THRESHOLDS IN THE PROCESS OF FINANCIAL INTEGRATION OF ALBANIA - HOW FAR AWAY IS ALBANIA FROM GREECE?

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Abstract
Recent global financial crises have caused immense debate about costs and benefits of financial integration. Overall, evidences show that industrial economies utilize benefits of financial openness and export their problems to the emerging and less developed countries. There is a substantial and empirical literature that define certain thresholds levels of financial and institutional characteristics beyond which the trade – off improves and makes opening of the capital account beneficial and less risky, especially for a developing country like Albania.
The main aim of this study *is to analyse institutional quality, financial sector development, macroeconomic policies and trade openness as thresholds that must be satisfied in order to foster further financial integration and making it work for good, in particular for Albania and Greece. In addition, the comparison of economic characteristics and institutional development between these countries and the minimum standard will be also estimated, in order to reveal their discrepancy and deficiencies and as well to develop several policy proposals.*
The main objectives *of this study are:*
- *To analyse the importance of institutional quality, financial sector development, macroeconomic policies and trade openness in the process of financial integration.*
- *To estimate the above mentioned economic and institutional indicators for Albania and Greece and to use the standards level of this indicators (Prasad 2009) as a benchmark in order to reveal deficiencies, the most problematic aspects, and as well future challenges for each country.*
- *To draw and assess policy implications and recommendations for improving economic characteristics in Albania and Greece, in order to fully utilise the benefits of financial integration.*

Keywords: institutional development, threshold, economic characteristics, Albania, Greece.

1. Introduction

The financial crisis has re-ignited the fierce debate about pain and gain of financial integration. Financial integration has the potential to play a catalytic role in generating an array of collateral benefits that may help boost long-run growth. Meanwhile, premature opening of the capital account in the absence of some basic supporting conditions can delay the realization of these benefits, while making a country, especially a developing one, more vulnerable to sudden stops of capital flows.

In theory, financial globalization should catalyze domestic financial market development, improve corporate and public governance, and provide incentives for greater macroeconomic policy discipline. Such indirect benefits may be more important than the traditional financing channel. It is supposed that these benefits should be much greater for emerging economies. These countries are

relatively capital scarce and labor rich, so far access to foreign capital should help them increase investment and grow faster. Developing countries also have more volatile output growth than advanced industrial economies, which makes their potential welfare gains from international risk sharing much greater.

Although the great impact of financial integration on the developing countries in theory, evidences demonstrate quite different results. There is a substantial and empirical literature that define certain threshold levels of financial and institutional characteristics beyond which the trade – off improves and makes opening of the capital account beneficial and less risky for a developing country. Financial sector development, institutional quality, trade openness and the quality of macroeconomic policies are defined to be as threshold conditions, above of which financial integration can lead to better macroeconomic outcomes. Apparently, developing countries, different from the developed ones, lack in fulfilling these conditions. A concrete evidence of this fact is the case of Albania.

Albania, as many other developing economies is still in the process of financial integration. It is consider as a country of small barriers towards the foreign capital and direct investments. An index of the "Economic Freedom" created by The Wall Street newspaper, ranks Albania above countries like Japan, Canada, France, Slovenia, Bulgaria, Malta, Cyprus, and all other countries of the former Soviet Union. Despite, the high degree of liberalization, the outer position of Albania is still fragile and it is not experiencing the full benefits of financial globalization. In this sense, Albania is a peculiar case. On the other hand, Greece the closest neighbor economy and the major trade partner of Albania outperforms the latter in many aspects. It is a longstanding member of EU, and it has a more developed financial system and institutional quality compared to Albania. However, it seems that both countries suffer from the same illness, that of corruption. It represents a serious obstacle for the overall development and the integration of the economy. In addition Albania and Greece seems to have significant low level of trade integration to the foreign economies.

On one hand, low level of openness serves as a shield that protects from the costs of financial integration, but on the other hand it is not the best solution in the contemporary times of globalisation. To think otherwise is wrongheaded and dangerous. Framing the issue this way generates a key question: Does Albania and Greece fulfil the threshold conditions in order to fully benefit from the financial integration? How far away stands Albania from Greece? This study provides the answer.

