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Evolution of the Albanian Banking System

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Evolution
of the
Albanian Banking System

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Précis

When I chose to analyze the evolution of the Albanian banking system I had in mind the economic development of Albania today. Albanian being one of the poorest countries in Europe and a country with a developing economy became a topic of interest since the banking system is a major influence in a country's economy.

Analyzing the evolution of the Albanian banking system will not only provide a historic view on Albania and its banking system but will also provide the necessary knowledge and historical background to be able to conclude why is the banking system in Albania shaped this way and why is the economy behaving in such a way.

This study in itself will examine the evolution of the Albanian Banking System and the path it followed based on the historical background of Albania. It will lay out the historical facts that shaped the way the Albanian Banking System has changed through time. The study is organized in six different stages. This organization is done with the purpose to recognize the different paths that the Albanian Banking System followed in certain periods of time and to distinguish one from another based on historical and economical factors.

During the analysis of the banking system importance was given to the ownership of the banks, the type of business these banks engaged and the role they played in the economy.

A great emphasis was put on the Albanian central bank and its evolution since it was the most important player in the Albanian banking system for a significant amount of time. The central banks monetary policies throughout the years and its role in the economy are discussed and analyzed.

The evolution of the Albanian Banking System is important to study because it does not only provide a historical view of the banks in Albania it also provides the necessary historical background that shaped the image of the Albania banking system. Also when this analysis is put

in the context of today's banking system in Albania and its economy it becomes easier for an outsider to really understand why Albania is a developing country, and what the economic situation really is in Albania.

Albania being a developing country brings up the idea that it is a good place of investment. Foreign investors who in the future might want to invest in Albania will need to have an understanding of its economy and banking system. Therefore a further research might analyze only the present status of the Albanian banking system and the economic stability in Albania. Having a clear understanding of the historical facts about the Albanian banking system one can see that the Albanian market has always been open to foreign investors and even though there were a lot of set backs, Albania is once again open to foreign investment.

Therefore a more extensive research on the future of the banking system in Albania and its growth might be the next step to analyzing the potential investment opportunities in Albania. And a healthy economic and banking outlook might be the first step to attracting foreign investors in Albania.

Once again, this thesis only analyzes the evolution of the Albanian banking system. However the knowledge gathered can help understand better the banking system in Albania and maybe conduct a further analysis of Albania's economy.

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The evolution of the Albanian Banking System is of interest not only because of its drastic changes that happened during certain periods of time, but also because of the unique political and economical situations that were present in Albania, which helped shape what is now the modern Albanian Banking System. The Evolution of the Banking System in Albania can be

divided into six different stages. Each of these stages, correlated with the historical background of Albania, represents a specific development of the Albanian Banking System. This study will analyze the evolution of the Albanian banking system in its entirety, and will relate Albanian history to the evolution of the Albanian Banking System.

The Albanian Banking System under the Ottoman Empire

The first stage is between the years 1863 and 1912. During this period of time, Albania is still under the rule of the Ottoman Empire and has yet to have a currency of its own or a banking system of its own. The only bank operating during this time in Albania was the Ottoman Imperial Bank, which was founded on February 4, 1863 and which had branches in 4 of the major cities of Albania, namely Shkodra, Janina, Shkup(Skopje) and Manastir. This bank although called the Ottoman Imperial Bank was financed through French and British capital and had start-up capital of 2.7 million British pounds which later increased to 5 million pounds, due to the bank actions as a creditor giving out long-term and short-term loans. Soon after in 1888 the Turkish Agrarian bank was founded with a capital of 10 million Turkish Lire and was raising profits from the interest rate of 1% it was collecting from all of the farmers on their production. However a real centralized bank in Albania, and a unified monetary system was yet to be seen. Still under the operation of these two banks in Albania there were multiple foreign currencies that were being used for exchange in markets that were very dissimilar from city to city. Therefore many Albanian scholars at the time were writing about the idea of a Central Bank in Albania. One of these scholars was Sami Frasheri who declared that a Central Banking system would be vital when Albania declares its independence. A unified economy and a central bank would be a key solution to many of the economic problems that Albania had at the time and would be very important in integrating the country's economy. Frasheri's ideas indicate the first

signs of the desire to create a Central Bank in Albania. However that dream was yet to become reality. As the years passed by, the interest of Italian banks in Albania grew. Since a banking system was yet to be created in Albania and there existed many outstanding profit possibilities, many Italian banks seized this opportunity and opened shop in Albania. The first of these banks was the Eastern Commercial Bank (Banca Commerciale D'Oriente) which opened its branch in the city of Shkoder under the name of Banca "Tozzi and Company" in 1909. Even though there were banks operating in Albania they were operated from foreign based banks and there were no Albanian based banks or even a central bank. As basic and sporadic the banking system might seem at this time, what is significant to mention is the fact that there was already talk about the need of a central bank and the unification of the currency. However this need cannot be fulfilled since Albania is still under the rule of the Turkish Empire.

