Ardian Fullani: South East Europe – pre-requisites for reform

Speech by Mr Ardian Fullani, Governor of the Bank of Albania, at the high-level seminar "South East Europe: pre-requisites for reform", hosted by the Bank of Albania in collaboration with the University of Oxford, Tirana, 14 June 2012.

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Dear Mr. Minister,

Dear Governors,

Dear Ladies and Gentlemen,

I would like to thank you all for your participation and interest in sharing opinions on an extremely important issue to all of us: economic reforms and policies the countries of the region need to undertake against a background of an unclear situation in Europe, our main trading partner.

I would like to thank in particular the representatives of the University of Oxford and the European Bank for Reconstruction and Development, who have worked closely with the Bank of Albania in hosting this Conference. This activity today is a follow-up of our joint study work with the University of Oxford dedicated to the competitiveness of the Albanian economy in a regional and global context, attraction of foreign investment and macro-financial stability of our economy.

Dear guests,

The year 2011 and the first part of the current year evidenced that euro area crisis has plunged into its most acute phase. Right at the centre of this crisis, the sovereign debt risk, the curtailed ability of the financial system to absorb this risk and the continuous economic activity slowdown are spinning in a vicious circle. Against a background of public and private sector deleveraging, there are heightened concerns about public debt financing, cost and sustainability. This phenomenon is a concern not only for the short but also for the long run, and moreover, it has spread across a number of euro area member states.

Developments in global economy, and particularly the European one, in the recent years are as significant to the countries of our region as to Europe itself. The direct effects of this situation on personal business budgets and the economy in general have been in the spotlight of daily discussions of politicians, policymakers, central bank, analysts and the public. The short-term and direct concentration is justifiable in light of the hard time facing our economies and taking into account that the euro area is our main trading partner. The short-term focus and problematic situation have shifted the attention away from long-term policies and reforms.

The fact that the global crisis was perceived and interpreted with an escalating crescendo tone is indisputable. It was partly perceived from the moment it first hit and, little by little, it transformed from a mortgage crisis into the deepest global crisis since the Great Depression. The response to the crisis and the lessons drawn from it followed in a similar fashion. The approach and extent of response to the crisis was not uniform across the countries. The economies having fresh memories of the financial crises responded swiftly and more strongly. The same can be said for the public and business community in these economies. The economies enjoying a favourable fiscal position also faced the crisis without impairing their long-term fiscal sustainability. The situation seemed slightly more complex in some developed European economies. Seeking to find a balance between deleveraging and fiscal consolidation, euro area authorities demanded setting up a protective wall against the possible fire bursting into from the outside. But, as noted, this fire had already burst out and was spreading inside the euro area walls; therefore, setting up this "protective wall against fire" was pointless at this point. The European Union and its institutional structures, along with the international financial institutions and partners, are undertaking a number of reforms to put this “fire” out. However, it is still unclear how long this “agony” will last and likewise is its impact on the euro area and its trading partners.

The exhaustion of fiscal and monetary policy incentives failed to increase economic activity and, moreover, it further aggravated the sovereign debt situation and financial stability. Consequently, the sovereign debt sustainability and banking system credibility-related issues were added to the concerns about economic growth.

The question facing many countries today has the form of a trade-off between stability and sovereignty. Currently, the latter two are intertwined in an endogenous relationship (of mutual impact on one another), in which the multi-dimensional need for stability (implying the maintenance of price stability, macroeconomic stability, financial and fiscal stability) requires taking balancing measures. The latter have considerable social costs in the short run. Social discontent against them and the governments proposing them erodes the credibility of reforms and the authorities, increasing, in turn, the sovereign debt risk.

Euro area, and particularly its Southern members, are facing a concern, whose solution bears consequences with economic and political implications for the future of all member states and the common currency. The reforms and policies undertaken by euro area authorities, individually or in a concerted manner, have important and direct implications for our economies.

Experience to date has shown that our partners and their large banks have adopted an approach that maximizes their benefits as “owners”. Consequently, their decision-making is entirely conditioned by the fear of loss of stability and sovereignty that associates the current concerns of the economy and the parent bank. This has pushed these countries to take biased measures against our economies, risk rating investment in our countries at 100%. This decision-making, which is directly linked to the events taking place within the euro area, has practically transferred the issue of stability versus sovereignty in our economies. These policies represent a negative phenomenon, which contradicts the positive and stabilizing role that our partners have been playing so far in South East European economies and societies.

