia.

Albania, according to National state agency for statistics, in 2009 had 3 194 417⁴, with population growth rate (2009 est.): 0.56%. According to projections till 2021 about the population, Albania slightly will increase the number of total population.⁵ (Graphic 2) From the statistical data about the cities, we can presume that there are many equal populated cities, for example there are 4 cities between 100 000 – 180 000 inhabitants, there are 6 cities between 210 000 – 374 00 inhabitants and there is the capital Tirana with around 800 000 inhabitants. About their development I'm going to write later in this work

Graphic 2, Population by projections, 2001 – 2021 (numbers are in thousands)



Albania is one of the countries in East Europe that has been highly affected by emigration, according to the Centre for Social and Economic Studies, in 2005, more than 25% of Albanian citizens is living abroad and in 2004 remittances sent by Albanian emigrants were estimated at 1 billion USD⁶. From Graphic 3, it's noticeable that the emigration trend is declining and many of highly skilled labor are staying in their home country.

²Makedonija vo brojki, 2010, str. 12

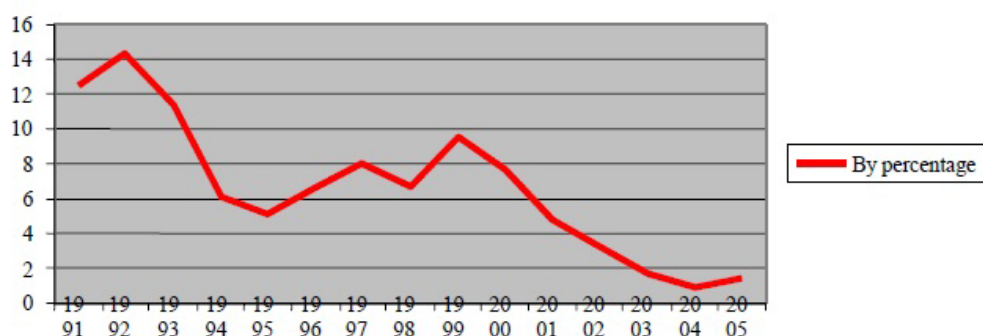
³Janeska, Verica, 2003. Migration of Highly Educated and Skilled Persons from the Republic of Macedonia, Skopje: Institute of Economics, at Skopje's University "Ss. Cyril and Methodius".

⁴Albania in Figures, 2010, page 9

⁵Albania in Figures, 2010, page 10

⁶From Brain Drain to Brain Gain: Mobilising Albania's Skilled Diaspora, page 3

Graphic 3: Percentage of emigrants from 1991 - 2005



Source: CESS, January 2006

As Horvat wrote that one of the most striking examples for brain drain is Albania, arguably Europe's poorest country. According to some sources, it was undergoing a potentially devastating brain drain. Around a sixth of the population—including roughly a third of the country's intelligentsia—was seeking work outside the country in 2001.⁷ This data is 10 years old, but from the graphic 3, we can notice that this trend has come to an end. It's hard to speak now for brain drain, maybe more about mobility and brain circulation.

Education system and statistics

The roots of education are bitter, but the fruit is sweet – Aristotle

There are a lot of debates about is there a need for government support and intervention in education. Is education creating positive externalities or not, is education market unfair, economic efficiency etc. In this work, we will consider education as a positive externality, so the government should subvention it.

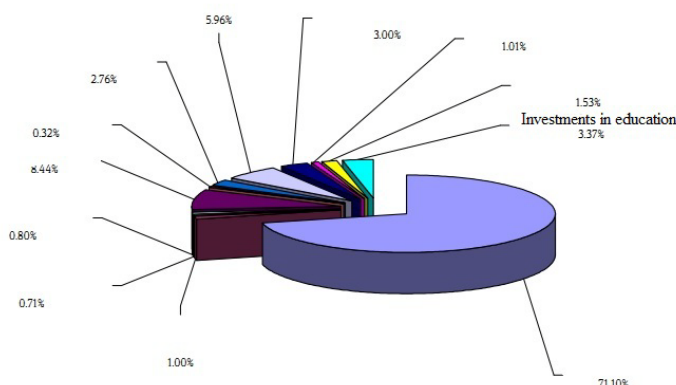
Similar to many public education systems, there is obligatory and free, primary and secondary education. Also, the government should produce the education with goal for society to gain positive externalities. Education improves the productivity and creates more informed and socialized citizen⁸. In Macedonia there are 4 public, 1 public-private and 19 private Universities. Macedonian government in their proposed budget for 2011 has decided to invest in education with 3.37% or 11 million €. (Graphic 4) Goals are: building and renovation of primary and secondary schools, construction of school sport halls, renovation of school and student public homes. The general goal of the program is improvement of conditions in schools, in public school and student homes which is essential for improved quality of education⁹. The goals of the Ministry of education and science are: implementation of 9 year primary education, improving school programs, program adjustment with Bologna process reforms and the credit transfer system, increased availability of high education through dispersed studies, development of science and research work, investments in technology and equipment etc.

⁷Brain Drain. Threat to Successful Transition in South East Europe?, Vedran Horvat, page 79

⁸ Public finance, 8th Edition, 2008, Harvey S. Rosen, Ted Gayer, page 138

⁹ Supplement proposed budget for 2011, 2010, Government of R. Macedonia, page 15

Graphic 4. Percentage for investment in education from supplement proposed budget for 2011



Source: Supplement proposed budget for 2011, Government of R. Macedonia

There is one interesting phenomenon happening in Macedonia, that is the number or the percentage of students which are enrolling at faculty, no matter public or private. And interesting fact is that the state statistical office is having contradictory data to this public opinion. In one research conducted in 2009 in Eastern region of Macedonia by Career and development Centre at University “Goce Delcev” Stip on representative sample of 1364 students from 4th year in secondary school, on the question: “Are you planning to continue your education?”, 93.2% of the students answered “Yes”.¹⁰ Almost, all the media are reporting about 85% + of enrolled students at the faculties. The number of graduates from secondary schools is almost constant, around 27 000 and according to State statistical office the number of students in last few years is declining.(Table 1) High education in Macedonia is available for almost all students, so the government has achieved the goal of availability of education. Somehow, there are few questions arising, having in mind that there is no entry test for faculty: are all students capable for enrolling at faculty, what is the impact on quality of education, are the programs adjusted to the business sector needs, is there a need for creating so many high educated people, are the students going to use their student status for leaving the country like Work and Travel programs, etc.

Table 1. Number of students enrolled in high education 2005 - 2010

Tertiary school (1 st year student)					
Year	2005-2006	2006-2007	2007 - 2008	2008-2009	2009-2010
Number of enrolled students	12 921	15 527	18 583	18 335	17 942
Percentage	45.5%	57.5%	68.8%	67.9%	66.4%

Source: State Statistical Office, R. Macedonia

In Albania there are 10 public and 33 private universities, much more than Macedonia and I suppose much older. Albanian government in 2007 has approved new

¹⁰ Research in Eastern region of Macedonia for 4th year students and their interest in continuing their education, 2009 by Career and development Centre at University “Goce Delcev” Stip

Law for higher education which main principles are: harmonization with the European higher education system and promotion of academic mobility of teaching staff and students, assurance of quality and efficiency of studies, participation of students in governance and decision-making, in particular in matters relating to teaching quality assurance, harmonization of teaching and scientific research and/or artistic work¹¹. Compared to Macedonia the fees are little bit smaller, in Macedonia on public universities one year costs 400€ and in Albania on public universities costs are between 90€ - 230€, except film studies which are 615€. While Albania's economy continues to grow, its total government expenditure is the lowest in Southeastern Europe with only 3% of its budget.¹²

From the statistical data taken from INSTAT Albania, the number of students enrolled in tertiary education is rising every year¹³(Table 2), so situation is seemingly similar to Macedonia. Ministry of education in Albania has almost similar goals as Macedonian that's adjusting higher education to Bologna process, consolidation of financial autonomy of higher education institutions, external and internal quality assessment (that's part of new proposed law for higher education in Macedonia), student mobility within the country and abroad etc. According to the report from Hatakenaka and Thompson, current percentage of the population/labor force (aged 25-64) with tertiary education was around 15/11% in 2004/2005, and it was the lowest compared with the countries in the region, for example Macedonia with 23%. Albanian government intention is that the percent of the working population with a degree should be increased to 25-30% by the year 2020, which suggests a reasonable target participation rate of around 25-30%. To achieve this, the capacity of the system would need to increase from about 43,000 full time students (in 2004-5) to nearer 60,000 by about 2020.¹⁴

Table 2. Students enrolled in tertiary education in Albania from 2004 - 2010

Year	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
Total number of students	63257	74157	86178	90202	93206	116292

Source: www.instat.gov.al, students enrolled in tertiary education

Education in every country is huge challenge for the government and policy makers, so we can't take it like something that is simple, easy to change and with short term solutions for ongoing problems. Although, it seems that the level of education is correlate with level of earning, in the most optimistic assessments 10% more investment in personal education creates only 1 -2% additional payment¹⁵, but it's hard to justify all the money that is spend in the educational system. There some ideas about improvement of the education, one of them is creating charter school. The idea is to create competitive market for schools about attracting more students to them, and the other important aspect is that

¹¹ Albania review of higher education,2010, Education, Audiovisual and Culture Executive Agency (EACEA) Unit P10 - Tempus and Bilateral Cooperation with Industrialised Countries

¹² Country profile , Education in Albania, 2005, UNICEF

¹³ <http://www.instat.gov.al>/ Number of enrolled students in terriary education, Visited: 08.04.2011

¹⁴ Albania Higher Education Report, 2006, by Sachi Hatakenaka and Quentin Thompson Report submitted to the European Investment Bank

¹⁵ Heckman James J.,1999, "Policies to foster human capital" , Working paper No. 7288

charter schools are publicly financed, but they are exempt from certain regulations and statutes, so they can experiment and independently make decisions about spending the money and employment¹⁶. This will create competitive market for other non-charter public schools, so there is a hope that they will improve their quality and became more efficient. Other proposal is school vouchers. The basic idea behind this is offering financial support directly to students, not to the schools. The third idea is school responsibility, in other words creating standardized forms of tests about student's success. However, providing good and according to the market needs education, creating self-conscientious, socially adjusted, morally and democratic person is more than important and it's better to go with baby steps and cleverly to plan, choose direction and create vision.

Strategy without tactics is the slowest route to victory.

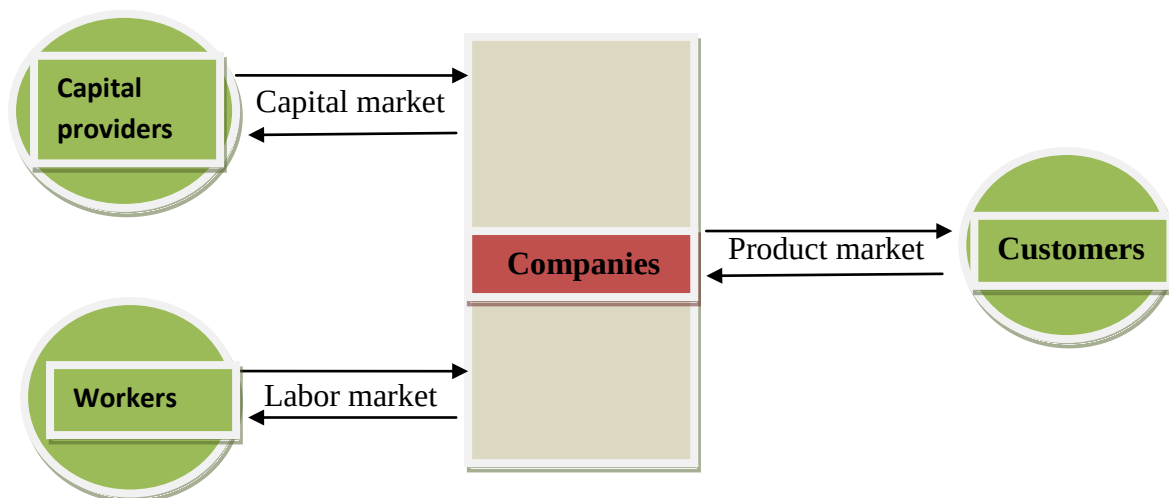
Tactics without strategy is the noise before defeat.

Sun Tzu, "Art of War"

Analysis and skills needed for the labor market

Labor market is one of the three markets on which they must successfully work if they want to survive. (Figure 4)¹⁷

Figure 4: Markets on which the companies must operate



The first thing that is important to mention about Macedonian labor market that is the percentage of unemployment which is 30.9%. According to the data of the State Statistical Office, in the IV quarter of 2010, the labor force in the Republic of Macedonia numbered 954 928 persons, of which 659 557 or 69.1% were employed and 295 371 or 30.9% were unemployed persons. (Figure 5) The activity rate in this period was 57.8, the employment rate was 39.9, whereas the unemployment rate was 30.9.¹⁸ One fact is very concerning, that is the years spend in job search for young people are really high, average is 9 years. This numbers are frightening and they last for years. Handling with long term unemployed is a huge challenge, but from the experiences from other European countries, training combined with active or career counseling and information about opportunities for job, had

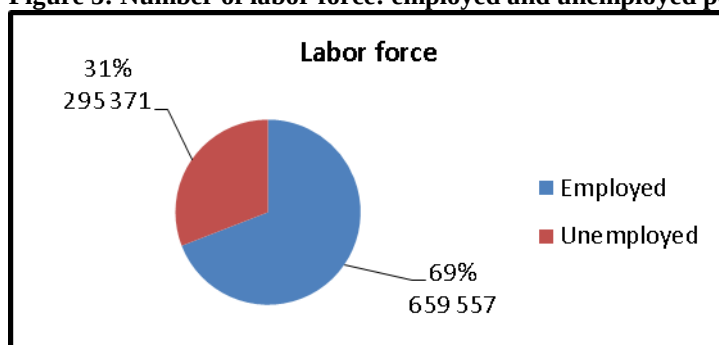
¹⁶ Public finance, 8th Edition, 2008, Harvey S. Rosen, Ted Gayer, page 144

¹⁷ Ronald C. Ehrenberg, 2010, Modern Labor Economics: Theory and Public Policy, page 35

¹⁸ News release, 24.03.2011, Year XLIX, No: 2.1.11.03, Labour market, State statistical office, R. Macedonia

shown like relatively effective tools. Contrary to that, in countries in transition, those tools are often ineffective. One idea is with creating temporary working places through public jobs or subventions for employment combined with job training and help with finding a job. Like preventive measure usage of career counseling and professional orientation are often useful and good starting point. Inexperience of the youngsters can be solved through practical work, internship and voluntary work. Government of R. Macedonia had approved regulation about obligatory internship for students at faculties. The sum number of students in Macedonia is more than 60 000 students. That's 1/5 from employed work force and from personal experience till now is that the business sector can't handle with such a huge number of interns. So, maybe the government decision for obligatory internship was based on wrong perception and the decision is inadequate to the labor market.

Figure 5: Number of labor force: employed and unemployed persons in Macedonia



However, lack of sufficient education is a major factor in unemployment - the LFS data shows that the employment rate (35-64 year olds) was only 31% for those with primary or lower education in 2006, compared with 77 percent for those with post-secondary education.¹⁹ The significant presence of unused, younger, skilled labour serves not only as a limiting factor to the growth of the Macedonian economy, but is also the main reason for the unwillingness of young people to get married and have children. This results in unfavourable demographic developments, and forces people to work and live abroad.” - Nikolovska, Margareta (2004).²⁰

Previously, I have mentioned about emigration and possible brain drain, and is hard to stay what is the real impact of the emigrants on the labor market, what is happening when people are leaving and what happens when they are returning, what are their chances for finding or creating job places etc. In the research conducted by GDN, India and IPPR, Great Britain they are trying to give answer of questions above and they have found out that:²¹

- Returners which are less than 3 months and with same age and same gender as the “home stayers”, have equal chances for finding job
- Those which are between 3 – 12 months have bigger chances for finding job
- After one or more years, there is increased chance for self-employment

¹⁹ FYR Macedonia Moving to Faster and More Inclusive Growth A Country Economic Memorandum (In Two Volumes) Volume I: Overview , June,2009, Report No. 44170-MK, page 11

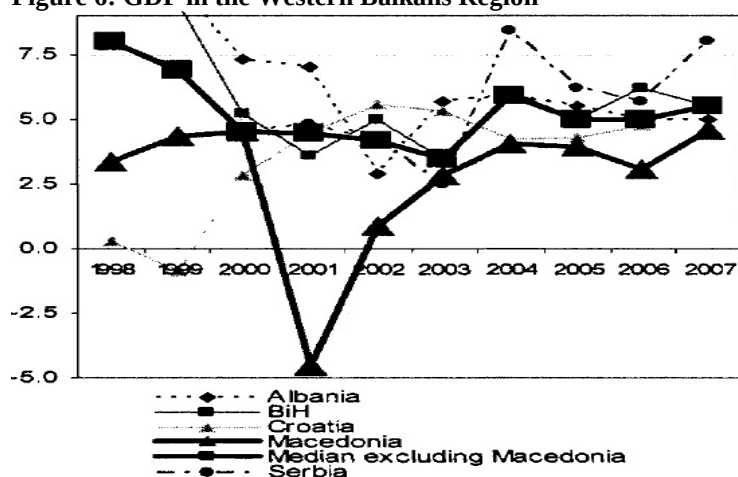
²⁰ Nikolovska, Margareta, 2004, Employment, education, and emigration: the FYR of Macedonia', Higher Education in Europe, 29: 3, page 319 — 328

²¹ Measuring and optimizing economic and social influences of migration in R. Macedonia, Development on the move, 2009, page 52

- Adults which are receiving dotation's, there is less probability for working as employees, but that depends from the family size

So, maybe the emigration is creating positive impact on Macedonian labor market, mostly about acquired qualifications, experience and better understanding of cultures for the emigrants. Macedonia needs to grow faster, to raise incomes and provide more jobs, which, accompanied by more human capital, will reduce poverty. Faster growth is needed, first and foremost, for reducing poverty, since it will create more jobs. But the pattern of growth also needs to change, and create jobs that will pay higher wages and allow workers to improve their standard of living. In turn, this means improvement in worker skills and education (across all segments of the population) to enable higher productivity. Faster growth will of course mean more rapid convergence: in 2007, Macedonia's per capita GDP, at purchasing power standards, was 29 percent of the EU27 average, compared with 42 percent for Turkey, and 55 percent for Croatia, the other candidate countries (Eurostat).²²

Figure 6: GDP in the Western Balkans Region



But regional comparators show that growth could have been faster. Despite the recent increase, GDP has grown more slowly than in the new member states or in the countries of the Western Balkans (Figure 6). Between 2003 and 2007, real GDP rose by a cumulative 18 percent in Macedonia, versus 24 percent in the Western Balkans (population-weighted GDP). While it is true that Macedonia suffered from the 2001 civil strife, most countries in the Central and East European region also suffered from various post-transition problems, but have been able to recover more quickly.²³

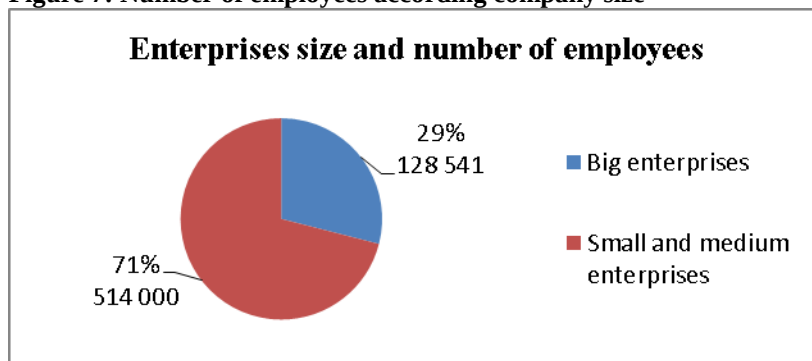
Macedonia spends a lot for National employment agency, around 1.43% from GDP in 2007, more than 60% from that or around 0.90% from GDP is used for pensions and health insurance for registered unemployed, and around 0.47% from GDP is used for passive programs. Less than 0.06% is used for Agency for promotion of entrepreneurship in Macedonia.

Few years ago, Macedonian minister for Economy, Mr. Fatmir Besimi said that about 99% from the registered enterprises are small and medium sized (SME), and that they are contributing in country's export with 50%. According to this, SME are the engine of Macedonian economy. (Figure 7)

²² FYR Macedonia Moving to Faster and More Inclusive Growth A Country Economic Memorandum (In Two Volumes) Volume I: Overview, June, 2009, Report No. 44170-MK, page 7

²³ FYR Macedonia Moving to Faster and More Inclusive Growth A Country Economic Memorandum (In Two Volumes) Volume I: Overview, June, 2009, Report No. 44170-MK, page 5

Figure 7: Number of employees according company size



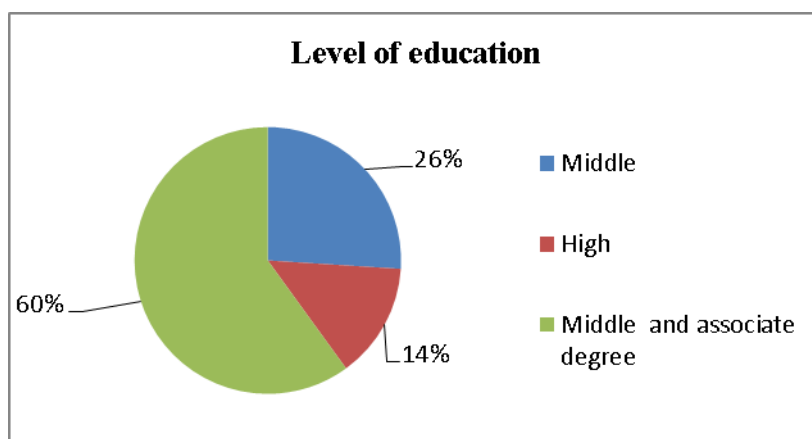
From 2006, once a year, Macedonian national agency for employment makes a research “Analysis for needed skills”. At first it was started as part of CARDS project and now National agency for employment (NAE) is doing with its own resources.

The goals of the research conducted by NAE are:

- Location of industries with biggest potential in R. Macedonia
- Location of industries with biggest need for labor in R. Macedonia
- Identifying needs for new employments in the next 6-12 months
- Identifying needs for labor regarding age, education, experience etc...
- Identifying needs for labor regarding skills, abilities, knowledge
- Creation of national plan with accent on educational process and business sector needs

According to research made in October- November 2009²⁴, companies are expecting more than 10 000 new employees, with more than 50% in manufacturing industry, others with more percentage are trade and construction. When asked about level of education, employers are mostly looking for middle and associate degree, 60.4%. (Figure 8)

Figure 8: Level of education for future employees



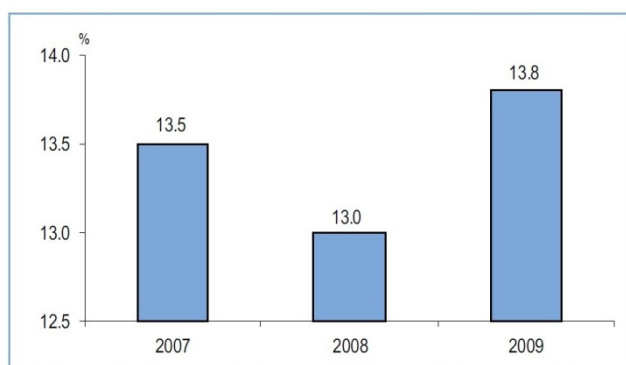
²⁴ Agency for Employment – Central Service, Results from “Analysis for skills needed on labor market in R. Macedonia”, 08.04.2010 (Received with request as Information from public character)

As a special skills and knowledge, companies are pointing: knowing foreign language - especially English, knowing new technologies - IT and basic pc applications, communication skills, teamwork, privacy, flexibility, skills for sales and marketing.

Despite the number of unemployment of 30%+, on a question “Did you faced a lack of work force while filling announced available working places in last 6 months?” 337 companies were facing problems and lack of work force on the labor market. As a problem they are stating: workers with experience which are deficit on the labor market, long absence from the labor market, additional skills and knowledge. In conversation with colleagues there is always one satirical statement: How can ONLY 337 companies had problem with finding workers?” Often, there are debates that educational system, programs and business sector needs aren’t synchronized, and that companies and universities aren’t communicating well. So, one big task for Macedonia is to improve this communication and take it to another level.

Albania still remains among the poor countries in Europe and faces a number of outstanding challenges. With per capita national income of just US\$2,960 per annum and a population of 3,1 million, Albania is classified as lowermiddle income country.²⁵ Main contributors to the economy are services with around 55 percent of GDP followed by agriculture with 23% of GDP and industry with around 19%.²⁶ It’s more than obvious that Albania doesn’t have so big problems with unemployment as Macedonia.(Figure 9)

Figure 9: Unemployed rate



Source: Labor Force Survey, INSTAT²⁷

From the latest report from INSTAT, the registered unemployment rate for the third quarter 2010 was 13.49 %²⁸. Male labor force participation rate is 72.1 percent while female labor force participation rate is 52.8 percent. A challenge for Albania is more involvement of the women in the labor market. Considering the development, Shkodër, Diber, and Elbasan are having the most of the families which are registered for social assistance, that’s around 40%. Also we must mention rural areas, which are still struggling with development. The activity rates of the population are satisfactory – at least among the male population – but the quality of jobs is poor. The total employment rate is very close to the EU-25 level (63.3% in 2004) because of the high employment rate in subsistence farming in rural areas. In the cities the female employment rate is particularly low because

²⁵ Albania decent work country programme document 2008 – 2010, ILO, page 1

²⁶ Mapping of Creative Industries in Albania, 2007, British Council Albania , page 12

²⁷ Labour Force Survey, Statistical yearbook 2010, INSTAT, page 13

²⁸ Quarterly statistical bulletin , IV 2010, INSTAT, page 9

of limited labour demand. Furthermore, those women who migrate from rural areas have insufficient skills for the limited number of formal jobs available, usually in the public and banking sectors. Compared to levels at the beginning of the transition period, unemployment has decreased, though it is high when measured against the EU-15 level (8.1% in 2004). Young people looking for their first job are particularly hard-hit by unemployment²⁹. In 2005, the share of young informal workers was estimated to total approximately 70 per cent of all young workers. The mobility between employment statuses is rather low. Only 15 per cent of the unemployed and 10 per cent of the inactive in 2002 had managed to find jobs in the formal economy two years later, while as many as 38 per cent of jobseekers had found jobs in the informal economy, and almost half of all informal workers were still in the informal economy two years later³⁰.

Similar to Macedonia, small and medium sized enterprises are dominating the market. In other words, the enterprises with 20 and more employed dominate the economy. In 2009, there have been active 73.7 thousand enterprises. These enterprises have 251.7 thousand employed, where 45 percent of them worked in 1,485 enterprises with 20 and more persons employed. These enterprises have realised also 58 percent of the total turnover and 66 percent of the total investments. These enterprises dominate in industry and construction sectors. Enterprises with 1-4 employed represent 92 percent of the total enterprises. They have realised 19 per cent of total turnover. Small enterprises are dominant in service producers.³¹

Table 2: Enterprises, Employed, Turnover and Investments by activity, 2009

Aktiviteti ekonomik	Ndërmarrjet Enterprises		Të punësuarit Employed		Shifra e afarizmit Turnover		Investimet Investments		Economic activity				
	nr. / no.	%	nr. / no.	%	mln Lekë	%	mln Lekë	%					
Gjithsej	73,702	100	251,799	100	1,149,470	100	93,600	100	Total				
Prodhuesit e të mirave	11,760	100	16	114,420	100	45	434,274	100	38	45,439	100	49	Goods producers
Industri	8,468	11.5		77,642	30.8		225,062	19.6		35,990	38.5		Industry
Ndërtim	3,292	4.5		36,778	14.6		209,212	18.2		9,449	10.1		Construction
Prodhuesit e shërbimeve	61,942		84	137,379		55	715,196		62	48,161		51	Service producers
Transp.kom.	8,125	11.0		23,923	9.5		114,365	9.9		22,873	24.4		Transp.& Comm.
Tregti	35,642	48.4		67,547	26.8		536,625	46.7		13,438	14.4		Trade
Shërbime	18,175	24.7		45,909	18.2		64,206	5.6		11,850	12.7		Services

Source: Annual Structural Survey of Enterprises 2009, INSTAT

As we can see from Table 2, it looks like that the leading part of Albanian economy is trade with 26.8% employment, 48.4% from all registered enterprises and 46.7% turnover, so it represents the main employer and engine in service producers. Almost 40% of job seekers in Albania in 2009 were between 15 -34 years, so it's essential for them to know what kind of profiles the enterprises are looking for and what kind of skills they should possess in order to be more competitive on the labor market. When speaking for youth unemployment ILO (International Labour Office) with Albanian government had started a project in 2009 in which one of the outcomes is youth employment policies and programmes and the impact on informal economy and management of migration. These programmes target underemployed and informal young workers who are exposed to

²⁹ Labour market review of Albania, 2006, by Agron Hetoja (national expert), Terry Corcoran (international consultant), Anastasia Fetsi, Natalia Popova and Francesco Panzica (ETF experts), page 7

³⁰ World Bank, Albania: Labour market assessment, Washington D.C. 2006

³¹ Annual Structural Survey of Enterprises 2009, INSTAT, page 1

migration and are mostly engaged in subsistence agriculture. Implementing vocational education and apprenticeship programs in the country will be important step towards. In one research in 2007 by British council, "Mapping creative industries in Albania", they have found out that more than 80% of surveyed companies are planning to invest in new technology for improving the quality of the products (49.7%), to introduce new ones (28.2%) and to increase the volume of their work (10.9%).³² From the findings, knowing the new technologies and IT skills, one foreign language - particularly English, knowledge in management and finance, marketing consultancy, soft skills are very important competitiveness on the labor market.

Conclusion

Macedonia was ranked among the top five reformers in the world in Doing Business 2008, climbed a further nine positions in Doing Business 2009, and saw solid improvement in Transparency International rankings over 2006-08.³³ Macedonia has been working a lot about promoting youth activism and entrepreneurship as a way for young people for starting and creating job places. In the last few years a lot of companies have shown up which is offering trainings, prequalification, certification, and so on. The most important thing about this is that there often expensive, so rarely who can afford them and gain new skills, knowledge and abilities. That's the place where the formal and informal education should stand up. Improving programs at the all the levels of the educational process, especially at the universities, better cooperation with the business sector and NGO's, promoting mobility, voluntary work, internship, but not in an obligatory way, but through work with quality students who wish to invest in them and learn about work and future working place.

In Albania absolute poverty declined to 12.4 per cent by 2008, or less than half the 2002 level, and also well below the figure of 18.7 per cent recorded in 2005. In numeric terms, more than 200,000 people out of 575,000 poor people had been pulled out of poverty. The country had become part of NATO in 2009, has successfully managed to weather the effects of the global financial crisis, at the same time maintaining a sound growth.

Consideration should be given to a more expanded programme that provides jobs for welfare recipients on minor public works projects, particularly in smaller towns and villages outside the main urban areas. Both countries, Macedonia and Albania are still having a problem with informal economy and that will be a big challenge for both countries in upcoming period. Very important category is small and medium enterprises. They need training programs to assist them to develop their businesses and increase their capacity in business management, taxation systems, advertising and creating networks, as well as the search for innovative ideas and alternatives. Unemployed individuals rarely visit the offices other than when they are required to do so for the purposes of registering for benefits or assistance. The national employment agencies are having lack of staff, in Macedonia it's 1 to 654 and in Albania 1 to 364, so most creating active policies and field work is maybe just an utopia. Both countries are having tradition with migration, but the

³² Mapping creative industries Albania , 2007, British council, page 29

³³ FYR Macedonia Moving to Faster and More Inclusive Growth A Country Economic Memorandum (In Two Volumes) Volume I: Overview , June,2009, Report No. 44170-MK

more recent literature on brain drain claims that sending countries can benefit from the return of migrant professionals, bringing back increased skills and knowledge³⁴.

In addition, from the report “Workforce 2018: Future is now” by Hogan & Hogan, these are the projections for US economy:³⁵

Ten Occupations with the Greatest Growth Increase 2008 – 2018

(US total projected job growth = 10.0%) US Bureau of Labor Statistics

Food Preparation and Servers	3,149,426	14.6%
Customer Service Representatives	2,736,825	17.7%
Long Haul Truck Drivers	1,845,612	13.0%
Nursing Aides and Orderlies	1,699,615	18.8%
Receptionists	1,302,100	15.2%
Security Guards	1,214,882	14.2%
Construction Laborers	1,180,571	20.5%
Landscapers and Groundskeepers	1,128,803	18.0%
Home Health Aides	1,058,041	50.0%
Licensed Practical Nurses	825,651	20.7%

There is a huge need for Macedonia, and I presume for Albania, for this kind information and sharing between public, business and NGO sector. Without coordinate action, sharing information and creating long term strategy, it will be really hard for small countries like Macedonia and Albania to succeed on the global market.

And as great leader, Sun Tzu, said: “In respect of military method, we have, firstly, Measurement; secondly, Estimation of quantity; thirdly, Calculation; fourthly, Balancing of chances; fifthly, Victory”.

³⁴ Working Paper T-25,2008, Highly Skilled Migration from Albania: An Assessment of Current Trends and the Ways Ahead, Etleva Germenji and Ilir Gedeshi, Page 8

³⁵ Workforce 2018: The Future is Now, 2011, Robert Hogan and Joyce Hogan

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International Student Conference on Economics and Finance

**Conceptualizing and implementing a long-term regional development policy
complimentary to decentralization reform**

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Abstract

This paper will focus in key challenges on conceptualizing and implementing a Regional Development Policy as a very new area of public policy in Albania.

At the moment it seems that regional development in Albania is associated mainly if not exclusively with decentralization and the scope of action of regional (county) councils. Although this link is evident and in most cases inevitable, it should not lead to the interpretation that regional development is equal to decentralization or to transfer of competencies to regional level (regional authorities).

Though the paper we will draw a distinction between decentralization and regional development policy and explain that does not mean that they should not go hand in hand. Regional development policy should be designed and implemented in close coordination not only with decentralization reform (and eventually administrative-territorial reform) but also with other major national policies and reforms.

Distinguishing feature of regional policies is that they are pro-active socio-economic development policies with a specific regional focus. Regional development does not simply involve a reactive transfer of resources between regions; rather, they have clear long-term regional economic development aims and explicit spatial objectives and involve active policy interventions at the regional level to achieve these aims and objectives.

In Albania the preparation of strategies for decentralization on the regional level and the design of regional policies required significant time; reaching political consensus

and implementing the process were not always straightforward and positive results were not always immediately achieved.

Introduction

As Albania is accelerating its preparations towards the EU candidate country status, numerous areas of public policy and practices undergo intensive development processes. Pressure for regionalization has thus come from two directions. Externally there has been the EU imperative regarding the need to establish the institutions necessary to administer the *acquis* at a national level and to effectively participate in EU regional development programmes at the regional level. Internal pressures arise through the increasing recognition of the emergence of regional development disparities as the transition process unfolds.

One of the most important policy domains in this respect is regional development, which initially will allow the country to tap into Instrument for Pre-accession (EU, European Union, 2006)(IPA)¹ Component III² money, and in the long term will decide on effectiveness and efficiency of use of the EU Structural Funds.

Regional development and Albania's preparedness for managing future IPA funding are becoming increasingly strategic priorities for structuring the country's development policy throughout the territory.

Defining regions

¹ In order to improve the efficiency of the Community's External Aid, a new framework for programming and delivery of assistance has been envisaged. The present instrument constitutes one of the general instruments directly supporting European External Aid policies. The IPA instrument seeks to provide targeted assistance to countries which are candidates or potential candidates for membership of the EU rationalizing Pre-Accession Assistance by replacing the various instruments which previously existed for the assistance which the Phare/ISPA/SAPARD/CARDS/Turkey Instruments. IPA prepares, *inter alia* candidate countries for the implementation of Structural and Cohesion Funds and Rural Development on accession, by specifically supporting institution building and introducing procedures as close as possible to the Structural Funds.

² The five IPA components for each component are detailed in Art. 3 (a) of the IPA framework Regulation: (I) Transition Assistance and Institution Building, (II) Cross-Border Cooperation, (III) Regional Development, (IV) Human Resources Development, (V) Rural Development. The first two components apply to all countries. Additionally, candidate countries also benefit from components III, IV and V.

A region is essentially a part of the land surface of the earth. In the geographical literature regions are defined in three ways as, respectively, uniform, functional and administrative areas (Dunford, 2008). Most useful for economic development purposes are functional areas which combine places characterized by strong degrees of interdependence and strong complementarities. Examples include market areas that combine market centres where the function is performed and the places in which the people who use those market centres reside. A classic case is afforded by Christaller's (1933) theoretical account of the size, number and spacing of market centres and market areas in Southern Germany. Another example is a travel-to-work area which combines places of employment and the places where the people who work in those places of employment live. As this definition implies, functional areas are essentially city regions.

The degree of emphasis placed on functional definitions of regions varies. In part this variation reflects the shifting relative importance attached in geography to the study of regions as self-contained entities (as in the regional tradition and more recent 'territorial' approaches to regional development studies) (Wrigley, 1965) (Pike, 2007) and as places that can only be understood in terms of their relationships with other places (as in the location tradition and in recent relational approaches to economic geography (Wrigley, 1965; Pike, 2007).

There has been significant debate and confusion in Albania as to exactly what is meant by the term "region". Different criteria have been used in subdividing national territory into regions. These are normally split between normative and analytic criteria:

- **Normative regions** are the expression of a political will; their limits are fixed according to the tasks allocated to the territorial communities, according to the sizes of population necessary to carry out these tasks efficiently and economically, and according to historical, cultural and other factors. In Albania the two levels of normative region are the Qark (County) and the Commune/Municipality.
- **Functional regions** are set up for a specific purpose: for example several countries have established functional regions for the purpose of the management of EU Structural Funds. For example, the United Kingdom has no normative region comparable to the EU's Nomenclature of Territorial Units for Statistics (NUTS) II region (an explanation of NUTS regions and its compatibility with Albania's regional policy will in chapter 5). The EU has created functional regions (comprising groupings of counties (normative regions) solely for the

purpose of programming Structural Funds. In Albania the district (which is no longer a normative region, but is still a level of statistical collection) is a functional or analytical region.

There were three precursors for the adoption and practice of regional development policy and planning in Albania (Kern, 2001):

- The first concerns the country's historical and socio-economic condition vis-à-vis development policies or directions taken prior to its adoption.
- The second relates to the general physical, cultural and political features of the country.
- The third factor is the government's continuing search for better administrative machinery.

A number of regions in the country lag behind the more developed ones in terms of growth, employment and provision of basic services to their growing population. These depressed regions especially the rural areas became the seat of discontent in many instances in the past. The rapid migration of population to a few urban areas of more developed regions resulted in serious employment, housing, health and other congestion problems. This premature migration made urbanization more an aspect of poverty than a symbol of growth.

General administrative and territorial background to Regional Development in practice

The territorial division of Albania is governed by Law No. 8652/00 (on the organization and functioning of Local Governments) and Law 8653/00 (on Administrative Territorial division). This legislation divided the country into two levels: regions/counties (qarks)³ and communes/municipalities. The region represents a territorial administrative unit with an average population (in 2004) of 260,605. The counties are sub-divided into districts (but the latter ceased to be a normative sub-division of the country following the passage of the two laws described above). From the administrative viewpoint, based on the above mentioned Albanian law of July 2000 the country is presently divided into 12 Regions/Qarks/counties (nominative regions), 309 communes and 65 Municipalities. Qarks/ counties are divided into 36 districts which represent geographical units composed by the aggregation of communes and/or municipalities sharing common historical, geographical and cultural features.