The Albanian Banking System from 1912 to 1925

On November 28, 1912 the dream becomes reality. Albania declares its independence which marks the start of a new era in Albanian history. This event sets up the second stage of the development of the Albanian Banking system. After the declaration of independence Ismail Qemali becomes Albania's prime minister and immediately starts working on the consolidation of the new Albanian State. One of the steps taken was to create an Albanian central bank. On October 4, 1913 the Albanian Government at the time signed an agreement with Carol Pitner and Oscar Pollack representatives of Wiener Bank Verein, which acted on behalf of the Austro-Hungarian Banks, and Pietro Fenolio and Guido Ansbaheer representatives of the Italian Commercial Bank (Banca Commerciale D'Italia) which acted on behalf of the Italian banks. This agreement represented a concession of 60 years which could be renewed for another 30 at the end of the agreement. The banks capital would be 10 million corona or 10.5 million Italian

lire in gold coins and deposited according to the banks needs. The capital could be increased only if the shareholders agreed in their general meeting. This central bank was the only entity allowed to print money and for any given amount of monies in circulation it had to have a deposit of gold equal to 1/3 of the total amount of monies in circulation. In addition this bank would act as the only financial agent of the Albanian government and as such would be the only institution allowed to trade government bonds. This agreement also provisioned that the Albanian Central Bank would also be part of a considerable amount of transactions such as: trade of coins, precious metals, and other trade commodities for its own account and others' accounts as well. The bank would also serve as a place of deposit and creditor for trade companies, financial institutions, industrial companies and agricultural companies as well.

Even though the establishment of the central bank was vital and was a necessary step to take in order to help the prosperity of the Albanian Banking System, it was short lived. After a small amount of transactions with the Albanian government at the time the bank closed its doors not because of its inefficiency but because of the political turmoil that took over Europe with the Balkan wars and the start of World War I. What is important to notice is that this bank although it was the central bank of Albania, was managed by foreign funds and foreign banks. And its profits did not go to the Albanian government but rather went to the pockets of the shareholders, which were the Italian and Austro-Hungarian banks. Even though the Albanian state did not profit from this bank directly, indirectly it started centralizing the monetary system and making the Albanian National Bank a good place for Albanian and foreign investors to take out loans and at the same time deposit their money. Even though this bank was short-lived, it was the first sign of the Albanian government and people wanting to unify their currency and have one central bank. After the closure of the Albanian National Bank the operations of other banks did not

cease to exist in Albania. In fact during the years of World War I, 1914-1918, many foreign countries set up their own banks to fund their military in Albania. However the activities of these banks were very limited as they served only as creditors. Again Albania was set back by the war climate in Europe and the banking system was damaged. Banks were very limited, there was no central bank and many people went to private creditors to borrow money rather than borrow from banks.

The end of World War I and the economic situation in Albania led the Albanian leaders at the time to start talks about a central bank again. The money that was being loaned was under the control of private creditors. There were many foreign currencies that were circulating and the few banks that remained in the country did not have enough power to control the economic situation. Talks with foreign governments about an Albanian National Bank were in place, especially with the Italian Banks. The secretary of finance in Albania and a group of economists went to Italy to meet with representatives of Italian banks to discuss the matter of a central bank in Albania. However the proposed idea of a central bank with 50% foreign capital and 50% Albanian capital was not accepted by the Italian banks and therefore the effort failed. At the time the talks between the two countries were taking place, many saw the foreign control of the national bank as a negative idea and wanted to have a national bank with 100% Albanian capital, therefore avoiding the interference of foreign banks in the national policy making process. However the foreign influence was still evident in the new state of Albania.

