

Ardian Fullani: Promoting a public debate around the new economic growth model

Speech by Mr Ardian Fullani, Governor of the Bank of Albania, at the Meeting with Agro-Business and Banking Sector Representatives, Lushnja, 13 March 2014.

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Dear guests,

It is a great pleasure for me to be here today to discuss one of the most important sectors of the Albanian economy – agriculture. Moreover, the fact that this meeting takes place in one of the areas with extraordinary potential for the development of this sector – I am referring here not only to Lushnja, but the entire Fier district – is very significant.

I do not think I am surprising anyone, particularly those engaged daily with entrepreneurship, when I state that the recent years' global economic crisis had an easily recognisable impact on the Albanian economy as well. The pace of economic growth has slowed markedly, particularly in the past two years. According to the latest forecasts, the Albanian economy is expected to pick up slightly in the next few years due to improved monetary and financial conditions, and the fact that our trading neighbours are, similar to Albania, showing the first signs of recovery after several years. However, we expect growth to remain weak for a while yet compared to the pre-crisis period.

Under these circumstances, the Bank of Albania has been promoting a public debate around the new economic growth model, even before this global financial crisis took hold.

The central bank's stance has been clear and transparent to the public. We have constantly stated that the main sources of economic growth in the two decades of transition are reducing markedly, and the Albanian economy needs to be re-oriented towards new sectors in the very near future. The Bank of Albania sees agriculture – and, in a broader sense, the entire agro-business – as one of the main sectors standing at the front of this re-orientation.

My presence here today, and Bank of Albania's presence, should serve as a confirmation of our commitment to discussing the new growth model and the primary role that agriculture should play in it.

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The Albanian economy had a very difficult year in 2013. Domestic demand, and consequently economic growth, hit one of the lowest levels in history. The inflation rate hit the lower bound of the Bank of Albania's target tolerance band, while budget deficit and public debt increased considerably.

The economic performance was also accompanied by uncertainties surrounding the external economy – Albania's trading partners in particular –, but also the domestic economy considering that 2013 was an election year. All the above contributed to the deceleration and a more cautious behaviour of economic agents. Some of domestic product indicators saw significant changes. Worth mentioning is the construction sector, one of the top contributors to economic growth during 2000–08, which has shrunk considerably in the past years.

Fortunately, the Albanian banking system remains solid and well-capitalised. Despite the increasing non-performing loan portfolio, banks have sufficient capital to address this phenomenon. I would like to elaborate more on this latter point.

The performance of lending has become the focus of attention for policy-makers and economic agents. The slower economic growth was followed by sharp deceleration in lending. The reasons are quite understandable: on the one hand, businesses have reduced their demand for loans due to uncertainties relating to the sale of their own products; and on

the other hand, banks have been pursuing a more conservative approach to lending, being uncertain about the success of different business plans.

Global theory and practice suggest that the investment and credit cycles progress in line with the performance of aggregate demand. In other words, we will see a stable recovery of lending only when economic growth recovers at a steady pace.

However, as we have already stated, we believe that there is room within the Albanian reality for a better performance of lending. Channelling savings into profitable investments and supporting businesses with lending are the reasons for the existence of the banking system. We have been constantly emphasizing this message, and we have taken concrete steps, which have lowered the banking system's financing cost and provided incentives for lending through an adequate regulatory environment.

The Bank of Albania expects the situation to improve in the next few months, following the macro prudential measures we have taken to facilitate lending, and banks' cleaning up of balance sheets and credit restructuring. I did not intend to make a random overview of the situation, but to show the Albanian economic reality at this moment and present the future challenges. It is easily understandable that the weak economic growth calls for innovative solutions from other new sectors.

There is room for banks to lend to profitable projects as they continue to collect deposits and maintain sound levels of financial ratios. It is now the responsibility of all policy-makers to help entrepreneurship, in order to get a clear view of the right investments for the future. We have stated in our reports that the new sources of growth should originate from competitive sectors in the domestic and, even further, in the external market, so that the trade balance keeps on showing the improvements of 2013.

Export growth is important in the long run to offset the moments of weakness in domestic demand, by diversifying the sources of income. Although the economy benefits from the increase in the exports of mineral products, the latter are often exported without any sort of processing in the domestic market and, consequently, make little contribution to improving productivity and competitiveness of the Albanian economy.

Bank of Albania's research and analyses show that traded goods' sector has shown increasing productivity compared to the non-traded one.

During the 2000s, the Albanian economy was most focused on non-traded sectors like construction, and hotels and tourism, with a low share in the growth of productivity. Improving them and successfully facing competition in the international markets should lie at the core of Albania's new economic growth model. Bank of Albania's analyses suggest that these structural changes will contribute to recovering the economy at a faster pace in the years ahead and restoring the previous growth rates.

The agriculture sector meets the above criteria to lie at the core of this new model better than any other economic sector. On the other hand, we must recognise that despite Albania's vast natural resources, we have not managed to fully utilise these potential resources for the agriculture sector to face competition in the international markets. The Bank of Albania sees great potential in agriculture, which, for a number of reasons, could not materialise in the past years but can become more beneficial in the future. Unlike other sectors, whose future benefits may be limited, agriculture may represent an important source for a second period of dynamic economic growth.