2. Methodology and Data Sources

Our methodology is based on estimating and analyzing the following indicators:
1. *Financial sector development* the brain of the economy that performs the essential coordinating function of channelling the funds and making productive investment. The ratio of private credit to GDP is used as a proxy for financial depth.
2. *Quality of domestic macroeconomic* is identified by the monetary and fiscal policy. To measure the quality of monetary policy we employ the logarithm of inflation, whereas to assess the quality of fiscal policy we calculate the average ratio of budget deficit (government revenues minus government expenditures) to GDP. In addition the Ln of initial GDP per capita will also be estimated in order to reveal the difference between Albania and Greece and deficiencies.
3. *Trade integration*: we use the sum of exports and imports of goods and services for each country, expressed as a ratio to the appropriate GDP.
4. *Governance quality*, which is defined as the traditions and institutions by which authority in a country is exercised[1]. This includes the process by which governments are selected, monitored and replaced; the capacity of the government to effectively formulate and implement sound policies, and the respect of citizens and the state for the institutions that

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[1] World Bank Governance Matters

5. govern economic and social interactions among them. The six dimensions of governance corresponding to this definition that we measure are:
    a. *Voice and Accountability* – capturing perceptions of the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media.
    b. *Political Stability and Absence of Violence* – capturing perceptions of the likelihood that the government will be destabilized or overthrown by unconstitutional or violent means, including politically-motivated violence and terrorism.
    c. *Government effectiveness* – capturing perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies.
    d. *Regulatory quality* – capturing perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development.
    e. *Rule of Law* – capturing perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence.
    f. *Control of corruption* – capturing perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests.

To assess the average governance quality index, we calculate a simple average of the above individual six governance indicators.

Data on assessment financial sector development, trade integration, fiscal and monetary policies are mainly obtained from the International Monetary Fund (IMF), World Economic Outlook Database April 2010, and Greek Ministry of Economic and Finance 2009, whereas the individual indexes of six governance indicators are provided from World Bank Governance Indicators.

3. Does financial sector development really matter to maximize the benefits of the financial integration? Albania versus Greece

Financial sector development is a key determinant of the extent of growth and stability benefits associated with financial integration. Inappropriate or mismanagement domestic financial sector liberalizations have proven to be a major factor of crises that may be associated with financial integration. Alfaro et al., (2004) and BHL find that the growth impact of FDI and equity flows is considerably stronger in economies with well developed financial sector. In addition, financial sector development has a significant positive impact on macroeconomic stability, which in turn has implications for the volume and composition of capital flows. By expanding the scope of diversification possibilities, developed financial market moderate the effects of shocks and help reduce macroeconomic volatility. Are Albanian and Greek financial sector developed enough for fostering benefits of financial integration?

The financial system in Albania passed the empirical stage, and is experiencing the credit one. Banking sector is the most relatively developed part of the financial system. This sector dominates the financial sector with over 90% of all intermediaries' assets. The prudential regulatory framework has been strengthened and modernized in recent years, although there are still substantial shortages in terms of information quality, banking supervision and risk management. Albanian financial system is highly based on foreign currency assets and liabilities, and so far this is a reason of being sensitive to various shifts in exchange rates and interest rate yield curves for different currencies. In addition, risk is also coming from the credit growth because of the competition, which forces banks to be more flexible and more aggressive on lending.

The non-bank financial sector is less developed than the former. However, the establishment of the Financial Supervisory Authority, that supervises the markets of insurance, pensions and treasury

bonds, constitutes a definite signal of consolidation and standardization of the supervisory and regulating regime. The insurance companies are implementing a very aggressive strategy by expanding in Kosovo, Macedonia and becoming as well important players in regional insurance markets.

Different from the Albanian financial system, the Greek financial sector appears to be largely sound and deep. The banking system is well capitalized and profitable, but faces challenges arising from the global financial crisis. Although the significantly depth of the capital markets, they play only a limited role in the economy. The insurance sector remains small by EU standards, and the financial condition of many insurance firms is weak.