³ We will consider here region=counties/qark, the same refers for the regional development in Albania

Communes and municipalities are divided into cities and villages, which represent the lowest administrative unit in urban and rural areas respectively. Cities with more than 15 thousand inhabitants are subdivided into municipal units. Communes and municipalities belong to the same administrative level. Commune boundaries include rural areas, while municipalities correspond to urban areas.

The twelve regions were established with a threefold purpose:

- To optimize the provision of public services. The small size of local government units impedes any economies of scale and often the endemic poor infrastructure and shortage of capacities and capital lead to a lack of investment.
- To provide a platform for achieving a common interest shared by all or a group of communes and municipalities within the boundaries of the region. Inter-municipal cooperation is one of the means that works towards this end.
- To ensure the alignment of local, regional and national priorities and the harmonization of local and regional policy with national objectives.

The organization, functions, duties and sources of revenues of the regional councils are defined in the Law on Organization and functioning of Local Governments (hereinafter the Law No. 8652). Organizationally, it specifies that regional councils are composed of representatives of the communal and municipal Councils. Within this body, a board is established whose members, and executive posts of Chair and deputy Chair, are elected by a majority vote of councilors. The Regional Council approves the regional statute in which the responsibilities and internal organization are defined. The administrative structure of the regional councils may differ by region, although the following units are usually present: public service, urban, finance, legal and land administration departments, cadastral and protocol offices, program and development office (in charge of strategy development), and personnel section.

The role of the Regional Council in the process of decentralization and regional development is important. However, proper capacity and institution building (including improved horizontal and vertical inter-governmental cooperation and donor coordination) is necessary in order to avoid the risk of having the resources without a mechanism to initiate delivery. This could impede the implementation of Regional Development Strategies and could limit the ability of the regional councils to perform their role in coordinating the implementation of regional policies through facilitating cooperation among local governments and with the central level.

Ambiguity prevails regarding the status/role of the regions in Albania. As mentioned above, the Regional Council is not directly elected by the citizens of the respective regions. The indirect election of the members of the Regional Council is stipulated in the Constitution (Art.110). International experience demonstrates that an indirect form of representation at the regional level means that the community members will lack democratic influence on the way local services are managed (Marinov, 2004). This often results in a lack of accountability on behalf of the regional councils. The regional councils are perceived more as local government associations, rather than in their envisioned role as an intermediary level of government able to effectively promote regional development and facilitate cooperation among local governments. Examination of the system of local government in Albania shows that the requirement of the regional level is also supported by the need for better coordination and planning.

Albania's local governments are characterized by significant disparities in size and capacity. This results in the inability of communes and small municipalities to take responsibility for public services that require large or/and increasing scales of production and which also involve significant externalities (e.g. water supply, waste management, secondary education). The challenge of fragmentation includes not only economical efficiency but also the administrative and technical capacities of local governments to provide services in an efficient and effective way. As international experience proves, the fragmentation of local government systems is related to the extent of financial decentralization (Commission of European Communities, 2001). It is apparent that larger municipalities are able to carry out a wider scope of functions than smaller municipalities and communes.

Furthermore, in numerous cases the autonomy of the smallest local governments is mostly symbolic, as in practice they are unable to take responsibility for any significant public service. For these reasons, the fragmentation of the local government system in Albania may act as a serious constraint for the further process of decentralization in the country and as an argument against decentralization.

The above challenges have prompted a discussion among the government and the Albanian think-tanks about the need for revision of the administrative and territorial division of the country (TAEX Mission and Charlie Woods, 19-22 May 2008). The main objective is perceived as twofold: a/ to overcome the fragmentation, deepening regional disparities and differences in size and economic capacities; and b/ to align with the EU requirements of minimum population sizes for its regional development funding. Some of the possible strategies for consideration and further pursuit are:

amalgamation of local government units, establishing voluntary associations, provision of incentives and technical support for inter-municipal cooperation, establishment of planning-structural regions equivalent to European NUTS (II-III) level, amongst others.

Regional development policy and reform

At the moment it seems that regional development in Albania is associated mainly if not exclusively with decentralization and the scope of action of regional (county) councils. Although this link is evident and in most cases inevitable, it should not lead to the interpretation that regional development is equal to decentralization or to transfer of competencies to regional level (regional authorities). Decentralization is only a means to an end and not an end in itself (World Bank, Albania: Decentralization in Transition, 2004).

Drawing a distinction between decentralization and regional development policy does not mean that they should not go hand in hand. Regional development policy should be designed and implemented in close coordination not only with decentralization reform (and eventually administrative-territorial reform) but also with other major national policies and reforms.

Development is more than delivery of services and regional development policy should not be associated only with fiscal equalization policies, uniform service provision regulations or the transfer of more competencies and resources to regions. *Distinguishing feature of regional policies is that they are pro-active socio-economic development policies with a specific regional focus.* Regional development does not simply involve a reactive transfer of resources between regions; rather, they have clear long-term regional economic development aims and explicit spatial objectives and involve active policy interventions at the regional level to achieve these aims and objectives.

The Albanian government and society have invested great effort in the decentralization reform especially after the preparation and adoption of the Decentralization Strategy (Department for Strategies and Donor Coordination, 2008). Significant progress has been made in this direction, even if in many cases the results are perceived as unsatisfactory. Albania has committed itself to speed up and deepen decentralization with a strong focus on immediate actions on the local level and especially on strengthening the financial capacity and autonomy of local authorities (municipalities and communes), as well as on increasing the mandate of elected officials from three to four or five years.

At first sight one could get the wrong impression that the regional level of governance and, more broadly, regional development and regional policy have been neglected despite the significant regional disparities and perceived need for regional actions (complementary to actions on the national level) and stronger regional development policy. In reality such conclusions could be misleading, as regional councils have been established and are operational (although there is room for improvement and enhancement of their operations), regional development strategies reflecting a new approach to development have been prepared in all regions.

In fact, the approach to decentralization and regional development policy in Albania is logical and is in no way unique. In all post-socialist societies in Central and Eastern Europe the first priority of decentralization has been to re-establish and strengthen local self-government as well as to complete the most urgently needed macro-level reforms. Only later has the issue of regional policy, regional level of government and in many cases introduction of regional self-government appeared on the political agenda. Some other common features of CEE countries should be noted: in most cases the formulation of a “national” policy for regional development has been strongly influenced, if not initiated, by prospective EU accession and the related access to EU funds (Payne, 2004) (EU, European Union, 2006).

In most cases the design of regional policy and especially the restructuring of the regional level and regionalization (the introduction of regional self-government or at least significant change in the administrative territorial structure) became a “stumbling block” to the reforms (Illner, 1997). In most cases the preparation of strategies for decentralization on the regional level and the design of regional policies required significant time; reaching political consensus and implementing the process were not always straightforward and positive results were not always immediately achieved.

Therefore the approach of the government not to deal immediately with regional level of government and regional development policy seems to be both rational and practical, indeed this approach has been supported by the road-map for decentralization in the World Bank report (2004). There are too many uncertainties, too many different experiences on the ground, too different and sometimes radical proposals and not enough clarity, consolidated visions and consensus to attempt to introduce significant changes immediately (or if such steps will be taken they will face the risk not to be well thought and prepared with related negative implications).

However this does not mean that the issue of conceptualization of regional policy should be postponed to a “better” time. The discussion and preparation should start immediately in order to agree on specific political options that, when fully developed, could be implemented through legislative changes, establishing new structures and supplying them with the required resources, developing new systems and inter-institutional relationships, etc.

Regional development and regional policy design are often perceived as “experiments”, as processes of “learning by doing”, based on the feedback principle (Marais, 2001) (McGarney, 1999). A large number of initiatives have supported this experimentation. Therefore the conceptualization of regional policy should be based on the already existing and diverse experience in the country gained in the last few years, especially with the development of regional development strategies and the transfer of new competencies to regional councils. It seems that it is the right time to consolidate this experience (on the basis of its assessment) and to mainstream it into national policy.

Regional development policy is a very new area of public policy in Albania. Formally regional development is mandated mainly under the duties of the Ministry of Economy, Trade and Energy (METE). The Directorate for Public Investment Programming is responsible for balanced regional development through harmonization of sectoral and regional policies. The Directorate must also coordinate with local government units the preparation and implementation of economic strategies and programmes.

In reality, however, because of the absence of a national policy for regional development and relatively low leverage, and also due responsibility being placed on one line ministry, the role of the Directorate in regional development is quite limited. Consequently there is no strategy or action plan for addressing the socio-economic disparities and regional inequities, which would allow for more effective targeting of resources. It should be noted that in most of the new EU member states an inter-ministerial coordination body (i.e. council for regional development), was established at the national level to develop the regional policy and supervise its implementation, and one of the ministries was authorized by the Government to coordinate the implementation of the regional policy.

Most of the twelve Albanian regions have already worked through one or more cycles of Millennium Development Goals (MDGs)-based Regional Development strategy⁴ preparation and implementation (HDPC, Human Development Promotion Center, 2005). The quality and the content of strategies differ and they are not compatible since different methodologies were used. While some regions may find it useful to return to a step or a process that may have been skipped over, such as: consolidating multiple sectoral strategies into an overarching framework; linking regional priorities with NSDI; establishing forecast indicators; costing and potential partners; resource mobilization strategy, etc; others may find it more urgent to focus on improving their data collection and monitoring system, operationalizing the strategies, preparing action plans and costing priorities thus further pursuing implementation.

Conclusions and recommendations

If growth in Albania is to be increased and sustained, investment in physical and human capital needs to be increased, innovation needs to be stepped up and Information Communication Technology widely used to boost productivity and employment. This, however, ought to happen not just in regions which are relatively more developed (e.g. Tirana) but throughout the country. Therefore wide regional disparities should not be ignored. These differences stem from structural deficiencies in key factors of development and competitiveness; inadequate endowment of physical and human capital (of infrastructure and skilled human resources), a lack of innovative capacity, of effective business support and a low level of environmental capital. Regions need assistance in overcoming these structural deficiencies and in developing their comparative advantages in order to be able to fight poverty, achieve higher levels of human development. This in turn requires that a regional development policy be established in Albania, which would address the above challenges through targeted support and the creation of a supportive investment climate.

⁴ In order to unify the approach to regional development planning, a manual on preparing regional development strategies was developed by METE in cooperation with UNDP since 2004. The manual outlines the methodology and promotes a unified approach to regional development planning. However, the manual gives little attention to the alignment of regional development strategies with NSDI and other sectoral strategies, and the links between regional planning and priorities/strategies of municipalities and communes are insufficiently addressed. The manual is also too complex and lengthy to be practically applied by civil servants on a daily basis. It should be noted, that the manual can only make recommendations and it is not necessarily used for the development of the RDSs in the regions.

The central government should vigorously pursue national cohesion policy to tackle disparities, whilst the donor community should respect national priorities and align its aid with them. The financial support to underdeveloped regions will come from domestic and external sources, including Official Development Assistance, Foreign Direct Investments and in the future EU pre-accession/ structural funds (DSDC, Department for Strategy and Donor Coordination, 2005).

Therefore, the need to establish a *regional development policy in Albania* is manifested by a number of reasons, as confirmed by a growing understanding among various stakeholders, including the business community, the donors and central and local government institutions.

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THE FISHER EFFECT: ALBANIAN APPLICATION

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Abstract:

This paper analyses the Fisher Hypothesis and the possibility of a Fisher Effect in Albania. By using a simple linear regression model it finds the relationship between nominal interest rates (deposit rates) and inflation rates in the Albanian economy in the long run. The empirical analysis in this study shows the impact that the changes in inflation rate have on the nominal interest rate and as a result it supports the existence of a weak form of the Fisher effect in Albanian economy.

Key Words: Nominal Interest Rate, Real Interest Rates, Expected Inflation

1- Introduction

The relationship between interest rates and inflation rates has been one of the most important and most studied relations all over the world. This type of relationship is also called the Fisher Effect or Fisher Hypothesis. It states that a one percent increase in the inflation rate will affect the nominal interest rate to increase by one percent leaving the real interest rate unchanged (Fisher 1896, 1930). There is a positive relationship between nominal interest rate and the expected inflation depending on the degree to which the fisher effect holds in any economy.

In this analysis the existence of such a relationship in Albania will be examined. Albania is a country coming from a severe communist regime with a closed state-owned economy and after 1990 it has undergone a transition into an open-market economy. The economical, political and social developments undertaken during the last two decades have enriched the functions carried out by the ¹Bank of Albania aiming to achieve and maintain the price stability. Since inflationary expectations influence nominal interest rate, the Fisher effect has too many implications for debtors and creditors as well as for the effectiveness of monetary policy and efficiency in banking sector (Hasan 1999).

And what is more important, because inflation is a key factor in economies, and because the difference between nominal interest rate and real interest rate affects all savings and investment decisions in any economy, the understanding of the Fisher Effect is an important factor in gaining knowledge about how each economy runs as a whole and how different economies interact with each other.

In analyzing the existence of the Fisher effect in Albania:

Section 2 of this paper will cover the Fisher effect and the Fisher equation and will provide the relevant definitions.

Section 3 will provide with some literature review.

Section 4 will show the data and the methodology used to make the analysis and using the linear regression analysis will show if there is any relationship between the changes in inflation rate and the changes in the interest rates in Albania.

Section 5 will conclude whether there is any relationship between inflation movements and changes in interest rates. If yes, to what extend these two variables move together and as a result to what extent the Fisher Effect holds in Albania.

¹ The Bank of Albania is the monetary authority of the Republic of Albania or the so called Central Bank of Albania. It has the exclusive right to design, approve and implement the monetary policy in Albania.

2- The Fisher Effect

The ²**Fisher effect** also called as the **Fisher Hypothesis** is “the one for one relationship between nominal interest rate and the expected inflation” (Mankiw 2006). It implies that a one percent change in the inflation rate will cause the nominal interest rate to change by one percent keeping the real interest rate unchanged. It is mathematically shown as $\Delta\pi^e = \Delta i$.

2.1 The Fisher Equation

The Fisher equation is the equation which links the nominal interest rate i , the real interest rate r , and the expected inflation π^e . It can be used in both the ex-ante and ex-post analysis. The difference is that the ex-ante analysis makes some predictions about the future inflation rate thus it uses the (expected) inflation but the ex-post analysis uses the realized inflation rate or the actual rate of inflation. The same thing is for the real interest rate

The Fisher equation can be shown as follows:

$$i \approx r^a + \pi^e \Rightarrow r^a \approx i - \pi^e \quad (\text{ex-ante}) \quad (1)$$

and

$$i \approx r + \pi \Rightarrow r \approx i - \pi \quad (\text{ex-post}) \quad (2)$$

Where:

- (r) is the **real interest rate** which shows the cost of borrowing and is very important when making an investment decision.
- (r^a) is the **ex ante real interest rate** which measures the real cost of borrowing given the inflation expectations.
- (π) is the **(actual) inflation rate** which shows the change of the price level between two periods. It can be observed from the CPI (Consumer Price Index) and the GDP Deflator.
- (π^e) is the **(expected) inflation rate** which shows the expected rate of change of the price level between two periods.

² Is named under the famous economist Irving Fisher (1867-1947) of Yale University

3- Literature Review

As we mentioned in the introduction part, Fisher Effect is one of the most studied relationships. Many empirical studies have been done in both developing and developed countries in order to test the existence of the Fisher Effect.

According to Boudoukh and Recharadson (1994) there is a positive relationship between interest rate and inflation rate in both short run and long run but in contrast Mishkin (1992) could not find such a relationship for the USA in the short run but only in the long run in which inflation and interest rates have a common stochastic trend when they exhibit trends. These results indicate that a strong Fisher effect will only appear in samples where inflation and interest rates have trends.

Berument & Jelassi (2002) showed that the empirical evidence supports the hypothesis that there is a one-to-one relationship between the interest rate and inflation for more than half of the countries under study. This was the result after the study of a sample of 26 countries by assessing the long run relationship between nominal interest rates and inflation rates taking into consideration the short run dynamics of interest rates. They used a simple model testing for a positive linear relationship between expected inflation and interest rate where inflation rate was taken as an independent variable and interest rate as a dependent variable. In such models if the coefficient of the independent variable has a value which is positive or equal to one, this means that there is a one to one relationship between inflation rate and interest rate. When the estimated coefficient is positive but less than one, this means that the Fisher effect is of a weak form.

Also Yuhn (1996) has reported that Fisher effect is more likely to be present and is stronger over the long horizons but it can also be found in the short term data.

Hasan, H. (1999) in his paper concerning the Fisher effect in Pakistan finds that there is a long-run relationship between nominal interest rate and inflation rate and accepts the partial Fisher Hypothesis. The acceptance of partial Fisher Hypothesis in case of rational expectation suggests that the rate of interest does not reflect all relevant information and real interest rate does not show a random walk behavior, which indicates in the inefficiency in the banking sector.

Evans and Lewis (1995) characterize the changes in inflation by a Markov switching model. They argue that the rational expectations of infrequent changes in the inflation process induce significant small sample biases in estimates of the long run Fisher relationship. According to them these small sample biases may create the appearance of permanent shocks to the real rates even when none are truly present. They examine the long run relationship between nominal interest rates and inflation rate and they accept that in the long run nominal interest reflects expected inflation one for one.

Even though many studies have found a positive relationship between the inflation rate and the interest rate, some other studies have found a negative relationship between inflation rate and interest rate. Hahn (1970) reports a negative relationship between inflation and interest rates.

4- Data, Methodology and Analysis

The data concerning Albania includes the deposit interest rate which represents the nominal interest rate, the real interest rate and the inflation rate for a timeline of (1992-2009). These data are taken from the World Bank (World Development Indicators and Global Development Finance 2010) and are also shown at the appendix part at Table1. This study uses the regression analysis model in order to find the relationship between nominal interest rate and the inflation rate and the impact that changes in inflation rate have on nominal interest rate.

The linear regression equation is as follows:

$$Y = \alpha + \beta * X + \varepsilon$$

Where:

(Y) is the dependent variable

(X) is the independent variable

(β) is the coefficient of the independent variable

(ε) is the standard error

We can substitute for i (nominal interest rate) and π (inflation rate) and the linear regression equation than becomes as follows:

$$\pi = \alpha + \beta * i + \varepsilon$$

Where:

(π) is the dependent variable

(i) is the independent variable

(β) is the coefficient of the independent variable

(ε) is the standard error

Analysis Results

This section will present the statistical analysis for nominal interest rate and inflation data of Albania for 18 year time series. In this analysis, it will present two different analysis results where one include analysis for 18 years and another for 17 year where one year time series (year 1992) where excluded due to the change of regime from communism to free market economy. Thus, the analyses of 18 year data presents that the determinant of coefficients $R^2=0.220$ (Table 3a, Appendix), that shows us a variation in nominal interest rate explained by inflation is 22% or

it can be said that around 22% of the nominal interest rate may be effected by inflation. In other words it means that there are other factors which explain 78% of the variation in nominal interest rate. Where the analyses of free market economy period of Albania gives the determinants of coefficients $R^2=0.842$ (Table 3b, Appendix), that shows us a variation in nominal interest rate explained by inflation is 84% or it can be said that around 84% of the nominal interest rate may be effected by inflation. In other words it means that there are other factors which explain 16% of the variation in nominal interest rate.

Similarly, the ANOVA results of all data presents that the F-ratio calculated the degrees of freedom for the model $df_M=1$ and degrees of freedom for residual of the model $df_R=16$ represents significant effect of inflation on the nominal interest rate, $F(1,16)=4.49$, $p < 0.05$. Our F-ratio calculated is more than 4.49, which is corresponding value for $F(1,16)$ of our model. This means, F value that exceeds the F – critical value force to reject a null hypothesis and accept the alternative hypothesis (Table 4a, Appendix). However, similar analysis for only free market economy period derives that F-ratio calculated the degrees of freedom for the model $df_M=1$ and degrees of freedom for residual of the model $df_R=14$ represents significant effect of inflation on the nominal interest rate, $F(1,14)=4.6$, $p < 0.05$. Our F-ratio calculated is more than 74.735, which is corresponding value for $F(1,14)$ of our model. This means, F value that exceeds the F – critical value force to reject a null hypothesis and accept the alternative hypothesis (Table 4b, Appendix).

The coefficients results for 18 year analysis show that the β for inflation is equal to 0.066. It shows that there is a positive relation between nominal interest rate and inflation. This means that, one unit increase in inflation increases nominal interest rate by 0.066 units on average. (Table 5a, Appendix) On the other hand the analyses of data for free market economy period of Albania shows that the β is equal to 0.654 which is much higher than the previous results (Table 5b, Appendix). Nevertheless, the t-statistics of both analyses are higher than the t-critical value of 1.96.

The difference between the values in these two separate analyses presents that the when there is regime change the fisher effect is not valid. It can also be seen from the (Graph 1, Appendix) the relationship between the nominal interest rate and inflation rate where the transition from 1992 to 1993 shows a negative relationship which is very significant, whereas during the other periods there is a positive relationship.

5- Conclusion

This paper analyzes the existence of a long run Fisher effect in Albanian Economy using the deposit interest rate instead of nominal interest rate and the inflation rate for a period length of 18 years (1992-2009). By using the linear regression analysis it finds the impact of changes in inflation rate into the nominal interest rate. In this context two separate analyses are done where the first one includes the nominal interest and inflation rate data of 18 years time whereas in the second analysis the data of year 1992 are excluded from the analysis.

As a result of the analysis we find two significantly different results. In the analysis done for 18 years we find a positive relationship between the nominal interest rate and inflation rate. The variation in nominal interest rate explained by inflation is 22% or in other words it can be said that 22% change in nominal interest rates is as a result of the changes in inflation rate. The other 78% changes are as a result of the other factors. As year 1992 is a period when Albania changed its regime from communism to free market economy it can be considered as a special case study it does not give a clear idea of the relationship between nominal interest rate and the nominal inflation rate.

In this context it is better to concentrate on the analysis done by excluding the data of 1992. When the 1992 data are excluded from the analysis the relationship between nominal interest rate and inflation rate becomes more significant. The changes in inflation rate effects the nominal interest rate by 84%. The remaining 16% can be as a result of the changes in the real interest rate or due to other factors. According to the coefficient results a one percent increase in the inflation rate results in a 0.65 percent increase in the nominal interest rate.

If the value of the coefficient of the independent variable is positive and equal to one this shows the existence of a strong form Fisher effect. As the coefficient of the independent variable in our analysis has a positive value but less than one. This represents that the Fisher effect for Albania is valid but it is a weak form Fisher effect.

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7- Appendix

Year	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Inflation Rate	226	85	22,6	7,8	12,7	33,2	20,6	0,4	0,1	3,1	7,8	0,5	2,3	2,4	2,4	2,9	3,4	2,3
Deposit Interest Rate	18,5	27,3	19,8	15,3	16,8	27,3	22,6	12,9	8,3	7,7	8,5	8,4	6,6	5,1	5,2	5,7	6,8	6,8
Real Interest Rate	-65.5	-39.7	-10.7	13.3	-3.5	-12.2	-11.9	16.4	17.0	15.7	11.6	10.5	5.4	9.3	10.7	10.6	9.4	10.1

Table 1

Table 3a³: Model summary for inflation and nominal interest rate

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.469 ^a	.220	.172	6.91843	.220	4.522	1	16	.049

a. Predictors: (Constant), Inflation

Table 3b⁴: Model summary for inflation and nominal interest rate

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.918 ^a	.842	.831	2.83264	.842	74.735	1	14	.000

a. Predictors: (Constant), Inflation

³ The tables named with (a) represent the analysis done for 18 years including the beginning of the transition from state owned economy into the free market economy.

⁴ The tables named with (b) represent the analysis done for 17 years where year (1992) is excluded from the analysis.

Table 4a: Analysis of variation for Nominal Interest rate and Inflation**ANOVA^b**

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	216.431	1	216.431	4.522	.049 ^a
	Residual	765.834	16	47.865		
	Total	982.264	17			

a. Predictors: (Constant), Inflation

b. Dependent Variable: Deposit_Interest

Table 4b: Analysis of variation for Nominal Interest rate and Inflation**ANOVA(b)**

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	599.663	1	599.663	74.735	.000(a)
	Residual	112.334	14	8.024		
	Total	711.998	15			

a. Predictors: (Constant), Inflation

b. Dependent Variable: Deposit Interest

Table 5a: Coefficients for Nominal Interest Rate and Inflation**Coefficients^a**

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95% Confidence Interval for B	
		B	Std. Error	Beta			Lower Bound	Upper Bound
1	(Constant)	11.166	1.794		6.224	.000	7.363	14.969
	Inflation	.066	.031	.469	2.126	.049	.000	.131

a. Dependent Variable: Deposit_Interest

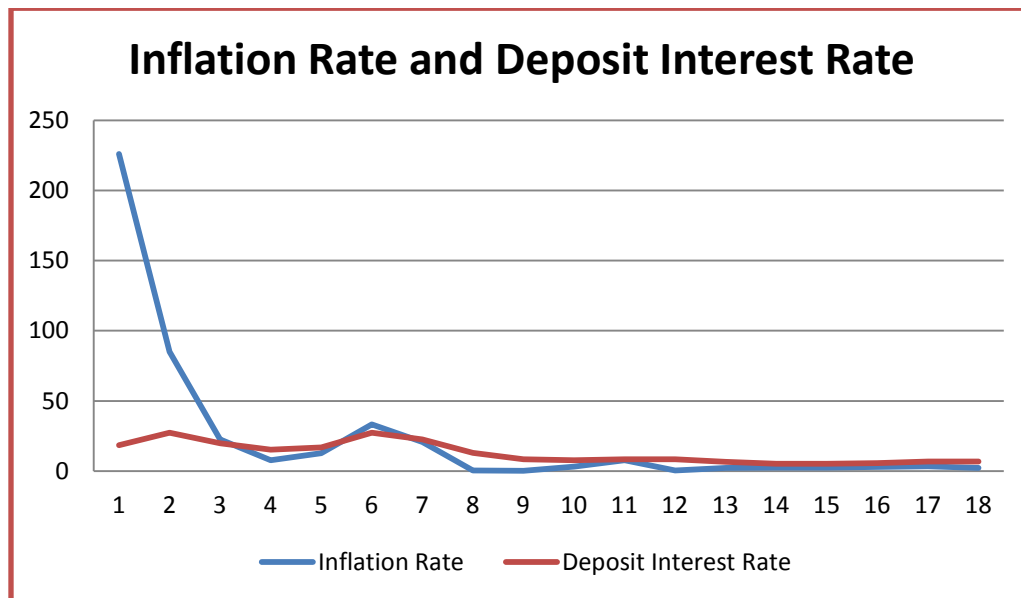
Table 5b: Coefficients for Nominal Interest Rate and Inflation

Coefficients(a)

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95% Confidence Interval for B	
	B	Std. Error	Beta	Lower Bound	Upper Bound	B	Std. Error
1 (Constant)	6.402	.921		6.953	.000	4.427	8.376
Inflation	.654	.076	.918	8.645	.000	.491	.816

a. Dependent Variable: Deposit Interest

⁵Graph 1



⁵ The data used in this graph are the data shown at Table-1

CONTRIBUTION OF FOREIGN DIRECT INVESTMENT TO IRAQ AGAINST THE RECENT ECONOMIC CRISIS

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ABSTRACT

Iraq ranks fourth in the world behind Saudi Arabia, Canada, and Iran in the amount of proved oil reserves. It is known that Iraq's economy is dominated by the oil sector. This country which has rich oil reserve is now in the socio-economic turmoil because of war in decades. The major problem is people in Iraq can't provide their needs.

We studied this problem and its solution way under three titles. Firstly, we analyzed economic situation of Iraq and effect of recent economic crisis; secondly, we analyzed contribution of FDI to Iraq economy. Finally, we analyzed regulations and laws to attract FDI to the Iraq.

Key Words; FDI, Contribution, economy, Iraq, crisis

JEL Classification: H12, F21

INTRODUCTION

Iraq ranks fourth in the world behind Saudi Arabia, Canada, and Iran in the amount of proved oil reserves. It is known that Iraq's economy is dominated by the oil sector. In the 1980s financial problems were caused by massive expenditures in the war with Iran that lasted in a span of eight years, where Iraq suffered economic losses of at least tens of billions. In previous years, Iraq was under Baath Party rule from 1968 to 2003; in 1979 Saddam Hussein took control and remained president until 2003 after which he was unseated by the US. Iraq which

has a population 31,234,000 people estimated in 2009, has a number of ethnic minority groups; Kurds, Assyrians, Mandeans, Iraqi Turkmen, and Shabaks. Kurdistan¹ Regional Government (KRG) borders Iran to the east, Turkey to the north, Syria to the west and the rest of Iraq to the south. Its capital is the city of Erbil, which is officially governed by the Kurdistan Regional Government (KRG). The three governorates of Duhok, Erbil and Sulaymaniyah accumulate a territory of around 40,000 square kilometers and a population between 4 and 6.5 million. As a major economic power in Iraq, Kurdistan has the lowest poverty rates and highest standard of living in Iraq, making it the most stable and secure (UNDP 2009) region of Iraq.²

Firstly, we analyzed economic situation of Iraq and effect of recent global economic crisis; It was seen that Iraq was effected indirectly by crisis. Demand and prices of oil decreased due to crisis. Secondly, we analyzed contribution of FDI to Iraq economy. Domestic and foreign private firms gave hand to the Iraq especially on reconstruction. Finally, we analyzed regulations and laws to attract FDI to the Iraq. It was concluded that Iraq was suffered from recent global crisis indirectly, but FDI contributed to the economy positively especially to the northern Iraq.

1. Economic Situation of Iraq and Recent Economic Crisis

Any country's economy may enjoy several years of exhilarating economic expansion and might be followed by a recession, depression or a financial crisis. When the economy faces recession,³ depression or a financial crisis national output falls, profits and incomes decline, unstable price of goods and services occur, and unemployment rates jump to uncomfortably high levels. Then economy reaches a bottom, and recovery begins. This situation can be

¹ The name Kurdistan literally means Land of the Kurds

² DINC, Ahmet, BAYAN Al Numan, CURA, Fatih, " **CAUSES OF GLOBAL FINANCIAL CRISIS AND ITS IMPACT ON FOREIGN DIRECT INVESTMENT TO IRAQ**", SSEM Society for the Study of Emerging Markets, Euro Conference 2010, Challenges and Opportunities in Emerging Markets, Milas, Turkey, July 16-18, 2010

³ We call short-term fluctuations –cycles–, the actual one is irregular. It usually takes from 6 months to a year. A milder form of business downturn is a recession, which has many of the features of a depression to a lesser extent.

named as Business Cycles are economic fluctuations in total national output, income and employment, generally lasting for a period of 2 to 10 years, marked by widespread expansion in most sectors. Upward and downward movements in national output, inflation level, interest rate, and unemployment rate form the business cycle that characterizes whole market economies.⁴ In order to give right political advice, economists should know the causes of boom and crisis. If a boom or crisis is the result of a spending or price shock, GNP will be away from its potential. In this situation, the government should interfere with the economy to speed the return to its potential. So, the government uses monetary policy -money stock- and fiscal policy – taxes and spending- to solve economic problem as demand shocks.⁵ (Hall and Taylor, 1991)

Iraq⁶ ranks fourth in the world behind Saudi Arabia, Canada, and Iran in the amount of oil reserves contains 115 billion barrels of proved oil.⁷ It is known that Iraq's economy is dominated by the oil sector, which has achieved about 95 percent of foreign exchange earnings. In the 1980s financial problems were caused by massive expenditures in the war with Iran that lasted in a span of eight years, where Iraq suffered economic losses of at least \$100 billion.⁸ In previous years, Iraq was under Baath Party rule from 1968 to 2003; in 1979 Saddam Hussein took control and remained president until 2003 after which he was unseated by the US.

Iraq which has a population 31,234,000 people estimated in 2009, has a number of ethnic minority groups; Kurds, Assyrians, Mandeans, Iraqi Turkmen, and Shabaks.

⁴ PAUL, A. Samuelson and WILLIAM, D. Nordhaus; (2001), Economics, McGraw-Hill Irwin, New York: p. 477-479

⁵ HALL, Robert E. and TAYLOR, John B.; (1991) Macroeconomics, W.W. Norton and Company, New York: p. 204-216

⁶ Iraq is the 58th-largest country in the world. Iraq mainly consists of desert, there are two major rivers. The north of the country is mostly composed of mountains; Iraq has a small coastline measuring 58 km along the Persian Gulf. The northern mountainous regions are called as Kurdistan region.

⁷ Shafiq Tariq, “Comment & Analysis: Iraq's oil and gas challenges and opportunities”,

June 28, 2010 <http://www.iraqoilreport.com/oil/production-exports/comment-analysis-iraqs-oil-and-gas-challenges-and-opportunities-3613/2010>

⁸ For More Information <http://en.wikipedia.org/wiki/>

Kurdistan⁹Regional Government (KRG) borders Iran to the east, Turkey to the north, Syria to the west and the rest of Iraq to the south. Its capital is the city of Arbil, which is officially governed by the Kurdistan Regional Government (KRG). The three governorates of Duhok, Arbil and Sulaymania accumulate a territory of around 40,000 square kilometers and a population between 4 and 6.5 million. As a major economic power in Iraq, Kurdistan has the lowest poverty rates and highest standard of living in Iraq, making it the most stable and secure¹⁰ region of Iraq.

Recent global financial crisis affected the world at different levels. Although Iraq is not the center of financial crisis, Iraq was affected due to low oil prices. In fact, to have rich oil reserve is a good opportunity for countries. But now that the collapse in the world's economy has caused oil prices to drop, what does the future hold for Iraq? It is known that Iraq's economy depends on oil revenues on a large scale, we can say oil clearly lies at the heart of the country's economy. Indeed, median estimates hold that oil accounts for more than 80 percent of its revenues. Iraq now faces several challenges spawned by the global recession. Iraqi deputy prime minister Barham Saleh said that the economic crisis "has had a serious impact" on Iraq's economy, with "plummeting oil prices" forcing the country "to constrain our government spending." Impact on Iraq's economy means that impact on Northern Iraq or Kurdistan region. Because of the oil boom economy had a surplus of \$35 billion from 2008 but Iraq's 2009 budget was slashed about 25 percent by government. It went down from 80 billion to about \$60 billion. However, these budgetary shortfalls will likely directly impact Iraq's ability to maintain security and salaries. America has economic woes but, U.S. will

⁹ The name Kurdistan literally means Land of the Kurds.

¹⁰ Whereas, People affected by conflict and insecurity can suffer some of the worst human development outcomes of all migrants. It is estimated that, internally displaced persons including 2.8 million in Iraq in 2009.

provide additional aid to cover Iraq's budgetary shortfalls, but it is also unlikely that the U.S. will decrease substantially its current commitments to Iraq.¹¹

2. Contribution of FDI

There are two types of investments: private and state ones. Private investments are totally aimed at profit gaining, and the state investments can be made in order to regulate economy. Sources of financing private investments are the companies' own funds, from selling shares, bonds, other securities as well as those being long-term credits and loans. State investments are financed on account of taxes profits of state enterprises, currency issue or by issue of domestic or foreign government loans.¹²

Direct investments, on the other hand, are real investment in factories, capital goods, land, and inventories where both capital and management are involved and investor retains control over use of the invested capital. Until the early 1960s, the theory of foreign investment was essentially different: it was indirect capital movements. And capital flowed across national borders through the intermediation of the international capital market. Flows of capital were bonds and notes from the public and private sectors. As well as capital that crossed borders in the form of Direct Investments (FDI). This (FDI) has been the dominant form of international private capital transfers and at the same time it has represented a significant proportion of all investments.¹³

By Foreign Direct Investment (FDI) we mean: Investment that involves ownership of a company in a foreign country. In exchange for the ownership, the investing company usually

¹¹ "The New York Times reported in February that wages ate up 35 percent of Iraq's budget. Many Iraqi lawmakers now fear that the government has gone too far in cutting critical spending. The electricity ministry, for example, has had its capital expenditure budget chopped by over 80 percent, from \$6.4 billion down to \$1.1 billion." Daveed Gartenstein Ross, Joshua Goodman D. (2009), "The Global Economic Crisis & Iraq's Future", 3(2), June 15, 2010

<http://www.jewishpolicycenter.org/966/global-economic-crisis-iraq-future>

¹² E. F. Borisov, A. A. Petrov, F. F. Sterlikov, " **Ekonomika**" **spravochnik**, Moskva, Finansy i Statistika 1997, p. 126.

¹³ John H. Dunning and John R. Dilyard, **Transnational Corporations**, United Nations Publications, Number 1, Printed in France, April 1999, p. 1

transfers some of its financial, managerial, technical, trademark, and other resources to the foreign country. It is distinguished from foreign portfolio investment.¹⁴

In the near future, Global FDI flows have been severely affected worldwide by global financial crisis. In the middle of sharpening financial and economic crisis, global FDI inflows fell from a historic high of \$1,979 billion in 2007 to \$1,697 billion in 2008, a decline of 14%. The slide continued into 2009. Inflows are expected to fall from \$1.7 trillion to below \$1.2 trillion in 2009, with a slow recovery in 2010 (to a level up to \$1.4 trillion) and gaining momentum in 2011 (approaching \$1.8 trillion). The crisis has changed the FDI landscape: investments to developing and transition economies surged, increasing their share in global FDI flows to 43% in 2008. This was partly due to a concurrent large decline in FDI flows to developed countries (29%).¹⁵ FDI inflows rose slightly in Bahrain, Iraq and the Palestinian territory, remained almost at the same level in Jordan, and fell in Kuwait, Oman and Yemen¹⁶

Table 1. GDP Estimates and Projections (Iraq)

	2006	2007	2008 p	2009 p	2010p	2011 p
Nominal GDP (in US\$ billion)	49.5	62.4	93.8	83.5	94.8	108.1
Of which non-oil GDP (%GDP)	42.5	43.4	35.8	47.3	45.1	43.1
Real GDP growth (in %)	6.2	1.5	9.8	7.7	7.2	7.3
Per capita GDP (US\$)	1,720	2,109	3,085	2,673	2,957	3,292
CPI (% change)	64.8	4.7	12	10	8	7
Iraqi oil export price (US\$ per	55.6	63	93.3	62.5	68.5	72.8

¹⁴ Jae K. Shim And Joel G. Siegel, **Dictionary of Economics**, Business dictionary series, printed in the USA, 1995, p.150

¹⁵ UN, **World Investment Report Transnational Corporations, Agricultural production, and Development**, New York, 2009, p. XVII-XIX

¹⁶ UN, **World Investment Report Transnational Corporations, Agricultural production, and Development**, New York, 2009, p. 57

barrel)						
-+Oil production (in mbpd)	2	2.1	2.4	2.5	2.7	2.9

Source: World Bank, **INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT**

INTERNATIONAL DEVELOPMENT ASSOCIATION, INTERNATIONAL FINANCE CORPORATION, February 19, 2009, p.7

If we highlight table above year by year oil production in increasing but real GDP rate fell in 2009 because of declining oil export price. It is seen that while the direct impact of the global financial crisis on the economy remains limited, the indirect impact through declining oil prices may be significant. Iraq's banking sector is underdeveloped and centered on the domestic market. Levels of FDI¹⁷ private capital flows are very low.

Private investment in Iraq is expected to be over 30 billion dollars. This is up from 10 billion dollars previous year. The tripling of private investment shows the growing investor confidence in Iraq. Iraq is proving to be a very fertile ground for investment. Iraq is becoming a new country through rebuilding. Foreign companies are eager to bid on projects to build out much need infrastructure like roads, commercial buildings, residential units and energy plants. 4 billion dollars have been invested in the electricity sector. This investment is much needed. Electricity is unreliable in Iraq and is essential in daily life for Iraq to move forward as a country.

The oil industry dominates Iraq's economy and is set to make record profits. However, Iraq has emerging industries that are ripe with investment opportunities. Industries with high

¹⁷ Let's look the growing impact of the crisis on large TNCs' investment plans by comparing the results of 2009's and 2008's WIPS. In the 2008 WIPS survey, only 40% of companies reported being affected by the crisis, and slightly lower than in the 2007 WIPS. This 2009's picture, in the context of the worst global recession is dramatically different. A large majority of TNCs now believe the global economic downturn and the financial crisis have had a negative impact on their investment plans.