The countries of our region have in the last 20 years undertaken numerous structural, political and economic reforms, in view of consolidating the democratic state, the rule of law based on principles of market economy and supported by a consolidated financial system.

These reforms have enhanced the credibility and independence of public institutions and, in particular, the central bank’s role and independence. They were not guided by the wish and goal to join Europe, but rather to build a society similar to the European one. By achieving economic, political and social convergence in these countries, each of them hopes to become a worthy partner to the developed Europe, and adopt the euro as the final phase of this transformation process. From this viewpoint, the European integration process, European Commission and the euro became powerful external anchors for each SEE country.

Current developments have diminished the anchoring role of the EU and the euro. Consequently, the European Commission and all European decision-making authorities should, in the future, pay greater attention to the characteristics of countries and regions aspiring to EU membership, and engage in closer cooperation with the respective national authorities.

It is, however, important to emphasize an evident and indisputable fact to all of us: external factors cannot safeguard long-term stability if internal anchors are missing. The current situation in Europe shows that the integration process does not prove to be a sufficient anchor, be it both inside and outside the euro area, as long as the internal economic and political choices are not stable in the long run.

This conclusion underlines the role and importance of internal anchors as warrantors for macro-financial stability and continuation of structural reforms that have brought our economies to this point. These anchors are strong arguments in the hands of the public at large to exert pressure on public institutions, and to formulate and implement policies that guarantee long-term stability and sovereignty.

Unfortunately, as I stated earlier, these anchors are currently being jeopardized by internal factors. Driven by short-term perceived benefits vis-à-vis the real costs of the correction process, the public, the business community, syndicates and stakeholders ask for short-term concessions from the institutions, and particularly from the central bank. Judging on the benefits, they require shifting the focus from the objectives and traditional instruments our institutions have been mandated for. These short-term perceived benefits, seemingly, have the potential to offer a right and moral solution to sovereignty versus stability, but they bear the risk of causing the loss of both in the long run.

Political and institutional factors have not addressed yet some important concerns identified by the Bank of Albania to have caused financial stability-related concerns and decelerated economic growth in Albania. I refer here to collateral execution, lowering of perceived risk arising from the severe political situation and lack of consensus, deceleration of reforms required by the European Commission and receiving EU candidate country status, severity of political warfare, and use of the economy and the situation for political gain.

Lastly, the Bank of Albania notes that the Albanian economy remains under the pressure of market developments in our main trading partners and their economic and financial policies. The measures taken by our trading partners to enhance confidence in their financial systems and adjust the macro-financial imbalances hamper monetary policy transmission in the economy. They heighten public concern and undermine its confidence in the future. These are the very reasons preventing the banking system to finance the economy and the government at lower interest rates and, consequently, the central bank's monetary policy transmission to easing the monetary and financial conditions.

What is currently happening represents higher risk premium in the countries of the region for all the reasons referred to earlier, rather than an increase in real interest rates. Concluding, I would like to clarify that central banks should make their utmost to preserve the frail macro-financial balances and bolster public confidence in institutions and the financial system.

In this context, the Bank of Albania, as to date, will continue to foster macroeconomic and financial stability in Albania. This is our major obligation arising from the Constitution and relevant laws. We are committed to meeting this obligation with dedication and meticulousity. We are fully focused on these two major objectives, just like a good captain focusing on the horizon, rather than on the hands laid on the ship's wheel.

The Bank of Albania believes that, by guaranteeing these two vital pillars to the stability and prosperity of the economy, we have provided the best contribution to achieving higher economic growth.

On the other hand, this would create an attractive surrounding for absorbing and accommodating foreign investment, and allowing the entry of new capital into the economy, which is vital to support the country's economic activity and its credibility in the region and beyond.

The Bank of Albania is committed to guaranteeing a sound banking system and efficient in channelling public savings into the economy. We will continue to carry out our periodic examinations to guarantee the banking system's stability. Sufficient capitalisation and capital quality remain our primary objective. I would like to guarantee the system that the Bank of Albania will take all the measures to supply with liquidity, while increasing the pressure for higher credit volume and improved quality.

Dear guests,

I invite you to actively participate in today's debate and discussions on issues that have been and will remain the focus and our common interest in the future. I invite you all to contribute, through presentations and discussions, to setting objectives our region will face in the future and solving the current challenges.

Thank you for your attention!