Risk management capabilities are being strengthened in response to regulatory change and rapid credit growth, but their application is still uneven across sub sectors and institutions. Supervision and regulation is also uneven across different segments of the financial sector. The bank supervisory authorities have been considerably effective. The Hellenic Capital Market Commission (HCMC) has been strengthen and is playing an increasing role in oversight and regulation. The insurance sector is more weakly supervised.

 The most important challenges that Greek financial sector faces are: (i) managing credit risk; (ii) managing competitive pressures; (iii) diversifying funding sources; (IV) limiting state influence on the banking system; and (v) strengthening risk management.

To quantify and evaluate the financial depth in Albania and Greece we use the ratio of private credit to GDP over a period of 9 years (see data on table 1) and the threshold standard of financial depth as a benchmark in order to reveal any deficiency in the financial sector development. Based on the GMM estimates calculated from Eswar S. Prasad 2009, the threshold levels of financial depth for a successful financial integration are approximately 50 percent minimum and 126 percent maximum. The progress of the financial depth in Albania in comparison with that of Greece is illustrated in the table and the line graph below.

Table 1
Source: World Bank

Year	Albania	Greece
	Private credit (% of GDP)	Private credit (% of GDP)
2000	5	47
2001	6	57
2002	6	60
2003	8	65
2004	9	70
2005	15	78
2006	22	83
2007	30	92
2008	36	93

From the table of statistics and the line graph below it can be observed a noteworthy rise in the ratio of private credit to GDP in both countries. Despite the significant increase, the data for the Albanian financial depth lie below than the minimum level, showing that Albanian financial development doesn't match the necessary condition to utilize the benefits of financial integration of Albania. Different from Albania, financial depth in Greece, overcomes considerably the former and represent a matured condition to maximize the benefits of financial integration.

Graph 1: Financial Depth
Source: World Bank
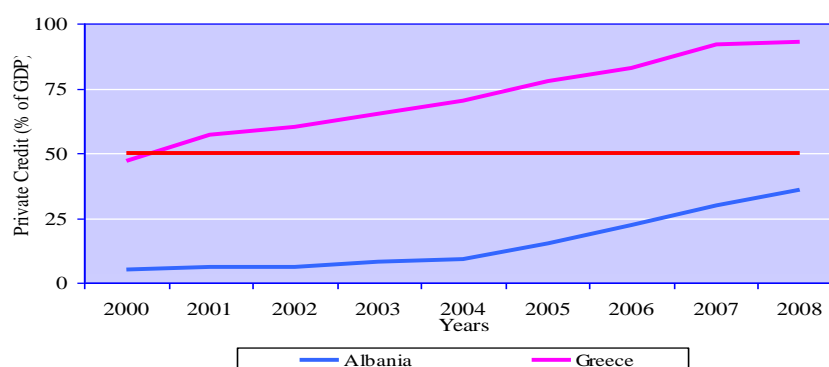
4. Institutional quality and its implication in the process of financial integration of Albania - Comparison with Greece

The quality of institutions appears to play a substantial role in determining the outcomes of financial integration. It defines the game-laws in a society. There are these laws that establish an efficient legal system, a stable financial system and also an effective regulation of the financial sector, which in turn affect the structure of a country's capital inflows. This has significant consequences since the composition of inflows appears to have considerable predictive influence for currency crashes. Frankel and Rose (1996) have proven that the share of FDI in a country's total capital inflows is negatively connected with the probability of currency crises. But, the level of FDI is highly correlated with the quality of institutions in the host country. Weak institutions affect harmfully the attraction of FDI and hamper the integration of a country since it creates uncertainty for the other ones. Furthermore, a high level of corruption will affect the overall economy. Without major anti-corruption reform; fiscal policy adjustment must rely on expenditure cuts alone to achieve budgetary balance. With respect to those government spending cuts, however, it is also considerably hard to be optimistic. High corruption is associated with excessive and wasteful spending that is hard to reverse. The existence of corruption reflects a deep inability to coordinate political action in pursuit of policies that would benefit the nation, including reducing wasteful spending. This fact is clearly demonstrates in the case of Albania.