The Albanian Banking System under the rule of Ahmet Zogu (1925-1939)

1925 was the year when Ahmet Zogu came to power in Albania and when foreign investors were eager to get concessions in Albania. Ahmet Zogu ruled from 1925 to 1939 and his ruling marks another stage in the development of the banking system in Albania. Again, during

this time the most important issue was the creation of a central bank. First the Albanian government was approached by the British government and as they looked to take total control of the economic concessions in Albania, they offered to create the Albanian National Bank with a start up fund of 500,000 sterlings and also would loan 2 million sterlings to the Albanian government as soon as the deal was signed. The deal also provisioned that British capital would have an advantage in the Albanian economy and trade. This news was received by the Italian banks soon before the deal finalized, and sparked an exchange between Italian and British governments deciding who was going to get the concessions in Albania. After a long exchange, the British retreated from the agreement and let the Italian banks get the concessions that they were seeking in Albania. Right after the Italian government closed the deal with the British government they came to Albania and promised to loan 2 million gold francs to the Albanian government in exchange for the Albanian government to end talks with British banks and to let Italian banks help create the Albanian National Bank. After the Albanian government agreed to the above terms, on March 11 1925 the contract between the Secretary of Finances of Albania Mufid Libohova and the Italian representative Mario Alberti was signed, provisioning all the details about the establishment of the bank, how it was to be managed and what percentage of shares went to the Albanian government and what percentage went to the Italian banks. What is important to notice is that even in this case the required gold deposit for the bank had to be in value equal to $1/3$ of the quantity of the monies in circulation, just like the required deposit when the first national bank was created. The bank also played the role of the treasury and was the only financial institution allowed to print money.

The key importance of this central bank was that for the first time it created a unified currency for the nation called the Albanian Gold Franck. One gold Franck was equal to five lek

or 100 cents. The money in circulation was 5, 20 and 100 Franck. But since most of the population used other currencies or gold or silver coins they did not like the idea of paper money. Therefore the central bank decided to adopt the Gold Standard to achieve a unification of the monetary system and making the Gold Franck the only official money in the market and as the only means of exchange. However the circulation of silver coins continued to exist and the replacement of the other means of exchange did not happen until March of 1936. Up until this time the Albanian Central Bank was putting into circulation different amounts of banknotes year after year, but since people were not letting go of their silver coins as a means of exchange it led to the artificial increase in value of these coins. Only in March 1936 when the central bank put in circulation 1,000,000 gold coins was the problem resolved and the Albanian Gold Franck became the only currency used for exchange and as a means of payment.

After the establishment of the Albanian National Bank and the opening of its branches in major cities such as Durres, Shkoder and Korça other foreign banks started to operate and opened their branches in Albania. The first was the Serb-Albanian bank based in Cetinje, which opened one of its branches in the northern city of Shkoder and its activities were fully legalized in May of 1925. A year later in 1926 the Bank of Athens, one of the strongest Greek banks, opened two of its branches in Albania in the cities of Durres and Korça. At this point the Albanian banking system seemed to have started to flourish and banks were operating in more and more cities. Later in June 1931 talks about a British Bank opening in the capital of Albania, Tirana, resumed. The bank would be called Anglo-Albanian Bank Ltd. and would have a capital of 2 million sterlings. Three years later on May 6 1934 a new bank opened its offices in Tirana. This bank called Export Bank, which had its central offices in Belgrade, Serbia would have a capital of 30 million dinar (the serb currency) or 2.7 million Gold Francks. The activities of this

bank did not have a great impact on the Albanian economy especially in the creditor market because of the great influence of the Italian capital and the Albanian National Bank in the Albanian economy. This bank ended its operations in 1939. At the same time there were talks about the establishment of an Agrarian Bank which would have a capital of 5 million gold francs and would operate under the credits accumulated from the ex-Agrarian Turkish Bank that operated previously in Albania. However by 1930 when the bank was to be opened due to the crisis of 1929-33, the Albanian Government ran into a deficit and it used the funds accumulated to open this bank to eliminate the deficit.

It can be seen from the above development that the World crisis of 1929-33 set back the Albanian economy as well. The decrease in the demand for different products led a lot of merchants to start a bank - run and to demand gold for their money. The gold reserves were almost depleted and the central bank decreed that people could no longer exchange money for gold and cut the amount of gold being exchanged to less than 1% of the total volume.

After the Crisis of 1929-33 talks resumed again about the opening of an Agrarian Bank. By the end of 1937 the Agrarian Bank was opened in Tirana and then later expanded its operations in other cities of Albania.

Up until this point the banks that were opened in Albania had both Albanian and foreign capital and were strictly regulated by the Albanian Government. This was about to change on November 1937. Bank of Naples (Banca di Napoli) which was established in 1539 in Naples would open a branch in Tirana and would be the first autonomous bank in the country. It would be called Bank of Naples – Albania and had a separate statute from that of other banks which were managed by the Albanian Government. This bank served an important role since it facilitated many bank transactions for foreign and domestic investors without having to go

through most of the formalities they had to go through with other banks. This bank was known for its ease of transactions in deposits, loans, and currency exchange, and became a formidable competitor to other banks especially to the Albanian National Bank.