The Albanian economy should be re-oriented towards those sectors whose capacity to compete in the international markets is the best signal for the development potential. The Albanian economy being a net importer of food products hints at a low level of competitiveness and represents one of the major future challenges. Lushnja is one of the main regions of the Albanian agriculture the recovery of our economy should start from – and holding this meeting here today is not mere coincidence.

Bank of Albania's analyses have been paying increasing attention to developments and related perspectives in this sector. As we speak, 47% of the Albanian population and around 49% of the labour force lives in rural areas and engages in agriculture-related activities. According to the latest data for 2012, around 24% of the land area is used to cultivate different agriculture cultures. However, despite the vast resources concentrated in agriculture and the important role it plays as the main source of income for a considerable part of the population, only 20% of gross added value comes from this sector.

The low share in economy in proportion to the considerable number of the population involved in agriculture indicates the low productivity in this sector. The latest data show that the exports of "food, beverages and tobacco" account for 6.2% of total exports. Livestock and agricultural products share 0.78% and 2.3% in total exports, respectively, whereas agro-industry shares 3%.

Fier district represents a considerable part of production factors in agriculture.

The latest data show that Fier shares 18% in total agricultural land, thus being classified as the district with the highest share in the country.

In 2012, more than 56 thousand farms were registered in Fier, the highest number on a country-level. This number accounts for 16% of total farms in the country, providing the highest share of income from the sale of agricultural products, and about 20% of Albania's total income. Related to livestock, Fier, and mainly Lushnja district, have a considerable share in livestock products. As a district, Fier produces 20% of total livestock production (milk), whereas Lushnja produces 9%.

The above setting witnesses private efforts and entrepreneurship to develop this sector. In order for this process to go ahead at a more accelerated pace, the policy-makers should identify the advantages and problems this sector encounters, in order to address them quickly.

In 2012, the Oxford University published a book focused on economic growth in South-Eastern European region. This book elaborates on a number of structural problems and challenges facing the Albanian economy, in its efforts to develop further. Agriculture has significant share in this analysis.

Some of these problems are acknowledged and frequently mentioned, such as the important infrastructure-related issues that include the road, watering, draining, storage and processing systems. Problems with land ownership and the transformation of its function for other activities continue to remain a major obstacle for the country's normal development, and raise ongoing concerns relating to the price and use of this important factor of production, and further on, to the normal functioning of product markets and other land-related factors.

Agriculture is affected by other structural problems that need a long-term solution. Average-size farms continue to be relatively small, thus restricting the development and growth of average productivity, or differently known as "the economies of scale". There are many reasons behind this. We can mention the inheritance of the communist system and the separation of land after its collapse. As it was stated above, the lack of a normal land market also due to ownership problems, naturally plays an important role in establishing larger farms and, consequently, more competitive ones. These problems also affect the agricultural sector-bank relationship and the lending activity at home.

The recent data show that lending to the agricultural sector accounts for 1.25% of total lending to businesses, on average. It is a considerably low figure, which should raise our concern, considering that this sector contributes by one/fifth to the gross domestic product.

I believe that there are two reasons driving the banking system to be reluctant to finance different projects in this sector. First, risk classification and categorisation for credit to agricultural sector is a commitment different from the other activities. The lack of formalisation, even for matters such as regular maintenance of information and statistics

about ownership, and financial statistics, damage the farmers' credibility from the early steps of lending. I find that there is room for prudential intervention by public institutions, not to condemn farmers, but to better prepare them and assist them in formalising their business.

In light of this, the Bank of Albania has in the past years initiated a campaign to improve the financial education of the Albanian people. The recent results of our questionnaires indicate that the Albanian urban population shows increasing and a more complete knowledge related to various financial problems they encounter. But the results on rural areas reveal that the education level remains considerably lower.

Second, the Albanian agricultural sector suffers from the lack of information and evaluation. As I noted above, one of the reasons why banks hesitate to increase their lending is the lack of complete information on farms and their products. Further, the quality certification standards for Albanian products remain low. One of the main reasons restricting higher exports and, consequently, higher production, is the lack of certification in accordance with the highest standards for all the Albanian agricultural products. This type of certification does not only prove the elementary food security required by the European markets, but also establishes a starting point for competition in the market.

The presence of these standards at a reliable level would lead to the improvement of all market mechanisms, by helping bank lending in proportion to the quality of products. In the framework of concerns facing the agricultural sector, the Bank of Albania has increased its interest in microcredit institutions.

In many developing countries, these institutions have led to an increase in lending, particularly to the agricultural sector and the rural population in general, thus trying to work out the formalisation and evaluation problems I stated above. I find that the successful experience of microcredit institutions in other countries could be imported to Albania. Consequently, all policy-makers should get closer to these institutions and help them grow, as the microcredit institutions are the ones that have great potential to become important lenders to the private agricultural enterprises, better than any other intervention by financial and public institutions.

Let me conclude by saying once more that the agricultural sector should be an important source for Albania's further development. But the solution to the problems facing this sector calls not only for greater attention, but above all, for a modern way of thinking and a more concrete cooperation between all related stakeholders. I, therefore, hope that today's meeting will contribute to drawing the attention towards this important sector and push forward the required structural reforms, which would also encourage the cooperation between agriculture and the banking and financial sector.