Albania in an international comparative perspective is rated extremely low compared to other transition economies.[2] International risk assessment agencies assess Albania as a country where foreign investors risk to lose their investment due to extremely high corrupt practices. Corruption is like a cancer in the Albanian economy. It has created so much uncertainty for entrepreneurs: almost one-half of private firms admit to pay bribes to public officials and they can never be sure when the bribe is enough or whether the corrupt official will keep coming back again to demand more money. The most common forms of corruption faced in Albania are theft of public assets and the fact that the majority of public jobs are "purchased". International organizations like World Bank and IMF have to think twice to lend or grant money to the Albanian economy, because of uncertainty whether this money will be used in productive investment or will be destine in the politicians' pockets. Higher corruption in Albania has weakened the quality of institutions since good legal framework without enforcement translates into nothing. How much does the Albanian institutional quality differ from the Greece institutional quality?

To quantify the institutional quality in Albania and to identify the discrepancy from that of Greece, we use the average of six aspects of the institutional development: voice and accountability, political instability and violence, government effectiveness, regulatory quality, rule of law, and control of corruption for each country for the period from 1996 to 2008. Detailed data for each institutional indicator for both countries are represented below in the tables 2,3,4,5, 6, and 7).

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[2] World Bank Governance Indicators, Percentile Rank comparison

Table 2: Voice and Accountability
Source: World Bank Governance Indicators

Year	Albania			Greece		
	Percentile Rank	Governance Score	Standard Error	Percentile Rank	Governance Score	Standard Error
	(0-100)	(-2.5 to +2.5)		(0-100)	(-2.5 to +2.5)	
2008	51.4	+0.13	0.13	73.6	+0.88	0.15
2007	49.0	+0.03	0.14	76.0	+0.96	0.15
2006	48.1	+0.02	0.16	77.9	+0.98	0.18
2005	48.6	-0.03	0.17	83.7	+1.09	0.19
2004	49.0	+0.03	0.18	85.1	+1.12	0.19
2003	49.0	+0.02	0.16	76.4	+0.99	0.20
2002	45.7	-0.09	0.17	79.3	+1.02	0.20
2000	38.9	-0.32	0.25	78.4	+0.93	0.21
1998	36.5	-0.44	0.26	83.7	+1.12	0.23
1996	30.1	-0.57	0.26	67.9	+0.72	0.23

Table 3: Political Stability and Absence of Violence
Source: World Bank Governance Indicators

Year	Albania			Greece		
	Percentile Rank	Governance Score	Standard Error	Percentile Rank	Governance Score	Standard Error
	(0-100)	(-2.5 to +2.5)		(0-100)	(-2.5 to +2.5)	
2008	45.5	+0.01	0.23	56.9	+0.32	0.20
2007	35.1	-0.22	0.24	63.9	+0.50	0.20
2006	32.2	-0.41	0.24	63.5	+0.53	0.20
2005	27.4	-0.61	0.26	63.0	+0.48	0.21
2004	23.1	-0.81	0.28	62.0	+0.44	0.22
2003	31.3	-0.43	0.30	64.4	+0.64	0.23
2002	27.4	-0.60	0.30	71.2	+0.72	0.22
2000	16.8	-0.95	0.30	66.3	+0.63	0.23
1998	19.7	-0.86	0.28	55.3	+0.26	0.24
1996	40.9	-0.12	0.39	57.7	+0.40	0.32