UN Conference on Trade and Development, **World Investment Prospects Survey 2009-2011**, Newyork, 2009, p.11

But, FDI inflows rose only slightly in Bahrain, Iraq and the Palestinian territory,

UN Conference on Trade and Development, **World Investment Report, Transnational Corporations, Agricultural Production and Development**, Newyork, 2009, p.57

technology, services and tourism are all fairly untapped markets. Those three industries are also essential for Iraq's development.¹⁸ Iraq wants close relationship with world to integrate and reconstruct the country. Turkey is the best represented, followed by France.

Salam al-Quraishi told AK news that there are now 270 Turkish companies operating throughout Iraq, mostly specialized in construction of residential complexes and providing electrical power.

“French companies are second in terms of their presence in Iraq, where their number reached to 123 operating companies, according to the National Investment Commission.”

The French embassy in Baghdad announced on Oct. 23 its intension to increase trade between Iraq and France during the coming months to 5 billion dollars, revealing that 230 French companies will be present in Iraq in 2011 for the implementation of important investment projects.

“The Iraqi government is seeking in the next phase to develop its economic relations with the United States, Britain, Italy and a number of countries in the world more broadly than it is now.”

The commercial exchange between Iraq and Turkey reached to eight billion dollars after the two sides signed a number of important agreements. Iraq developed an integrated plan to double the commercial and economic exchange, especially with regard to energy, agriculture and industrial development that would improve the economy by Iraq. Iraq seeks to apply the Turkish experience in dealing with unemployment, the housing crisis and other real problems facing the Iraqi economy. Iraq had signed an agreement to develop trade with Turkey on August 2008 that stress on the need to increase trade exchange between the two countries after it was at that time \$ 3.5 billion. Turkey established several trade fairs, most recently was last

¹⁸<http://www.dinarprofits.com/private-investments-in-iraq-to-triple/>

November in Basra province, and it was attended by more than 150 Turkish investment companies.¹⁹ Stronger diplomatic relations established between Turkey and northern Iraq have paved the way for Turkish companies to invest more in the region, according to Kurdish Globe, an English-language-newspaper from Erbil. A local official speaking to the newspaper said Turkish company assets in the region had reached a volume of \$621 million. According to the newspaper, better diplomatic relations have helped economic ties flourish. Regional President Massoud Barzani visited Turkey in May, followed by a two-day visit by a high-ranking Turkish delegation to the region.²⁰

FDI shows its importance as well as neighborliness –Turkey-: 241 investment licences were issued from August 2006 to February 2010. About 1,200 foreign companies working in Kurdistan, the greatest number - some 620 - were from Turkey. Housing attracted around \$4.7 billion in the same period with \$2.29 billion in banking, \$1.6 billion in industry and \$1.1 billion in tourism.²¹ At ongoing global financial crisis, According to data from the Turkish Statistics Institute (TurkStat), Turkey's exports to seven neighboring countries -- Azerbaijan, Bulgaria, Georgia, Iraq, Iran, Syria and Greece -- were recorded as \$13.74 billion in 2009, while this figure was \$14.31 billion in 2008, representing a year-on-year fall of 3.9 %. The only neighboring countries that Turkey managed to increase its exports to last year were Iraq and Syria.²² Exports to Iraq saw a rise of 30.9 %, increasing from \$3.91 billion in 2008 to \$5.12 billion in 2009.²³ According to the Board of Investors of the Kurdistan Regional Government. Non-oil investment in the Kurdistan Region of Iraq totaled more than \$12

¹⁹Source: Aswat al-Iraq)

<http://www.iraq-businessnews.com/2010/12/04/turkish-and-french-companies-most-active-in-iraq/2/>

²⁰<http://www.hurriyetdailynews.com/n.php?n=turkish-investments-surpass-620-million-in-n-iraq-2010-07-25>

²¹ Jack Kimball and Shamal Aqrawi, **Kurdistan Region attracts 12 billion dollars investment in three and half years, the Kurdistan Board of Investment.**, 17 Feb. 2010,

<http://www.krg.org/articles/detail.asp?smap=02010200&lngnr=12&rn=73&anr=33844>

²² TODAY'S ZAMAN, Ankara, 22 FEBRUARY 2010, **2009 saw 3.9 pct drop in exports to neighbors**

²³ TODAY'S ZAMAN, **Global financial crisis negatively affects Turkey's exports to neighbors, Ankara, 21 February 2010**

billion over the last three years. Overall, about 70 percent of foreign investment in the Kurdistan Region comes from neighboring Turkey.²⁴

3. Regulation and Laws to Attract FDI

The new investment law made a big qualitative change in the Iraqi economy by means of incoming capital and foreign experience, which contributed to establishing the basic infrastructure of the Iraqi economy. Iraq suffers from lack of capital available for reconstruction and development due to the accumulation of loans as well as lack of experience due to ongoing wars. This law helped in meeting this need.

The Iraqi federal budget is derived to 93-95% from the proceeds of crude oil. These proceeds are spent on the subsidies for the ration cards, low fuel prices, the social welfare system, as well as the salaries and wages of workers in the Iraqi state. The remainder is not enough to realistically rebuild in Iraq an infrastructure that needs hundreds of billions, which are not readily available according to the reality of the Iraqi state that owes more than 130 billion dollars to the rest of the world, And thus, like many countries in the world, it must resort to investment. The Iraqi economic infrastructure has been destroyed over more than 25 years since the beginning of the Iraq-Iran War in 1980. New law enables to establishing a secure environment for investment. That the investment law establishes the basic rules for the investor with guarantees and protection is a very good step in the field of investment, although the land problem remained unresolved.²⁵

Privileges and Guarantees Offered to Investors:

1. Taking out the capital brought into Iraq with its revenues in hard currency
2. Dealing with the Iraqi securities market

²⁴ PRNewswire-USNewswir, Investment in the Kurdistan Region of Iraq Surpasses \$12 Billion, 18 subat,erbil,<http://www.prnewswire.com/news-releases/investment-in-the-kurdistan-region-of-iraq-surpasses-12-billion-84719997.html> #linktopagetop

²⁵ <http://www.edinarfinancial.net/iraq-investment-law.php>

3. Leasing land needed for the project or using it on condition that the term does not exceed a period of 50 years that can be renewed
4. Insuring the investment project at any national or foreign insurance company
5. Opening accounts in Iraqi or foreign currency or both at Iraqi banks or at banks outside Iraq
6. Obtaining residency and facilitating investors entry to Iraq and leaving Iraq
7. Non-confiscation or nationalization of the investment project
8. Non-Iraqi workers have the right to transfer their salaries and indemnities outside Iraq
9. Exemption from fees and taxes for ten years beginning with the date of starting the project. This period is renewable. Also, furniture and assets needed for expanding and modernizing the project are exempt.²⁶

The Kurdistan region of Iraq (KRG) is also blessed with plentiful water, fertile land, forests, oil and gas and many other energy and mineral resources. Liberal foreign investment laws have been introduced both in their central Iraq and in the Kurdistan region. They have both been endorsed by their respective parliaments. KRG, in order to further facilitate the smooth application of the investment law, four complementary laws are being prepared namely, competition law, consumer protection law, environment protection law and an update of the Iraqi 1958 labor law.²⁷

Investment opportunities and risks in KRG: The area of northern Iraq under the control of government today enjoys a surprisingly accessible and secure business investment climate. Compared to middle and southern Iraq, this area is safe, protected and governed by a general rule of law. Of course the foreign companies (such as: from Turkey and French) play a big role for developing. That is the result of government investment guarantees and the country's law's easiness of rules and regulations for investors. These easiness are for example;

- Free land for strategic project

²⁶<http://www.edinarfinancial.net/iraq-investment-law.php> (Source)Niqash

²⁷ Kurdistan, the commercial gateway to Iraq, Erbil 2007, Fathi M. Ali Abdullah

- Land grants at attractive price for non strategic project
- Exemption from tax and duties for several years from entry into production of industrial project
- A three-year exemption on taxes and duties on the importation of raw materials
- 100% foreign ownership of investment capital.

One of the most important guarantee from the government to the investors is the permit ion of having 100% of ownership of capital. This attracts most of the foreign companies to come for FDI to Iraq.

The ministry is expecting the issuing four important laws to be proved by the parliament:

1. Consumer protection Law.
2. Competition protection and monopolistic practices prevention law.
3. Free trade and industry Zone Regulation.
4. Kurdistan free Zone.²⁸

Conclusion

In fact, Iraq's economic condition was so bad. Iraq's economy was/is based on oil sector. Year by year, production of oil increased, but because of low demand and low price of oil, Iraq was affected from global financial crisis. Therefore, Kurdish regional Government was affected from crisis too, because of being part of Iraq (Kurdish regional government's income comes from Iraq in a proportion based on the relation of the region's population to the total population of Iraq). If Iraq's income decrease this induces low income to that region. But, regional government saw that importance of FDI, then it tried to attract FDI to that region. Iraq and especially Northern Iraq set lots of law to attract FDI. When government saw benefit of FDI they continued their easy law change. In addition to security in Northern Iraq eased investment condition. Finally, Northern Iraq's people are optimist for future. It was concluded that stability of the Kurdistan region has allowed it to achieve a higher level of development than other regions in Iraq. If you come to Northern Iraq you can feel yourself in construction site. Because there are lots new building erecting.

There are most of countries private sector especially Turkish companies are doing lots investment to this region. Such as; Hospital, airport, factories, housing, university, etc. Kurdish regional government was benefited by FDI as some advantages. Such as; employment rate increased, Kurdish labor force is becoming skillful, managerial experience, regional

²⁸ KRG, Ministry of trade, Fathi M. Ali Abdullah Trade and investment conference 2010. London.

development, trade balance, qualified goods and services, extra income which we counted are advantages of FDI to this region's people. That's why, standard of living of people in this region is higher than others.

It was analyzed that neighborhood is so important in financial crisis time. Necessities goods, intermediate goods are still being imported by Syria and Turkey.

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**E-BANKING IN ALBANIA:
EVOLUTION, ASSESSMENT AND OUTLOOK**

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Abstract

Continuous developments in information technologies have increased the diversification of products and services in the banking and finance sectors. Providing the customers with banking services via internet network remains a crucial part of this development.

The main objectives of this research consist in analyzing the important role of e-banking to offer fast and diversified service to the banking customers helping the banks and clients in Albania, to generate continuous benefits.

Our research tries to find out the expansion of e-banking services and the manners how the financial institutions in Albania can use this technology to gain a competitive advantage with lower costs.

Furthermore, we aimed to understand the main concerns of the financial institutions related to what do they need to improve in their online services and products.

This market survey may be useful for those financial institutions that plan to implement e-banking services in the near future.

Key words: *E-banking, Internet banking, online banking, banking transactions, financial institutions, Albania*

1. INTRODUCTION

The world lending system has endured a process of transformation and evolution in terms of structure and organization. The banking industry has been the most crucial part of this change.

Many banks have experienced change of their shareholders' structure, organizational structure or change of their strategic visions for the future, influencing in the whole banking system.

In the beginning, banks had been used for simple services such as small time deposits and saving accounts and also short-maturity credit facilities. Future showed a splendid expansion into a larger line of deposits and lending products.

Being operative in an aggressive environment, financial institutions are obliged to use different strategies to achieve a better service quality for their customers, helping that way the increase of the turnover volumes, market share and also their profits.

Providing the clients with a faster and very qualified service through e-banking has been one of the most important strategies implemented. Technological and internet world has been a strong support for generating new opportunities from these financial organizations.

Year after year the usage of Internet to perform banking transactions has increased and the future trend looks very positive.

The central banks especially have significant position in orienting the strategic objectives of the second level banks toward development of online banking considering all the risks and advantages of this kind of service.

Main levels of e-banking are:

1. Informational-the first stage of e-banking; This kind of online banking means that the bank provides the clients with its products and services on a server separated from the main server of the bank. Each bank can connect with the customers through Web sites. The only risk related to this service is related to possible unauthorized changes of these Web sites.
2. Communicative – is more developed form compared to the first aforementioned type of e-banking system. This form permits the interface among the financial institution' system and the customer. The interface may be limited to electronic mail, account requests, credit applications or identification updates. This type of e-banking system carries high risk level due to unauthorized efforts to access the internal bank's system. It is very important to have a strong antivirus control and also other kinds of controls to avoid the risk.
3. Transactional — this stage of e-banking gives permit to the clients to perform transactions. There is an interaction between the server the internal system. This stage has the highest risk and requires the highest levels of control because in this level the customers can access their accounts, transfer funds, pay phone or other sorts of bills, etc.

Albanian banks use generally a combination of the three levels of e-banking, but they focus mainly in the third level (transactional level)

Table 1 shows a detailed list of strengths and weaknesses that accompany the e-banking services (Buzzle.com, 2010)

Table 1: Strengths and weaknesses that accompany the e-banking services

STRENGTHS	WEAKNESSES
1. Perform banking services in every preferred time	1- Higher comfortability of working with real branches and banking personnel
2. Faster service performed to the customers	2- Mistrust of the customers
3. Avoidance of additional service costs	3- Difficult to be understood from a beginner user
4. Cheaper services	4- Possible network problems that can lead to important financial economic wastage
5. Increase of the demand for internet usage	5- Continuous increase of internet installation fees
6. The internet access provides new educational opportunities for people	6- Illegal interventions through internet may cause juridical entrance barriers from the government
7. Simple usage trainings for the customers	7- Fear from fraudulent or unauthorized online interventions

It is evident that some people like better to contact directly the banking employees if they have any problems. They like most the “personal contact” part of the banking service. This kind of clientele never feels comfortable to use online banking, so every time will be chosen a real branch to perform every transaction. However, there is also a second group of clients that are very busy, travels a lot or never feel cozy in front of customer service employees. This is the most favorite group of customers for offering the e-banking services.

2. INTERNET USAGE

Below are some information about the internet users & usage at the end of 2009.

Table 2. Internet Usage in the World (Resource: www.internetworldstats.com (2010, April 29))

Region	Population (2009 Est.)	% Pop. of World	Internet Users, Latest Data	Penetration % Population	User Growth (2000- 2009)	Users % Table
Europe	803,850,858	11.9 %	425,773,571	53.0 %	305.1 %	23.6 %
Rest of World	5,963,954,350	88.1 %	1,376,556,886	23.1 %	437.9 %	76.4
TOTAL	6,767,805,208	100.0	1,802,330,457	26.6 %	399.3 %	100
WORLD		%				

- The countries that use more the internet service are shown in figure 1:

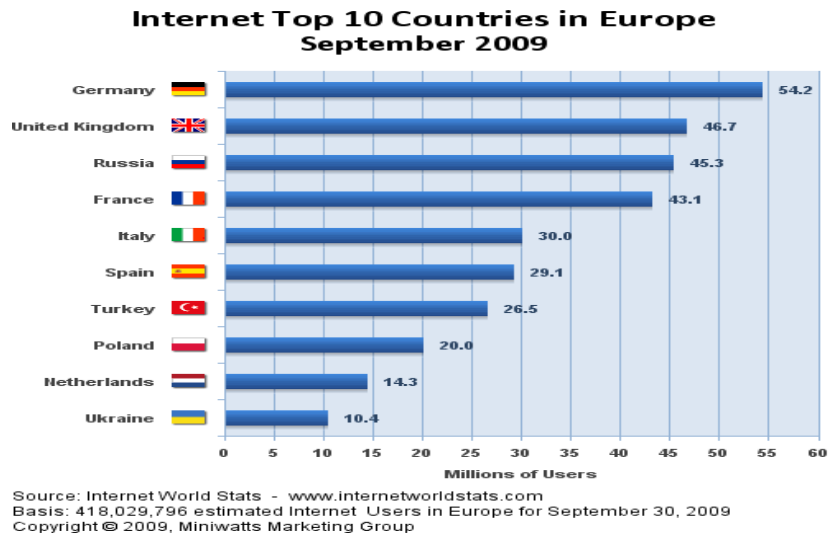


Figure 1. Rating of the internet top 10 countries

Germany and UK lead the part of internet users in Europe respectively with 54.2 ad 46.7 MIO users, followed by Russia and France (45.3 and 43.1 MIO users).

Internet users in Europe represent 24.1% of the total internet users in the entire world as seen in Figure 2.

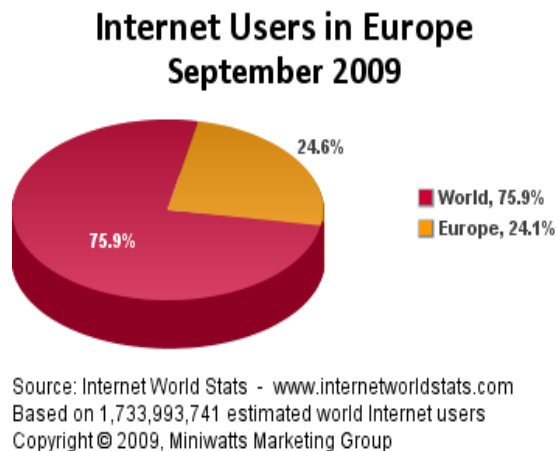


Figure 2. Internet users in Europe

According to Internet Worlds Stats Albania (Table 3) represents only 0.2% of Europe internet users, ranking at the end of the list together with other small countries. However, it is important to emphasize that the user growth is one off the highest in Europe (i.e. : 29,900%).

Table 3. Internet usage in Europe

Country	Population (2009 Est.)	Internet Users, Latest Data	Penetration (% Population)	User Growth (2000-2009)	% Users Europe
Albania	3,639,453	750,000	20.6 %	29,900.0 %	0.2 %
Andorra	83,888	59,100	70.5 %	1,082.0 %	0.0 %
Austria	8,210,281	5,936,700	72.3 %	182.7 %	1.4 %
Belarus	9,648,533	3,106,900	32.2 %	1,626.1 %	0.7 %
Belgium	10,414,336	7,292,300	70.0 %	264.6 %	1.7 %
Bosnia-Herzegovina	4,613,414	1,441,000	31.2 %	20,485.7 %	0.3 %

Sources: InternetWorld Stats .. © Copyright 2010, Miniwatts Marketing Group. All rights reserved worldwide.

3. E-BANKING IN ALBANIA

In Albania, the usage of Internet is in low levels, due to:

- general lacking in telecommunication infrastructure;
- also the lack of knowledge of the people to use the technology as a common helpful feature;

E-banking has experienced a constant development because of the low costs and the demand of important customers to perform online transactions due to their collaboration with other companies abroad.

Since June 2008 internet service in Albania has faced significant developments through the increase of promotional offers and reduction of accessing fees. Also many operators have started to offer package for three services (TV, telephony and internet). The main expansion had Albtelecom through the usage of ADSL service reducing the fees with 50%. Among this a development was recognized for the alternative operators that offer access in internet through usage of a higher speed technology ADSL2+ optical fiber. Even the mobile phone companies, such as AMC, Vodafone and Eagle Mobile have offered internet services via mobile phones affecting the decrease of fees for these services.

In our country there are approximately 31 operators which are mainly operating in Tirana and other big cities in western Albania. This concentration is based on the demographic concentration of the population. The most popular used technology is ADSL and Hybrid fiber-coax technology and less used is wireless technology as the main investments of operators were made in two first types of technology.

Due to lack of connections of high capacity with foreign countries from where internet connection is provided, is one of the main issues to be solved.

Except Albtelecom that uses optical fibers connected with Italy, the other operators use microwave connections to be provided with internet services from foreign countries.

The number of users for internet services in Albania has increased the last years. Below there is a graphic that shows the development of internet users in Albania during last 4 years:

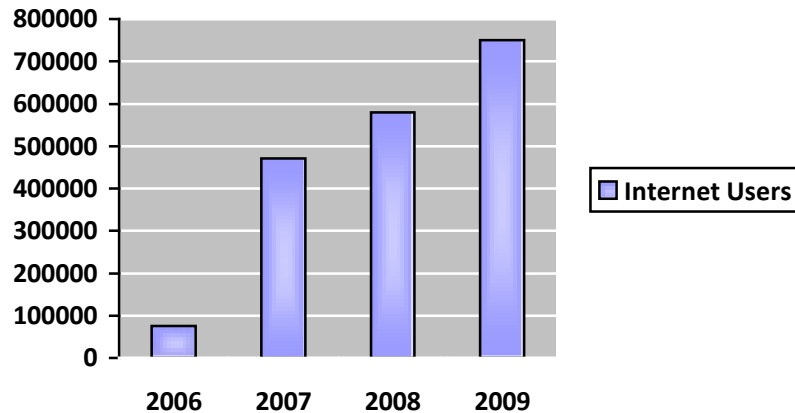


Figure 3. Development of internet users number in Albania (Resource: <http://www.internetworldstats.com/stats4.htm#europe>, 2010, April 29)

Internet is being very useful in every field of economy especially for the banking system.

As the development of online technology gives to banks opportunity for lower cost banking services, Albanian banks are attempting to implement this technology to gain competitive advantages and increase the market shares. The number of internet users in Albania increases every year based on the new online infrastructure offered by many internet operators. As far as the information channels expand, the necessity for information also grows, and this is the main reason why the customers require e-banking as a new way to fulfill their demands for faster banking services. The long queues at the customer services or tellers' desks have become a way of wasting time for even the simplest transactions. Also the risk of being stolen makes the customers to be careful and to avoid carrying liquidities with them.

The Albanian banking systems include 16 operative commercial banks with a summarized background as following:

BANKS	Total Assets		Loans		Deposits	
	in EURO	Market share	in EURO	Market share	in EURO	Market share
Raiffeisen Bank – Albania	1,899,678,776	31.6%	699,114,108	22.1%	1,730,393,456	34.5%
Intesasanpaolo Bank Albania	869,567,955	14.5%	367,889,183	11.6%	701,952,558	14.0%
Banka Kombëtare Tregtare	820,515,225	13.7%	271,857,265	8.6%	707,515,242	14.1%
Tirana Bank	601,996,635	10.0%	423,368,449	13.4%	379,736,146	7.6%
Alpha Bank – Albania	505,564,182	8.4%	348,857,307	11.0%	394,691,588	7.9%
National Bank of Greece – Albania	n/a		291,133,039	9.2%	144,562,612	2.9%
Credins Bank	310,562,154	5.2%	196,580,496	6.2%	270,093,676	5.4%
BankaPopullore	274,873,592	4.6%	111,804,030	3.5%	223,020,168	4.4%
ProCredit Bank	252,057,440	4.2%	133,029,632	4.2%	203,719,712	4.1%
Emporiki Bank – Albania	206,939,525	3.4%	192,547,761	6.1%	82,129,033	1.6%
Union Bank	97,606,260	1.6%	63,557,507	2.0%	76,563,829	1.5%
International Commercial Bank	38,309,002	0.6%	13,022,242	0.4%	27,418,223	0.5%
United Bank of Albania	40,000,881	0.7%	16,285,585	0.5%	24,091,442	0.5%
Italian Development Bank	36,437,760	0.6%	25,445,078	0.8%	27,902,964	0.6%
First Investment Bank– Albania	36,945,360	0.6%	11,269,025	0.4%	25,191,750	0.5%
Credit Bank of Albania	13,238,057	0.2%	2,174,760	0.1%	3,269,503	0.1%
	6,004,292,804	100%	3,167,935,465	100%	5,022,251,900	100%

Note: Q1 2009 data for BankaPopullore, Credins Bank, International Commercial Bank and ProCredit Bank

Source: Albanian Association of Banks.

Note: All market shares are calculated among the 16 commercial banks.

Figure 4. Summarized overview of the banking system as of year 2009

In Albania there are 10 out of 16 banks that offer e-banking service for their customers. These banks are: Raiffeisen Bank, National Commercial Bank, First Investment Bank, ProCredit Bank, Credins Bank, Alpha Bank, Intesa San Paolo, Union Bank, Tirana Bank and Veneto Bank.

In general banks are divided into two groups according to e-banking: a) traditional banks that operates in the market including e-banking service as a diversified service; b) Web Banks that are found in internet network and that have no real branches.

The banks that operate in Albania are traditional banks that uses e-banking to be competitive in the banking market.

Most of the Albanian banks use web sites to inform potential customers about their products and services. E-banking in the Albanian banking market has its real start after 2007 and one of the first banks launching this service was American Bank of Albania (actually named Intesa San Paolo Bank, S.A) Nevertheless, an aggressive expansion of online banking was experienced during 2008.

However, was year 2008 that was a fast start of e-banking service launching in the banking marketplace for many banks such as: ProCredit Bank, Raiffeisen Bank, First Investment Bank, Credins Bank, etc.

Table 4 displays advantages and disadvantages of e-banking usage in Albania

Table 4: Advantages and disadvantages of e-banking usage in Albania

ADVANTAGES	DISADVANTAGES
No entrance barriers	High implementation costs for banks
Usage of banking transaction in every time	Limited internet users
Avoid large queues	Limited computer skill users
Decrease administrative costs	Risk from the hackers

Faster banking service	Old age people have difficulties to easy-use the internet options
Use of banking service without allocation difficulties	The cash-usage culture of the Albanians
Better time management for the customers	Limited transactional amounts
Avoidance of face-to-face contact with the banks' employees for timid people	Limited banking services offered online
Offering a diversified type of banking service	High internet installation fees
One of the main goals of the Albanian government is the expansion of internet use in every field of economy	Expensive access fees

E- Banking has become very important even in the Albanian banking system however this market is a new one (as the real Albanian banking system dates its beginnings since early '90s).

Below are some samples of 6 banks (out of 10 that offer internet banking), how do they use the online connection to perform the daily banking transactions.

Intesa San Paolo Bank, S.A

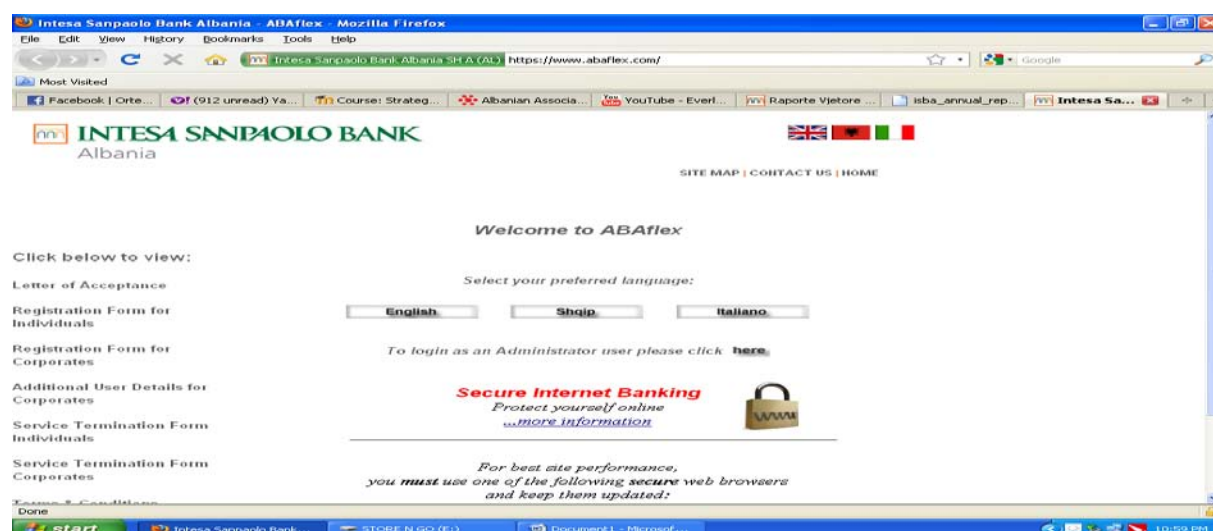


Figure 5. Official website necessary to be logged in

The product offered by Intesa San Paolo Bank Albania is called ABAflex.

In order to be provided with the online service the clients use: a Key (or known as the user ID code) and an online Password (which must be with a length of minimum 8 characters as a mixture of letters, numbers and different symbols).

Every customer, user of ABAflex must access only the official link of the bank (<http://www.intesasanpaolobank.al>) and avoid logging from other links or web addresses. This is a way to predict any possible fraudulent interventions from hackers into the clients' accounts or in the banking system. The bank has chosen the usage of virtual keyboards to avert any possible password spy device that may have been installed in the

computers of internet centers that customers can use to get logged in. However one of the main advices of the bank is not to use computers of public internet centers because there the risk from hackers is higher than if the customers use personal computers or laptops.

The main services offered by ABAflex for the customers are:

- Control of the account balances within the Bank
- Transfer of funds both within the country and internationally
- Payment of utility bills (phone charges, tax payments, etc)
- Opening of e-deposits
- Information about new products and services offered by Intesa San Paolo Bank
- Request for banker's checks

The usage of this service has only one limitation: the completion of banking transactions can be executed only during business hours (from 9 am up to 4 pm).

Procredit Bank of Albania

ProCredit Bank (www.procreditbank.com.al) offers e-banking services through the application of a user ID and a password. In addition to these, the client advisors must provide the customer with a Token (which has a number that change every 60 seconds) for additional security. Every time the customer logs in for e-banking, he/she has to insert this number.

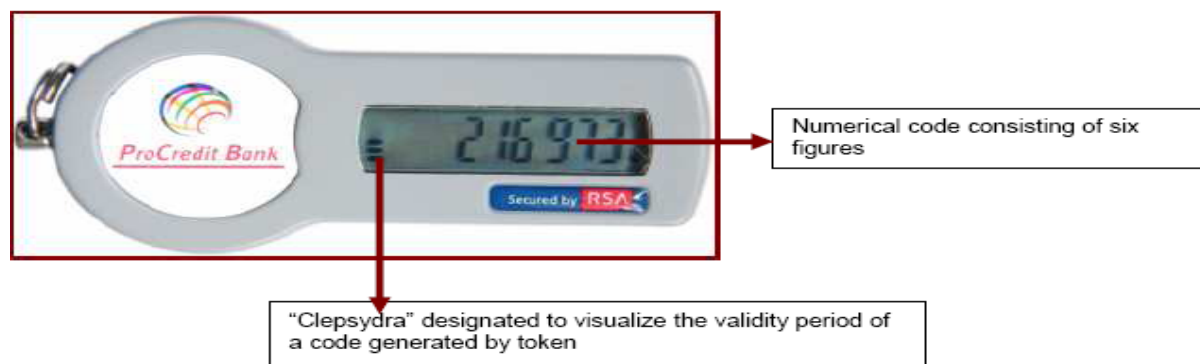


Figure 6. Token used in ProCredit Bank

The main services offered by Pro E-banking for the customers are:

- Daily account transactions and balances
- Viewing 100 recent orders made through e-banking
- Institutional Payment executions within PCB Branches (transfers within customer, transfer utility payments, Municipal Tax Payments)
- National Payment for other local banks in ALL currency.

National Commercial Bank of Albania

National Commercial Bank Albania (www.bkt.com.al) provides the customers with internet banking service giving them the possibility to log in using the PIN/TAN system where the PIN represents a password, used for the login and TANs representing One-Time Passwords to authenticate transactions. TANs can be delivered in different ways but the most popular one is to send a list of TANs to the e-banking user by postal letter. The most secure way of using TANs is to generate them by need using a security token.

Through e-banking BKT offers services such as:

- Check of accounts and deposits
- Transfers domestic and transfers within BKT branches
- Applications for credit/debit cards
- General information about BKT's products and services
- Investments
- Payment of bills

Registration form: To perform the registration process, we should complete the following steps:

- Enter customer ID and press NEXT.

Figure 7. Official website necessary to be logged in

- At the next page,
 - We choose the card type
 - Enter last 4 digit of the card that we have selected
 - Enter PIN of the card
- At the same page the current mobile phone number will be displayed which partly encrypted
- Press NEXT to proceed to OTP page

Figure 8. Official website necessary to be logged in

Then an SMS will be sent to registered mobile phone number which we will enter at OTP page.

Figure 9. Official website of BKT

Then we will proceed to a page where we will define our Internet Banking password

At the following page, we have to enter a password that we want to use when login to BKT Internet Banking. At the same page we will see our e-mail address that we have given to BKT. If we want to modify it, we can change it.

Then we will choose our Digital Stamp which is a security element when login to BKT Internet Banking.

- Choose a category from the list.

- Choose a Digital Stamp and press NEXT in order to complete our registration process.

Login is a process for the customer in order to login to BKT Internet Banking.

Only registered users can login to BKT Internet Banking, Registration process can be initiated by clicking “Register Now” button at the login page. Registered users must complete the following steps in order to login to BKT Internet Banking.

- Enter customer ID and Internet Banking password.
- At the next page, Digital Stamp that we have chosen during registration will be displayed, and we will press NEXT.

Then an SMS will be sent to registered mobile phone number which we will enter at OTP page.

- Press NEXT after we enter OTP that has been sent to our mobile phone number in order to complete login process.

Tirana Bank (PIRAEUS GROUP)

Figure 10 shows the main page of Tirana Bank

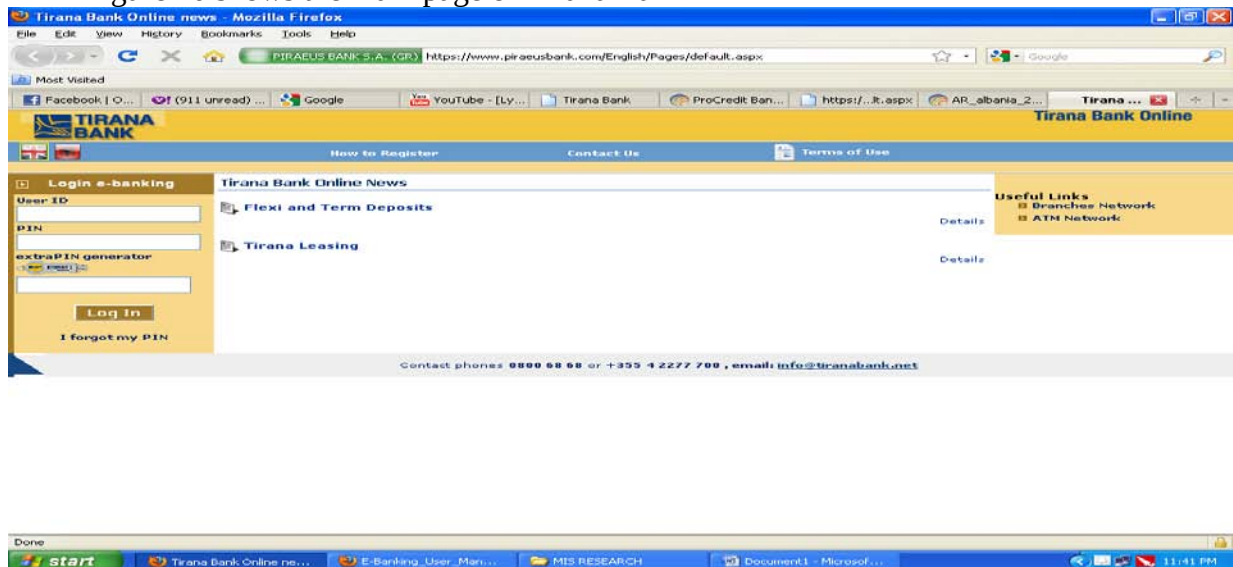


Figure 10. Official website of Tirana Bank

Tirana Bank, part of Piraeus Group offers to its clientele the possibility to use online banking “Tirana Bank Online-Internet Banking”. Through the link <https://mobile.piraeusbank.com> the customers can have detailed information about:

- The balance and the transactions performed with the accounts
- The used limits of credit/debit cards
- Installments to be paid for the consumer or mortgage loans

- Payment schedule for the monthly installments
- Money transfers within Tirana Bank
- Domestic money transfers
- International money transfers
- Payments of Visa credit cards maintained with Tirana Bank
- Payment of installments of outstanding credit facilities
- Payment of mobile phone bills (AMC and Vodafone)

The customers, to get logged in, use a user identification number and a PIN, which changes every 2 months.

Alpha Bank of Albania

Figure 11 and 12 show the main and login pages of Alpha Bank

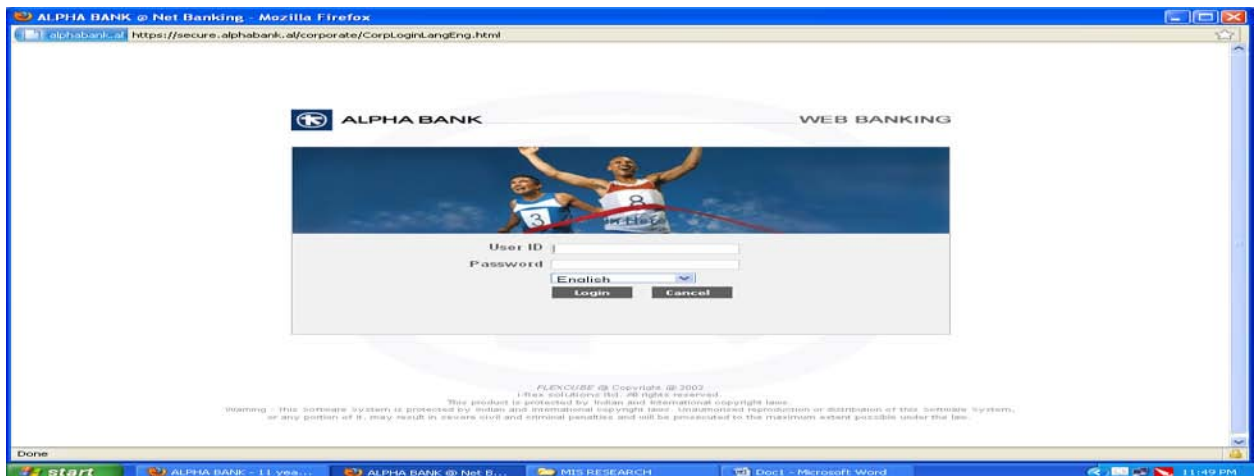


Figure 12. Official website of Alpha Bank



Figure 12. Login page of Alpha Bank

Alpha Bank offers online banking services applying a user ID and a password. However, customers can buy a token that creates additional single use 5-digit numbers for additional safety.

With its easy menu, Alpha Bank offers:

- Access to bank accounts, time deposits, loans, credit/debit cards,
- Online payments
- Information about the last 10 transactions performed
- Payment of bills
- Fund transfers or payment execution that require an additional password

Raiffeisen Bank

Figure 13 shows the login page of Raiffeisen Bank



Figure 13. Login page of Raiffeisen Bank

Raiffeisen Bank offers the following e-banking services via Multicash:

- Electronic link with the bank –directly from your computer you can make money transfer & and extract your account statement
- Payments within Raiffeisen Bank
- National & International payments
- Information of the movements in the account
- Print of the data per accounts

- “Elektronik“ sign

4. SURVEY RESULTS

A summary of results obtained from the survey is shown below. Exact questions and response options are displayed in the appendix of this study

- 1.) Total assets of companies surveyed:
 - 31% of the banks have a Total Assets <EUR 50MIO
 - 6% of the banks have a T.Assets 51-100MIO
 - 18% have Total Assets EUR 101-300MIO
 - 44% of the banks have a Total Assets >EUR 300MIO
- 2.) Number of customer visiting the website:
 - 78% of banks have a visit for their websites 1001-3000 persons/day
 - 22% of banks have a visit for their websites <1001 persons/day
- 3.) Number of years have for offering internet banking?
 - 20% >3 yrs
 - 60% 1-3 yrs
 - 20% <1yr
- 4.) Website update frequency:
 - 70%- monthly
 - 30%- weekly
- 5.) Aim of offering e-banking?
 - 40% -Pre-planned objective
 - 2-10%-Due to customers' demand
 - 50% to gain a competition advantage
- 6.) The main target clientele for the usage of e-banking:
 - 80% of banks offer e-banking for all 3 groups
 - 20% of banks offer e-banking only for corporate clients
- 7.) E-banking is used for:
 - Banks use e-banking for both reasons Perform transactions and Give promotional information about the products and services
- 8.) Have e-banking fasten your services to the clientele?
 - 70% of the banks answered YES
 - 30% of the banks answered NO
- 9.) Does e-banking help your bank to improve the relation with customers?
 - 60% of the banks answered YES
 - 40% of the banks answered NO
- 10.) Way of informing clientele about the website of the bank
 - 60% use Leaflets
 - 20% use Media promotions
 - 20% use 3 ways
- 11.) 100% of the banks offer the term & conditions and the fees in their websites

12.) 100% of the banks analyzed affirmed that the customers prefer most the usage of real bank branches rather than e-banking.