In the same year that the Bank of Naples opened, an Albanian Business society called SITA (Society of Industry and Trade in Albania) was lobbying the government to get the rights to open a bank of their own funded through Albanian capital only. The plan was to have an initial capital of 2 million gold francs, 600,000 of which would be deposited right away in the Albanian National Bank under this new bank's account. The bank planned to operate as a creditor to Albanian investors but the deal was never finalized.

Up until 1939 the Albanian National Bank tried to keep the Albanian currency in a deflationary status and had a small amount of currency circulating compared to what was needed. Prices were kept artificially low, which in turn hurt the income of small farmers and low income families. An important issue that created much speculation on the currency was the low level of coins in the marketplace and which led many speculators to charge different prices from the face value of the coins specifically silver coins. Besides this problem, the Albanian National Bank had achieved its goal of creating a healthy national currency and soon the speculation of silver coins was alleviated.

By 1939 there were four banks operating in Albania with a combined total of 17 branches throughout the country. These banks were: The Albanian National Bank with 8 branches, Bank of Naples with 4 branches, The State Agrarian Bank with 4 branches and the Export Bank of Belgrade with 1 branch. The rest of the banks created up until this point ceased to exist.

The Albanian Banking System during World War II (1939-1944)

In 1939 World War II started which marks another period in the banking system of Albania. Between 1939 and 1944 Albania was under occupation and the banking system in Albania saw many changes. On April 7, 1939 Italy occupied Albania and the reign of King Ahmet Zogu I was terminated. After the occupation of Albania all the banking groups operating in Albania entered into a fierce competition for the control of the Banking Market in Albania. This competition was based in three major categories: Nationwide expansion, increase in total amount of deposits and increase on loans given out to investors. The Albanian National Bank, even though fully operational, had trouble expanding and getting more clients. The Bank of Naples – Albania had expanded significantly and had become a major player in the Albanian Banking System so much so that it either made it hard for other banks to enter the market or they were forced to close. For example, the Bank of Naples' competitiveness forced the Export Bank of Belgrade to close down its business and exit the Albanian Banking System. The strengthening of the Bank of Naples – Albania came also as a result of its acquisition of the Agrarian Bank which was previously owned by the Albanian government. This acquisition helped Bank of Naples have the monopoly in the Agrarian market and further strengthen its position in the Albanian Banking system.

On the other hand the Albanian National Bank which was run by Italian bankers became a tool in the financing of the Italian military while they were militarily defeating other countries. The Italian government decided to finance its military with Albanian Currency and use it as a means of exchange for the Greek currency. The Albanian National Bank became a key supporter of the Italian war machine and was now completely run by the Italian Government and lost its independence from any government. However, the heavy reliance on the Albanian gold franc led to the over production of banknotes and to inflation. The expansion of the fascist influence in

the Balkans led the Italian government to use the Albanian National bank and its banknotes as the official currency for the conquered states of Montenegro, Kosovo and Serbia.

While the Albanian National Bank was being used at the discretion of the Italian Government, Another Italian bank had started its operations in Albania. The bank called the National Labor Bank (Banco Nazionale del Lavoro) started its operations in Tirana in 1939 and by 1942 had two branches and a considerable amount of deposits.

By 1942 there were only 3 banks operating in Albania since the Agrarian Bank and the Export Bank had ceased to exist. The Albanian National Bank and the Bank of Naples – Albania had become the two major players and they were in continuous competition. The battle of branch expansion was won by the Bank of Naples since by 1942 it had 18 operating branches compared to only 13 branches run by the Albanian National Bank. On the contrary the Albanian National Bank won the battle for the deposits of the political and military institutions established in Albania. Even though the Bank of Naples was very active in this battle, the Italian leaders in Rome preferred keeping their military and political deposits in Albania in the Albanian National Bank. If the Bank of Naples had received these deposits as well it would have become the number one bank in Albania and the Albanian National Bank would have suffered from this loss. This fierce competition between the two main banks in Albania would soon come to an end.