5. CONCLUSION

E-Banking is promising great opportunities in developing countries like Albania. This study aimed to investigate these issues, hence contributing the financial institutions and even potential customers to do business in a more convenient way.

Empirical findings of our study indicate that Albanian people are very eager to use e-banking services. Therefore banks should increase the quality & quantity of their online services. This market survey study may be useful for those financial institutions that plan to implement or improve e-banking services in the near future.

Appendix: Questionnaire Form

To: The Product and Development Department

Dear Sir/Madam,

We are two MBA students, studying Business Administration at Epoka University in Tirana. We are currently working on a research project for MIS (Management Information Systems) course lectured by Dr. Özcan ASILKAN. Our research topic is E-banking service implementation and development in Albania.

We are delivering the attached questionnaire to banks operating in Albania. We would appreciate if you could accept to answer this questionnaire. Please be avouched that your answers will be treated with the most accurate confidentiality.

If you consider that you are not the appropriate person to fill in this questionnaire, would you please pass it to the person in your bank that is in charge for this information.

If you have any questions, please do not hesitate to contact us.

Thank you in advance for your collaboration,

Sincerely yours,
Ortenca TUÇI & Nereida XHAJA

Questions:		a)	b)	c)	d)	e)
1	Total assets of your company are	< EUR 10 MIO	EUR 11 MIO- EUR 50 MIO	EUR 51MIO- EUR 100 MIO	EUR 101 MIO-300 MIO	>EUR 301MIO
2	How many customers /day visit your website?	<1000	1001-3000	3001-5000	5001-10000	>10000
3	How many years have you been offering internet banking?	<1 yr		1-3 yr	>3 yr	
4	Your website is updated:	weekly	monthly	yearly	daily	
5	Why do you offer e-banking?	Due to customer's demand	To gain a competition advantage		Pre-planned objective	
6	What are the main target clientele for the usage of e-banking	Individuals		SME	Corporate	All 3 groups
7	E-banking is being used for:	Perform transactions	Give promotional information about the products and services			Both

8	Have e-banking fasten your services to the clientele?		Yes	No	Indifferent		
9	Does e-banking help your bank to improve the relation with customers?	Yes	No	Indifferent			
10	How do you inform your clientele about the website of the bank		Bank leaflets	Media promotions	Net advertisement	3 Ways	
11	Does the website of your bank give information of e-banking service?			Yes	No	Indifferent	
12	Customers prefer most	e-banking		real bank branches			

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FINANCIAL CRIME
CORPORATE CRIME IN TURKEY
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ABSTRACT

Turkey has suffered from different economic crises since 1990. However, Both February 2001 and last international financial crisis (2008 ABD crisis) have been unprecedented in intensity and repercussions. Although many factors, both internal and external, may have contributed to their occurrences, the former owing to their inducing corruption and waste in the economy, seem to have fomented them more than the latter. Although Turkey has been getting transformed into a market economy since 1980, government intervention is still pervasive in its economy. Government still controls Central Bank, owns commercial banks, and operates public enterprises. It has liberalized market, currency, foreign trade and foreign direct investment (FDI), but still operates sectors like energy, sugar and tobacco. Such a level of state intervention had adverse implications for corruption, waste, effective reforms, etc. in the country.

Further, since the transformation of the economy could not be accompanied by concomitant structural, legal and institutional reforms in 1990s, resources have constantly been misused over the years. Further still, groups owning bank, media and holding companies jointly have notoriously precipitated domestic financial crisis by stashing away the home deposits in their offshore branches. Finally, supporting agriculture and industry with politically-motivated credit for voting purposes has constantly been aggravating the drain of resources and thereby financial crises of the country. This paper aim of the critical examination of financial crimes and corruption such factors may have contributed to the occurrence and accentuation of financial market's disorganization suffered by Turkey over the last decades.

ÖZET

1990'dan itibaren Türkiye farklı krizler çekmiştir. Buna karşın, Hem 2001 Şubat krizi hem de son uluslar arası finansal krizi benzersiz güce ve yankı uyandırma özelliğine sahiptirler. Buna rağmen, birçok faktör, hem içsel hem de dışsal, vakalarla ilişkilidir. İlki baskın yolsuzluklar ve ekonomide ki kayıp yüzünden, onları ikincisinden daha çok kışkırtıyor gibi geliyor. 1980'den beridir Türkiye Piyasa ekonomisine dönüşmesine rağmen, hükümet hala yaygın olarak ekonomisinde müdahil olmaktadır. Hükümet hala merkez bankasını kontrol etmektedir, ticaret bankasına sahiptir ve kamusal yatırımlar etkindir. Liberal piyasaya, şuanda, dış ticaret ve direkt dış kaynaklı yatırıma sahiptir. Fakat devlet hala enerji, şeker ve tütün ve tütün mamulleri gibi sektörleri yönetmektedir. Ülkede ki kamunun piyasaya karışma seviyesi gibi muhalif çıkarımlarla yolsuzluklar için uygun ortam vardı, kayıp, etkili reform, vb.

Dahası, 1990'larda ekonomik dönüşüm için bir arada ki yapı tarafından resmi ve kuruluş reformları ayak uydurulmamalıydı. Yıllardır kaynaklar boşa kullanılmaktadır. Dahası, banka sahibi gruplar, medya ve holding şirketleri ortaklaşa olarak ülkede ki hesaplarını denizaşırı hesaplarına taşıyıp saklayarak mahalli finansal krizi hızlandırdılar. Sonuç olarak, tarım destekleme ve oy için politikal endüstriyel kredi motivasyonu ile birlikte sürekli kaynakların sömürülmesi kötüleşti ve böylece ülkedeki finansal kriz oldu. Bu çalışma hedefi finansal suç ve yolsuzluk eleştirel bir şekilde incelemek ve bu olaylarla ilişkili örnek vakaları irdeleyerek son 10 yıllı aşkın sürede Türkiye'de ki finansal piyasada ki düzensizliğin üzerinde durmaktır.

1. Introduction

Turkey has possessed an interesting financial background in the last 11 years. It has experienced several times of financial crisis and depression due to the irregular financial systems. These irregular systems caused Turkey to be regarded as a heaven country for illegal businesses as it provided perfect opportunities for money laundering and tax frauds.

In 2001, owing to banks crisis, Turkish financial system went was negatively affected. Many customers were aggrieved by bankruptcy of certain banks and firms. We could describe that period as the financial crash for Turkish banking and finance systems. This crash had such a vast effect on the systems that Turkish government, which dragged Turkey into this period, had to resign. Despite the negative period for Turkish financial systems, the country had a quick recovery and gained better framework against the financial crisis. The last global crisis was devastating for powerful countries which had (– A) economic grade and caused bankruptcy of many companies in different parts of the world. However, Turkish financial associations made excellent attempts against the crisis and Turkey was not seriously affected. Turkish banks gained 6, 2 billion ytl in first quarter of 2008. This means that they could improve their assets by 5, 7 %.

Apart from Turkish financial system's positive atmosphere and excellent situation today, we want to emphasize financial crime experiences of Turkey. Especially, Uzan family's story is a great example of financial crime for Turkish financial criminology in terms of helping to gain maintainability and further understanding of how Turkish financial security systems struggle against illegal activities and which foundations have been commissioned to do it.

2. Description Of Corporate Crime

2. 1. Definition of Criminology

Corporations commit corporate crime. This type of crime can be defined as having been a separate legal personality from the natural persons to manage activities for business entity, or by individuals that may be identified with a corporation or other business entity (see vicarious liability and corporate liability).

Corporate crime includes:

- White-collar crime, because a great number of people who may represent the interests of the corporation are employees or professionals of a higher social class;
- Organized crime, because corporations are established by criminals with the aim of committing crime or as vehicles for laundering the proceeds of crime. Organized crime has become a branch of big business and is simply the illegal sector of capital. It has been estimated that, by the middle of the 1990s, the "gross criminal product" of organized crime made it the twentieth richest organization in the world-richer than 150 sovereign states (Castells 1998: 169).¹ The world's gross criminal product has been estimated at 20 percent of world trade.² (de Brie 2000).
- State-corporate crime because, the relationship between the corporation and the state leads to the opportunity to commit crime in many contexts.

2. 2. White Colour Crime

Edwin Sutherland, a proponent of Symbolic Interactionism, defined **white-collar crime** as "a crime committed by a person of respectability and high social status in the course of his occupation" (1949) and believed that criminal behavior was learned from interpersonal interaction with others. White-collar crime therefore overlaps with corporate crime because white-collar employees have more access to the opportunity for fraud, bribery, insider trading, embezzlement, computer crime, and forgery.

3. Requirements To Overcome Corporate Crime

3. 1. Function Of Law

Laws have always served as instruments of regulation throughout history. Lea (2001) argues that crime used to be the exceptional event, disrupting the otherwise normal socio-economic processes. However, as crime became more frequent, it lost its status as an

¹ Castells, Manuel, *The Rise of the Network Society (The Information Age: Economy Society and Culture, volume I.)* Oxford: Blackwell. ISBN 0-631-22140-9, (1996), p. 169.

² de Brie, Christian '**Thick as thieves**' *Le Monde Diplomatique* (April), (2000), pp. 84-97.

exceptional event and turned into "a standard, background feature of our lives—a taken for granted element of late modernity."³ (Garland 1996: 446)

3. 2. Policy to Enforce The Law Against Corporation

In some countries, corporate crime has become politically sensitive. In the United Kingdom, for example, following a number of fatal disasters on the rail network and at sea, the term is commonly used in reference to corporate manslaughter and to involve a more general discussion about the technological hazards posed by business enterprises (see wells: 2001).⁴ There exist similar incidents of corporate crime, such as the 1985 Union Carbide accident in Bhopal, India⁵ (Pearce & Tombs: 1993) and the behavior of the pharmaceutical industry (Braithwaite: 1984)⁶.

The Law Reform Commission of New South Wales explains such criminal activities as follows:

"Corporate crime poses a significant threat to the welfare of the community. Given the pervasive presence of corporations in a wide range of activities in our society, and the impact of their actions on a much wider group of people than are affected by individual action, the potential for both economic and physical harm caused by a corporation is great."

Similarly, Russell Mokhiber and Robert Weissman (1999) assert:

"At one level, corporations develop new technologies and economies of scale. These may serve the economic interests of mass consumers by introducing new products and more efficient methods of mass production. On another level, given the absence of political control today, corporations serve to destroy the foundations of the civic community and the lives of people who reside in them."⁷

3. 3. What Behaviour To Criminalization

The civil law (including administrative law) or the criminal law regulate behavior. The legislature makes the political judgment that this behavior is sufficiently culpable to deserve the stigma of being labeled as a crime while deciding to criminalize particular behavior. In law, corporations can commit the same offences as natural persons. Simpson (2002) avers that this process should be straightforward because a state should simply engage in victimology to identify which behavior causes the most loss and damage to its citizens, and then represent the majority view that justice requires the intervention of the

³ Garland, David (1996), "The Limits of the Sovereign State: Strategies of Crime Control in Contemporary Society", **British Journal of Criminology**, Vol 36, p. 446.

⁴ Wells, Celia. (2001). **Corporations and Criminal Responsibility (Second Edition)**. Oxford: Oxford University Press. ISBN 0-19-826793-2, pp 48-77.

⁵ Pearce, Frank & Tombs, Steven. (1993). "US Capital versus the Third World: Union Carbide and Bhopal" in **Global Crime Connections: Dynamics and Control**. (Frank Pearce & Michael Woodiwiss eds.). pp 99-147.

⁶ Braithwaite, John. (1984). **Corporate Crime in the Pharmaceutical Industry**. London: Routledge & Kegan Paul Books. ISBN 0-7102-0049-8

⁷ Mokhiber, Russell & Weismann, Robert. (1999). **Corporate Predators : The Hunt for Mega-Profits and the Attack on Democracy**. Common Courage Press. ISBN 1-56751-158-9, pp 47-98.

criminal law. But states depend on the business sector to deliver a stable economy, so the politics of regulating the individuals and corporations that supply that stability become more complex.⁸ For the views of Marxist criminology, see Snider (1993) and Snider & Pearce (1995), for Left realism, see Pearce & Tombs (1992) and Schulte-Bockholt (2001), and for Right Realism, see Reed & Yeager (1996). More specifically, the historical tradition of sovereign state control of prisons is ending through the process of privatization. Corporate profitability in these areas therefore depends on building more prison facilities, managing their operations, and selling inmate labor. In turn, this requires a steady stream of prisoners able to work. (Kicenski: 2002)⁹

People commit crimes as the offender has the 'right opportunity'. This is the point where the offender simply sees the chance and thinks that he or she will be able to commit the crime and not be detected. For the most part, greed, rather than conceit, is the motive, and the rationalization for choosing to break the law usually arises out of a form of contempt for the victim, namely that he, she or it will be powerless to prevent it, and has it coming for some reason. For these purposes, the corporation is the vehicle for the crime. This may be a short-term crime, i.e., the corporation is set up as a shell to open credit trading accounts with manufacturers and wholesalers, trades for a short period of time and then disappears with the revenue and without paying for the inventory. Alternatively and most commonly, the primary purpose of the corporation is as a legitimate business, but criminal activity is secretly intermixed with legal activity to escape detection. To achieve a suitable level of secrecy, senior managers will usually be involved. The explanations and exculpations may therefore centre around rogue individuals who acted outside the organizational structures, or there may be a serious examination of the occupational and organizational structures (often hinged on the socio-economic system, gender, racism and/or age) that facilitated the criminal conduct of a corporation

In the developed world, bribery and corruption are problematic issues, and the corruption of public officials is regarded as a primary cause of crime in developing societies, where massive foreign debt often undermines the provision government services. While discussing the implications for policing in Eastern Europe as it seeks to adapt its laws to match a capitalist model, Peèar (1996) points to the difficulty of distinguishing between lack of morality and criminality in economic crimes that tend to emerge from the structural relationships in modern commerce.

4. Corporate Crime Experience Of Turkey

Turkey has gone through many incidents of corporate crime so far and Turkish Government has struggled against them. The most popular corporate crime story in Turkey belongs to the Uzans, known as one of the wealthiest business families in the country .

On December 6, 2004 the British High Court reportedly permitted two multinational companies, Motorola Credit Corporation and Nokia Corporation, to enforce an American judgment of more than \$2 billion in England against British-based assets of the Uzan family of Turkey. Most members of the family fled into exile to avoid arrest in

⁸ Simpson, Sally S. (2002). **Corporate Crime, Law, and Social Control**. Cambridge: Cambridge University Press. pp 97-143.

⁹ Kicenski, Karyl K. (2002). **The Corporate Prison: The Production of Crime & the Sale of Discipline** pp97-120

connection with an alleged bank fraud in Turkey, and another key Uzan family member was jailed in Turkey after inflammatory remarks during a political campaign.

In the 1990's, Uzan family was controlling Telsim, the second largest Turkish telecom company at the time. The company wanted to expand into the area of cellular telephone service, however, it was in need of substantial financing to undertake the cellular project it had in mind. Telsim arranged to purchase the cellular infrastructure and equipment it would need for its expansion from two industry multinationals, Motorola Inc. and Nokia Corporation.

According to court documents, Telsim took a loan of \$360 million from Motorola's finance division, Motorola Credit Corporation, to purchase the equipment and another \$200 million to fulfill requirements to obtain a 25-year nationwide license for its cellular activities.

Nokia's bank, ABN Amro financed Telsim's purchase from Nokia, with Nokia itself guaranteeing the loan. Both companies later extended additional credit until Telsim owed over \$2 billion to Motorola and over \$800 million to Nokia. Telsim offered its own shares as collateral for these large loans.

Telsim was controlled indirectly through Rumeli Telefon- another company the family had. This company held about 73% of Telsim's stock and pledged 51% of Telsim's outstanding shares to Motorola and 5% of Telsim's outstanding shares to Nokia to secure the loans. According to 2003 court documents, Telsim repaid about \$200 million of these loans.

In April 2001 when the Uzans decided to triple the number of Telsim shares, the trouble began. At Motorola and Nokia, suspicions emerged and the purpose of this move was considered as an action to reduce the value of the Telsim shares pledged as collateral for their loans. When Rumeli Telefon, which controlled the pledged stock, failed to acquire any of the new stock to maintain its relative ownership position, the suspicions reached a peak. Its share of Telsim's stock dropped to about 24% while another Uzan company, Standart Telecom, snatched up the new stock to increase its holdings to over 66% of Telsim's shares.

The Uzans were anxious about the real possibility of losing Telsim to the two creditor companies and according to 2003 US court documents, they filed false criminal charges in Turkey against executives of Motorola and Nokia. The charges reportedly accused the managers of threatening the Uzans with everything from blackmail to murder and kidnapping, but the Uzans reportedly expressed a willingness to drop the charges if the two companies would please extend the terms for repayment of the loans.

Attempts to negotiate a resolution in Switzerland apparently broke down. In 2002 Motorola and Nokia filed suit in federal court in New York against several members of the Uzan family and three Turkish companies they controlled. Neither Telsim nor Rumeli were named as defendants in the lawsuit.

The Uzans disputed the case vigorously, but Motorola and Nokia managed to get a court-ordered freeze of Uzan assets, which was recognized by several countries, reportedly including Germany, France, and Bermuda.

In the summer of 2003, the US District Court in New York awarded a judgment of over \$4 billion to Motorola and Nokia, ordered the Uzans and other defendants to turn in the Telsim shares that had secured the large loans, and ordered the arrest of several

members of the Uzan family if they came within 100 miles of New York, according to press reports.

With this massive judgment in hand, Motorola and Nokia began the search for the trappings of Uzan wealth to be seized and sold to satisfy their judgment-- expensive apartments in New York City, world-class yachts, and aircraft were reportedly some of the early targets. The December 2004 order in the UK may allow the two companies to execute their judgment against the luxury London real estate owned by the Uzan family.

There was a certain urgency to the asset search, because a third hunter had entered the scene. European media reported in June 2003 that the Turkish government had seized Imar Bank, a local bank controlled by the Uzan family which was found to have an alleged deficit of some \$6 billion.

The Turkish Savings and Deposit Insurance Fund, an entity associated with the central bank of Turkey, later accused the Uzans of siphoning enormous amounts of money from the bank into offshore accounts and manipulating the bank's records as to the number of customers it had and also accused the bank of selling fake treasury certificates to investors, according to a BBC report of the case.

Uzan family members associated with the Imar Bank fled Turkey in 2003 and disappeared. Among the missing: family patriarch Kemal Uzan, his brother Yavuz Uzan, son Murat Hakan Uzan and daughter Aysegul Akay. Another of Kemal Uzan's sons, Cem Cenghiz Uzan, was charged as a defendant in the Motorola/Nokia case in New York, but was not allegedly involved in the operation of Imar Bank.

Cem Uzan in fact remained in Turkey after his relatives fled and carried on a political campaign as head of a new political grouping called the Youth Party, which reportedly sought a mass following with promises to take on the IMF and reduce taxes. According to BBC reports, its rallies leading up to Turkish parliamentary elections in 2002 featured concerts by popular entertainers and confrontational speeches by party leader Cem Uzan. His remarks at one such gathering in June 2003 later landed Cem Uzan in a Turkish courtroom where he was sentenced to serve eight months in prison and pay a fine for insulting Turkish Prime Minister Recep Tayyip Erdogan.

The exiled members of the Uzan family, meanwhile, began to claim that the government's pursuit of them over the failure of Imar Bank was politically motivated, apparently as retaliation for Cem Uzan's 2002 anti-government campaign. The Turkish government responded in early 2004 by seizing over 200 Turkish companies controlled by the Uzan family (including Telsim) reportedly to cover the costs of bailing out the failed Imar Bank, for which the government claimed the Uzans were responsible.

By December 2004 most of the Uzan's remained in hiding, while the Turkish government struggled to sort out the maze of companies it had seized, and Motorola and Nokia were on the prowl for Uzan assets in England and were eyeing Switzerland, where the family was suspected of stashing over \$100 million. Swiss courts so far have reportedly not allowed Uzan creditors to seize assets there.

Back in Turkey the Savings and Deposit Insurance Fund began negotiations in December with Motorola and Nokia for a possible settlement funded by proceeds from the possible sale of Telsim. According to a Reuter's report of December 30, 2004, such an agreement would depend on adoption of a law by the Turkish legislature allowing the government to sell the assets it seized from the Uzans.

In January Russian mobile phone company VimpelCom's affiliate in Kazakhstan, called KaR-Tel, received a demand for payment of some \$5.5 billion from the Turkish Savings and Deposit Insurance Fund. Press reports say that VimpelCom bought KaR-Tel from the Uzans in September 2004 for \$350 million and assumed \$75 million of debt.¹⁰

5. Turkish Ministry Of Finance's Strategies Against Uzan Family

5. 1. Duties, Powers and Responsibilities of Council of Financial Crimes Investigation

On 19.11.1996, with the enactment of law no. 4208, which aims to prevent money laundering, Turkey became one of the countries combating money laundering and the presidency of financial crimes investigation board (MASAK) was established.

MASAK, founded on 17th February 1997, is an administrative institution directly bound to Ministry of Finance, and its duties and powers were initially defined in Law no. 4208. The Draft Law on prevention of Laundering proceeds of crime, which was drawn up to attain international standards in AML/CFT measures and to establish a more effective combating system, was adapted on 11th October 2006 by TGNA.

In Article 19 of the Law no. 5549 on prevention of laundering proceeds of crime, which was put into force on 18th October 2006 after being published in the official gazette no. 26323, MASAK's duties and powers were redefined as follows:

- a) To develop policies and implementation strategies, to coordinate institutions and organizations, to conduct collective activities, to exchange views and information in order to prevent laundering proceeds of crime.
- b) To prepare law, by-law and regulation drafts in accordance with the policies determined, to make regulation for the implementation of this Law and the decision of council of Ministers regarding the Law.
- c) To carry out researches on the developments and trends on laundering proceeds of crime, and on the methods of detecting and preventing them.
- d) To make Sectoral studies, to improve measures and to monitor the implementation on the purpose of prevention of laundering proceeds of crime.
- e) To carry out activities to raise the public awareness and support
- f) To collect data, to receive suspicion transaction reports, to analyze, and evaluate them in to scope of prevention of laundering proceeds of crime and terrorist financing.
- g) To request for examination from law enforcement and other relevant units in their fields, when required during the evaluation period.
- h) To carry out or to have carried out examinations the subject matters of this law.
- i) To denounce files to the Chief Public Prosecutor's office for the necessary legal actions according to the criminal procedure law in the event of detecting serious findings at the conclusion of the examination that a money laundering offence.
- j) To convey the cases to the competent public prosecutors and to fulfill the requests relation to the determination of money laundering offence.

¹⁰ **Newyork Times Newspaper** , "Turkey Seizes 219 Company of Uzan Family", Published: monda, February 16, 2004.

- k) To convey the cases to the competent public prosecutor's office in cases where serious suspicion exist that a money laundering or terrorist financing offence is committed.
- l) To ensure inspection of obligation within the scope of this law and relevant legislation.
- m) To request temporary personnel assignment from other public institution and organizations within the presidency, when their knowledge and expertise is necessary.
- n) To carry out international affair, to exchange views and information for the subjects in the sphere of its duties.

To exchange information and documents with counterparts in foreign countries, to sign memorandum of understanding that is not in the nature of an international agreement for this purpose. ¹¹

5. 2. Functions of MASAK

There are two types of activities for combating crime and criminality. The first type includes the activities of detecting crime, criminal and punishment. This examination function is entirely for detection of the criminal. With evaluations and examinations specialized support is provided for public prosecutors.

The second type consists of measures to prevent committing crime and activities for implementing these measures. The title of the law no.5549 is "Law on prevention of laundering proceeds of crime".

In terms of prevention of laundering proceeds of crime According to the Law no. 5549 functions of MASAK may be categorized into the five following main titles:

- Developing and regulating policies
- Coordination
- Collecting, analyzing, evaluating data
- Supervision of obligations
- Examination

MASAK is considered only as an investigating institution by public opinion, however, this does not fully reflect the truth. MASAK should be regarded as an institution focusing on preventive measures in combating crime, as well. ¹²

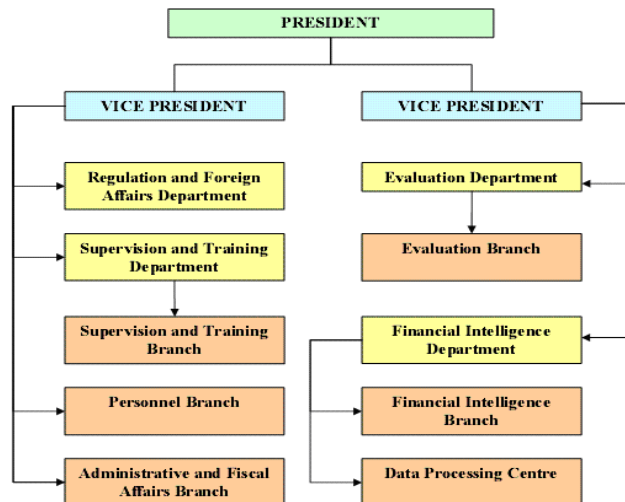
¹¹<http://www.masak.gov.tr/en/LaunderingProceedsofCrime/Chronology.htm>

5. 3. Masak's Position Within The Ministry And Organization Structure

Four departments were established within MASAK after the alterations in organization structure and duties definitions of MASAK on 20th September 2006. The components of the organization are as follows: Departments of Regulation and Foreign Affairs, Financial Intelligence, Evaluation Supervision and Training, and Branches of Personnel and Administrative and Fiscal Affairs attached to vice presidencies that are attached to the president.

Figure-1. Demonstrates The Organization Structure Of Masak And Its Position Within The Ministry

Figure1- ORGANIZATION CHART OF MASAK



Turkey has two important departments, which are bank watchdog organization and Council of Financial Crimes Investigation, for struggling against financial crimes. These two are essential for fighting against crime at companies. They inspect the instruments of Turkish market such as corporations, banks, exchange offices, financial investment companies and etcs. Aim of their establishment is to support Turkish government to overcome financial crimes successfully by providing clues about how criminals work. This strategy has brought big advantages for defense against criminals. Consequently, Turkish

¹²<http://www.masak.gov.tr/>

court of justice could issue efficient laws and reinforce the related security systems against financial crimes.¹³

6. Conclusion

We can understand the power of security systems thanks to the story of Uzan family, who committed financial crime. The organizations mentioned above are all important parts of a security system that revealed the crime.

Turkish banking watchdogs claimed to discover a double account system for Uzan family at IMAR bank and followed the required procedure to set criminal charges against the Uzan family. Then, Turkish government pressed the button. Firstly, Council of Financial Crimes Investigation documented the Uzan's crime and sent the records to Turkish high court of justice. After the court decision, Turkish Council of Ministers was notified and they sent the decision to both banking watchdogs and other related departments. As a result, these organizations had the right to confiscate the Uzan's bank and all companies within 7 days. Kemal Uzan, who is the biggest shareholder of Uzan holding's, was arrested immediately by government's officials. Turkish Court of justice sentenced him to 55 years in prison.

As we see in this story, Turkey has many departments to collaborate for precaution against corporate crimes and frauds. Aim of the system is to control market and the security of government incomes. Turkish financial security system can be powerful through cooperation among organizations. Security departments can work in collaboration with courts. Officers should never waste time to connect with each other so that they can trace and arrest criminals quickly and easily. Turkish governments could enact legislation against financial crimes with the help of the clues provided by council of financial security.

Turkey is expected to overcome corporate crime provided that Council of Financial Crimes Investigation works successfully against criminals and legislations that may help the process are introduced. Therefore, the rate of financial crime in Turkey can decrease, leading to high standards of security in Turkish finance departments.

¹³ <http://www.masak.gov.tr>

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THE ROAD FROM EFFICIENT MARKET HYPOTHESIS TO THE FINANCIAL CRISIS

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ABSTRACT

With the recent financial crisis , the debate of the validity of the efficient market hypothesis has been raised once again, since the stock market crash of 1987. This theory in a simple way states that markets are efficient and make a rational allocation of resources because all of the available information is reflected into prices. However, as many economists claim , this financial crisis has badly beaten the theory of efficient markets , moreover there are voices that blame the hypothesis itself as culprits of crisis. The aim of this research paper is to address the very true origins of the crisis and to respond to the blames against this hypothesis. The research incorporates an investigation into economic journals, financial newspapers, economic forums, and blogs, through which a wide variety of ideas and arguments of professional economists are provided and at last I provide my position and judgment in this debate.

Key words : efficient market hypothesis , Eugene Fama , financial crisis

JEL Classification : G01, G14

1.INTRODUCTION

The concept of efficiency is crucial in economics. Widely, rational allocation of resources is attributed to efficiency of that market. Eugene Fama, a nobel - price winner, introduced for the very first time this concept in the financial market , which would bring the most debated and discussed theory in finance : the efficient market hypothesis. The theory states that financial markets are efficient. This implies two things ; Firstly , no one can beat the market, that is the market as a whole is wiser than single investors ; Secondly, prices in the market reflect all the available information. However, according to the theory there are different degree of efficiency based on the level of available information, which can be categorized into weak, semi-strong and strong form of efficiency . Empirical tests show sufficient evidences for the weak-form of market efficiency, while concerning semi-strong and strong form of efficiency there are controversial and extensive evidences. However, it is obvious that market cannot be totally efficient as these forms assumes. The recent financial crisis reopened the hot debate between efficient market opponents and proponents. Many economists have argued that this crisis drove a stake through the heart of the academic notion of efficient market hypothesis. The statements have been much more severe from considering the theory as guilty and culprit for the crisis to assuming that the theory is dead for ever and ever. On the other hand advocates of the theory, continue to argue that it wasn't the fault of the theory , as long as the theory has its own limitations and as long as a wide range of economists and investors fail to understand what the theory imply, what it says and what it doesn't. The aim of this research paper is to enlight the case of this debate .

2.METHODOLOGY

The paper is a theoretical one. What I aim to test is the validity of the efficient market hypothesis. The two main assumptions of this theory that “there are no free lunches” and “prices are right”, are tested within the context of global financial crisis. The research's methodology cover an analysis of the ideas and arguments of different economists and financial professionals published in economic journals, financial newspaper , forums and blogs. Three are the main questions I arise in this paper and try to find the answers :

1. Is it fair to blame the efficient market theory as responsible for the financial crisis ?
2. Which are the very roots of culprits under the financial crisis ?

3. What is left after from this theory ?

The paper will be constructed as follow : On the first section I will provide a general overview about the market efficiency theory, where I explain what does this theory imply, what are some tests, what are anomalies and which are the critics of the theory. Providing the necessary knowledges about efficient market hypothesis, on the second section I describe the financial crisis by the perspective of rising the question towards the validity of the market efficiency hypothesis. Here are also enlightened the origins of the crisis . On the last section, after having provided different points of views , I support the ideas of Jeremy Siegel and I join the group of economists who argues that it is not fair to blame the efficient market hypothesis for the financial crisis .

3.LITERATURE REVIEW

A brief history of evolving Efficient Market Hypothesis

The efficient market hypothesis is the most discussed and debated theory in finance. It derives from the concept of “efficient market”, firstly introduced by Eugene Fama in 1965 as “ a market where there are large numbers of rational , profit-maximising actively competing , with each trying to predict future market values of individual securities,and where important current information is almost freely available to all participants” (Fama,Jan 1965, “The behaviour of stock market prices”). To understand the above statement well , one has to know the exact meaning of “efficiency” as it used in finance literature because this concept is a generalised term used widely in overall economic literature. However, I will be based on the definition of Richard Thaler, a colleague of Fama, who defines it as having two components ; “no free lunch” part and “prices are right” part. No free lunch principle is related to the fact that at an efficient market any profit opportunity is eliminated using arbitrage. The price is right principle says what Fama in other words formulated as prices in financial markets fully reflect all the available information and thus provide accurate signals for resource allocation. Combining together “ no free lunch” and “ price are right”, efficient market hypothesis states that one cannot make abnormal profit on a risk-adjusted basis, given the information publicly available at the time the investment is made. Most individuals buy and sell stocks assuming that the buying price is less than the selling price, but since efficient market hypothesis states that current prices reflect all the public information ,

any of their attempt to outperform the market will be just a matter of chance, a game rather than a matter of skills. It is impossible for investors to beat the market by picking stocks, finding a secret formula or timing market. All of these are of no value because stock prices follow a random walk. Literally, it is commonly known the analogy of a drunk man ,whose movements are totally unpredictable which was discussed by Karl Pearson(1905) in the frame of finding the optimal predictable movements. Later on, in 1953, Kendall applied this analogy to a series of prices whose successive returns have been independent. Kendall results on 22 UK stock were that data behave as wandering series. The near 0-correlation of prices was a surprising inconsistent observation with the view of economists until that time, which lead to the so called “Random walk model” or even “Random walk theory”. This theory states that movements in prices will not follow any patterns or trends. Past price movements cannot be used to predict future prices movements. Roots of this insight can be traced back to dissertation titled “The theory of speculation”(1900) of French mathematician Louis Bachelier, who concluded that “The mathematical expectation of the speculator is zero” and described this condition as a fair game. Anyway, one of the first tests of random walk theory was developed by Cowles and Jones(1937), to be followed later by Cootner (1962;1964), Fama (1963;1965a) , Fama and Blume(1966), and Osborne (1959). With the exception of Cowles and Jones(who acknowledged an error in their analysis-Cowles ,1960) all of these articles found evidences supporting random walk hypothesis, using historical price data. The results that future prices cannot be predicted has led to the argument that even a blindfolded chimpanzee which selects stocks by throwing darts at a newspaper’s financial pages would have performed as well as the highly-paid portfolio manager who picks stocks using quantitative methods.The inevitable claim is that one cannot beat the market , unless it assumes much riskier investments.

2.Theoretical background

Another crucial concept behind this theory is rationality. Efficient market hypothesis requires that investors have rational expectations and they update their expectations properly as soon as a new relevant information appears. The efficient market hypothesis allow for a different reaction of investors while facing a new information, such as overreaction or underreaction , however the market is always rational as long as there are some rational traders present together with arbitrage opportunity (Shleifer, 2000). To summarize what he described above, the efficient

market hypothesis concerning rationality allows for any one to be wrong about the market, but the market as a whole can never be wrong, indeed market is always right.

There are three forms of the efficient market hypothesis :

1.The “weak” form asserts that all past market prices and data are fully reflected in securities prices. Future prices cannot be predicted by analyzing prices from the past. Excess returns cannot be earned in the future if one bases his investment strategies in past prices and historical data. Thus, technical analysis which tries to predict trends using past data is here of no use, it will not be able to provide excess returns. However, fundamental analysis which takes into account markets fundamentals such as : inflation rate, interest rate, economic growth etc. may provide excess returns.

2.The “semi-strong” form of efficiency implies that all publicly available information is already reflected into stock prices, so no excess return can be earned by trading that information. In this way, nor technical analysis, neither fundamental analysis can make good use in earning excess returns.

3.The “strong” form asserts that all the information including public and private or insider information is fully reflected in stock prices, so no one can earn excess returns. Strong form of efficiency can be impossible when there are legal barriers disclosure of private information into public, as with insider trading laws.

Testing the implications

The literature begins with studies of weak form of efficiency. In 1970, Fama made a summary of his own contributions and research studies of the information contained in the historical series of prices and concluded that there are strong support of weak form of market efficiency. While testing semi-strong and strong form of efficiency, he concluded that the evidence in support of market efficiency is extensive and controversial.

Studies of the semi-strong and strong form of efficiency were focused on the speed of adjustment of prices to the new information. The first event studies were conducted by Fama, Fischer, Jensen and Roll (1969). They used the Capital asset pricing model as a benchmark, and found evidences on the reaction of share prices to stock splits and earnings announcements. The studies

provided that the information is anticipated by the market and most of price adjustment is complete before the event to be announced; when the news is released, the remaining part adjusts rapidly and accurately. In 1972, Scholes studied the price effects of the secondary offerings and he examined the case when the seller may be in possession of non-public information. He found that stock prices fall by an amount that reflects the value of this information.

Concerning the implication of strong-form of efficiency, a number of papers have found that early identification of new information can provide substantial profits. Insiders who have the privilege of the private information, can earn excess returns, showing an evidence against the strong-form of efficient market hypothesis.

The concept of market efficiency leaves the ground for possible minor market inefficiencies. The evidences accumulated during 1960-s and 1970-s seems to be broadly consistent with this view. It was obvious that market cannot be totally efficient as the strong form of efficiency assumes, yet there was sufficient evidences for the weak and semi-strong forms.

Anomalies and Criticism

Investors and researchers do not find consistent the efficient market hypothesis both empirically and theoretically. Anomaly, which is defined as a regular pattern in an asset's return which is reliable, widely known and inexplicable, is the most common violation of the efficient market hypothesis. The fact that the trend is regular and reliable, means that many investors can make predictions and take advantage of it. Small firm effect is one of the most enduring challenges against the efficient market hypothesis. The apparent excess expected return that accrue to stocks of small-capitalization companies-in excess of their risks, was first discovered by Banz(1981). Another well-known anomaly is the so called "January effect" which shows that small capitalization stocks tend to outperform large capitalization stocks by a wide margin over the turn of the calendar year, and it was documented by Keim(1983), Roll(1983), Rozeff and Kiney(1976). Other well-known evidences against efficient market hypothesis include: the value-line enigma (Copeland and Mayers), the relation between price-earnings ratio and expected returns (Basu,1977), the volatility of orange-juice future prices (Roll,1984),

the calendar effects such as holiday, weekend, and turn-of –the month seasonalities (Lakonishok and Smidt,1988) etc.

Their persistence in the eyes of public seems to be a clear violation of the efficient market hypothesis. Most of these anomalies can be exploited by trading strategies, and while the resulting profits may not be riskless, they seem unusually profitable relative to their risks (Lo,2007) (Lehman, 1990).

However, supporters of the efficient market hypothesis argue that these anomalies cannot be exploited to any significant degree because of factors such as risk and transaction costs. On the other hand, luck can be an important factor of causing anomalies. Regular pattern can be found in historical data, though no regularities exist just because of pure chance. Though the probability of finding such regularities is too small, data-snooping biases are illustrated in Brown et al.(1992) and Lo and MacKinlay(1990b). They found out that even the smallest biases can translate into substantial anomalies such as superior investment returns or size effect.

Behavioral Criticism

While there are empirical findings that brings evidences against the efficient market hypothesis, theories evolved do it as well. Behavioral finance , an approach which takes into account the preferences and behaviors of market participants , still being one of the most enduring critiques of the efficient market hypothesis. Psychologists and experimental economists part of the behavioralism have attributed investors's decisions and choices to a combination of cognitive biases such as : overconfidence (Fischhoff and Slovic,1980;Barber and Odean ,2001;Gervais and Odean,2001), overreaction (DeBondt and Thaler,1985), loss aversion (Kahneman and Tversky,1979; Shefrin and Statman,1985; Odean,1998), herding (Huberman and Regev,2001), psychological accounting (Tversky and Kahneman,1981), miscalibration of probabilities (Lichtenstein,Fischhoff and Phillips,1982), hyperbolic discounting (Laibson,1997) and regret(Bell,1982). According to these critics, investors made often irrational decisions, exhibiting predictable and financially ruinous behaviors and thus leading to imperfections in financial markets.