In 1943 Italy retreats from the Balkans and Germany takes over. On September 11, 1943 since the Italian troops retreated an order was given suspending the activities of all the banks in Albania. This order created a crisis in the Albanian Economy and paralyzed the entire banking system in Albania. All accounts were frozen and the banks were not allowed to return to people their deposits, take deposits or even extend people loans. This resulted in the slow down of activities of the two Italian banks operating in Albania and eventually their retreat from the

Albanian banking system and the end of their existence in Albania. Within the same month of the order both Italian banks left Albania and only the Albanian National Bank was operating in the country, but with very limited capabilities. In fact the Albanian National Bank acted as a creditor to the German military and considerable amounts of loans were taken out by the Germans. The loans reached up to 99 million gold Francks by October 1944.

The Albanian National Bank being the only bank operating in Albania became the exclusive financier of the German troops. It printed money at the discretion of the German government and financed the German military machine in the Balkans. At one period in time the Germans opened the banks treasury and took all the gold and cash that was in the vault. The Albanian leaders at the time pleaded for the gold to be returned to Albania or for it to be deposited in a Swiss bank account under the name of the Albanian government, but the German government did not agree and decided to keep the gold in Berlin. By 1944 when Germany was retreating, German troops forced many of the safes in the branches of the banks open stealing whatever money or gold they could get.

The Albanian Banking System during the communist regime (1944-1991)

After a short period of time the German troops who were defeated in Russia were retreating and getting ready to go back to Germany. Once the Germans left Albania independence was declared on November 29, 1944. The group that took control of Albania was the communist party led by Enver Hoxha. As soon as they came to power they eliminated their political rivals, established a totalitarian system and started the centralization of the economy. Since Albania was coming out of a devastating war, many people liked the idea portrayed by the communist party for people to be equal with each other especially economically. The communist regime immediately took control of the government and started establishing its policies. By 1945

the communist leaders had already established themselves as the only governing body in Albania. This marks the start of a new and unique period in the Banking system in Albania, which lasted until 1991.

As mentioned before the communist regime started the massive centralization of the economy, meaning everything private now belonged to the state. As for the Banks only the Albanian National Bank was the only operating bank in Albania, but it was not state owned, it had Italian shareholders. The first move was to freeze all activities of the Albanian National Bank until a further decision was made as to what should be the steps to make the bank state owned. As a result soon after the declaration of independence in 1944 the communist party held a meeting discussing foreign investments in the country. They decided that any foreign investment specifically Italian or German and any foreign-operated business would automatically become property of the Albanian government. Laws were passed prohibiting the export of precious metals and gemstones outside the country. And on January 13, 1945 the governing body of Albania passes a law making the National Bank of Albania property of the state. The agreement of March 1925 between Ahmet Zogu and the Italian banking group is nullified and all the shares owned by that group are not recognized by the Albanian government. Also all deposits in gold and foreign currency are declared as property of the state and the government did not recognize any of the banks debts anymore. Within a week of the passing of this law on January 21, 1945 the official inaugural ceremony of the new state owned National Bank of Albania takes place and members of the government and different walks of life take part in the ceremony. The name was also changed to the Bank of the State of Albania.

The bank started its normal functions on January 22nd and was operating under the new statute decreed by the Albanian Government. Everything was controlled by the Ministry of

Finances. The gold standard was brought back again. The bank had to have in deposit in its vaults or in a foreign bank at least 1/3 of the banknotes that were in circulation at any given time. Still at this time the Albanian franc is the official currency in Albania and the new bank prints the new Albanian franc in 1945, the first of its kind since the declaration of independence. The new money was put in circulation in 1946. The problem arose that there were a lot of different banknotes in circulation from the pre-war period and from the war period. So the government decided to take action and have a monetary reform. The Bank of State after it put the new money in circulation declared that the old money had to be exchanged for the new money as soon as possible or it would be deemed invalid. The exchange rate was 5:1. For every 5 old francs people would get 1 new franc. By this ratio the Bank adjusted the prices of goods and services and the exchange rates on foreign currency. By July 1947 the Bank of State launched the second monetary reform in Albania. It printed a new currency called Lek. The banknotes were 10, 50, 100, 500 and 1000 Lek and coins were 0.50, 1, 2 and 5 Lek. The exchange rate this time was 1 franc for 9 lek. Again prices were adjusted by this exchange rate, and the lek became the only official currency in Albania. All other currencies that existed before and which were left in circulation for a while became invalid.

With the hopes to gain allies under a special contract the Albanian –Yugoslavian Bank is created in 1946. Its main offices would be in Belgrade but it would also have a branch in Tirana. Both sides would have a 50% control of the bank. The bank's capital would be 6 million francs or 600 shares and each side had to deposit the initial capital in the bank reserves. The bank did well and by February 1947 the Albanian government had made all the necessary deposits in the banks reserves. On the contrary the Yugoslavian side did not make any deposits and claimed that they did.