4.EMPIRICAL EVIDENCES AGAINST THE EMH

An outlook of the financial crisis

As until now it has been provided enough theoretical background of efficient market hypothesis, I am able to jump to a further analysis of the event : the financial crisis, the leitmotiv that will follow this second part. The financial crisis of 2008-2009 was the most severe downturn since the great depression of 1930s. What started as a collapse of the main financial institutions in USA was widely spread throughout the world in Europe and Asia due to financial markets interconnectivity. The financial meltdown was caused by the downward movements in real estate prices and other securities related to housing prices. Leading rating agencies mistakenly underestimated the risk, rating with an AAA relatively high risk-securities, which at last drove many firms to bankruptcy. As Nicole Bobbin put in an article in Forex Trading Currency, a blog-spot, “The housing market began to collapse in 2005 and 2006 when defaults started to increase on subprime and adjustable rate mortgages. When hedge funds went belly-up and banks started to report large write-downs, it turned into a Wall Street crisis in 2007. In March 2008 , Bear Stearns became the first investment bank to fail , requiring a bailout and acquisition by the Fed and JPMorgan”. The downturn spillover had just began with these failures to be followed by the takeover of Fannie Mae and Freddie Mac in September, Lehman Brothers’ bankruptcy a week later and the gulp of Merrill Lynch by Bank of America. Shortly after that , the last two remaining publicly traded U.S. investment banks (Goldman Sachs and Morgan Stanley) filed for change of status to bank holding companies while JPMorgan absorbed Washington Mutual. Soon from 2008 and on, the crisis became a crisis of confidence. Banks became skeptical of lending to each other as they did not know who might be the next to fail (Bobbin,N.,2009,The origins of 2008 financial crisis). So, lastly with the recent financial crisis, it turned out that once again since the stock market crash of 1987, the whole profession of financial engineering went out of game giving the second-real world reminder of market capriciousness (Financial Economist ,2009). What was happening with the Efficient market hypothesis?

So much noise about the” death knell” of the academic notion of efficient market

The current irony was that It sounded very foolish under these circumstances the boldly once-upon a time declared statement of Michael Jensen, a Harvard professor,that “there is no other

proposition in economics which has more solid empirical evidence supporting than the efficient market hypothesis”(1978). Since that time, many were those economists who had taken it as the fact of life or even further taking the fact that prices are unpredictable to infer that prices in fact are right. However, since early in 1984, Robert Schiller correctly called this “one of the most remarkable errors in the history of economic thought” . Mr.Jensen’s doctoral thesis published in 1968 went through the same road of conclusions of dozens of other studies that “ even, as a group, mutual fund managers could not outperform the market” . Although there are some anomalies , it is hard to beat the market. Yet this did not prevent people from trying it (Richard Thaler,2009).

So, based on Fama’s essence that the price of a financial asset reflects all the available information that is relevant to its value, powerful conclusions were drawn, not at least in Wall Street. Since market would price financial assets broadly correctly , deviations from equilibrium would not last long, wiser investors would spot and pop any bubble, and trying to beat the market would be a fool’s errand since the information was out there, already in prices. However, what it seemed to make the financial system healthier and safer due to the confidence in well-designed models of asset pricing came out to be a devastating blow of the entire academic discipline of financial economics (Financial Economics,2009).

Widely was claimed that the so called academic notion of “efficient markets” went to death knell with the recent global financial crisis, not at least were the claims of critics who blame this hypothesis as responsible for the crisis. Anyway, whether the efficient market hypothesis can be blamed as “guilty” for the crisis or not, one thing that is becoming conventional in the wisdom press is that efficient market hypothesis was somehow disproven by the global financial crisis,as stated in many financial newspapers. Roger Lowenstein,a financial journalist and best-selling author, in an article on Wall Street Journal “The price isn’t right” didn’t think twice when he said that “The upside of the current Great Recession is that it could drive a stake through the heart of the academic nostrum known as efficient market hypothesis”(2008). Jeremy Grantham,a british investor in the same way wrote “The incredibly efficient market hypothesis caused a lethally dangerous combination of assets bubbles, lax controls, pernicious incentives and wickedly complicated instrument that led to our current plight”. Following the articles in financial news, published by economists, we see a number of such statement. David Wighton , a business editor,

reported on The Times that the theory was officially declared dead at the World Economic Forum in Davos, during a brainstorming session that involved many of the world's top economists, politicians and business leaders (2009). Nobel laureate Joseph Stiglitz, in a conference in International House, based his talk to his new book "Freefall : America , Free markets and the sinking of the world economy" saying that "The idea behind the efficient market hypothesis ,which says that is impossible to beat the market because the prices are already incorporated and they reflect all relevant information, is very powerful ,but wrong. The crisis has provided numerous examples of markets that cannot be described as efficient in any reasonable way"(2010). Another news source wrote in july 2010 that "The efficient market hypothesis is not only dead. It's really , most sincerely dead "(Minyanville). It seems quite enough the lists of those economists that criticise Efficient market hypothesis, however isn't it exaggerated to blame a theory as responsible for a meltdown when in fact a theory is just a theory? Is it really the efficient market hypothesis itself the only one to be blamed ? Did a theory make economists blinded ? On the other hand, wasn't it their own fault to fail recognize and warn about the signs of a possible bubble ? And last, what is to conclude now about this theory? This are some of the main questions that we will enlight on the below.

Limitations of the Theory

According to our opinion , rather than the theory , the economists themselves do matter in this financial crisis. As in all cases, a theory is just a theory : it has its own limitations , there are boundaries in testing it and the real world is much more complex than a set of thought and ideas.

No theory can explain everything. I will be based on the arguments of Ray Ball in his article "The Global Financial Crisis and the efficient market hypothesis _what have we learned ?" to explain that actually this theory is just an abstraction from the reality, that cannot totally determine our thoughts and actions, and thus like all theories , it has " anomalies"-facts or findings that the theory itself cannot explain (Kuhn, "The structure of the scientific revolutions",2nd edition , Chicago).

Firstly,the theory itself has some limitations that should be taken into consideration.The theory mention only the demand side : Given the supply of all the available information, the investors will trade until every profit opportunity is exploited and there are no more excess returns. If we

have a short look to the major models of assets pricing of modern financial economics , we will see that absolutely their total focus on demand side, thinking of supply as given is a major weakness (Discounted present value_Given an expected stream of future cash flows,...; The Miller Modigliani theorems_Given the corporate investment decisions and the earnings from that investment ,...; The CAPM _given the variance –covariance matrix of future returns and the pricing of two benchmark efficient portfolios,...; The Black-Scholes option pricing model _given the share price, price volatility and several other variables,..)

Secondly, another limitation raising with this theory is that information is assumed to be an objective commodity meaning the same for all investors,when in fact investors have different beliefs and information. Investors' actions on the financial markets are based not only on their own beliefs , but other traders'beliefs as well. For example, herding behavior plays a significant role here.

Third, the efficient market theory also assumes that information processing is costless and hence prices reflect the information immediately and exactly. Even if public information is acquired with negligible costs, one cannot reject costs of interpreting this information.

Fourth, ignoring liquidity effect by assuming continuous trading, bring out another limitations when in reality illiquidity was a fact of credit markets and real assets markets during 2007 and on.

Lastly, accounting for the limitations on testing the theory and for the fact that the real world is much more complex, we can conclude that there is much more than just a theory to be blamed as a cause of the global meltdown.

John H. Biggs, an economics professor, in a reply-letter written to Paul Krugman said to him that “economic models are like photons’ models going through the slits. Just as those models predicts only the statistical distributions of photons, so economic models only predict the likelihood of downturns –they do not predict when any particular downturn will happen”(2009).

So, I join the position of advocates of the argument that one has to criticize researchers who simplified these models of assets pricing and moreover those who blindly acted as a fool, thinking that the efficient market hypothesis meant the same thing as these elegant mathematical

formulas of assets pricing. Myron Scholes, widely known for winning the Nobel prize in 1997 because of creating the most used model in finance industry-The Black Scholes formula for price options, -says that “There are models and there are those who used these models. Apparently a lot of the model used for structured products were pretty good, but the inputs were awful. Indeed the vast majority of derivative contracts performed exactly as their models said they would. It was the exceptions that proved disastrous” (Brett Ryder , Financial Economics,2009).

My opinion is absolutely against the “ transformed science of economics”. Pretending to have transformed the economics from a social science into a predictive science and equalized it with the pedestal of natural sciences, what actually it turned out to be, was just their failure of both predicting the looming crisis and incorporating the effects of it, in contrary to their expectations and beliefs (Paul Krugman, How did economist get it so wrong, New York Times,2009). Major part of economists and financial analysts failed to predict its knocking on the door.

As Krugman continues blaming in its article “How did economists get it so wrong” , economists fell in love with the renewed idealized market ,desiring to encompass an intellectual elegant approach and thus they turned a blind eye to the limitations of human rationality that often lead to bubbles and busts, to imperfections of financial markets that cause suddenly unpredictable crashes and to the dangers created when regulators don’t believe in regulation

Earlier precautions of deaf voices

As Dereck Scott has been quoted in the financial Times (2010), the current crisis reflects not the failure of the capitalism , but the failure of the people running the capitalism to understand how it works. However, not everyone was part of the mindless herd. Few economists dared to warn when everything was still rosy. In 2005, Raghuran Rajam , a professor from Chicago university , while presenting a paper, warned that financial system was taking on potentially dangerous level of risks. Robert Shiller, another economist identified the bubble and warned the painful consequences if the bubble burst. However, both of their warnings were dismissed and ignored at that time. According to Paul Krugman the blind faith of many economists if not most, emerged the biggest financial hubble in history. Late at the beginning quarter of 2008, Meredith Whitney an executive director of equity research at Oppenheimer and Co., layed out the template for

financial crisis, predicting very bad troubled times ahead. However, many dismissed those precautions.

Misconceptions about the efficient market hypothesis

According to Ray Ball, one cannot blame the efficient market hypothesis as long as many things are not captured by this hypothesis. The failure of investors or economists to clearly understand what the hypothesis stands for, brings out many fallacies that have to be discussed here.

So, according to Ball, one common misconception arising from this theory is related with confusing the efficiency as statement of equilibrium resulting from investors' actions with the actions themselves. Because prices are said to reflect the all available information, investors wrongly assumed there was nothing to gain from producing information. So as a result by confusing the statement of equilibrium settlement and the actions required to set that equilibrium, the prices of securities deviated substantially from their true value.

Another misconception is related with the statement too big to fail. George Soros, opined that "On a deeper level, the demise of Lehman Brother conclusively falsifies the efficient market hypothesis". However, I find here reasonable the argument of Ray Ball that no matter of how much vulnerable you are, you will lose one day if taking massive risk with extraordinary leverage. According to Ball's article "The global financial crisis and the efficient market hypothesis, what have we learned" Lehman's demise illustrates exactly what efficient market hypothesis predicts "The size and vulnerability will not guarantee you positive abnormal returns, and will not protect you from the forces of competition"

Another important point is related to the shape of distribution of returns. Widely the blame goes to efficient market hypothesis for practices such as calculating future risk entirely from recent historical data. However, the efficient market hypothesis is silent about whether the past distributions-including means, variances, skewness and correlation matrices, will mechanically repeat themselves in the future. The efficient market hypothesis do not say anything about the stationary over time of return distributions.

Also, the failure of financial regulators to monitor and control the risk-position of financial institutions at the high leverage position, is attributed to the blind faith in what efficient market

hypothesis suggest to us that public information is already incorporated into prices. However, as Ball continues to argue in his paper “ if regulators were true believers of the efficient market hypothesis , they would have been more skeptical about some high returns which could have been attributed to high leverage, high risk, inside information and dishonest accounting”. If they were relying truly on the efficient market hypothesis, they would have been more skeptical about Lehman Brothers , Bear Sterns, AIG , Freddie Mac and Fannie Mae and other investment banks in general . Actually the problem was that they didn’t believe enough.

So , as a conclusion of putting the blame on efficient market hypothesis, I would state that it isn’t the fault of a theory , rather it is the fault of economists and investors to take it as for granted even in those aspects when it didn’t say nothing. It is the fault of investors who wrongly interpreted it and assumed that things would go exactly as their models told them.

The very true origins of the financial crisis

As, I said on the above , whether is the efficient market hypothesis the real responsible for the current financial crisis, my response is absolutely no. According to Fama statement, all known information is reflected into a security price which impacts its value. One cannot beat the market as long as prices are overthere. However this doesn’t imply that prices are always right : it leaves the space for one to think of prices as being even wrong . However, one cannot say whether they are too low or too high at a specific moment. The fact that even the greatest sophistication of financial engineering at Wall Street failed and made so many mistakes in predicting assets prices, shows what the hypothesis imply : it is hard if impossible to beat the market.

Thus, one cannot use the efficient market hypothesis as an excuse for the crisis. Rather ,this is the fault of the rating agencies’ mistakes and overleveraging by the financial firms. As Jeremy Siegel writes in the article “Accounting for risks that rocks boats”, CEOs failed to exercise their authority to monitor the overall risk of the firm and instead put their faith in technical whose narrow models could not capture the big picture”. So, It is quite exaggerated to blame the efficient market hypothesis as responsible for the crisis, however the blind faith due to misconceptions should be taken into consideration . As Jeremy Siegel argues the fact that risk premium were low, did not mean that they were inexistent and market prices were right.

In order to enlight the argument that the efficient market hypothesis did not cause the crisis, below I will summarize some of the events which lead to our financial crisis, as described in the paper of Baily, Litan and Johnson(The origins of the financial crisis, November 2008), and Daniel Daianu (What this financial crisis tells us , 2008).

According to them, the financial crisis had its origins in an asset price bubble that interacted with new kinds of financial innovations that masked the risk ; with companies that failed to follow their own risk management procedures, and with regulators and supervisors that failed to restrain excessive taking. So, the roots of crisis can be traced at the following events classifying as below:

1)Housing demand and the perception of low risk in housing investment : The roots of this current credit crisis are in financial and mortgage markets which exhibited excess due to the sustained rise in house and belief that they would continue to do so, neglecting the signs of the bubble.

2)The shifting composition of mortgage lending and the erosion of lending standards : After the booming in mortgage markets, a shift in the composition of lending occurred from prime mortgages to non-prime or subprime mortgages. In 2004-2006 the share of subprime and home equity lending expanded greatly, nearly half of mortgage originations in 2006 were subprime, Alt-A or home equity.

3)Economic Incentives in the Housing and Mortgage Orientation Markets : There were pattern of incentives for encouraging households to take out mortgages looking good in the short run but unfavourable in the long run.The perverse policy of disintermediation of selling a completed loan off book to other financial institutions caused an increase in housing demand and house prices . Studies by Miam and Sufi (2008) showed that key factor in inflating the housing bubble was the availability to securitize subprime mortgages.

(4)Securitization and the Funding of the housing boom : Earlier mortgage loans were made by Savings and Loans Institutions taking on the default risk, the risk of prepayment and the risk of changes in the interest rate, so they had incentive to monitor the quality and performance of loan. However, under the old system a limited number of loans could be made, so the switch to the new system allowed lenders to sell off loans to a third party, take it off their books and make

even more loans. Exactly for this purpose were created Government sponsored enterprises GSEs such as Fannie Mae and Freddie Mac, in 1938 and 1970. GSEs are pointed as one of the main culprits in the financial crisis, because they did begin to buy riskier loans being under pressure of the congress , but this was late in the game , after private subprime lending had already taken off.

(5) Financial recycling with more securization and more leverage-CDO s, SIVs, and Short-term borrowing: In an article “Taking stock: is the efficient market hypothesis in trouble” published in Risks and Rewards(2009), Nino Boezio states that “One of the unsettling things that occurred in 2008 was the endless spiral down of investment performance”. Companies who sold their packages of bad investments feared about their market value on writing downs. This fear was transmitted to the hedgers , subprime and related holdings leading to a further deterioration of their market value. By 2000s ,banks, brokers, hedge funds and other institutions using new financial instruments based on technical computer models, securitized more and more subprime , contributing by doing so in the bubble that ultimately burst in August 2007. The complexity, lack of infrastructure and public information on CDO, SIVs etc. were the causes that their risk could not be estimated accurately which created a massive panic in the financial system,which began in August 2007. SIVs (Structured investment vehicles) as another form of financial innovation allowed banks to leverage their holdings of these assets more than they could on their balance sheet. Under this housing bubble , the very little capital of leveraged financial institutions led to the freezing up of liquidity in credit markets. Institutions such as Bear Stearns and Lehman Brothers borrowed at very short term and held risky long-term assets, with low levels of capital or reserves to cover changing market conditions. While securitisation was meant to spread out risk away from the center of the financial system, the risk in August 2007 was in fact heavily concentrated among leveraged institutions at the heart of the financial system.

(6)The credit rating agencies : Credit rating agencies failed in grading accurately the risk of the securitized assets . Because of the lack of transparency and the complexity of instruments such as CDOs, judgment of their risk was difficult and the agencies became the effective “arbiters of risk” for the entire market in structured finance products.

(7)Failure of company risk management practices : Two major failures are remarked here ; firstly, the problem when top managers didn’t control and monitor trading of CDOs and other

related securities and secondly, the problem of rating agencies who failed to rate the risk of their mortgage portfolio.

(8)Regulation and supervision : As Daniel Daianu conclude in his paper , “ the root cause of this crisis is an inadequately and under-regulated financial system. The U.S financial system was oriented towards a more liberal and deregulated wave which was strengthened by the Phil Gramm-Leach Bliley act of 1999. The act allowed plethora of fancy products whose risks were poorly understood to be brought into the market, and moreover packaging and repackaging of these financial products made them toxic, making their evaluation of risk even more unclear.” (What this financial crisis tells us, Daniel Daianu)

So, there are enough reasons to conclude that the crisis was due to the failure of the entire system from financial engineers to investors’s actions, agencies’ ratings and government regulations, so no a simple theory was the greed to blame. Rather the whole wrong interpretation leads to a spillover of effects that generated the latest meltdown. While Wall Street was making large profits by bundling and selling securities, The GSEs; Fannie Mae and Freddie Mac helped fuel the subprime and on the other hand Congress was happy to see that more americans could enjoy “the American dream” of home ownership. CEO based on their technics and models, underestimated the risk and failed to monitor the overall risk, so they did not capture the whole picture.

Consequently, I believe none of this was the fault of efficient market hypothesis. If statistical data on the market showed a low risk, this didn’t mean they were inexistent. On the below, I will use the analogy of Jeremy Siegel in one of his article to conclude this paper with the belief that one should not blame the efficient market hypothesis as responsible for the current financial crisis. According to Siegel “The fact that automobiles today are safer than they were years ago, does not mean that you can drive at 120 mps. A small bump on the road, perhaps insignificant at lower speeds, will easily flip the best engineered car. Our financial firms drove too fast, our central bank failed to stop them, and the housing deflation crashed the banks and the economy” (Accounting for risk that rocks boats, 2010).

What is left from efficient market hypothesis ?

As Brett Ryder wrote in Financial Economics in February 2009, behavioral economists were among the first to set the alarm about market trouble. Robert Schiller warned about the booming in house market, but his warnings were ignored. Robert Shiller is an advocate of behavioralism that thinks that macroeconomics should draw lessons from psychology. He thinks that there are two lessons that this crisis teaches to us : Firstly “the no free lunch part” is correct, clear and convincing. Many new investment strategies based on technical models which aimed to beat the market, didn’t do so, considering the great risk they were taking on. So , lunches still not being free. Secondly, the part “prices are right ” is not consistent ; this idea is badly dented. We have now enormous evidences that show that the reliance on the idea that prices are right and they contribute to an efficient allocation of resources, has in fact led to a misallocation of resources, due to price distortion. If prices would be right, the bubbles wouldn’t have occurred. So, what is left from the efficient market hypothesis after this financial crisis is that price is not always right.

5.CONCLUSIONS

The concept of efficiency of financial markets , a term described firstly by Fama in 1965, was the leitmotiv of this paper. This theory have been the topic of a number of papers , however based on diversified economists’ analysis and arguments, I tried to bring it in another perspective of discussion. The financial crisis of 2007-2008 disproved considerably what this theory implies in that prices are right. From this event, opponents of this theory grew even strongly to attack it and moreover, there were even those who dared to blame it as responsible for the crisis. The aim of paper was to give an answer to the question whether one can blame the efficient market hypothesis as responsible for the crisis or not. Investigating in papers written about the recent financial crisis and efficient market hypothesis on the other hand, I found that the theory itself has its own limitations. Secondly , many interpret it wrongly, so I provided some of the main misconceptions about this theory. And the last satisfying argument to be found was that a number of origins stays behind the crisis so no single theory is responsible for the crisis. Concerning the limitations of the theory I would summarize it as below :

- ❖ The theory is limited only to the demand side.

- ❖ Information is considered to be an objective commodity meaning the same for all investors.
- ❖ The theory assumes that information processing is costless and hence prices reflect the information immediately and exactly.
- ❖ The theory assumes continuous trading ignoring liquidity problems.
- ❖ The real world in fact is much more complex than how a theory presumes it.

Concerning the fallacy of the theory, I would briefly describe as follow :

- ❖ The efficiency as statement of equilibrium resulting from investors' actions is commonly confused with the actions themselves.
- ❖ Another misconception arises from the statement too big to fail, as in case of Lehman Brothers.
- ❖ Predicting based on the shape of distribution of returns is another fallacy while the hypothesis is silent about it.
- ❖ The Crisis is attributed to the failure of financial regulators to monitor and control the risk-position of financial institutions at the high leverage position due to blind faith in what efficient market says, but the true ugly is that they did not take it seriously, rather than just put a blind faith in it.

Lastly, using the findings of Baily , Litan and Johnson (2008), and Daianu (2008) , I tried to enlight the very true origins of this financial crisis. Shortly these can be summarized as below:

- ❖ asset price bubble ;
- ❖ new kinds of financial innovations that masked risks ;
- ❖ companies that failed to follow their own risk management procedures ;
- ❖ regulators and supervisors that failed to restrain excessive taking.

As a conclusion , I believe that the efficient market hypothesis is not responsible for this crisis. Rather , the fault can be pointed to the whole financial system starting from Wall Street profession, housing market, hedge funding, financial innovations, financial regulatory institutions to the government which made nothing and felt satisfied by seeing the American dream of home ownership coming true. What is left after from the efficient market hypothesis,

was the last question to be answered on this paper. I concluded that concerning the free lunch part, the hypothesis is right because evidences are clear and convincing that market can not be beaten. However, the financial crisis showed that the “Price is right” principle is not always true. Unfortunately, this time prices were badly wrong.

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EPOKA UNIVERSITY

Faculty of **ECONOMICS**

Dep. Banking & Finance

CASE OF INDEPENDENCE OF BANK OF ALBANIA

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Overview

1. Historic Background
2. Main Objectives
3. The Mission
4. Functions

Case of independence of BOA

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1.A brief history of the Bank of Albania

The History of the Bank of Albania and its credit and monetary system in Albania is the history of the attempts preceding the foundation of the National Bank of Albania (1925-1944), the transformation to the State Bank of Albania (1944-1992), to be concluded in 1992 with the Bank of Albania, which enjoys with the attributes of a modern central bank.

Albania had its first central bank institution in 1913. It was founded under the agreement concluded between Ismail Qemali Government with Mr. Karol Pitner and Mr. Oskar Pollak, representatives of Wiener Bank Verein, acting on behalf of the Austrian-Hungarian bank-group and Mr. Pietro Fenolio and Mr. Guido Ansbahe, representatives of the Banca Commerciale Italiana, acting on behalf of the Italian banking group. This institution did not live long due to the political climate of the era and to the outbreak the First World War.

It recommenced its activity in 1925 under the name National Bank of Albania, with the administrative centre located in Durrësi and Administrative Committee placed in Roma. The re-establishment of the Bank became a reality due to the concluded agreement between Mr. Mufid Libohova acting on behalf of the Albanian Government with Mr. Mario Albertit operating on behalf of the Italian financial group.

The circulation of the first Albanian currency unit took place in February 1926. The gold franc was set out as the official monetary unit. Our currency had its subdivisions (Lek, cents, 1 gold franc equated to 5 Lek and 100 cents) and its manifolds (5, 20 and 100 gold francs).

The National Bank of Albania, throughout this period, implemented the gold standard implying that banknotes are converted into gold and into strong foreign currencies, as dollar, lira, pound, etc. This bank, in addition to the issue function, carried out crediting functions as well. Over a 10 –year period it acted under monopoly conditions in this field, while since 1938 found itself in competition with the Bank of Napoli and the National Bank of Labour.

In 1945, the Leadership of the Antifascist National-Liberation Council approved the Law on the cancellation of the National Bank of Albania's concession and of its shares, which opened the way to the nationalization of the Bank. The organic Law of the State Bank of Albania was approved on January 3, 1945, giving to the bank the attributions of a central bank and simultaneously those of a commercial one. After the Second World War until the year 1990, the State Bank of Albania supported the program for the development of the socialist economy having as characteristic the extremist centralisation of this system into the state's hands.

At the end of 1990, the transition of the political system in Albania reflected vital changes, leading the economy to enter into a transforming stage from a state-owned economy in a free market one. This changeover gave life to the two-tier banking system in Albania. Thus, on April

22, 1992, the Bank of Albania was established by the approval of the Law No. 7559, “On the Bank of Albania”, which was reviewed latter in accordance with the models taken from the western countries and the recommendations provided from the international organisations.

The Bank of Albania, within the competences defined by the Law, is independent of any other power for the accomplishment of its main objective and in exercising the tasks assigned. Every subject is obliged to respect the independence of the Bank of Albania, to not try to have influence on any member of the Supervisory Council for impinging on its obligations to the Bank of Albania, and to not interfere in the activity carried out by the Bank of Albania.

2.Bank of Albania Main Objective

The primary objective of the Bank of Albania is to achieve and maintain the price srability.

Through its policies and in view of the duties assigned by the law, the Bank of Albania makes efforts to achieve this principal objective, which implies control on inflation level. The Bank of Albania, prior to compiling the policies it should follow, it determines the final targets, middle targets and the instruments and the instruments through which it will operate to achive these targets.

The Bank of Albania, in accordance with its primary objective and based on the domestic banking market, promotes and supports the development of the foreign exchange regime and systems, the domestic financial market, the payment system, and assists in improving monetary and lending conditions, supporting the country's economic stability and development.

The other objectives of the Bank of Albania, conditioned by its primary objective, should promote the maintaining of liquidity, solvency and normal functioning of the market-based banking system.

Any other objective or task assigned to the Bank of Albania is conditioned by the achievement of the primary objective.

3.The mission of the Bank of Albania

The stability of the financial system is a fundamental condition for the financial system to enhance its efficiency in the intermediating process and to contribute in the orientation of financial sources towards investments in productive projects within acknowledged parameters of the activity risks. In this way, the contribution of the financial system in the country's economic development and in the fulfillment of the needs of its clients is crucial.

In order to achieve and maintain the stability of the financial system, sound financial institutions are needed, which act in a financial market with a developed and monitored infrastructure,where mechanisms which stimulate the effective management of financial sources and risks faced by investors exist.

The central banks play an important role in the achievement and preservation of the stability of the financial system; however such role is not an exclusivity of central banks.

4. Functions

The Bank of Albania, with the attribute of the monetary and supervisor authority of the country, enjoys the following functions:

- It compiles, approves and implements the monetary policy of the country, and employs the appropriate monetary instruments to achieve the monetary policy targets;
- It has the exclusive right to issue and circulate the national banknote and currency;
- It keeps and manages the foreign reserve of the Republic of Albania;
- It compiles, adopts and implements the foreign exchange regime and the exchange rate policy;
- It licenses or revokes a license on exercising banking activity and supervises the banking activity to ensure the banking system stability;
- It acts as banker, advisor to, and as fiscal agent, of the government of the Republic of Albania;
- It serves as Bank of banks;

Case of independence of BOA

5. How is central bank independence defined?

What is the definition of an independent central bank? There is no unique (sole) definition of the term “central bank independence”.

An operational paper from the Monetary and Exchange Affairs Department of the IMF lists three necessary preconditions for effective central bank autonomy:

- An autonomous central bank should have a clearly defined objective, namely price stability.
- The central bank should have both sufficient authorities (De jure and de facto) and adequate instruments to manage liquidity in the banking system to meet its primary responsibility.
- A central bank’s operations should be transparent, and information should be disclosed on a regular basis so that the central bank can be held accountable for its monetary policy and inflation performance”

6. Why an independent central bank?

Over the past decades there has been a trend in increasing in the independence of central banks as a way of improving long-term economic performance. Even it's considered as ambiguous the relation between the bank independence and economic performance. Advocates of central bank independence argue that is better for the bank to be a part of the political cycles (ups&downs) to perform better. There are different arguments that are presented in favor of an "independent central bank" "but the most important reason is that "more independent central banks are associated with lower levels of inflation"

7. MEASURING CENTRAL BANK INDEPENDENCE

Bank independence is measured according to different various factors ranging from legal Independence to the integrity and reputation of the central bank administrators and the tradition and mentality of a given country. Of course there are some parameters that are unmeasured but we can make a ranking according those ones.

Legal independence

Legal independence implies the degree of central bank independence provided by its law or charter. Legal independence consists of two components: political independence and economic independence.

- Political independence: The former is defined as the capacity of the monetary authority to choose policy goal it indicates whether the law provides clauses which allow central bank to pursue its objective(s) without being under political pressure.
- Economic independence: indicates the independence from government interference. The economic aspect of central bank independence depends on legal limitation over credit facilities offered by the central bank to the government.

Legal independence breaks down into other aspects such as policy formulation independence, instrument independence and staff independence

- *Policy formulation independence*: The first aspect indicates whether the central bank is independent in formulating policies on its own;

- *Instrument independence*: the second aspect deals with independence in implementing policies formulated by the central bank itself or other institutions. In other words, it indicates whether the central bank can freely choose those instruments that it deems appropriate to implement a given policy.
- *Staff independence policy*: The third aspect means independence in staff recruiting process.

Goal independence: the Central Bank has the right to set its own policy goals, whether inflation targeting, control of money supply, or maintaining a fixed exchange rate. Some banks make even partnership with different government departments. This thing of course that increases the credibility of the goals chosen to be fulfilled the setting of common goals by the central bank and the government helps to avoid situation where monetary and fiscal policy are in conflict.

Operational independence: the central bank has the independence to determine the best way of achieving its policy goals, including the types of instruments used and the timing of their use.

Management independence: the central bank has the authority to run its operations without excessive involvement of the government. To be considered independence should have a certain level of independence .for ex:if a government is in habit of appointing & replacing the governor frequently ,it clearly has the capacity to micro-manage the central –bank through its choice of governors.

8. Factors that affect central bank independence

1-Political instability

It is believed that instability affects central bank independence but it is not clear whether there is a strong correlation between the two. It is argued that more unstable is the political situation is the less independent .is its central bank since each groups that comes to power tries to appoint its representatives, or a second scenario when political forces in power notice that they will lose grounds they try to strengthen the independence of state institutions especially of the central bank .Albania has experienced both of the cases or scenarios that have had an effect on owes bank independence.

2-Financial market development

It is widely accepted that deep financial system markets and considerable level of finance intermediaries leads to higher central bank independence. Because the supervision is related to central bank authority, in our case independence of central bank is harmed by the lack of capital market and low level of intermediate transactions. Those financial sectors have a small role in

economy and the central bank decisions do not give optimal solution, so bank appears inferior compare to government.

3-Internal debt

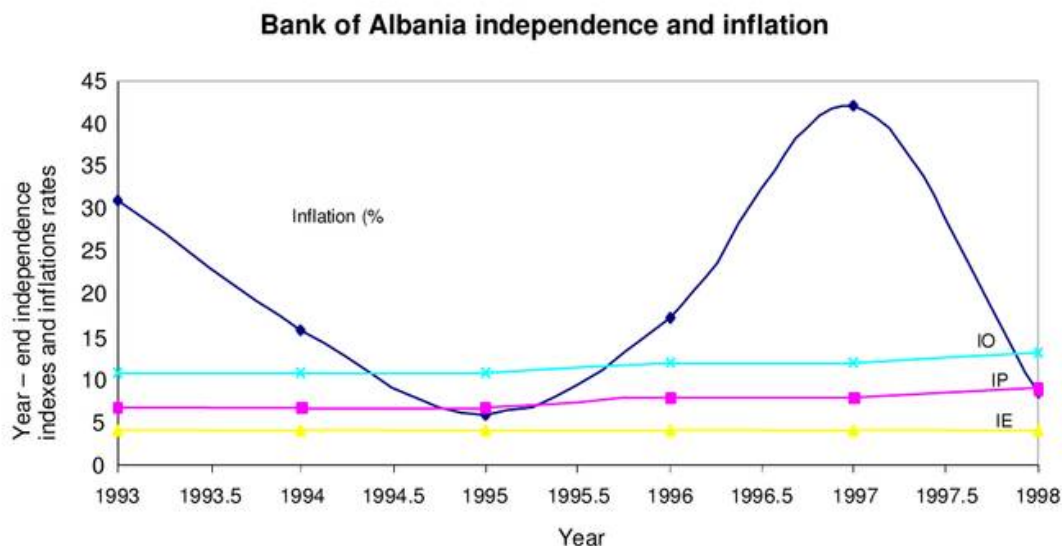
Political groups are not interested in increasing central bank independence ,if internal debt is large first there is a tendency not to pay debts owned by the public through inflation so there's the tendency to be higher the debt. Second the higher the role of government as a debtor in financing markets the lower is the central bank independence.

4-Operations in open market

Central bank enjoys a higher independence if it is granted the ability and the conditions to intervene sufficiently in the open market when needed arises, if government securities are tradable this ability of central bank is limited and also its independence.

9. Central bank independence and inflation

It is sad that “every country and society has the central bank it deserves” this means that changing the laws on central bank is not enough to guarantee low inflation rate. “only if Central Bank anti-inflation policies find considerable support the inflation rate can be reduced for real .About Albania in less developed countries financial sector opposition to inflation is weaker and this is a matter of interest clashes other than institutions .In owe case the correlation between central bank and inflation rate is very strong.



⁴¹ Qt. in Mas. Ignacio. "Central Bank Independence: A critical view", WP/World Bank, no. 1359, September 1994, pg. 10.

In 1992 law grants a considerable level of independence of bank of Albania. Inflation progress during 1992-1995 proves that higher independence is related to lower inflation, in 1996 when another law increase the central bank was approved, inflation changed in opposite direction. Regulation implemented by Bank of Albania to manage banking system have not acted in favor of opposition of inflation. It's accrued that those regulations do not fully comply with international standards.

Conclusions:

1. From a legal perspective bank of Albania holds a considerable degree of independence. It is not only considered but it's given the right legal space to act accordingly. This legal independence that the bank of Albania holds is also provided by the relatively high values of indices used to measure it, and we can mention that are those values that rank Albania in a favorable position compare to other central banks.

Legally, Bank of Albania is recognized an independence which is not the maximum one possible considering the traditions and time. However, the goal is to increase central bank independence in the future whenever possible.

2. In the 1992 law gave to bank of Albania a favorable legal status. During the years this independence has increased according to the laws approved in 1992, 1996 and 1997.

3. In general, it might be concluded that legal independence is not the same as real independence. This conclusion is reflected in the case of central bank of Albania. Though from the legal point of view, Bank of Albania enjoys a considerable independence, unfortunately its real independence scores low.

Governor's turnover rate is high. Five governors have been appointed during one official term. According to Cukierman index, Bank of Albania ranks one before the last, thus losing the favorable position as per legal independence index. Other factors, which affect central bank independence as mentioned above, act negatively in the case of Albania.

4. Actual legal independence level of Bank of Albania and the provision of a certain real independence for it are ensured by "IMF factor", among other things.

5. Albania is listed among countries where the correlation between inflation and central bank independence is not strong. Inflation rates are caused by other factors, which from BoA's point of view are considered "external". They are the so called "election year", "pyramids"...ect

The law "On Bank of Albania" has improved qualitatively in 1996 when "price stability" was specified as the main objective of the bank. This is a further step to increasing central bank independence. Also, each new law tends to clarify the clauses related to objectives and tasks of Bank of Albania. The most obvious case is the clarification of types of reports and statements delivered by central bank. Moreover, the trend has been that of increasing central bank's responsibility towards the public and legislative and executive branches.

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ENVIRONMENTAL MANAGEMENT AND ORGANIZATIONAL BEHAVIOR IN MARKET DRIVEN ECONOMY

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Abstract

Some feel environmental management has or is developing a more flexible and sensitive style than natural resources management. The focus of environmental management is on implementation monitoring and auditing. Organizations are increasingly under pressure from environmental regulation, decreasing margins and shortages of certain resources. Combined with the growing sustainability awareness of customers these are important drivers for companies to reduce the environmental impacts of their operations. The area of protection of the environment includes the social responsibility of organizations as one of the main challenges to solve this problem. The present task of the organizations is not just maximization of profit. Today, society expects of them to help in protect the environment, and to generate positive environmental and social externalities etc. As a result the importance of environmental management has significantly increased. Environmental management has become an integrative part of business management because it ensures regulatory compliance and efficient management of energy, water and other resources. Another challenge in environmental management is the increasing complexity: performance indicator systems as well as the data acquisition and evaluation process with all its linked workflows are covering more and more business areas.

Key words: *environmental economics, natural capital, ecological intelligent design, quality management, externality theory, social responsibility*

Introduction

Environmental management is not as the phrase could suggest the management of the environment as such, but rather the management of interaction by the modern human societies with, and impact upon the environment. The three main issues that affect managers are those involving politics, programs and resources. The need for environmental management can be viewed from a variety of perspectives. A more common philosophy and impetus behind environmental management is the concept of carrying capacity. Simply put carrying capacity refers to the maximum number of organisms a particular resource can sustain. The concept of carrying capacity whilst understood by many cultures over history has its roots in Malthusian theory. Environmental management is therefore not the conservation of environment solely for the environment's sake, but rather the conservation of the environment for humankind's sake. This element of sustainable exploitation, getting the most out of natural assets, is visible in the EU Water Framework Directive. Environmental management involves the management of all components of the bio-physical environment, both living (biotic) and non-living (abiotic). This is due to the interconnected and network of relationships amongst all living species and their habitats.

The environment also involves the relationships of the human environment, such as the social, cultural and economic environment with the bio-physical environment.

Today's businesses must comply with many Federal, State and local environmental laws, rules, and regulations. It's vital to safeguard your company against compliance short-cuts. This approach leaves you vulnerable to violations of the law, in addition to missing important environmental liabilities.¹

Environmental planning and management are strategic challenges confronting businesses in the 21st century. As customers and stakeholders demand that global companies lead by showing corporate citizenship the health, safety and security of both the people and the natural environment have become a litmus test for good citizenry. Successful companies today are not only measured by how profitable their products are, but also how well they respond to the call to protect the natural environment².

The nature of environmental management

Environmental management is an approach to environmental stewardship which integrates ecology, policy making, planning and social development. Its goals include³:

- The prevention and resolution of environmental problems;
- Establishing limits;
- Establishing and nurturing institutions that effectively support environmental research, monitoring and management;
- Warning of threats and identifying opportunities;
- Sustaining and, if possible, improving existing resources;
- (Where possible) improving "quality of life";
- Identifying new technologies or policies that are useful.