On the other hand the Bank of State was acquiring more and more responsibility. It was given the role of the treasury. It had control over the state's budget. And was in charge of all the transactions for all the state departments, which meant it controlled all the financial aspects of the country since everything was centralized.

Due to the centralized economy and the 5 year plans implemented by the Albanian government, the Bank of State was the only legal entity financing all the rebuilding endeavors. It controlled the budget for all the specific plans and became an indivisible part of the ruling system.

On August 1949, 5 years after independence the Bank of State decides to open up a sub division or a smaller bank under its tutelage called the Savings Bank. This bank would be directly dependent to the Bank of State but would serve as a savings bank for Albanian citizens since the Bank of State only dealt with the government and its different sectors.

Throughout the years the Bank of State printed more money and signed contracts with the central bank in Russia to print the Albanian currency. It continued to help finance the government projects by playing the role of the creditor and by giving out long term loans anytime the government requested to finance new projects. The extensive projects and their expenses exceeded the states budget. Therefore in 1965 the Bank of State in accordance with a new government regulation printed the new Lek. The value of the new Lek was equal to 10 old Lek. The name was not changed but the image on the new money changed. The old money had to be taken out of circulation and the new money would be the only currency in use. The new banknotes came in quantities of 100, 50, 25, 10, 5, 3, and 1 Lek. All the old banknotes had to be exchanged and all the prices and salaries and everything in the market and the budget were adjusted to the ratio of 10:1. This was the third and last time that the monetary system was

changed and even to this day the system has not changed. However it is important to note that even though the system changed in everyday life, people did not adjust well to the new policy and still used the old way of pricing goods. This phenomenon is still present in Albania but to a much smaller extent.

Four years later in 1969 the Agrarian Bank is established. This bank was first created as an independent entity, but later became a division of the ministry of finances. This bank was created as a supervising body and controller of the financial aspects of the Cooperatives in Albania and would administer all the financial needs and profits of the Cooperatives. This duty was originally fulfilled by the Bank of State but as the government wanted to separate the heavy industry and the agrarian production it established the agrarian bank.

The establishment of the agrarian bank can be seen as a competitor to the State Bank but the reality was completely different. They were two independent bodies from each other who served the Albanian government and competition did not exist. By 1976 everything had become state owned and all the banking operations were done in accordance to the government requirements.

Furthermore by 1976 an important discovery was done by the Bank of State managers. Since the Bank of State came to life as a result of the National Bank of Albania becoming state owned, it also inherited the shares that were originally deposited by the National Bank of Albania in the Bank for International Settlement in Basel Switzerland. The Albanian government had an emergency meeting discussing what should be done with the bank shares deposited outside the country and they decided to take the shares back and close their account with BIS Basel.

By 1985 the Albanian government decided that the Bank of State would be dependent to the ministers' cabinet and the prime minister. The Agrarian bank on the other hand would continue to be under the ministry of finances. For the following years the activities of the banks are rather small and routine like. By July 31, 1991 the Albanian Bank of Commerce was created.

It can be seen that during this period of the Albanian banking system pure bank operation and competition was nonexistent. The one original bank was further turned into four banks all of which served the same purpose, control the financial aspect of the socialist economy that was present in Albania. These banks were part of a centralized economy and their functions as banks were very limited. Even the central bank which was previously set up as an independent entity had become a state controlled bank. The three new banks that were created throughout the years, the Agrarian Bank, the Savings Bank and the Albanian Bank of Commerce were all derived from the central bank with the idea of creating a banking system in Albania. But little was achieved since the Banking system at this time lacked the private sector and was very limited in its operations. The banking system of the communist era became very similar to the banking system of the late years of World War II when the Albanian central bank at the time had become a tool in the hands of the Nazis and was used to finance their military machine. The same path was followed by the Albanian communist government as they used the central bank to finance the building of a communist society. What is important to note is that for the first time in the history of the Albanian Banking system is that all the banks had Albanian capital and the foreign control over the central bank was avoided.