Environmental management

State of global environment

All things are connected. Biosphere on Earth is a system composed of infinite complexity. Mankind is also part of the Earth system; it depends of its condition variable. Activities such a reproduction of the global human population, indent a real problem of the human ecosystem. Man doesn't appreciate nature enough. We experience nature as it is unlimited. We need to ensure that the system loss of natural systems will be reduced and ideally will be diverted. If we want to create quality life, we should take care to purify air and water, as well as providing food and other natural features, to take place in the best order. Two thirds of the earth surface is covered with water. However we can notice that the water is resource that is taken for granted for all the time. A concern about the quantity of water and its quality is on rice. It is not only problem the quantity, but the implementation to the

¹Anastasios Xepapadeas, "Ecological Economics, *The New Palgrave Dictionary of Economics*, 2nd Edition, 2005

²Christian N Madu, "Environmental planning and management", Imperial college press, USA, 2007

³C.J. Barrow, "Environmental management: Principles and Practice", Routledge, 1999

right place. In the cities, rapidly growing population has a demand of water exceeds available supplies. Some major rivers are drying up even before reaching to the relevant sea. Cities that once were coastal now are 50km far away from the water. If these trends continue, it is possible to evaporate sea, for one to two decades to stay only one geographical memory that will exist only on old maps. Natural ecosystems, such as forests, possess the ability to save the water in the underground and later with managing the environment it can be used as fresh and clear water. This pumping of water becomes harmful, because the pumping intensity is faster than the intensity of the recovering. If we are facing with future without water, we are also facing with deficit of food. This kind of future is the future that the mankind is frightened of. Pressures like the new development, climate changes, excessive energy consumption of the home appliances, are growing and making problems with failure of water. As a consequence of short-range plans of exploitation that erodes the long-term plans, loss of top incrustation of soil, in large areas of the world, with phase out of fertile soil, brings in windstorms, hurricanes...

Tree may be economically valuable means of collecting, but blazing a trail may be expensive. Long time ago, the earth masses were covered with green vegetation including trees and nature, but now all that is gone under the chainsaw, and the intensively agricultural activations that manifest with untenable rate of growing. On the worldwide level, the forests are decreasing with 9 million hectares every year. Impoverishment of the forests is characteristic for Southeast Asia and western Africa, and also in the near of the Brazilian Amazon. After the loss of 97% of the Atlantic rainforest, Brazil now is consuming the Amazon rainforest. This rainforest has volume like all Europe. The addition of 80 million people for year on the world population, in this time when the water masses are decreasing, can be followed by the food deficit. Calculated 70 % of water that is used on the world level, including the water supplied from rivers and that is pumping out of the soil is used for irrigation. The other 20% are used in the industry, and 10% are used for home needs. In this big race for water between these three sectors, the economy of water doesn't favor the using of water in agriculture, or reconstruction of the sources, although the longtime human wellbeing depends of this. We should be worried about what do that people eat? The alimentation In USA is full of animal products, and it needs to be fooled with corn a product four times more and this is connected with four times more needs of water. This is connected with needs of energy and muck, and other agricultural chemicals. This leads to high pressures on the earth, and big consequences for the wild world and the health of the soil. All this things are connected with climate, and the world recovering in the direction of climate changes. The conflicts between the Economy and natural systems on Earth can be seen in the day news about the failed ponds, reduction of the forests, beach erosion, the destruction of pastures, and dilatation of the desert, the reduction of water area... Money are turning around the world. In the Earth there are only two types of capital resources which are intertwined in the production and trade. They are natural resources and human resources. Today the biggest part of the global trade is based on things that don't exist. The modern model of economic growth has lost the connection with the real world of natural and humanity production. Sustainability market fails to tell the ecological and human truth. The economists maybe today are looking on environment, like subset of the economy, because of the paying for her also for protection on account on the profitable activities.

We are sharing a world, that is easy breakable, but has unlimited possibility to be regenerated, when its natural rules are respected. We can choose in a collective way to be endlessly or with another word, to sustain us, or we can suffer together. If we provide access to the basic resources and if we keep the integrity of the national eco system than

we can think about healthy and better life of the poor people on the planet. Keeping the integrity of the natural eco system is difficult in front of the increasing population. It seems illusory to think about long-term politics. For an example if we consider that 1994 the Chinese government has decided to develop a vehicular transport system. When this aim would have become true and in every Chinese citizen has had one or two automobiles in their garages, and if they would have used the petrol in the way that USA is doing it, China would have had a need from over 80 million barrel of petrol daily which is more from 74 barrel of petrol that is produced in the world. We can realize that the western model for development is not suitable for China. Simply because there are not enough resources for making it functioning. It seems that we are leaving but slowly, that the same plane has not the future even in the West. Prognoses are dangerous while the answers of the educated ones seem far than “educated”. We are sinking inevitably and there are numbers and facts confirming that our moment situation is leading us to the syndrome – rabbit in front of the car lights: action of paralyzing in front of the inevitable. In front of this inevitable situation the mankind is also in search for answers, solutions, light in the darkness. Is there a place for any optimism? Maybe there is a chance. We have the resources to deal with some of the frightening problems, relation with the resistance of the Planet. Just an example: the cost of providing pure water in every willage, town or metropolis in the whole world would be 200 milliard dollars. This is almost the same sym of money that is used in the States for commercials every year. The resources are here maybe they will still not make the transition from short-term individual interest to collective survival.⁴

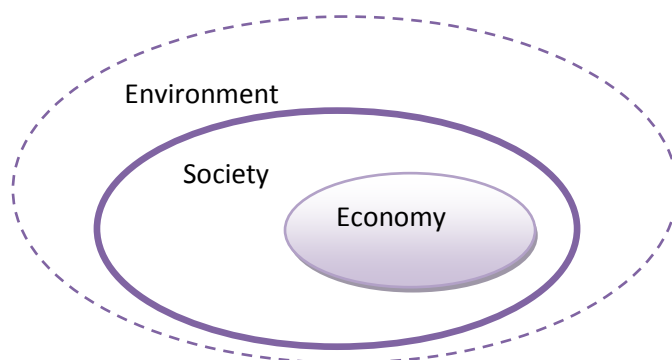
Environmental economics

For more than decade, the Environmental Literacy Council has been dedicated to helping teachers , students, policymakers and the general public find cross-disciplinary resources on the environment. Environmental economics is a relatively new field of economics that looks a lot at environmental issues in relation to economic development and sustainability. Environmental economics looks a lot at environmental policies in countries, and how they impact the local and global economies either positively or negatively. Environmental economics is generally viewed as a form of progressive economics, trying to account for various forms of market failures to better model markets in the future and lead to more widespread gains among people. Environmental economics takes into consideration issues such as the conservation and valuation of natural resources, pollution control, waste management and recycling, and the efficient creation of emission standards. Economics is an important tool for making decisions about the use, conservation and protection of natural resources because it provides information about choices people make, the costs and benefits of various proposed measures and the likely outcome of environmental and other policies. Since resources – whether human, natural or monetary –are not infinite, these public policies are most effective when they achieve the maximum possible benefit in the most efficient way. Therefore, one job of policymakers is to understand how resources can be utilized most efficiently in order to accomplish the desired goals by weighing the costs of various alternatives potential benefits. In competitive markets, information exists about how much consumers value a particular good because we know how much they are willing to pay. When natural resources are involved in the production of that particular good, there

⁴ John Brady, “*Environmental management in organizations*” , The Institute of Environmental Management and Assessment (IEMA), 2005

may be other factors – scarcity issues the generation of pollution – that are not included in its production cost. In these instances, scarcity issues or pollution become externalities, costs that are external to the market price of the product. If these full costs were included, the cost of the good may be higher than the value placed on it by the consumer.⁵

Three circles enclosed within one another showing how both economy and society are subsets of our planetary ecological system. This view is useful for correcting the misconception, sometimes drawn from the previous “three pillars” diagram that portions of social and economic systems can exist independently from the environment.⁶



Environmental economics is related to ecological economics but there are differences. Most environmental economists have been trained as economists. They apply the tools of economics but there are differences. Most environmental economists have been trained as economists. They apply the tools of economics to address environmental problems, many of which are related to so-called market failures circumstances wherein the “invisible hand” of economics is unreliable. Most ecological economists have been trained as ecologists, but have expanded the scope of their work to consider the impacts of humans and their economic activity on ecological systems and services, and vice-versa. This field takes as its premise that economists are a strict subfield of ecology. Ecological economics is sometimes described as taking a more pluralistic approach to environmental problems and focuses more explicitly on long-term environmental sustainability and issues of scale. Environmental economics is viewed as more pragmatic in a price system, ecological economics as more idealistic in its attempts not use money as a primary arbiter of decisions. These two groups of specialists sometimes have conflicting views which may be traced to the different philosophical underpinnings. Another context in which externalities apply is when globalization permits one player in a market who is unconcerned with biodiversity to undercut prices of another who is creating a “race to the bottom” in regulations and conservation. This in turn may cause loss of natural capital with consequent erosion, water purity problems, diseases, desertification, and other outcomes which are not efficient in an economic sense. This concern is related to the subfield of sustainable development and its political relation, the anti-globalization movement.

⁵.Erica Brehmer, Charles Fritchner, Dana Hyland, Megan Wertz, “*Environmental economics volume 1:the essentials*”, The Environmental Literacy Council, 2007

⁶ Konard Ott “*The case for strong sustainability*”P.Thapa, Canada ,2003

Environmental economics was once distinct from resource economics. Natural resource economics as a subfield began when the main concern of researchers was the optimal commercial exploitation of natural resource stocks. But resource managers and policy-makers eventually began to pay attention to the broader importance of natural resources. It is now difficult to distinguish “environmental” and “natural resource” economics as separate fields as the two became associated with sustainability. Many of the more radical green economists split off to work on an alternate political economy. Environmental economics was a major influence for the theories of natural capitalism and environmental finance which could be said to be two sub-branches of environmental economics concerned with resource conservation in production and the value of biodiversity to humans respectively. The theory of natural capitalism goes further that traditional environmental economics by envisioning a world where natural services are considered on par with physical capital. The more radical Green economists reject neoclassical economics in favor of a new political economy beyond capitalism or communism that gives a greater emphasis to the interaction of the human economy and the natural environment as know edging that “economy is three fifths of ecology”. These more radical approaches would imply changes to money supply and likely also a bioregional democracy so that political economic and ecological “environmental limits” were all aligned and not subject to the arbitrage normally possible under capitalism.

Corporate social responsibility

When we talk about environmental management, it is necessary to mention the social responsibility of organizations. Every organization, regardless of what type it is, has an obligation to protect the environment and the whole society. Thus, social responsibilities have hospitals, schools, cultural and artistic organizations, religious associations, but most of all enterprises with their business activities. In literature, special emphasis is given to corporate social responsibility.

The broadest definition of corporate social responsibility is concerned with what is – or should be – the relationship between global corporations, governments of countries and individuals citizens. More locally the definition is concerned with the relationship between a corporation and the local society in which it resides or operates. Another definition is concerned with the relationship between the corporation and its stakeholders⁷.

In many organizations, however, this area of social responsibilities is often not identified as a major or separate functional area. Quite often the responsibility for actions in this area is vested to individual or small staff, frequently within the human resources management area. Personnel assigned to this area, then, have responsibility for social issues in three major areas:⁸

1. Total compliance with international, federal, state, and local legislative laws and acts;
2. Moral and ethical standards and procedures under which the firm will operate;
3. Philanthropic giving.

⁷David Growther&Guler Aras, *Corporate social responsibility*, USA, 2008

⁸Jerry W. Anderson, Jr, *Corporate social responsibility*, USA, 1989

Hierarchy of social responsibility

Social responsibility is an extremely complex category. It expresses the four types of responsibilities that managers should take in carrying out their activities in the company. According to the chronological order, they can be represented as follows⁹:

1. **Economic responsibility** – first level of social responsibility because, first of all, the company is an economic entity that works on economic principles. The main obligation of managers is to create products and services that will satisfy the needs of the society, but also to maximize owner's profit.
2. **Legal responsibility** – this type of responsibility exists because all enterprises must respect the law and rules that are adopted within the community in which the company works.
3. **Ethical responsibility** – this refers to company's behaviour that is neither in the domain of codified laws, nor in the domain of a totally free choice of behaviour. This behaviour is conditioned by the accepted moral norms and values in the society.
4. **Discretionary responsibility**- does not rest on any moral or legal norms. It refers to the voluntary undertaking of activities in order for the company to make a contribution to the protection and development of whole society.

Stakeholders

In order to understand the social responsibilities of enterprises, it is important to define their stakeholder. Stakeholders are all individuals and groups which are directly or indirectly under the influence of the company's work. What is a stakeholder? There are several definitions regarding this question¹⁰:

- Those groups without whose supports the organization would cease to exist.
- Any group or individuals who can affect or is affected by the achievement of the organization's objectives.

According to several authors, the most important stakeholders of the company are: shareholders, customers, employees, banks and other financial institutions, suppliers, the whole society, the government etc.

-Shareholders play a major role in the functioning of the company, because they provide capital that helps the company to develop.

- Customers are stakeholders whose requirements are generally realized with the motto "customers are always right". There are two areas that companies should take care of when it comes to their stakeholders: healthcare and customer safety, and quality of the products and services.

⁹R. Draft & D. Marcic, *Understanding Management*, The Dryden Press, Florida, 1998

¹⁰David Growther&Guler Aras, *Corporate social responsibility*, USA, 2008

- Employees are very important stakeholders in the company. Their main responsibilities are to respect the specific legal obligations relating to the regulation of employment. Managers have a legal obligation to give employees salary that should not be below a certain minimum level. They also must comply with legal requirements for safety in the workplace and many other things that are not legally regulated, but contribute to the success or failure of the company. This also has an economic importance such as reducing the costs for training and adaptation of new employees in the company.
- At banks and other financial institution, managers are obligated promptly to settle their due obligation on the basis of numerous financial arrangements with them.
- Managers should treat suppliers fairly and care for their demands. They must fully meet their obligations under the agreements they have made.
- With their businesses, managers must not endanger the general progress of the community. On the other hand, they should participate in the financing of various training, educational programs, to organize charitable actions, expanding business in underdeveloped areas, to finance infrastructure projects, to encourage cultural and artistic events, sports events, to participate in projects for protection of national treasures etc.

Almost all can be considered as affected in some way by many things a corporation might do in order to achieve its objectives. Many types of individuals and groups have been considered to be stakeholders, in addition to those listed above, including¹¹:

- Stakeholder representatives such as trade unions or trade associations of suppliers or of distributors;
- NGOs or 'activists' that have been considered individually or as stakeholder representatives;
- Competitors
- Financiers other than stockholders (creditors, bondholders, debt providers)
- The media
- The public in general
- Non-human aspects of the Earth, the natural environment
- Business partners
- Academics
- Future generations
- Past generations (in particular the memory of founders of organizations)
- Archetypes or 'memes'

The organization itself should be thought of as a grouping of stakeholders and the purpose of the organization should be to manage their interests, needs and viewpoints. In so doing, a particular group of stakeholders—(top-level) managers—are thought of as the focal group, charged with taking the role of stakeholder management. The concept was elaborated by Evan and Freeman as the following two principles:¹²

1. Principle of corporate legitimacy. The corporation should be managed for the benefit of its stakeholders: its customers, suppliers, owners, employees, and local communities. The rights of these groups must be ensured, and, further, the groups must participate, in some sense, in decisions that substantially affect their welfare.

¹¹Andrew L. Fieldman, Samanta Miles, "*Stakeholders Theory and practice*", Oxford University Press Inc., USA, 2006

¹²ibid

2. The stakeholder fiduciary principle. Management bears a fiduciary relationship to stakeholders and to the corporation as an abstract entity. It must act in the interests of the stakeholders as their agent, and it must act in the interests of the corporation to ensure the survival of the firm, safeguarding the long-term stakes of each group.

Arguments pro and against social responsibility

a) Arguments in favour of social responsibilities are trying to justify the view that companies are not just mechanisms for creating profit. These arguments include the following:¹³

1. The company's main interest is to promote and enhance the community in which it works;
2. Social activities can be profitable;
3. Social activities are ethically correct;
4. It is a social responsibility to promote the public image of the company;
5. Socio-cultural norms require social responsibility;
6. The social responsibility is necessary to avoid some legal regulations;
7. Laws cannot be implemented in all circumstances that may occur in practice. So business has to start from a certain presumed liability which would preserve order and discipline in the legal society.
8. The social responsibility is very important for shareholders. On the long term, it increases the share price because the market sees the company as less risky subject and subject that is less open to attack by the public.
9. The society should give business a chance to solve the social problems that government failed to solve;
10. Some social groups see business like an institution which has financial and human resources that can help solving social problems;
11. Preventing problems is better than treating the consequences – because of that business should be given a chance to solve the problems before they become too large.

b) Arguments against social responsibility originate from the traditional theory of social responsibility and explain that the basic objective of the company's work is maximization of profit. The company doesn't recognize any other responsibility except legal. The most important arguments against social responsibility come from the Nobel Prize winner Morgan Freeman. Some of these arguments are:¹⁴

1. Social responsibility may be illegal;
2. Social activities cannot be measured;
3. The costs of social responsibility are very large and they may cause significant increase in prices;
4. Social responsibility distracts the company from its primary goals;
5. Business already possesses a great power. Involvement in social responsibility will make it even more powerful;
6. Business has no responsibility to the public. Because of this, the public won't have control over its involvement in social programs.
7. Business involvement in social programs has lack of public support.

¹³Samuel C. Certo, "Modern Management", 5-th edition, 1992

¹⁴ibid

Areas of social responsibility

There are many areas of activities in which the company should realize its social responsibility. Some of those activities may show ambiguity regarding the benefit or damage they may cause. The most important of them can be classified in six groups:¹⁵

Tabele1. Areas of social responsibility

Environment	-Pollution control - Protection of the environment - Conservation of natural resources - Effort for recycling
Energy	-Energy saving in products and marketing operation - Efforts for increase of the efficiency of used energy - Other problems for energy saving
Honesty in business practice	- employment for women and members of ethnic minorities - employment for people with special needs - support for businesses owned by members of ethnic communities

¹⁵Social responsibility Disclosure:1977 Survey of Fortune 500 Annual Reports, Ernst, 1300 Union Commerce Building, Cleveland, Ohio

Human resources	- Health promotion - Training and development of employees - Continuing education of employees with special needs - Programs against using drugs and alcohol - Career development - Programs for recreation and stress management
Involvement in activities for social necessities	- Donations in money, products, services, donations for public health projects - Support in education and art - Participation in community's projects
Products	- Safe usage of product - Sponsoring educational programs for safe usage of products - Increasing the nutritional value of product - Improvement in the packaging of the products

Conclusion:

Perhaps is true when we say that life is full of risk. There are many uncalculated outcomes, we are not prepared to some changes and we should be ready to act in some situations, we should be interested to save the world. On one hand there is need for money, because of the better life but if we still destroying the world with polluting that risk isn't unexpected and on the other hand everybody wants to live healthy life, and with all that factories that are knowingly destroying the earth in the race for more money it is impossible. One word on caution, we are now in the situation of knowing that we should have an emergency plan, and as we understand the law , if we know that something should be done and we choose

to do nothing about that, than we can't expect positive results. The phrase "noblesse oblige"¹⁶ is usually translated as "nobility has its obligations". If nobility has its obligations, then so do emergency planning and safety, health and environmental management.

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¹⁶ Is a French phrase literally meaning "nobility obliges"

The Short Run Tradeoff between Inflation and Unemployment: The Case of Albania

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Outline

- Abstract
- History of Albanian Economy
- Unemployment in Albania
- Inflation in Albania
- Phillips curve and “stagflation”
- Inflation and Unemployment rates in Albania
- Application of Phillips curve in Albania
- Conclusion
- References

Abstract

In this paper you will find a brief history of the Albanian Economy how it has been behaving during the past years from the end of the centralized economy in the communist system till now, here we will see the potentialities of the Albanian economy how it has been developing. Mainly in this paper we will be focused in unemployment and in the inflation rates in Albania how did they change during the time and the main determinants of inflation and how does Albania estimate it. Then we will try to conduct them with the theory of A. W. Phillips about the short run tradeoff between inflation and unemployment and we will see if this stands or not with the real data from the Albanian economy.

Key words:

Albania Economy, IMF, GDP, Global financial crisis, CPI Banking sector, Unemployment, Inflation, Inflation estimation. Core inflation, short run, A. W. Phillips, Stagflation.

Albania's economy has improved substantially over recent years and has performed better than many other countries in the region. However, it is still considered one of the poorest countries in Europe the Albanian economy has been partially sheltered from the global financial crisis and the economic downturn. Albania's economy grew 2.8% in 2009, according to International Monetary Fund (IMF) data. However, a reduction in remittances from Albanian workers abroad and in demand for its exports has constrained economic activity.

During the global financial crisis, bank deposits shrank considerably and lower liquidity pushed commercial banks to tighten lending. While current bank deposits have reportedly surpassed pre-crisis levels and bank liquidity has improved, the demand for credit is still low. In December 2009, the growth rate of loans dropped to 10% from 35% in 2008. In general, the banking sector remains viable, well capitalized, and able to further finance the economy, as the ratio of loans to deposits, approximately 65%, is still low compared to Western standards. Tourism has been boosted significantly by ethnic Albanian tourists from throughout the Balkans. GDP is comprised of services, including trade, hotels, and restaurants (21%), transport (5.5%), and communication (4.5%); agriculture (19%); construction (14%); industry (10%); and remittances (9%). Albania's economy has improved markedly over the last decade; reforms in infrastructure development, tax collection, property law, and business administration are progressing. Despite the effects of the recent global financial crisis and economic downturn, the country has outperformed many other countries in the region.

About the unemployment in Albania the statistical data concerning the unemployment rate pertain to registered unemployed since Albania does not conduct labor force surveys. As already mentioned, this is an important shortcoming regarding Albanian statistics. It is often argued that registered unemployment in Albania is not an appropriate measure of real unemployment and does not reflect the real tension in the labor market. Some of the reasons for this relate to the large informal economy, the importance of emigration, the high rate of hidden unemployment in agriculture and the significant number of jobless people who failed to register. The economic and social changes of the early 1990s caused a significant rise in the unemployment rate. The unemployment rate was 26% at the end of 1992, meaning that it was almost multiplied by three compared to the previous year. The unemployment rate declined significantly to around 12% in 1996. This decline however was not matched by an increase in formal employment. After the 1997 crisis unemployment was again in the increase. In 2002 the unemployment rate was about 16%. Imbalances in the labor market were one of the immediate effects of the transition process in Albania. The structure of the economy was changed from a centralized into a liberal one. In that period most of the fabrics stopped and this led in lowering employment but this situation didn't last for a long time the employment was increasing year by year until it reaches the normal levels. A problem for the unemployment has been also the mentality of the Albanian. Because in the region mostly males use to work in order to maintain the family. But we cannot say the same thing for the present days this mentality have changed and also the females are integrated in the labor market.

In fighting inflation Albania has been one of the most successful transition economies very high inflation in the early stages of transition gave way to moderate and smoothly declining rates. Since the start of transition process, inflation has declined substantially in Albania. The price level increased by 200 percent in 1992 since then the inflation has been declining. Albania faced another increase in inflation 14% due to the collapse of the pyramid schemes. In 97 Albania has faced again a great increase in the inflation, 33 percent but the authorities have gained control of this situation by implementing strong stabilization policies and they have reduced the inflation. And we can say that Albania has succeeded in reducing inflation to very low levels. This has been possible by understanding the driving forces behind the behavior of the price level.

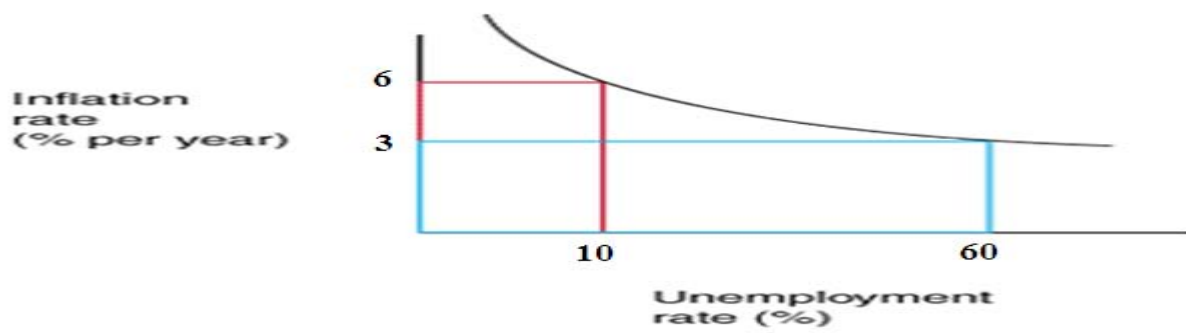
In economics, inflation is a rise in the general level of prices of goods and services in an economy over a period of time. When the general price level rises, each unit of currency buys fewer goods and services. Albania has been successful in regulating the inflation rate by using their policies for price adjusting over the past years and now is facing moderate and smooth declining inflation rates.

The natural rate of unemployment depends on various features of the labor market. Minimum wage laws, the role of efficiency wages and the effectiveness of job search. For the estimation of the inflation central bank of Albania is using the CPI decomposition into seasonal, cyclical, trend, and random. The simple formula of this decomposition is:

$P_t = f(S_t T_t C_t R_t)$ also Albania is using core inflation. Core inflation is most often calculated by taking the Consumer Price Index (CPI) and excluding certain items from the index, usually energy and food products. Other methods of calculation include the outlier's method, which removes the products that have had the largest price changes. Core inflation eliminates products that can have temporary price shocks because these shocks can diverge from the overall trend of inflation and give a false measure of inflation.

The inflation rate depends primarily on growth in the quantity of the money controlled by the central bank or authorized institutions. A. W. Phillips discovered a relationship between unemployment and inflation. It has reached this idea because of the chain reaction that happens in the economy. As more people work the national output increases, causing wages to increase, causing consumers to have more money and to spend more, resulting in consumers demanding more goods and services, finally causing the prices of goods and services to increase. In other words, Phillips showed that unemployment and inflation shared an inverse relationship: so if the policy makers increase inflation the unemployment will fall if unemployment rise inflation will fall. The main goal of the economic policies is to keep both inflation and unemployment in low and stable positions.

Phillips' discovery can be represented in a curve the Phillips curve.



As we can see at the Phillips table we notice that when inflation is increasing the unemployment is decreasing and when inflation decreases the unemployment increases. While the Phillips curve is theoretically useful the equation only holds in the short term. In the long run, unemployment always returns to the natural rate of unemployment, making cyclical unemployment zero and inflation equal to expected inflation.

This simple table Policy seemed effective in the 1960's as inflation went up and unemployment went down. However, the 1970's brought higher unemployment and higher inflation which was termed "Stagflation." High rates of both at the same time cannot be explained by the Phillips theory.



The Phillips curve can be represented mathematically, as well. The equation for the Phillips curve states

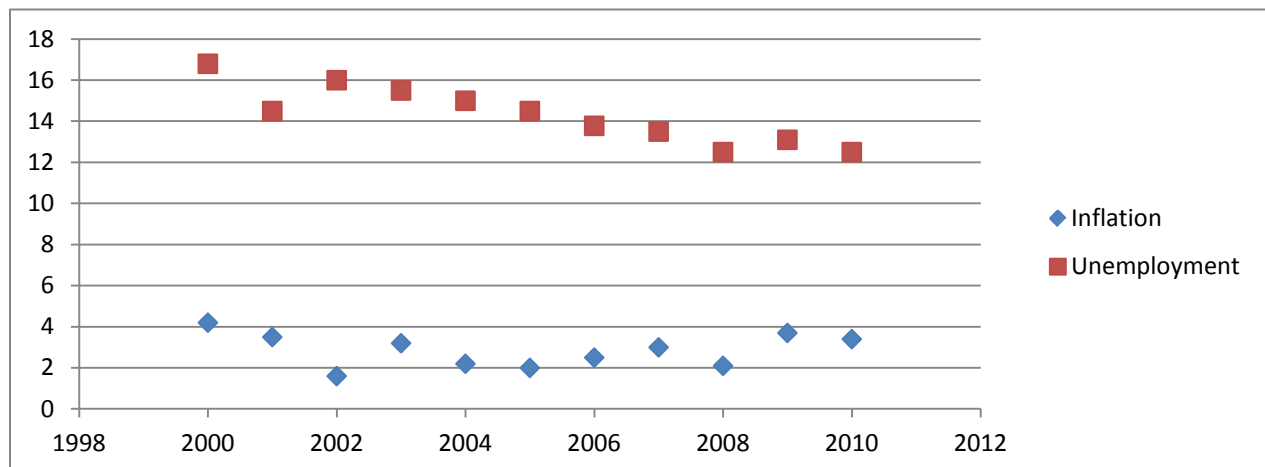
$$\text{Inflation} = [(\text{expected inflation}) - B] \times [(\text{cyclical unemployment rate}) + (\text{error})]$$

where B represents a number greater than zero that represents the sensitivity of inflation to unemployment.

The phenomenon of stagflation is somewhat a mystery, though many economists believe that it results from changes in the error term of the previously stated Phillips curve equation. These errors can include things like energy cost increases and food price increases. But no matter its source, stagflation of the 1970's and early 1980's seems to refute the general applicability of the Phillips curve.

Then let us implement it with real data economic data and see if this theory stands or not. These are the historical data of Albania for inflation and unemployment from 2000 till 2010.

Year	Inflation	Year	Unemployment
2010	3.4	2010	12500
2009	3.7	2009	13100
2008	2.1	2008	12500
2007	3	2007	13500
2006	2.5	2006	13780
2005	2	2005	14500
2004	2.2	2004	15000
2003	3.2	2003	15500
2002	1.6	2002	16000
2001	3.5	2001	14500
2000	4.2	2000	16800



As we see from the real data of the Albanian economy the inflation and unemployment doesn't seem to have a constant inverse relation we can see this relation in 2001 till 2003 and from 2005 till 2007 so when inflation raises the employment decreases and vice versa as Phillips has stated but this is not true for the other years. So there is something else that has to be considered in this function in order to make this relationship work properly.

Most economists no longer use the Phillips curve in its original form because it was shown to be too simplistic. But still today, modified forms of the Phillips Curve that take inflationary expectations into account remain influential. The theory goes under several names, with some variation in its details, but all modern versions distinguish between short-run and long-run effects on unemployment. The "short-run Phillips curve" is also called the "expectations-augmented Phillips curve", since it shifts up when inflationary expectations rise.

Conclusion:

Albanian economy had a really rough time in the past because of the change of the economic system because of the pyramid scheme because of the Kosovo war etc. But the Albanian government knew how to manage this bad situation and with their strong monetary policies decreased and maintained the inflation and unemployment in low and non problematic levels. We tried the Phillips curve in order to show the short run tradeoff between inflation and unemployment. Because A.W Phillip has stated that this two factors have an inverse relationship in the short run. As we tried with the real data of the Albanian economy taken from IMF we saw that there were not such a perfect relationship between these two factors in the Albanian case were year that inflation and unemployment were moving in the same way together called as "stagflation" and this doesn't make any sense if we refer to the Phillips model, so this model is not correct but the logic of this model is really helpful for the economists even if they don't use this model anymore because they think it is simplistic. But still today, modified forms of the Phillips Curve that take inflationary expectations into account remain influential. The theory goes under several names, with some variation in its details, but all modern versions distinguish between short-run and long-run effects on unemployment. The "short-run Phillips curve" is also called the "expectations-augmented Phillips curve", since it shifts up when inflationary expectations rise. Judging by the data's we can say that Albanian economy is performing well and keeping normal rates of inflation and unemployment.

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**UNDERSTANDING THE INFLUENCE OF INTERNATIONAL ECONOMICS AND PROMOTING
THE DEVELOPING COUNTRIES AS THE NEW “ROBIN HOOD” OF FDI - AN
INTERNATIONAL MARKETING PERSPECTIVE**

FULL PAPER

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Abstract

As it seems, we constantly hear more and more about the global economy and the global market. Company's orientation towards the foreign markets and FDI is tightly linked to its development and growth and it is not only a consequence of corporation's management decisions, but among all of the development and growth of the national economy and the changes in the international and local business environment. In the last few decades we witness the fast growth of international trade, which on the other side indicates the significance of international marketing as a base for successful business ventures on international level. From the imported cereals we eat for breakfast to our retirement funds being invested abroad while we sleep at night, our lives are deeply influenced by the "World Economy". As the importance of "made in" is shifting towards "made by" it's no wonder that developing economies are trying to steal every cent of FDI from the developed ones and make its people a little richer and a lot more satisfied. It is clear as day that production only is the key to prosperity, so we should do our best in promoting our homeland and try to bring production companies in our back yard, so our "garden" can have more "roses" and look prettier than our neighbors. With the methods of deduction, induction and secondary research and information, we could easily find out the right changes that are to be made, promote them loud and clear so everybody can hear us, which would mean learning on other countries mistakes, rather than on our own ones...

Key words: *International economics, FDI, International marketing.*

JEL Classification: F20, F21, M31, M38.

1. Introduction

My bellowed grandmother often said something I'll always remember: Proper household economy is half of your wealth. From her saying, by the method of induction I can state that the the world economy is really no more complicated than the domestic economy we experience every day. We are often attracted to the bank that gives us a better interest rate than the one next door, but in an expanding global economy we shouldn't think twice about crossing borders to invest our money or sell our goods and services. It is not only as a consumer of foreign goods and services that we are part of the world economy. The world economy consists of all those interactions among people, businesses, and governments that cross international borders. Global investments, food imports, automobile exports, trade in services, they all contribute to each country's international economic activity. In economic terms globalization refers to complete mobility of countries capital and labour and their products, so that the world's economies are on the way to becoming totally integrated. The driving forces of the process are reductions in politically-imposed barriers and in the costs of transport and communication. It is estimated to have resulted in net welfare gains worldwide – The IMF Research Department

(2007). Countries have become more integrated through increased international trade, foreign investment, migration and more efficient transportation and telecommunication. Industries prosper and fail in the face of global competition. International agreements such as the World Trade Organization (WTO), North American Free Trade Area (NAFTA), and European Union (EU) are becoming a fundamental form of government. Government policy protects some favored industries from the pressures of international competition and subsidizes others for export, at the expense of everyone in the economy. Tax policies are designed to hinder trade and investment. Government central banks interfere with the foreign exchange market. Such policy maneuvers impede international commerce and lower average income in the economy. In microeconomics, an economy can be seen as a collection of interdependent markets. In international economics, markets and economies are linked across borders. The basic tool for predicting the international pattern of production is comparative advantage. The international supply of traded products is based on underlying production and the production and trade of minerals and agricultural goods are based on geographical advantages. An important input that can be installed where there is labor and infrastructure for traded manufactured goods and services is capital. International demand is based on income and tastes and the interaction of international supply and demand determines production and trade. Empirical research confirms that the greater the trade linkage between countries the more coordinated are their business cycles (Frenkel and Razin, 1987). In the global business environment, every country should think from the perspective of international marketing and see the huge corporations as potential customers who want to spend their FDI there where the best product is offered, since "International marketing consists in finding and satisfying the needs of the global customer better than the competition in terms of the global surrounding" (Terpstra & Sarathy, 1995). Among all of the different ways to enter a foreign market like import – export, leasing, license, strategic alliances and investments, developing countries should be focused on FDI, because of their strong impact on development and growth.

2. International Economics and FDI - factors of change in a county's economy

In many small and developing countries, international economics is a matter of life and death. It examines a great number of hot topics, such as trade and labor standards, outsourcing, exchange rates, economic sanctions, etc. According to the Institute for International Economics, International economics is concerned with the effects upon economic activity of international differences in productive resources and consumer preferences and the institutions that affect them. It seeks to explain the patterns and consequences of transactions and interactions between the inhabitants of different countries, including trade, investment and migration. In other words, International economics builds models to capture the essence of international commerce. In the moment when a country decides to step up to the "playground", it is by nature of things directly sucked in the whirling of international trade and only if it has more to sell than to buy, it can have hope of prosperity and growth. But, sorry to say, developing countries with inherited little or no production, with bureaucratic administration, corruption in every level of society, ineffective judicial and legal system, weak national currency, etc., often have less to offer, but more to seek, which results in trade deficits, small GDP growth, high rates of

unemployment and small or no economic development at all. To avoid such terrible destiny the countries should take measures to change and adjust their business climate and attract their “saviors”, which on the other side are trying to avoid the drawbacks from globalization, such as expensive labor, high tax rates, the confrontation with strong and organized labor unions, etc., and create a win-win situation. Countries with open economies could complain that the only thing worse than foreign investment is no foreign investment. Foreign investments are the result of trade surpluses. When a hardworking country due to the developed economy and its production companies, exports more than it imports, it ends up with money to invest in the global economy. This money can be used abroad to buy anything from foreign government bonds to real estate and whole companies. We are witnesses of Americans “buying up France” – even Euro Disneyland is under American control, Japanese “buying up America” – especially in automobile industry, Russians “buying up Montenegro” – real estate sector, and even if such actions are often criticized by the people or political parties, they bring more good than bad to the national economy. When the United States began running trade deficits in the 1980s, the billions of dollars spent by Americans on foreign goods returned as foreign investments in the U.S. economy and they did help to keep the American economy running on track and created many new jobs for local workers. There is a natural fear of strategic industries falling into foreign hands and because of that most countries have laws that prohibit foreign ownership of vital hightech industries and military suppliers, but this can easily be accomplished without limiting foreign investment in other sectors of the economy. Countries with trade deficits can often benefit from foreign challenges to make their industries more competitive on the international markets. By the mid-1990s, U.S. car makers had succeeded in increasing their sales abroad, mainly because Japanese competition in the U.S. market forced them to make higher-quality automobiles at competitive prices. In the long run, competition forces everyone to do a better job. If a country chooses to restrict foreign investment, jobs and needed capital are often lost to other countries with more open economies. The size, the structure and the efficient use of the investments are the key factors for sustainable development of a countries economy. The investments are the starting point of renewing and expanding of the economies production base. Investments are generated from domestic savings and loans from abroad in a form of loans and FDI. In less developed economies there is constant lack of investments, little savings which withdraw more loans from abroad and lack of FDI.

In transition economies, with transition from planning to market system, a significant part of overall economic production capacity becomes obsolete because in the new system to which countries adapt there is no demand for these “old” products. The effect of economic limitation in transition economies is not a gradual limitation, but a single strong shock, which can be offset by faster finding of new markets and an influx of new investments. By some estimates, in transition the economic limitation causes a reduction of capital in the economy for about 35% (Pula, 2003). Investments can be classified as follows:¹ FDI, portfolio investments and other investments. Among these, FDI are the key factor for economic growth, because of their stimulating effect on: production, import of know-how, increase of the employment, infrastructure development, reduction of poverty etc.

The prime motives that make FDI attractive for the host country can be linked to their main characteristics such as:

- FDI as a source of investments that do not causes debt for the country;

¹ <http://nbrm.mk/>

- FDI as a strategy for a new market entry and export growth;
- FDI as a factor for employment growth;
- FDI as a way of import of new technologies, know-how, new forms of organization and company management;
- FDI as a reason for activation of the domestic resources, which otherwise would be insufficient used because of the lack of domestic capital.

The benefits achieved through the increase in FDI has created strong competition in the global market of free capital, all with the aim to attract as many and as diverse FDI as possible. The general trend in the global FDI market is the erasure of geographic borders between developing countries and developed ones: in the past three years, developing countries have not only represented a growing FDI market, but have also been aimed at attracting capital intensive investments, as well as R&D investments.²

According to the research made by KARNEY Group, the most attractive investment locations remain:³ China, USA, India, Russia, Brazil and Mexico, while it is predicted that there will be a strong expansion of investments in the SEE region, as well as in the new EU member states (see figure 1).

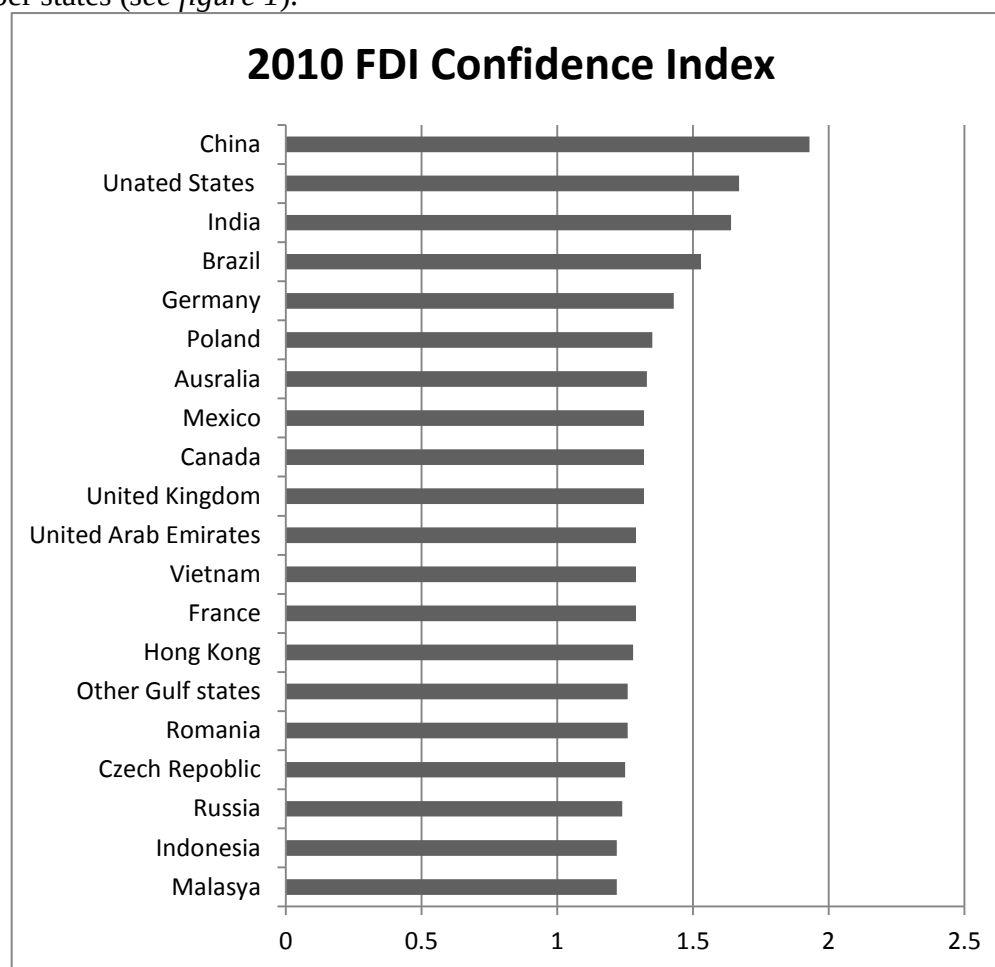


Figure1. Most attractive investment locations

Source: http://www.atkearney.com/images/global/pdf/Investing_in_a_Rebound-FDICI_2010.pdf

² Source: UNCTAD, The World Investment Report 2005: R&D investments represent investments in research and development. The overall report for 2005 is based on internationalization and influx of R&D investments in the developing countries, which was mostly a privilege of developed countries until this year.

³ http://www.atkearney.com/images/global/pdf/Investing_in_a_Rebound-FDICI_2010.pdf

Europe's new leaders are Germany and Poland where investors see large, relatively stable economies, and Romania is the highest – raking newcomer.⁴ Romania, in spite of a severe recession, fiscal troubles and a standoff over budget deficits, is still attractive for investors because of the 2007 EU membership that has made the country a safer destination and its large population, the continent's 10th biggest. Many investors see Romania as low-cost, near-shore destinations for European operations, especially in the oil and gas sectors.⁵ Among the top 15 investment destinations, the UAE has developed a stable business environment and opportunities, drawing investor interest far beyond what the country's size suggests.⁶

2.1. Factors that influence the companies choice of a strategy for a foreign market entry and a way of addressing them

With analysis of the incentives for entrepreneurial activity abroad we should answer the question: "Why do companies establish their own companies in foreign countries?" From the microeconomic point of view there are several groups of motives for investing abroad: ⁷ internal (achieve maximum profits, realization of technological rent), external (bypassing of the protective measures), offensive (the conquest of new markets, optimal utilization of available resources), defensive (retention of the existing market position), etc.

From a macroeconomic point of view there are three groups of motives for investing abroad:⁸ International movement of capital - export of capital (companies invest capital in foreign countries due to its greater profitability than in the home country); theory of the life cycle of the enterprise (investments abroad are explained in terms of avoiding risks and dangers that threaten the position of the enterprise on the domestic market in line with the position in the life cycle of the product); theory of monopolistic advantages (based on imperfection of the production and financial markets, i.e. the benefits for the foreign investors that will help them overcome the initial advantage of the local enterprises in a situation of equal market conditions. These advantages are expressed through better technology, patents, world-famous brands, etc.).

FDI occur in several types: as individual investments in their own enterprises and joint ventures with local or foreign partners. Personal owned companies abroad are those that are fully owned by residents of the country where the company is located, and may be established in two ways: with a buyout of an existing company or through building a new company. Today it is considered that there are more advantages when purchasing a company because the existing production facilities can immediately be exploited, there is established marketing organization and other business functions. There is immediately secured market share and the fear of something strange and unfamiliar (Xenophobia) can be avoided. On the other side, joint ventures are the result of direct investments of partners from two or more countries for joint production, division of risk, profit, strategy and tactics and joint policy for development. Joint ventures can be bilateral - with partners from two different countries or multilateral - three or more countries.

⁴ http://www.atkearney.com/images/global/pdf/Investing_in_a_Rebound-FDICI_2010.pdf

⁵ Ibid.

⁶ Ibid.

⁷ J. Previsic, Motivation for direct investments abroad, Marketing, 4/1988, p. 267-274

⁸ Ibid.

International companies are open to new markets and better alternatives of doing business and often have to choose between the so called Outsider⁹ and Insider market position as a way to access a foreign market. The strategy linked directly to FDI is the Insider strategy - it allows moving resources (technology, capital, know-how, people etc.) in foreign countries and exports not only marketing, but also production and other types of activities. In order to be able to make effective changes in the business environment and create efficient promotion strategy for the country, we must be aware of the driving factors that make companies choose the Insider market position and their marketing strategy:¹⁰

- Internal variables: companies strategic goals; the type of products or services and their life cycle; available resources and scale economy; degree of companies internationalization and the knowledge of the foreign markets;
- External variables: globalization of preferences and customs – homogenization of tastes up to the point where they can be predicted and put in a scheme that can be repeated; the type, features, risk of the foreign markets; methods of global communication; government, economic and social policies and the competition.

Unlike the indirect foreign investments, the direct foreign investments aim at creating a continuous, active economic interest for the investor who strives to make profits on invested capital through management and control. Direct investments allow foreign investors to acquire:¹¹ right to ownership, possibility to manage the company and the right to control the working operations. In a broader sense elements for which direct investments differ from the rest are the right to control and manage. In the narrow sense, elements that characterize the direct investments are the following: direct impact on the business of a foreign company, entrepreneurial activity abroad, the right of control over the operations of the foreign company and consistency of participation and business interest.

All of these issues should be directly addressed from the country which main interest is attracting more FDI and on these basic steps can be created a successful change and promotional strategy. The way of addressing these issues should be precisely determined through a list of measures that can be applied as a relief and incentive for the companies to choose FDI as a way of accessing a foreign market. These measures can be divided in two groups:¹²

- Broad measures: global stability in economic, legal and political sense - one step forward might be making a credit rating; reduction of the risks calculated in the discounted inflows of investors, monetary risks (inflation rate, interest rate, external sector - trade deficits, exchange rate and fiscal risks (budget deficit, low financial discipline); regulation of entry and exit - sometimes it is better to define what is prohibited than what is allowed - the investor would feel more free to work when known that what is not forbidden is allowed; the market size and potential for economic growth - taking into consideration the liberalization.

⁹ When using the Outsider strategy, the company produces in the home country and exports the products in other foreign countries. The company produces only marketing activities in the foreign countries.

¹⁰ Note: These views and opinions presented in this paper are personal views of the author based on scientific analysis prepared for the respective area.

¹¹ J. Previsic, How to invest in foreign countries, IP, Zagreb, Samobor, 1986, p.37

¹² <http://www.cea.org.mk>

- Narrow measures: fiscal measures (reducing the tax burden, tax holidays (exemptions), transmission loss in the next period, accelerated depreciation, subsidized loans, infrastructural benefits (for example, power and water plugs provided by the state), lower tax rates for reinvestment - a measure for existing businesses who want to reinvest) and financial measures (preferential loans - for SMEs or family businesses, for example; state guarantees for investment loans; export guarantees and insurance; grants for green projects, research and development, infrastructure and rural projects.

Empirical studies and surveys conducted by international consulting firms show that the most important are the broad measures to attract FDI (providing a favorable legal and economic environment and a healthy civil society), and that the narrow measures are much less important, and in some studies with ambiguous results.¹³ The experiences show that negotiations between the government and the investor may result in additional discounts (for large projects) in the price of electricity, cost of buildings, providing of a land, special services from investment agencies, simple import-export procedures etc. This is the moment when in the future the government may suffer from severe monopsony role of the developer. And where are the developing countries in this story? Well, they are generally weak in the area of the broad measures, with relatively small potential for economic growth, which indicates the need to improve in this particular area. Experiences show that it is more likely that narrow measures will not yield greater FDI if there is no sound basis of broad measures and a healthy civil society with built infrastructure. Yet it is important not to give up the implementation of narrow measures and to be careful not to enter in the so-called dilemma of the prisoner (prisoner's dilemma)¹⁴ in competition with other countries for FDI.

The research made by KARNEY group shows the most attractive sectors for investments in SEE countries:¹⁵

- The service sector – transportation, infrastructure, commerce, IT sector, tourism and energy;
- The production sector – food and beverages, automotive components, healthcare products (pharmaceutical and medical devices), clothing, textiles and leather;
- The primary sector – agribusiness, metals and metal products, construction and mineral resources.

The measures for attracting foreign investments can't be effective if they can be found only on paper. It is important to remove the main obstacles that push investors away. The research of "Economist Intelligence Unit" shows that corruption, cumbersome bureaucracy and political instability are the main reasons that keep investors away from the SEE region.

The most common limiting factors that drive the foreign investors away from the developing countries are:

- Poor infrastructure;
- Corruption;
- Increasing cost of labor;

¹³ Ibid.

¹⁴ For comparison, the rate of profit tax in Slovenia is 25%, in the Czech Republic it is 31% and in Hungary is 18%, and there is no income tax in Estonia, for example.

¹⁵ http://www.atkearney.com/images/global/pdf/FDICI_2007.pdf

- Lack of macroeconomic stability;
- Inefficient market of accompanying service activities;
- Rigid labor markets and uncompetitive structure of employees;
- Insufficient legal framework for a competitive market for the private sector;
- Political instability;
- Insufficient domestic demand (purchasing power)
- Insufficient use of free zones.

An efficient way of creating a general positive environment for attracting more FDI is by enhancing the transparency of public sector, providing an institutional framework, creating and implementing quality legal framework, providing conditions for healthy competition in the private sector and reduction of fiscal barriers. The SEE region and the developing countries are more and more attractive for the investors mainly because of the changes they have made in the investment policies, which in the end can result in creation of a more favorable business climate.

2.2. Targeting the investors for promotion of the developing countries as attractive markets for investments

The developing countries should create effective strategies for efficient promotion of their changed and improved investment policies. They should rely on their inner strengths, use the opportunities that the global environment offers, try to transform their weaknesses into strengths and if possible, to avoid the threats. The key points that should be indicated when promoting the country, should arise from the transformation and change of the limiting factors pointed out by investors after the transition period. A SWOT analysis can summarize the mutual positive factors of the developing countries and offer a solid base of investment incentives for luring the investors into their “back yard”.

Table1. A SWOT analysis of mutual factors of the developing countries

Strengths	Weaknesses
- Political and macroeconomic stability; - Competitive financial risk on regional level; - Tax incentives; - End of privatization process; - Solid level of economic changes; - Remodeling the old and building new institutions; - Restructured and privatized banking system; - Developed telecommunication structure; - Substantial level of high educated workforce; - National treatment of foreign investors; - Relatively low custom rates; - Free economic zones; - Prompt procedure for company registration.	- Poor infrastructure; - Insufficiency of recognizable locations for FDI attraction; - Limited natural resources; - Implementation gap in the primary and crucial laws; - Poor judicial system; - Market size; - Administrative barriers – long lasting procedures for permits for activities on local level (construction permits, frequent change of land use, etc.); - Insufficient development of sectors technological base; - Insufficient level of know-how (especially managerial skills).
Opportunities	Threats

- Government devoted to improvement of the economic development, fiscal policy, and building a sustainable environment for attracting more FDI; - Continuous development of financial markets; - Creating a liberalized fiscal system for attracting more FDI; - Continuous strengthening of the banking sector; - Reforms in the education according to the needs of the developing sectors in the country.	- Inability of developing strong institutions for attraction of FDI; - Slow changes in the legislation according to the EU standards; - Borrowing from international financial institutions and improper usage of the money for non-capital investments.

Based on the SWOT analysis, which shows that there are more strengths than weaknesses and more opportunities than treats, the developing countries can use strategy of further development in the direction of more flexible investment policies and new investment incentives like: educated, highly-qualified, and ethical workforce, developed infrastructure, lower corporate and personal income tax rates, one-stop-shop system that enables investors to register their businesses in short period of time (within one day), market freedom, the freedom of entrepreneurial activity and property rights, easy access to work visas, licenses and permits, signing multilateral bilateral free-trade agreements in order to ease the access to bigger markets and more consumers, etc.

Shifting trends in the global business environment have led many analysts to question the sustainability of their long term business strategies and make changes in their investment strategies, which as a fact should be taken in consideration by the countries that are targeting new investors. (see figure 2).

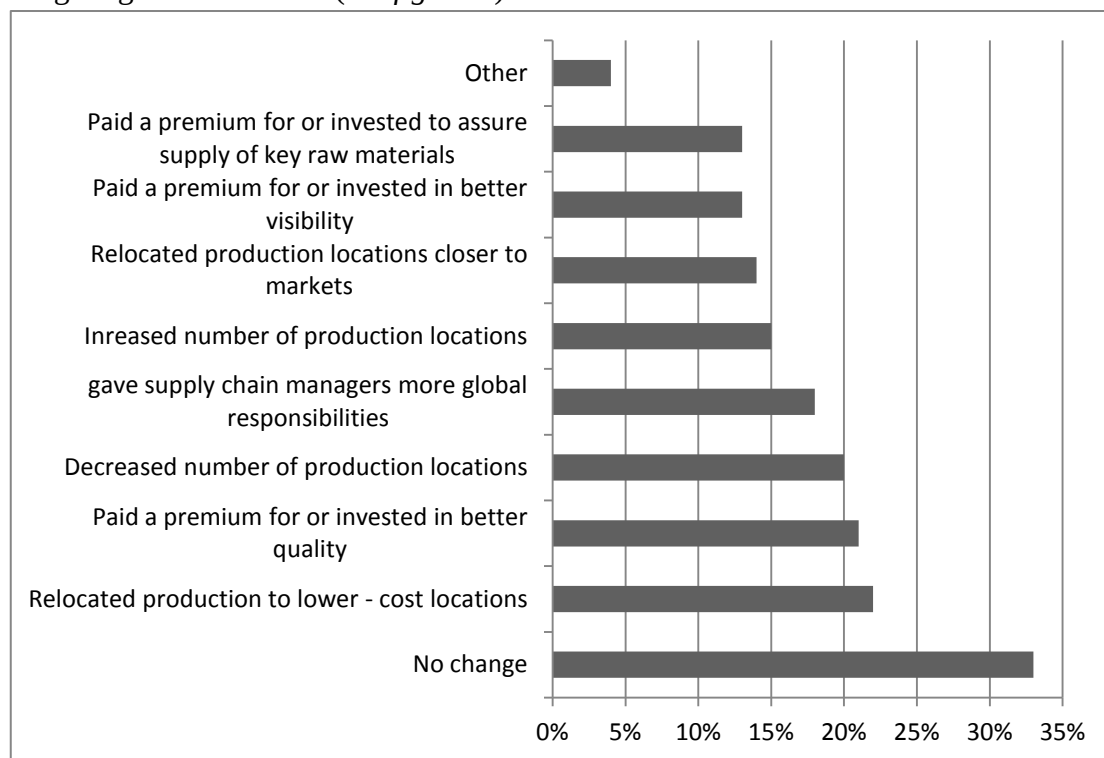


Figure2. Changes in supply chain strategies

Source: http://www.atkearney.com/images/global/pdf/Investing_in_a_Rebound-FDICI_2010.pdf

Before the last economic recession came upon us, consumers in many developed countries spent large proportions of their income and saved a little. But, as stock values, savings and retirement funds dwindled during the crisis, the consumers were forced to change their consumption pattern and consume less. Even before the crisis, consumers began demanding more sustainable practices from companies, and the general belief is that it is a trend that will continue in the future and that it will have effect on companies investment policies world-wide. This trend should also be taken in consideration when creation a countries investment policy (see figure 3).

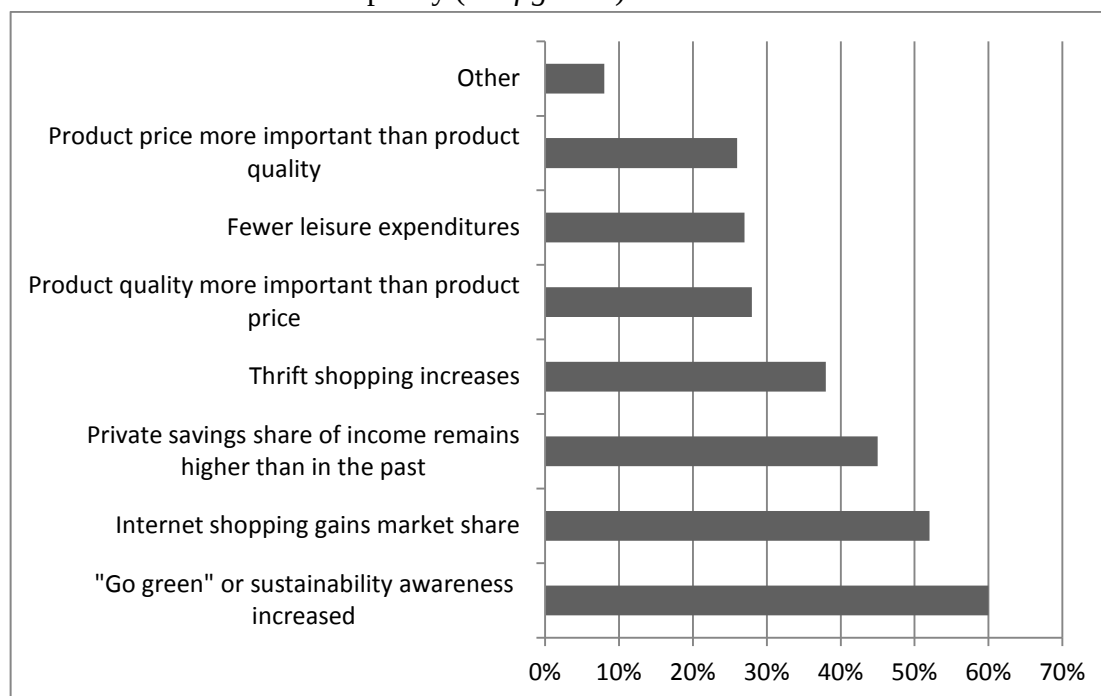


Figure3. Consumption patterns likely to persist post - recession

Source: http://www.atkearney.com/images/global/pdf/Investing_in_a_Rebound-FDICI_2010.pdf

The target group of investors and target sectors that should be pursued and on which the countries should focus their investment policies are:¹⁶

- Medium sized and large enterprises from the neighboring and other closer well developed countries, with a need for expansion of their production;
- Multinational companies that are still not present in the region;
- Multinational companies that are already positioned in the neighboring countries, with an offer for competitive location for logistic and distribution centers;
- Companies that already collaborate successfully with the country, but seek to enter new industries or markets.

Based on the analysis prepared for the respective area, the concept of promotion in front of the foreign investors can include the following tree activities:¹⁷

¹⁶ Note: These views and opinions presented in this paper are personal views of the author based on scientific analysis prepared for the respective area.

- Image building – IPAs¹⁸ promoting the country through its strengths as attractive location for FDI;
- Investment generation – IPAs ensuring FDI through direct and more targeted promotion;
- Service for investors – national care in providing services for the foreign investors.

IPAs can use integrated marketing communications to complete the sales process and meet the AIDCAS sales model. AIDA stands for Attention, Interest, Desire, Action, and it is a reminder of the four stages of the sales process. A variant on AIDA is to add a 'C' for Conviction. The letter 'S' for satisfaction also gets added, indicating the fact that happy customers will buy more (whilst unhappy customers will tell their friends!)

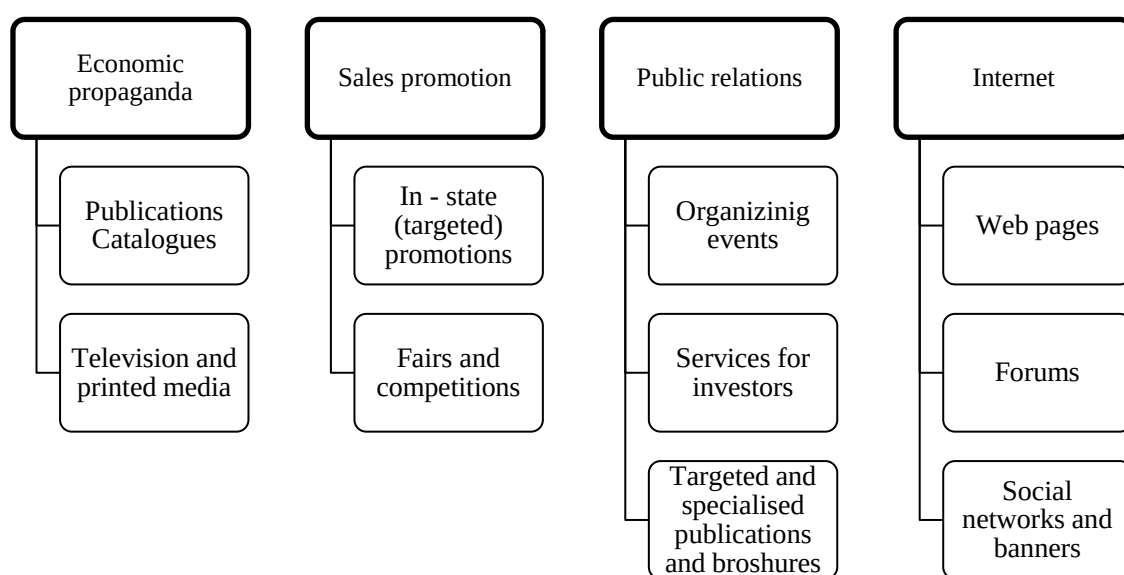


Figure4. Combination of the elements of the promotional mix for national promotion of the country¹⁹

The chosen and developed promotional mix can often be the key element that leads to investors action, which means that the country with the best promotional strategy will succeed in closing the deal and get the desired amount of “foreign money” and inject it into its national economy.

¹⁷ Ibid.

¹⁸ An investment promotion agency (IPA) is most often a government agency (or occasionally a non-profit organization functioning similar to a chamber of commerce) whose mission is to attract investment to a country, state, region or city. The agency does this by introducing investors with local real estate developers and other commercial service companies, providing useful statistical information such as average wages and by managing any investment incentives that the city, state or country may offer to companies which invest there.

¹⁹ Note: These views and opinions presented in this paper are personal views of the author based on scientific analysis prepared for the respective area.

Table 2. Possible Influence of the Promotional mix²⁰

Promotional mix = Market force		Promotional mix = Information
The promotional mix affects the preferences of investors, changing the possibility of the investment and differentiates the country from the competing countries.	Promotional mix	The promotional mix informs the investors about the country, but does not change the valuation of its investment conditions.
The investor becomes attracted to the country and is less sensitive to the risk, and also accepts less substitutes.	Investors behavior	The investor becomes more sensitive to the risk, and takes in consideration only the best offer.
The countries with market services for investors gain more discretionary power.	Structure of the industry and market power	Investors compare competing offers and only efficient offers can seriously be taken in consideration.
The possibility for competition through prices is decreases.	Global market activities	Informed investors lead to competition through quality.
Higher prices and profits derived from the promotional mix of countries provide more funds for promotion.	Performance on the global market	Increasing the quality of business environment on long term leads to increased profits.

3. Conclusion

Prospects for global foreign direct investment (FDI) are promising in both the short term and the medium term. The stage for the expected FDI growth is set by the foreseeable macroeconomic climate, which is largely favourable to FDI, and growing corporate profits that increase the availability of investible funds for corporate future expansion. Furthermore, investment liberalisation continues at both national and international levels. Competition to attract FDI through various promotion and facilitation measures has also escalated further. All this has set the scene for increased FDI flows over the next few years. At the same time, there are also risk factors that can be potentially detrimental to future FDI growth rates, such as protectionism, lower-than expected growth in industrialised countries, financial instability in major source economies, global terrorism, and the volatility of petroleum and other raw material prices. Investors' attention appears to be shifting away from traditionally important locations in developed countries in favour of certain emerging markets. Asia and South-eastern Europe are the two regions with the most favourable FDI prospects. Prospects for FDI vary significantly by industry. The outlook for the services sector is more positive than for the manufacturing or primary sectors. The industries expected to be at the forefront of FDI growth are computing and ICT, public utilities, transportation and tourism-related services in the services sector; electrical and electronic products, machinery and metals in the manufacturing sector; and mining and petroleum in the primary sector. IPAs expect the United States to be by far the most important source of global FDI flows, followed by the United Kingdom, Germany and China. The current trend shows that developing country's TNCs are becoming global players through outward investment. Prospects for TNCs' mode of entry indicate that the primary vehicle for FDI is expected to be mergers and acquisitions. In contrast, most IPAs

²⁰ Ibid.

from developing countries concentrate on non-M&A FDI, and expect greenfield investment to be the most important mode of entry. Nonequity investment, such as through strategic alliances or licensing, is also expected to remain significant. Prospects for the relocation of corporate functions are as follows: production in goods and services is the corporate function that will most likely be relocated. Next in line are logistics and support services, followed by distribution and sales. As competition for FDI increases, countries worldwide are becoming more proactive in their investment promotion efforts. The majority of IPAs are increasing the number and range of FDI-attracting initiatives. In particular, in a case of limited resources, most IPAs should try to employ a more targeted approach to investment promotion. In summary, although there are some potential risks, FDI growth is likely to continue. The recovery is increasingly fuelled by investment into, and from, developing countries and the overall mood should be one of cautious optimism.

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DEMOCRATIZATION PROCESS IN ALBANIA AND ITS SOCIAL, POLITICAL AND ECONOMIC IMPACTS¹

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Abstract

After the collapse of communism, Balkan countries have been undergoing political and social transformation. This transformation is described as “third wave of democracy” by Samuel Huntington. Albania is one of the most influenced country, which experiences this transformation. Compared to other Balkan countries, Albania’s transformation process has characteristically different properties from other Eastern European Countries owing to the history of Albania’s communist regime.

Globalization has also played a major role in the democratization process in Albania and Balkans in general. Since 1990, Neo-liberal policies, EU process and Albania’s increasing relations with EU, among others, have all contributed to this democratization process in Albania. Besides, Albania has been experiencing economic growth, increase in import and export rates, privatizations etc. Yet, could one assume all these developments as the indicators of a process towards a better democracy? Are people right in their worries about the elections and corruptions? In this paper, Albania’s political, social and economical development process is analyzed after the collapse of communism and the democratization process is reviewed.

Key Words: Albania, Democratization, Balkans, Economic Growth, Corruption

Jel Classification: F59, P44, P24

¹ Authors thank to PhD. Hakan Mehmet Kiriş for his contributions.

Introduction

Albania, referred to as a key country of the Balkans, has always faced challenges in the location of its Adriatic coast for centuries. The origin of Albania which is the oldest communities in the Balkans was based on B.C. 600. The country was been colony of the Ottoman Empire from 1517 to 1912, and declared independence on November 28, 1912. The country border was determined in London Conference which held on July 10, 1913. The date November 28, 1912 is regarded as the independence day. Albania was struggled with enemies of the country, was won companions and entered the political organizations in 1944 until 1985, named the period of Enver Hodja. In order to strengthen its economy and develop a sense of its security thinking, Albania was made treaties with Yugoslavia, the Soviet Union and China, respectively, between 1944 and 1978. Between the periods of 1978 and 1985, Albania remained alone rather than above periods.

Today, Albania demand to join close encounters of the political by democratization movement, demand to improve its economic and cultural and want to find a solution of the problem about borders with its neighbour countries. Albania is affected both positive and negative with respect to Albanians, lives from Turkey and Yugoslavia with distinctive feature and common historical past with Turkey. The country for a relation Turkey has located a key point in Balkans. In this paper, it is studied the period communist of Albania, the process of transition from communism to democracy and effect of that period. (Akyol, 2007)

Albania And Democratization

Enver Hodja died in 1985 and was brought to the leadership of the Communist Party of Albania, Ramiz Alia has expressed its commitment and will not alter the stated policy of the country. Although it has a strict understanding of management as it may seem more the period of Enver Hodja, Ramiz Alia has a softer understanding of management. During this period, Albania partially relaxed the stress of the atmosphere in the country, by taking steps towards ending the isolation from the outside world (Kut, 1998), has worked to improve its relations with Italy, Greece and Turkey. This shows itself in the field of trade relations in particular. Also, Albania exports and import with these countries more than anothers. In addition, Albania began to contacts with Yugoslavia to solve the problems, but a hostile attitude towards the United States and the Soviet Union also given up (Coşkun, 2001).

While Albania was rejecting to participate in all regional cooperation in the 1960s and 1970s, its joining the Balkan Foreign Ministers Conference in February in 1988 showed a major deviation from the traditional foreign policy, and for many years showed one of the signs of giving an end the continued loneliness (Biberaj, 2001). Albania has hosted meeting of Balkan foreign ministers's asistants in January 1989 in Tirana, was the first

regional multi-party meeting after the Second World War. Albanian Foreign Minister visited to Turkey and signed the Treaty and Postal Services the Cultural Agreement between Turkey and Albania (Şimşir, 2001).

Positive developments in administration's policies of Albania affected by some internal and external dynamics. Albania's repressive internal policies and strict foreign policies were giving up because of the economical difficulties and getting harder the financing itself. However, Gorbachev put forward the idea of Glasnost and Perestroika and the Soviet Union entered disintegration process and movements which is appeared after resolving of Eastern Block and resulted in Poland, Hungary, Czechoslovakia, Bulgaria and Romania also the political regime change requests affected the Albania (Armaoğlu, 1991). Despite Aliya Ramiz announced that the movement which began after the collapsing of communist regimes did not affected the Albania, in Tirana in 1990, thousands of students protested the regime and destroyed the statue of Enver Hodja.

Following the events of the early leaders of the Eastern Block countries and the affected Albania abandoned its policy and decided to not to avoid the reforms of the country which is in economical (www.msxlab.org/forum/countries-on/-Albania-tarihi.html). In the 22-23 January 1990, the Party Central Committee's economic and political decisions were taken in the meeting.

Albania change its regime to democracy without touching the principles of the socialism. In the democratization process, Albania focused on relations with international corporations. Albania was requested to attend to Conference on Security and Cooperation in Europe (CSCE) by entering a path of no return towards democratization (Armaoğlu, 1991). Albanians believed in change and started showing reactions for reforms to occur quickly. But the promises of reform and the government's failure to meet the needs of the population is increased the tension (Yilmaz, 2001). Political power have noticed the transformation of Balkans in the period. However, these concessions could not stop the reactions of public to government and demands for reforms.

Elections in Democratization Process

Albania is a parliamentary republic and the elections are hold every four years while local elections holds every three years. Despite the continuous efforts, free and fair elections, one of the main pillars of democracy, still appears to be an unachieved objective in Albania (Tafili, 2008). One of the main reasons of it, is political elites and the culture of Albania is heritated from communist regime. The first pluralist elections in Albania were organized in 1991, while the Party of Labor of Albania (the Communist Party) remained in power. These elections were not largely considered a part of the democratic process in Albania since they were organized while former communist elites, remained in power. Nevertheless, these elections signaled fundamental changes for Albanian society and politics (Tafili, 2008). From that time, Albania holds the elections which is one the entailments of democracy. Despite of many trick claims about Albania government elections, The government is elected by democratic elections.

After the transition to multi-party system in 1990, Albania's first political party, the Democratic Party was founded on December 12th. At the end of December, the Christian

Democratic Party was the second party (Göktaş, 1995). Communist Party and the opposition parties decided to postpone the elections to 31 March 1991 to let the new parties to prepare. Democrat Party provoked the students and the statue of Enver Hodja was destroyed again (Coşkun, 2001). On February 21, Adil Çarçari was unseated and replaced the new government headed by Fatos Nano to decrease the tension (Şimşir, 2001). Towards the elections, on March 11, 1991, Albania became a member of OSCE. On March 15 was officially established political relations with the United States of America (Yilmaz, 2001). The first parliamentary elections hold on March 31, 1991. Worker Party which take advantage by its policy before the elections, keep its politic power against to Democrat Party. After the elections, National Stability government established. The observation reports were not clean but these steps on elections were the good signals of democracy future of Albania.

As a result of the first elections, the People's Assembly of Albania's membership to 250;

- 169 members of the Albanian Workers' Party,
- 75 member of the Democratic Party,
- 5 member of the Party of Omonia,
- 1 member of the Albanian Party of Struggle has occurred.

The Communists won the first democratic elections but the thinkings about elections as it is unfair, ongoing students acts, strikes and economical problems pushed the country to conflict. After the Ramiz Alia who fired from party leader, Albania's Worker Party change its name as Socialist Party but could not renew itself, yet Democrat Party had strengthened itself (Yilmaz, 2001). Labour Party, in July 1991, has established a new coalition government headed by Ylli Bufi. Labour Party 67.6%, 30% of the Democratic Party, Party of Omonia (Greek minority party) 2% took of the votes. In the meantime, government has decided to hold early elections on March 22, 1992 because the coalition government couldnt satisfy the needs of the people, national turmoil and reforms werent done. Prime Minister Sali Berisha elected to President of the State and he signed Meksi Alexander as prime minister of country (Şimşir, 2001). In the 1992 election, Democratic Party, by taking the full support of the public and election results began to change the communist system in Albania's new foreign policy become evident. It began to take decisions as arresting the wife of Enver Hodja, Necmiye Hodja Hodja, and his son, Ulir Hodja (Elbrit, 1997). Despite of the reactions to these attempt, Democrat Party applied what they think to need for new democratic system. Albania's fastly political transformation is the indicator of entering into democratization process. In 1996, the 140-member parliament's 122 seats won by the Democratic Party in the elections and had an absolute majority (Cerrahoğlu, 1997). In the 140-seat People's Assembly, elections resulted as;

- The Democratic Party 92 seats,
- Socialist Party 38 seats,
- Social Democratic Party 7 seats,
- The Human Rights Union Party (Greek minority) 2 seats,

- The Republican Party 1 seat.

Albania's Foreign Policy

When the democratization period began, the most important goal of Albania, was integrating to the West (Coşkun, 2001). Albania realised that it should opened itself to other world when new term began for Albania. Albania needed peacefull contacts and social order to develop economically and socially.

Albania's foreign policy has the following basic features after the end of the bipolar world order,:

- To develop political and economic relations with Western countries and organizations,
- As a member of NATO and the European Union, to guarantee the security of the country,
- To develop good relations with countries in the region,
- To defend the rights of minorities and ensure resolve problems through peaceful means especially Albanians living outside the country in Kosovo and Macedonia,
- Taking economical aid from western countries and institutions to development of Albania which were one of the poorest country in East Europe (Biberaj, 1999).

The primary aim of Albania after 1992 were the International Monetary Fund (IMF), World Bank, the Organization for Security and Cooperation in Europe (OSCE) and the World Trade Organization membership. Albania has some advantages on integrating to the West. Albania is the country in Europe, has better relations with Italy. Italy played a big role in Albania's gateway to the west and in the Albania's foreign relations and also trade has a great importance. Tirana thinks that it will reach its goal of integration with the West with the support of Rome (Coşkun, 2001). One of the basic issues of foreign policy of Albania is Albanian minorities, lives in other countries problem. During the Communist regime, there were no international attempts for the Albanians who lives in abroad and Tirana had avoided to express its thinkings about Albanian minorities in abroad. Thanks to the new democratic system, minorities believed that Albania would interest with them to solve their problems and had believed that their disappointments of communist regime would end (Türbedar, 2003). During this period, winning their independence and the whole world's attention after the collapse of Yugoslavia and the crises in Albania's the new neighbor countries deeply affected the Albania (RFE, RL Research Reports, 1992).

Albania is the last country in the Communist block which opened itself to the outside world. Albania has different characteristic structure than the other Balkan countries. One of the distinctive features of Albania, is its strict isolation from the outside world in the communist period. Enver Hodja closed off all trade channels, it lasted 40 years later and made Albania the poorest country in Europe. In that year, the Albanian leader of the regime, Enver Hodja, blocked every relation with Moscow and consequently with the entire Soviet Union (www.girodivite.it). One of the factors which adversely affect the process of democratization in Albania is the institutions. They were tried to create in a new democratic order. The instituitons which established for new democratic system were new

and untried. This problem adversely affected the growing of internal democratic culture. For the institutions which is rooted in the period of Communist regime, it would be hard to design them for new democratic system. However, in this transformation process, the effect of external factors were great. The external factors of the democratization were a support for the Albanians who dreamed democracy. America has the greatest support for the process of democratization of Albania. President Sali Berisha tried to explain this support to the public because he believed that the existence of this support, people will accept his rhetorics more. According to the Tafili (2008), Albania was one of the poorest countries when it entered the democratization period. Albania took a lot of food aid by international organizations. Italy played a big role in these aid. However Albania focused on agricultural sector, main actor of the economical growing were trade. But the economical policies in this period, were criticised and dissatisfied.

Impacts of the Democratization on Economic Development

As a result of liberal policies, implemented in Albania's economic figures has increased drastically. Despite of the negative effects of civil unrest in Albania in 1997 and the Kosovo War in 1999, Albania growth in the period of 11 years between 1991-2002. Albanian economy has been growing. Privatizations, Foreign investmens contributed to this development. For example, Albania's GDP was increased about two times from the year 2004-2008. Albania's GDP were 7.3 billion dolar in 2004 and it has increased to 13.3 billion dolar in 2008. The economic indicators are good too. Inflation rates are stability. (Istanbul Trade Office Report, 2009). Albania's economy is based on agriculture. However, in recent years, the urbanization rate increased while as share of agriculture in the economy were decreasing and the servise sector have growth.

According to report of Foreign Economic Relations Board (2009); Albania is one of the poorest countries in the Balkans. To get rid of this economical trouble, Albania made privatization its telecom, energy, mining and petroleum sectors, infrastructure and transport services. Thus, the government gradually reduced the share of the goverment in economy and the private sector of GDP has reached 75 percent. The developing of tourism, service and construction sectors contributed to Albania's growing.

The followings are the instutiations which made privatised;

- National Commercial Bank of Albania was sold with shares to Kentbank for 60 percent, 20 percent of the IFC (World Bank), and 20 percent of the European Bank for Reconstruction and Development (EBRD) in 2000 (Foreign Economic Relations Board, 2009).
- Cement factory was bought by a consortium of Fushi-Kruja'nin Seament / United Quarries (Lebanon / UK) in \$ 12.5 million (Foreign Economic Relations Board, 2009).
- AMC company, actives in mobile telecom sector, was bought by Telenor / Cosmote (Norway /Greece) in \$ 200 million in 2001 (Foreign Economic Relations Board, 2009).
- Deposit Bank of Albania in 2003 was bought by Raiffeisen Bank (Austria) in \$ 126 million (Foreign Economic Relations Board, 2009).

- 51-76 per cent of stake in Telecom sector Albtelecom actively for sale (Foreign Economic Relations Board, 2009).
- The sale of Albanian Power Corporation KESH company by divided into three (Foreign Economic Relations Board, 2009).
- The sale of Albpetrol, Servcomand ARMO in the oil and natural gas industry and Petro-mechanical plant which is in Kuçove.
- Sale of insurance foundation of Albania (Foreign Economic Relations Board, 2009).
- Tobacco Factory and Plant Sale (Foreign Economic Relations Board, 2009).