The Albanian Banking System in a Free Market Economy (1991-2008)

In the spring of 1992 open demonstrations protesting against the communist regime began in many cities in Albania. The student movement was the major movement and their

marching down the streets of the capital led to an uprising in many other cities and eventually the overturn of the political system in Albania. New political leaders emerged and the first democratic elections were held. The Democratic Party came in power and with it a new political and economic system. Right away the new leaders set out to build a free market economy and opened the doors for Albanians to start their own private companies. With the change in the type of economy a change in the banking system was necessary. So the bank leaders and the government established a new banking system. The national bank was going to be composed of two tiers. The highest bank became State Bank which was now called Bank of Albania. The second tier of banks, which were still owned by the state, were the Savings Bank, National Commerce Bank, and the Agrarian Bank. Within the same year that this banking system was set up the Bank of Albania became a member of the IMF, and strengthened its ties throughout the years.

This was just the beginning of a new era in the banking system in Albania. The Albanian government right away acted to attract foreign investors to set up their own banks in Albania and to start operating in the free market. Soon after the National Bank of Commerce starts its operations it signs a contract with the Bank of Rome to start the new privately owned Italian-Albanian Bank. This bank would have a capital of \$10 million and would be located in the capital, Tirana. The bank started its official business in July 1993. Soon after another bank was licensed to operate in Tirana, this time it was Dardania Bank. Privately owned banks were opening year after year in Albania. In July 1994 United Bank of Albania started its operations in two cities, Shkoder and Fier. And in September 1996 Tirana Bank is opened as a bank whose capital came directly from the Pyre Bank in Greece. However two other banks were not allowed to open up their branches in Albania since the government saw it more fit at the time for banks to

be fully incorporated in Albania rather than having branches of Banks Incorporated in other countries.

However not everything went as well as people wanted things to go. The market was still not fully developed and the private banks had minimal power in an economy where 90% of the deposits were controlled by the state banks. By 1996 and early 1997 some so-called financial firms started up offering high interest rates on the money deposited. Most of the people unfamiliar with the financial sector started depositing their money in hopes of high returns, little did they know that these firms were pyramidal schemes. A pyramidal scheme takes more and more money in order to pay interest on the first deposit, and then second and so forth. However when people stop depositing money the scheme stops functioning and the depositors who are waiting on their return lose their deposit and interest. The firm does not have enough capital to sustain all the deposits and the interest payments; in fact these firms in Albania did not have any capital. Despite this fact many Albanians rich and poor, educated and uneducated without exception deposited money in these pyramidal schemes.

The lucrative returns of 300% in 3 months offered by these pyramids tempted everyone in the country. People put all their life savings and sold their property to have money to put in these firms. This blind trust in these firms became even more secure and real when the Albania prime minister at the time declared that these firms are healthy and that everyone's money is secure. But as predicted these firms were not secure, and they did not have any start up capital of their own. When people stopped depositing and waited for their return to come these firms experienced an immediate crunch in their cash flow and as a result collapsed very rapidly. Everyone had lost.

Right before the collapse the total amount of money these firms had in deposits had reached to \$1.2 billion. The economy was destroyed. Inflation had reached as high as 40%. Only through the help of foreign investment did the interim Albanian government achieve some kind of stability in the economy. An important factor which helped achieve stability was to freeze the assets these firms had in their bank accounts in the Bank of Albania.

This was the worst episode in the history of the Albanian Banking system. These pyramids portraying as benevolent banks towards the people's needs shook the general belief people had in banks. Especially when in the civil uprisings led by the pyramid schemes local branches of banks in many cities were looted and then burnt. As a result the Bank of Albania decided to permanently terminate the branches in the cities of Shkoder and Gjirokaster. The Albanian banking system was in stand by. However as time passed the situation ameliorated and there were more investments coming in the country. The increase in capital flowing in Albania restored the need for a functional banking system which for a while had been sedentary. New banks started to open up in Albania again.

In August 1997 the Albanian American Bank opens up for business in Albania. This marks the first bank opening since the crisis that happened in March of 1997. As a result the rights of this bank were limited for a short period of time due to the uncertainty the Albanian government had still about new banks operating in Albania. The bank started operating fully in August 1998.

After the Albanian American Bank opened up, a series of banks started business in Albania. Some of these banks have offices nationwide and some are local banks. As of today there are 17 banks operating in Albania. However most of these banks have come to life as a result of mergers and acquisitions between the banks.

The first of these acquisitions was made by state banks when the Agrarian Bank was closed down and all its assets and credits in good standing were split between the Savings Bank and the National Commerce Bank. All the bad loans were left with a government agency called the Agency for the Treatment of Credit. This was the first step to the consolidation process in the Albanian banking system. On the other hand Dardania Bank's license was revoked due to financial problems and its illiquidity. Later on November 19, 1998 the National Commerce Bank is no longer a government owned bank and is now privately owned. By early 2000 the bank was sold out to a group of foreign investors. And in 2006 60% plus of the shares of the bank were sold to the Turkish group called Çalik-Seker Konsorsiyum Yatirim A.S., which became the leading shareholder of the bank.