Conclusion

Albania, growing country of Balkans, has good social and economical indicators for the future. The main goal of this paper is to analyze Albania's economic and the social impacts in the country's democratization process. Even if Albania seems undeveloped than the other Balkan countries, all the policies are practising for its development. After the collapse of communism, Albania recognised its potential and immediately applied neo-liberal policies. In this period, Trade was the most important goal of Albania. After the Enver Hodja period, Albania opened itself to the outside world and began to import and export. For a good economy, countries need contacts and way to other countries. However, not only Albania, but also other countries needed it too. Together with growing Albanian economy, the other countries which has trade relations with Albania, will affect positively. To make good relations on trade, countries's social atmosphere and the order should be fine. For the process of democratization in Albania, in particular European countries and the USA have provided a large amount of support. However, Albania, because of strict communist past, was unable to accommodate to the movements of this transformation. Internal culture still bears the effects of the communist past of Albania's state institutions. Even though, the name of the new system is democracy, some of the authoritarian practices in the process of transition were opposite with new system. In the process, some oligarchic properties. Reaction of the public to the administration, elections doubts and the economic problems that impedes the functioning of the process. However, this period was a transitional term and transitional periods are always difficult. Even though, Albania has many social and economic problems, future seems bright for a better social and economic order with democracy.

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“Inflation and Money Growth”: The Case of Albania

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INFLATION AND MONEY GROWTH: THE CASE OF ALBANIA

ABSTRACT

The purpose of this study was to test the long run relationship between inflation and money growth for Albania during the 1996-2008 years. We conduct the study by analysing the quantity theory relationship of money and inflation for a sample of four different countries during the same period of time. This has been done by examining events, which were focused on macroeconomic indicators between 1996-2008 years. Afterwards, we compare Albania with those four different countries as well. When we test those countries, we obtain a strong positive relation between inflation and money growth. The results indicated that, an excess injection of money was reflected by an increase in price level and vice-versa. The principal conclusion of this study was quantifying the impact of money supply on the inflation rate in Albania, and uses it as a benchmark in order to expect inflation for following years.

Keywords: Inflation; Money Growth; Quantity theory of money; Albania

1. INTRODUCTION

Albania is one of the transition economies that have performed very well at fighting the inflation. Since it was a post communist country, the price levels increased sharply after the fall of communist system in 1990 and during the born of private enterprise system 1992-ongoing. In addition, the people were given for the first time the right to have a private property and the freedom to choose. Above all, thanks to many serious reforms regarding economic developments, the output level increased enjoyably for each year. Contrary to other years, 1997 was the black year for Albanian people; it was the year of pyramid scheme bankruptcy. Many people deposited the money at banks hoping to double or triple them in a very quick time. Unfortunately, most of them lost their money deposited in the so-called pyramid schemes¹. However, after the collapse of pyramid schemes the flare of prices didn't last any longer. In 1999 the inflation changed directions from higher to lower and stable rates. Experiencing such inflation rates means a good performance of monetary policy as well.

Three main objectives of this paper are as follow: The first is to examine if there is a relationship between money growth (M2) and inflation rate (CPI) in Albania. The second is to show whether an increase in money supply will cause an equivalent increase in inflation rate. The third is applying regression analysis in Excel and examining whether the constant² (real GDP growth rate) is negative where QTM equation has the form of $\Delta P = \Delta M - \text{CONSTANT}$ at a fixed velocity.

I have organised the paper as follows. Next section of this paper provides a brief explanation of theoretical fundamentals, concerning the quantity theory of money, causes of inflation and differences among Keynesians and Monetarists.

Section 3 deals with literature review.

Section 4 shows the data used to carry out the study and the methodology chosen for research purposes.

Section 5 examines the correlation between two variables money supply and inflation, where money supply is independent variable and inflation is dependent variable. This is done by applying regression analysis and then examining: T test. Moreover, we interpret the meaning of graphs obtained by the results of analysis. Afterwards, we compare those results of Albania with four other countries taken as sample for our study.

Section 6 concludes the paper by restating the main points of our study .Mentioning the central idea about inflation and money growth, and summarising briefly the results from entire work.

¹ Christopher J, The rise and the fall of Albanian pyramid's scheme, Finance and Development, IMF, Volume 37, number 1, 2000

² In the equation of quantity theory of money constant implies real GDP growth rate

2. THEORETICAL FUNDAMENTALS

2.1 The Main Model

The quantity theory of money says that: If velocity is fixed, then changes in nominal money will lead to equivalent changes in the price level. The quantity theory of money is expressed as follow:

$$M*V = P*Y^3$$

Where:

M = money supply

V = velocity of money

P = price level

Y = real GDP

The velocity is the nominal income $P*Y$ derived by nominal money M . If real output is kept at potential output when prices adjust, then M and P should move together, on the condition that V is fixed. Furthermore, the quantity equation states that changes in total of spending, $M*V$, must equal the total of receipts, $P*Y$. In addition to that, the quantity theory assumes that velocity is fixed by the central bank and it remains stable over time. Since, velocity is stable over time, shifts in money supply affects only nominal GDP, $P*Y$. Namely, 1% increase in money supply will cause equivalently 1% increase in nominal GDP. As a result, left hand and right hand side of equation will move proportionally at the same direction.

2.2 Model Extensions

According to those assumptions specified above at 2.1, we can write the quantity theory equation as follow:

$$\Delta M + \Delta V = \Delta P + \Delta Y \quad (1)$$

Moreover, since V is fixed, the equation will be:

$$\Delta M = \Delta P + \Delta Y \quad (1a)$$

Similarly:

$$\Delta P = \Delta M - \Delta Y \quad (1b)$$

The theory assumes that economy operates at full output level in the long run; as a result, output level will be constant. So, the equation will shift to:

³ Quantity theory of money theory developed by Irving Fisher

$$\Delta P = \Delta M - \text{CONSTANT} \quad (1c)$$

The equation above means that changes in price level or inflation rate will be equal to changes in money supply minus CONSTANT (real GDP).

2.3 Causes of Inflation

Firstly, inflation is an overall increase in the price level and it is caused by the following factors:

- a) Demand-pull inflation result when aggregate demand for goods and services increases. The increase in aggregate demand causes excess demand. In turn, that leads to a shortage and make sellers to raises price until the new equilibrium is reached.
- b) Cost-push theory is known also as supply shock inflation, stating that the producers decrease the supply of goods and services when the cost of production increases. The main reasons that raise the cost of supplies includes increases in input prices such as: rent, wage, interest. Another main reason is the increase of taxation or the cut of subsidies.
- c) Built-in inflation refers to the idea that inflation is expected to increase. Upon this expectation labours demand higher wage. Consequently, the cost of production will drive up causing an artificial raise in the price level.
- d) Money supply has a crucial importance at determining inflation rate. According to monetarist economists central banks don't control money supply sufficiently. So, in case the money supply grows faster than real GDP it will put pressure to the price level resulting in inflation.

2.4 Keynesians vs. Monetarists

At first, in 1970s Keynesians and Monetarist fought head to head for the viewpoints regarding monetary policy. According to many economists, Keynesians won the war, but Monetarists won many battles. In addition, Keynesians are sceptical about the importance of money supply and monetary policy in the short run. However, they now prefer more monetary policy to fiscal policy. Despite the convergence, both Keynesians and Monetarists share many differences.

On one hand, Keynesians suggests that Central Bank should use discretion when conduct monetary policy. Secondly, they believe that fiscal policy is useful and shouldn't be considered as less important. Thirdly, they argue that the Aggregate Supply curve is more horizontal than vertical in the short run meaning that economy can be unstable.

On the other hand, Monetarist recommends a long run money growth rule. So, monetary policy must be tied to rules. Also, Monetarist don't believe too much in the usefulness of fiscal policy. Lastly, they suggest that Aggregate supply curve is more vertical and the economy is inherently stable.

3. LITERATURE REVIEW

To carry out the research, it was indispensable to understand the quantity theory of money and application of its equation at an integrated level. Another important task was to extend it so as to develop the econometric model, helpful to show the impact of money supply quantitatively on inflation rate. Money supply, velocity, price level and real GDP are the necessary data used to formulate the QTM equation. If the velocity and real GDP were fixed and constant respectively then there should be a one-to-one relationship between money growth and inflation in the long run.

Accordingly, Bruggeman et al. (2005) test the link between money growth and inflation in the euro area using money augmented Phillips curve as the underlying model to describe fluctuations in inflation for the period 1986Q1 to 2003Q2 and suggests that there exist a positive relationship between monetary growth and inflation over long-run horizons. Another important research study that demonstrates short-run consequences of periods of strong monetary growth for inflation dynamics in 15 industrial economies was conducted by Roffia and Zaghini (2007), who found a positive link between monetary aggregates and prices over a 3-year horizon. A similar study concerning money growth and inflation was conducted by Amisano and Fagan (2010), applying Bayesian techniques from 1960s up to 2010. They come to the conclusion that money growth provides timely warning signals of transitions between inflation regimes.

Moreover, Herwartz and Reimers (2006) takes the argument a step further testing the relationships between money supply, prices and real output for a wide range panel of 110 economies and find that homogeneity between prices and money cannot be rejected and the main authorities, central banks can achieve and maintain price stability by controlling monetary growth even for high inflation countries. Moreover, Dwyer (2001) examine whether money growth helps to predict inflation. This was done by estimating a small Vector Auto-regression (VAR) using quarterly data from 1953 to 1997 for four variables: the logarithm of nominal income; the logarithm of the price level; the interest rate on 3-month Treasury bills; and the logarithm of the money stock measured by M2. As a result, money growth was more useful for forecasting inflation than other variables besides past inflation.

Somewhat a different study that yielded similar results was conducted by Kalra (1998) on inflation and money demand in Albania during 1993-1997 suggesting that in the long run exist a positive relationship between price level, exchange rate, money and interest rates. Ohnsorge and Oomes (2004) estimated a long-run inflation equation, using a markup model where inflation was a weighted average of increases in unit input costs. They found that, in the long run, inflation depends for roughly 50 percent on nominal effective depreciation, for 40 percent on unit labor costs, and for 10 percent on utility prices. Another study was conducted by Qayyum (2006), who tested Money, Inflation, and Growth in Pakistan. Furthermore, they estimated the relationship between the rate of inflation, money growth, growth in real income, and growth in velocity in Pakistan in the 1960–2005 period. The results from the correlation analysis indicate that there is strong relationship between the money growth and inflation, suggesting that the important policy implication is that inflation in Pakistan can be cured by sufficiently tight monetary policy. So, the formulation of monetary policy must consider development in the real and financial sector and treat them as constraints on the policy.

About the same study was done by Gerlach (2006) on Money Growth, Output Gaps and Inflation at Low and High, the work was conducted using quarterly data for the period 1970-2006, emphasising important findings such as, the notion that movements in steady-state inflation depend on long-run money growth and fluctuations around this steady state on the output gap. Also, that at higher frequencies the output gap causes inflation implying that analysing inflation by solely considering the information in the monetary aggregates would forego important information.

Most importantly, Teles (2010) investigates whether the quantity theory of money is still alive the data chosen refer to 1970, 1990 and 2005 for all OECD countries, drawing on statistics of the IMF as well as the OECD. The findings for that investigation states that quantity theory of money is still useful and for countries with low inflation, the relationship between average inflation and the growth rate of money is tenuous at best. Frain (2004) using Multi-Country Data-Set test the link between Inflation and Money Growth. In the end he finds that all the correlations estimated in the paper were long run. Also they do not establish any direction of causality between money and inflation even in the long run. The analysis shows that this data set and methodology cannot be used to deny the existence of a long run relationship between money growth and inflation. Simply, if money supply is growing faster in the long run in a country that country will have greater inflation even if that country is a low inflation country. Dwyer and Fisher (2009) use a set of countries and find a positive correlation across all countries. The correlation falls as countries with higher excess money growth are excluded, but the correlation is 0.47 across countries with excess money growth of ten percent or less.

Finally, Muço et al. (2004) analyses relationship between money supply and inflation in Albania from 1994 to 2003 basing estimations on a vector auto-regression model (VAR) of key macroeconomic variables such as: money growth, inflation, exchange rate, remittances and the trade balance. Their findings indicate a weak link between money supply and inflation up to mid-2000. However, from 2000 ongoing a greater link between money supply and inflation was detected.

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4. DATA AND RESEARCH METHODOLOGY

In order to test the theory we need to gather data which must be relevant. In this example the data cover the period 1996-2008. The data for Albania include money growth (M2) and inflation rate which is measured using consumer price index. Concerning sample countries, I have used money-quasi money growth (M2) and inflation rate (CPI) exhibited at Table 4.1 and 4.3. Data for money supply (M2), money-quasi money growth (M2) and inflation rate are provided by Central Bank of Albania and World Bank shown at Table 4.2. To carry out the study we develop an econometric model, through which we can make a statistical test of the quantity theory of money. The model that we use resembles that of equation (1c):

Instead of equation (1c) mentioned above we use a regression equation model as:

$$\text{Inflation} = \alpha + \beta * \text{ms}$$

where :

Inflation: is the percentage change in price level

α : is the intercept and equals the constant in equation (1c)

β : is the value for the slope coefficient

ms: is the quantity of money supply that change yearly.

Upon this basis, we will test the hypothesis that “ α ” or the constant in equation (1c) is negative and “ β ” or the slope is almost 1. The research is done by taking four different countries as sample to test the quantity relationship between change in money supply and inflation rate. Moreover, those countries are chosen randomly under the same period of time. This is done based on no any specific criteria so as to give a picture of a wide range of economic experiences. This sample includes low and high inflation level countries. Summary statistics for the sample countries in this example are shown in Table 4.4.

5. APPLICATION AND RESULTS

5.1 Regression Analysis, Albania

This section deal with estimation of the regression equation model we developed. To conduct regression analysis I used Excel 2007. By going first to “data” then “data analysis” after that “regression” I selected the money growth as independent variable and inflation rate as dependent variable and at 5% significance level I got the results exhibited at Table 5.1, 5.2 and 5.3 :

Most importantly, we focus on empirical results. Such as, dealing with the statistical regression equation:

Where:

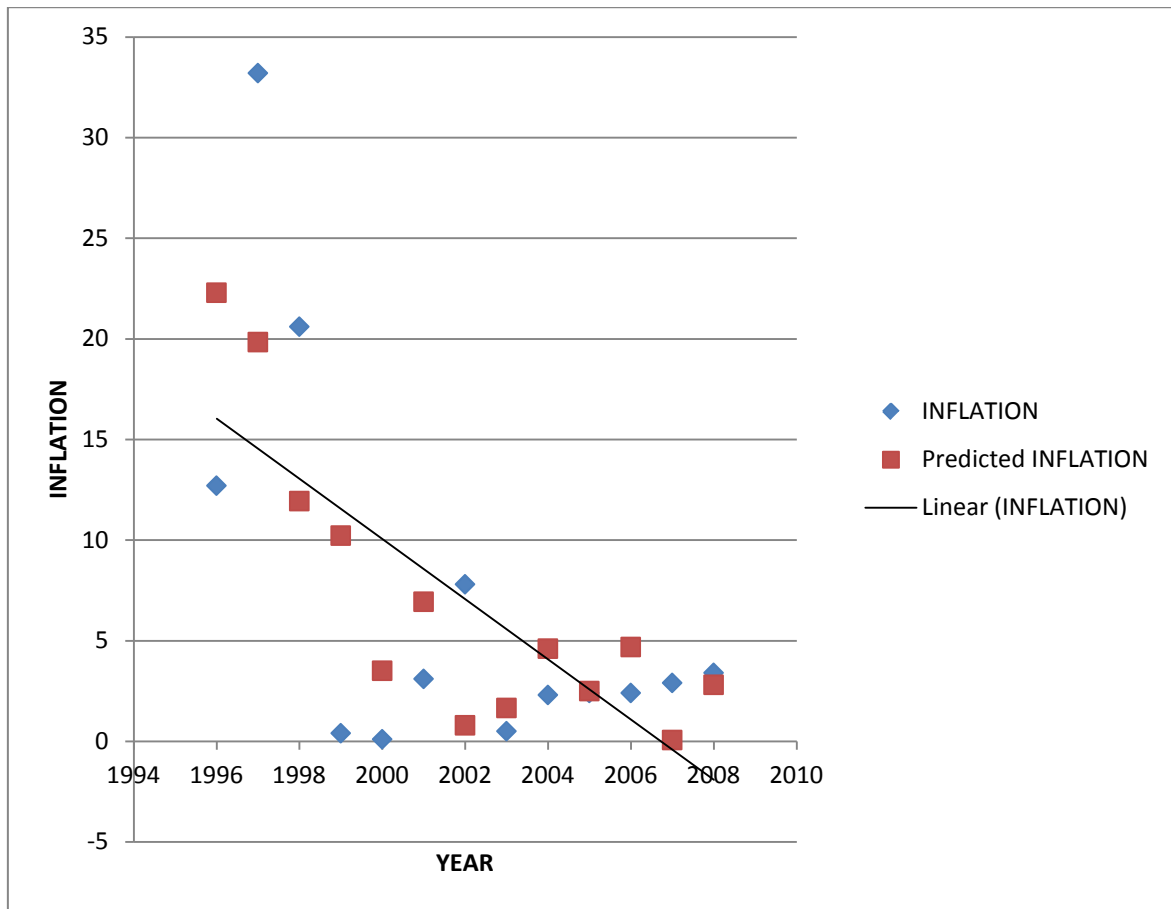
$$\text{Inflation} = b_0 + b_1 \text{ms}$$

After removing data input of velocity of money as mentioned above for the regression analyses, we have the constant of dependent variable (inflation) $b_0 = -3.51676$ and coefficient of independent variable (money supply) $b_1 = 0.6776283$. The regression analyses result presents that the money supply has positive relationship with the inflation. Where, one unit increase in money supply will increase inflation by the 0.677 coefficient. So, if we apply these results into our regression model presented above in section 4, the model will be:

$$\text{Inflation} = -3.51676 + 0.6776283 * \text{ms}$$

Again in Table 5.3 it can be seen that the t-statistics for this equation is 3.53 where the critical value of (t) for thirteen observations is 2.2. In order to reject the null hypothesis the t-value must be greater than t-critical value. Thus, it allows rejecting null hypothesis and accepting hypothesis 1. In addition, similar to the results of t-test the p-value test also confirms that the result of regression model is to reject null hypothesis and accept an alternative one where the p-value must be lower than the p-critical value. Here, the result shows the p-value of 0.0047 where p-critical value is 0.025.

Figure 5.1: Money Growth Line Fit Plot, Albania



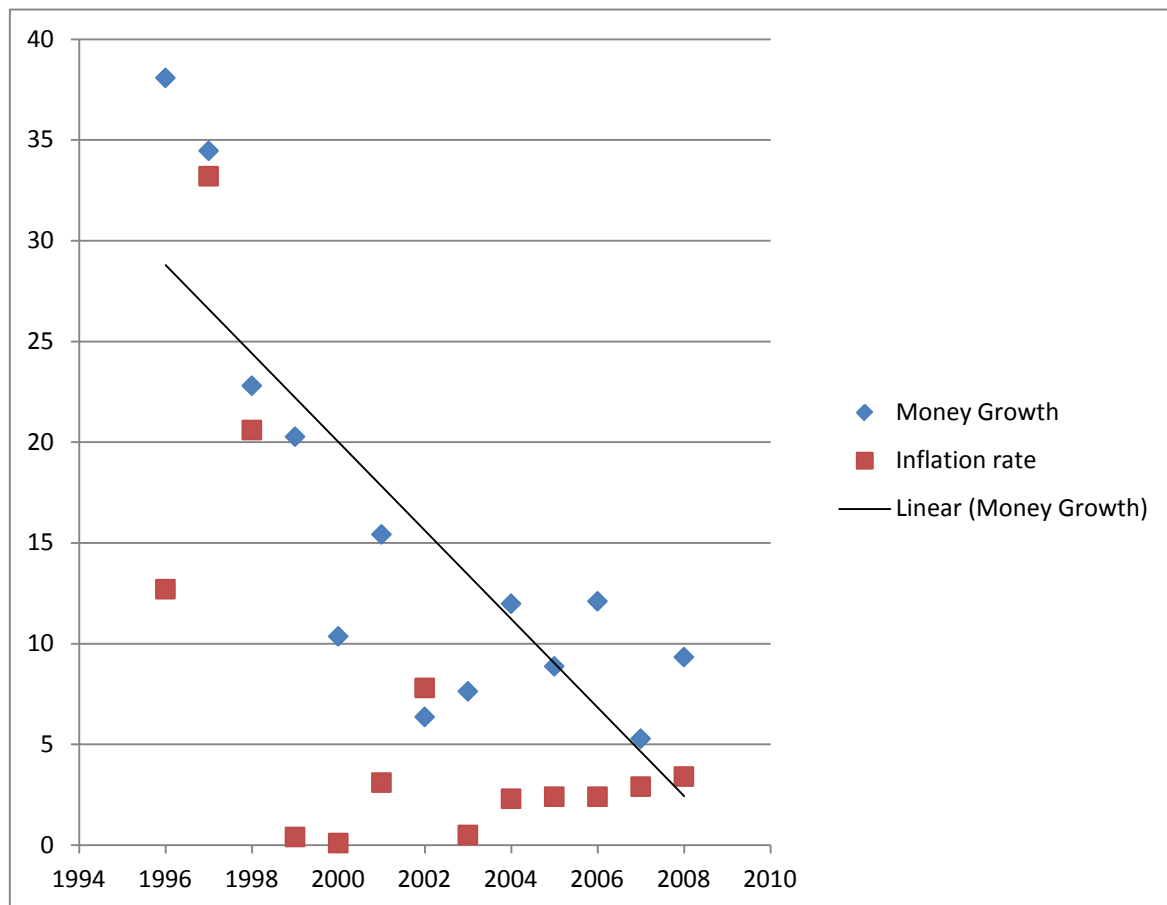
Based on the Figure 5.1 we can see a relationship between the actual inflation experienced in Albania and the predicted inflation as a result of function computed above. Also, there appear to be a positive relationship between actual inflation and predicted inflation meaning that actual inflation is close to the predicted inflation.

Where:

-INFLATION: shows the actual inflation

-Predicted INFLATION: shows the predicted results, which are computed by the linear regression above.

Figure 5.2: The correlation between Money Growth and Inflation, Albania



At first, if we look to the Figure 5.2, there appear to be a relationship between money growth and Inflation rate in Albania during 13 years taken in our analysis. Secondly, the relationship between money supply and inflation is positive, meaning that as money supply increases also inflation increases. Thirdly, the form of the graph seems linear and suitable to model this relationship with a line. Additionally, as relationship appears linear, it is suitable to calculate the correlation coefficient. Being a numerical summary, the correlation coefficient describe the strength and direction of linear relationship and equal to $r=0.73$. Since $r = 0.73$, it is positive and near positive 1, as a result, we conclude that this linear relationship is moderately strong and positive. Furthermore, the slope of the line (0.67) indicates that for every increase of 1 unit money supply, we would expect the inflation to increase by 0.67 units. Contrary to other years, during 1999, 2000 and 2003 money supply increases by 20.27, 10.36 and 7.63 units but inflation rises only by 0.4, 0.1 and 0.5 units respectively. Afterwards, the α -intercept of -3.5167 indicates that; in case money supply change by zero units, we would expect inflation to be -3.5167 units. Finally, the r^2 value of 0.5313 shows that 53.13% of the variation in the dependent variable which is inflation can be explained by the variation in the change in money supply or our independent variable.

5.2 Regression Analysis, Brazil, Bolivia, Mexico, Turkey, Albania

I have checked if there exists a correlation between inflation and money growth for four different countries from the same period, among 1996-2008 years. The statistical test is done including Albania as well. The countries I have selected to test the quantity theory of money are as follow: Brazil, Bolivia, Mexico and Turkey. Before two thousand years Turkey has experienced a high money growth, and a low growth after two thousand years. The increase or decrease of money supply is reflected to inflation rate. Contrary to three other countries, Turkey has experienced the highest changes in money supply and price level. The three other countries experience low changes in both money supply and price levels. The common thing among them is a positive responsiveness of price level after a change in money supply. As a result, inflation and growth rate of money supply increases together. Moreover, the results obtained from the four countries tested, which appear also at the Figure 5.4, show that when we have an increase in money supply, we will have an increase in price level. Finally, the inflation and predicted inflation are closely related and move on the same trajectory, such a thing can be seen at Figure 5.3.

However, to create a better idea about the correspondence of price level to money supply we compute the regression analysis in Excel for the sample countries and Albania. Consequently, we obtain the results exhibited at Table 5.4, 5.5 and 5.6. In the statistical analysis I have removed velocity since it was assumed to be fixed by central bank as I did for Albania. Afterwards, the same regression analysis model applied for Albania is used:

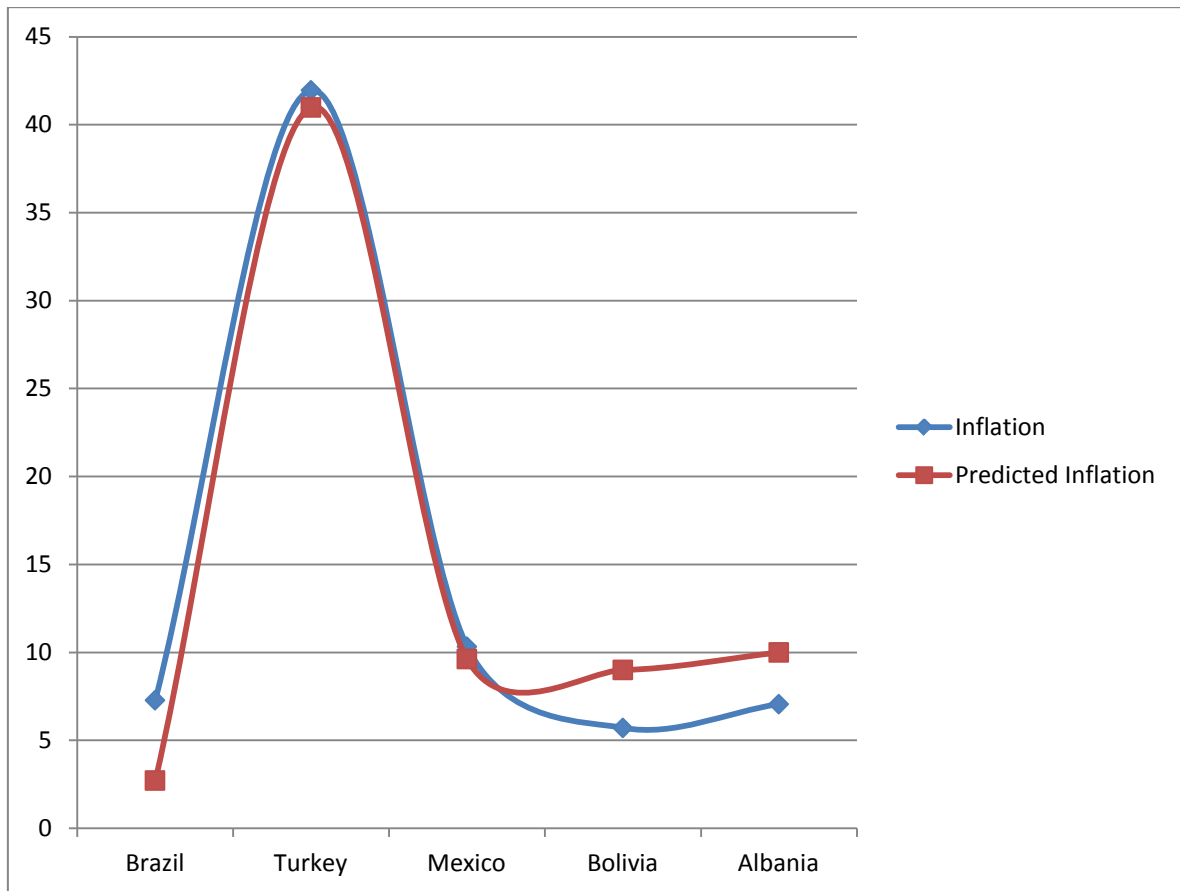
$$\text{Inflation} = \alpha + \beta * \text{ms}$$

From the regression output we have the constant of dependent variable (inflation) $\alpha = -2.728979774$ and the coefficient of independent variable (money supply) $\beta = 0.815563871$. The regression analyses result presents that the money supply has a strong positive relationship with the inflation. Where, one unit increase in money supply will increase inflation by the 0.815563871 coefficient. So, if we apply these results into our regression model presented above in section 4 and for Albania, the model will be:

$$y = -2.728979774 + 0.815563871 * \text{ms}$$

In order to accept that there exist a relationship between money growth and inflation for sample countries and Albania we have to reject null hypothesis. We can reject the null hypothesis on condition that t-statistics and p-value is greater and less than t-critical value respectively. From the Table 5.6 we can see that t-statistics = 8.103715 and p-value = 0.003927 for 5 observations, and their t-critical values are 3.18 and 0.025 respectively. So, the t Stat is higher than 3.18 and The P-value is lower than 0.025. Accordingly, the Null Hypothesis is rejected either in compliance with the P-value or the t Stat; this means that there exists a relationship between money supply and inflation for sample countries and Albania.

Figure 5.3: Money Growth Line Fit Plot for sample countries and Albania



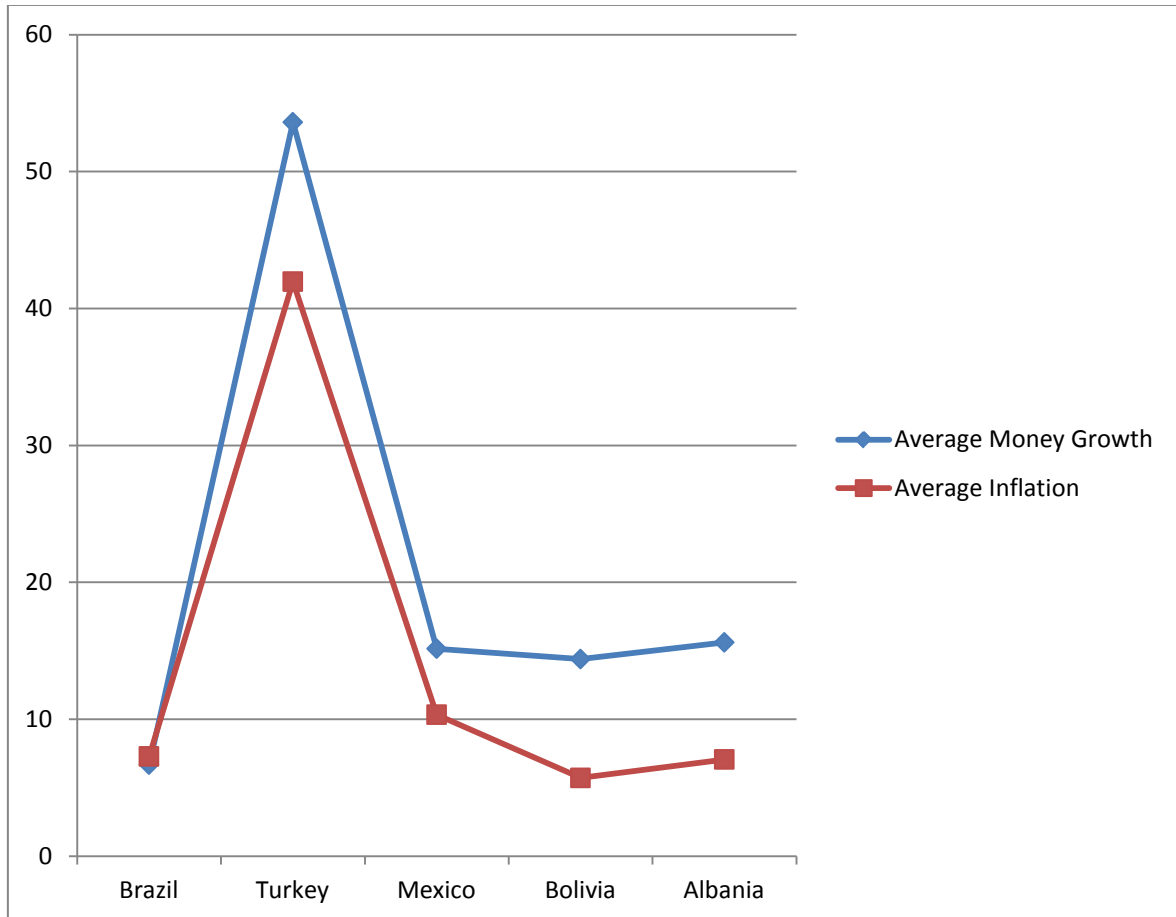
Initially, from the graph we can see a relationship between the actual average inflation and predicted average inflation tested for the sample countries, including Albania. Obviously, there is a strong relationship between these two variables. Moreover, the actual average inflation rates are very close to the predicted ones.

Here:

- Average inflation: shows the actual average inflation
- Average predicted inflation: shows the predicted results, which are computed by the linear regression above.

Comparative Analysis

Figure 5.4: The correlation between Average Money Growth and Average Inflation for sample countries and Albania.



In the Figure 5.4 is shown the correlation between average money growth and average inflation. In terms of inflation level, Albania is the country that resembles more Brazil, Mexico and Bolivia .Namely, country with low level of inflation and money growth in average. It is clear that countries with low money growth rates experience low inflation rates and the change in money supply is associated with increase/decrease of inflation rate. On the other hand, Turkey is the country with high level of inflation. It is obvious that the cause of that level is due to high growth rates in money supply. So, countries with high growth rates tend to have high inflation and countries with low growth rates tend to have low level of inflation. Of these five countries, on the whole, money growth rates exceed inflation rates.

6. CONCLUSION

To sum up, I investigated the link between inflation and money growth for Albania and for a sample of four countries during 1996-2008 years. The countries taken in the analyses were: Brazil, Bolivia, Mexico and Turkey. As a first step, I developed an econometric model through which I made a statistical test of quantity theory of money. After that, I applied regression analysis for M2 and CPI where I found a moderately strong relationship between these two variables for both Albania and sample countries. Meanwhile, I found that the constant (real GDP) was negative as I assumed it to be in my hypothesis. Moreover, the coefficient of money supply (M2) 0.67 tells us that as long as money supply in Albania increases by 1%, inflation rate increases by 0.67%. Most importantly, t test analysis allows me to conclude that there exist a relation between changes in money supply and inflation rate for both Albania and sample countries.

In the Figure 5.2 was shown the linear function between inflation and money growth for Albania, and at Figure 5.4, was shown the linear function between average inflation and average money growth for the Albania and for sample countries taken in this study. In addition, both those function demonstrate a positive relationship between inflation and money growth. Later, if we see at Figure, 5.4, we realize that, when money supply increases it is accompanied by an increase in inflation rate, and in case the money supply decreases the inflation correspond accordingly.

The results in this paper are consistent with the view, that money growth is associated by an increase in the price level. Since the money supply has a big impact on inflation rate in Albania, I suggest that money growth is more suitable to predict inflation rate rather than other variables.

Finally, to conclude I will quote the Milton Friedman saying: "Inflation occurs when the quantity of money rises appreciably more rapidly than output, and the more rapid the rise in the quantity of money per unit of output, the greater the rate of inflation"

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APPENDIX

Data tables

Table 4.1: Money Growth and Inflation for Brazil and Turkey

Year	Brazil: Money Growth	Brazil: Inflation	Turkey: Money Growth	Turkey: Inflation
1996	5.003844647	15.7574361	116.5397528	80.34690278
1997	6.314188527	6.925316945	97.79596298	85.7332416
1998	7.737938986	3.198591891	89.31653727	84.6413357
1999	7.06374999	4.857966241	101.9909036	64.8674792
2000	9.22891879	7.044702451	40.65796037	54.91538241
2001	7.37643514	6.837830757	87.40902779	54.40018404
2002	6.150858815	8.450220696	29.82879781	44.96412355
2003	5.470773026	14.71532583	14.42043625	25.29636788
2004	6.270570412	6.599124847	20.79563056	10.58423624
2005	8.857943655	6.86734958	35.80948785	10.13840492
2006	7.384185142	4.183680532	22.16272689	10.51097667
2007	4.656999756	3.637027934	15.22568324	8.75618091
2008	5.396831528	5.663098519	24.85723597	10.44412838

Source: World Bank, March 2011

Table 4.2: Money Growth and Inflation for Albania

Year	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Albania: Money Growth	38.08	34.46	22.8	20.27	10.36	15.42	6.36	7.63	11.98	8.87	12.1	5.28	9.33
Albania: Inflation	12.7	33.2	20.6	0.4	0.1	3.1	7.8	0.5	2.3	2.4	2.4	2.9	3.4

Source; World Bank and Bank of Albania, March 2011

Table 4.3: Money Growth and Inflation for Mexico and Bolivia

Year	Mexico: Money Growth	Mexico: Inflation	Bolivia: Money Growth	Bolivia: Inflation
1996	27.01118486	34.37765819	39.8379395	12.42548662
1997	56.84953317	20.62648433	18.96451803	4.70844436
1998	17.44889536	15.92799503	13.42318824	7.673228957
1999	18.74792479	16.58560509	3.230578524	2.159516268
2000	-4.487430895	9.495019139	1.553122951	4.608229989
2001	9.328248557	6.362500348	17.96973748	1.589653779
2002	4.730708853	5.031089531	-4.059200878	0.928258852
2003	11.08054593	4.548137924	13.53965445	3.337274997
2004	11.52065494	4.688282872	-7.316961701	4.437380801
2005	9.989798026	3.9875716	17.13282852	5.393231069
2006	11.11717209	3.629376913	24.02770727	4.285549266
2007	13.76023216	3.966838443	26.15074318	8.706247231
2008	9.858928128	5.125510246	22.70405338	14.00040758

Source: World Bank, March 2011

Table 4.4: Average Growth Rates

	Year	M2	CPI
Brazil	1996-2008	6.68	7.28
Turkey	1996-2008	53.6	41.96
Mexico	1996-2008	15.15	10.33
Bolivia	1996-2008	14.39	5.71
Albania	1996-2008	15.61	7.06
Averages	1996-2008	21.08	14.46

Source: World Bank, Bank of Albania, March 2011

Regression Results, Albania

Table 5.1: Regression Statistics	
Multiple R	0.72892016
R Square	0.531324599
Adjusted R Square	0.488717744
Standard Error	6.991598604
Observations	13

Table 5.2: ANOVA

	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>Significance F</i>
Regression	1	609.5838078	609.5838	12.4704	0.004703701
Residual	11	537.7069614	48.88245		
Total	12	1147.290769			

Table 5.3: Coefficients

	<i>Coefficients</i>	<i>Standard Error</i>	<i>t Stat</i>	<i>P-value</i>
Intercept	-3.51676004	3.568398503	-0.98553	0.345546
M2 Growth	0.677628267	0.191889535	3.531346	0.004704

Regression Results for sample countries and Albania.

Table 5.4: Regression Statistics	
Multiple R	0.977912536
R Square	0.956312928
Adjusted R Square	0.941750571
Standard Error	3.731521986
Observations	5

Table 5.5: ANOVA

	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>Significance F</i>
Regression	1	914.408711	914.408711	65.67020091	0.003927431
Residual	3	41.772769	13.92425633		
Total	4	956.18148			

Table 5.6: Coefficients

	<i>Coefficients</i>	<i>Standard Error</i>	<i>t Stat</i>	<i>P-value</i>
Intercept	-2.728979774	2.699667485	-1.01085774	0.386536908
Money Growth	0.815563871	0.100640736	8.103715253	0.003927431

To find Albania Money supply (M2) growth rate we use the following formula:

$$\text{Growth rate} = \frac{\text{Value of year}_t - \text{year}_{t-1}}{\text{Value of year}_{t-1}}$$