Until the year 2004 new banks were opening up but consolidation was not present. Then in 2004 Raiffeisen International purchased the government owned Savings Bank. It was the biggest acquisition in the Albanian banking history and Raiffeisen International purchased 100% of the shares of the Savings Bank for \$129 million.

And the latest merger came when the Italo-Albanian Bank announced its merger with the American Bank of Albania. This announcement was made on September 28, 2007. Since both banks are part of the Intesa SanPaolo group, an Italian banking group, they will merge their assets and liabilities together but the name of the company will remain as the American Bank of Albania.

These mergers show that even though the modern Albanian banking system is fairly new it still has prospered in such a way that many banks are already consolidating trying to gain an edge in the banking market in Albania.

The Albanian banking system in the last 17 years has prospered in a remarkable way. Now banks offer a variety of products and services, 24 hour ATM's are available. Deposits are secured by the government and loans for businesses and consumers are easier to get. The Bank of Albania also played a major role by putting in place many regulations to protect consumers from being taken advantage from non-secure banks and at the same time keeping banks under control with their loans and lines of credit. Some of the most important regulations passed by the Albanian central bank were as such:

- Banks who had 20% or more bad or underperforming loans had to stop giving out loans or the central bank would intervene.
- The minimum requirement to open a bank in Albania was 700 million Lek or roughly \$10 million.
- Deposits were secured by the Bank of Albania
- Banks are audited regularly by outside auditors and reports are given to the central bank
- Banks who under-perform and risk bankruptcy are stopped from operating and the central bank may revoke their license.

As it can be seen from these measures the Albanian banking system is very well regulated, and what is most important they are regulated according to the international accounting standards. These two outside auditors, that help insure these standards are met, are the two American accounting firms KPMG and Deloitte & Touche.

From the services and the advances that the banking system has made in Albania during the last 17 years one can see that the banking system in Albania is operating based on free market principles and that it is going in the right direction. Nowadays Albania has a much more

advanced and automated banking system compared to that of the communist era. The banking system is not only advancing for itself but it is pushing the technological and automated advancement into other parts of everyday life and is modernizing living in Albania.

Concluding Remarks

To recap the development of the Banking system in Albania it is important to realize the hardships that the Albanian banking system went through to become the modern system it is today. And the main reason for this hardship was the political and historical arena of the late 19th century and the 20th century.

First the Turkish occupation of Albania, which striped Albanians of many rights, left Albania behind compared to neighboring countries. Albania being the last country in the Balkans to gain independence was way behind in the banking arena and started its endeavors more than 50 years later compared to any other country in the Balkans. And even when the first attempt to set up a central bank was made in 1913, World War I compromised the plans and dreams and the banking system failed in Albania.

Secondly during the reign of Ahmet Zogu Albanians attempted for the second time to create a central bank and setting up a banking system in Albania. And things went fairly well even though the majority of the banks including the Albanian National Bank had Italian bankers as majority shareholders or were completely owned by Italian bankers. However the Albanian banking system was again set back. This time it was World War II. The banking system in Albania was devastated. The central bank was fully exhausted of its funds and after the war the banking system in Albania was down to zero. But the communist system did not do much to improve the banking system in Albania. In fact it centralized all the banks and turned the central bank, then called the Bank of State, into a tool in the hands of the communist government used to

facilitate the process of centralization. The central bank was making policy as it was going along and as the government requested. The only positive side to the centralization was that the bank was no longer funded from international banks. For the first time in the history of the Albanian central bank the bank capital was 100% domestic, and the bank was serving to profit the country rather than the foreign shareholders.

Even after the fall of communism the prosperity of the Albanian banking system was set back by the financial crisis of 1997, but due to interventions from the Albanian government and foreign aid, the crisis did not last long and bank stability was again established. From that point on, the Albanian banking system seems to be going in the right direction. The number of private banks has increased be it domestic banks or foreign owned banks. The central bank has been reorganized in order to meet the international standards for a rigorous central bank. And the availability of banks to people has become better and better throughout the years.

It is obvious that even though the Albanian banking system was not making a significant progress for many years but once the circumstances were in its favor it flourished and is going in the right direction. The present banking system of Albania is still going under a lot of change and following the footsteps of modernized foreign banks. Only time will tell when the banking system in Albania will have finally grown to be compared to western modernized banking systems.

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