Table 4: Government Effectiveness
Source: World Bank Governance Indicators

Year	Albania			Greece		
	Percentile Rank	Governance Score	Standard Error	Percentile Rank	Governance Score	Standard Error
	(0-100)	(-2.5 to +2.5)		(0-100)	(-2.5 to +2.5)	
2008	44.5	-0.34	0.19	70.6	+0.56	0.19
2007	43.1	-0.36	0.19	70.1	+0.46	0.18
2006	35.5	-0.50	0.18	72.0	+0.61	0.17
2005	31.3	-0.62	0.18	73.5	+0.68	0.17
2004	41.7	-0.38	0.22	77.7	+0.83	0.17
2003	32.7	-0.56	0.21	77.3	+0.83	0.17
2002	32.2	-0.59	0.21	77.3	+0.84	0.17
2000	20.9	-0.81	0.21	76.3	+0.74	0.18
1998	23.2	-0.71	0.14	78.7	+0.90	0.13
1996	55.0	-0.18	0.35	78.2	+0.67	0.26

Table 5: Regulatory Quality
Source: World Bank Governance Indicators

Year	Albania			Greece		
	Percentile Rank	Governance Score	Standard Error	Percentile Rank	Governance Score	Standard Error
	(0-100)	(-2.5 to +2.5)		(0-100)	(-2.5 to +2.5)	
2008	57.0	+0.16	0.16	74.9	+0.81	0.20
2007	55.8	+0.10	0.18	75.2	+0.83	0.21
2006	51.7	-0.11	0.18	73.2	+0.79	0.20
2005	46.8	-0.25	0.18	76.1	+0.88	0.20
2004	48.8	-0.17	0.19	77.6	+0.86	0.20
2003	36.6	-0.44	0.19	80.0	+1.01	0.19
2002	43.4	-0.25	0.22	80.0	+0.99	0.21
2000	39.5	-0.25	0.26	79.0	+0.88	0.22
1998	38.5	-0.28	0.28	73.2	+0.72	0.25
1996	44.9	+0.02	0.35	76.1	+0.74	0.24

Table 6: Rule of Law
Source: World Bank Governance Indicators

| Year	Albania			Greece		
	Percentile Rank (0-100)	Governance Score (-2.5 to +2.5)	Standard Error	Percentile Rank (0-100)	Governance Score (-2.5 to +2.5)	Standard Error
2008	32.5	-0.60	0.14	73.2	+0.75	0.15
2007	28.1	-0.69	0.15	71.9	+0.69	0.14
2006	26.7	-0.73	0.15	71.4	+0.74	0.14
2005	24.3	-0.80	0.16	71.0	+0.70	0.15
2004	20.0	-0.88	0.16	80.5	+0.88	0.14
2003	15.7	-1.02	0.17	75.7	+0.82	0.15
2002	19.5	-0.94	0.18	72.4	+0.77	0.15
2000	13.8	-1.09	0.18	76.7	+0.86	0.14
1998	9.5	-1.21	0.21	70.5	+0.72	0.17
1996	53.3	-0.14	0.26	83.8	+1.01	0.21

Table 7: Control of Corruption
Source: World Bank Governance Indicators

Year	Albania			Greece		
	Percentile Rank (0-100)	Governance Score (-2.5 to +2.5)	Standard Error	Percentile Rank (0-100)	Governance Score (-2.5 to +2.5)	Standard Error
2008	39.1	-0.45	0.13	60.9	+0.10	0.15
2007	35.7	-0.59	0.14	62.8	+0.21	0.14
2006	28.6	-0.69	0.13	65.0	+0.33	0.14
2005	29.1	-0.73	0.14	65.0	+0.32	0.15
2004	26.2	-0.75	0.15	71.4	+0.52	0.15
2003	26.2	-0.79	0.16	71.4	+0.51	0.17
2002	23.3	-0.85	0.19	70.4	+0.49	0.17
2000	23.3	-0.82	0.19	75.2	+0.68	0.19
1998	13.1	-1.07	0.20	75.2	+0.69	0.19
1996	59.2	+0.03	0.48	64.6	+0.36	0.21

The line graph below provides information about the simple averages of institutional quality's governance score for Albania and Greece. At a glance it can be seen that Albanian institutional development index lies below the red line – which represents the minimal level that must be met, whereas Greece institutional quality index lies above this standard. This is a clearly evidence which demonstrates that Albania is significantly less developed institutionally when measured by the standard level (which stands at 0.171) and lags considerably behind the development of institutional quality of Greece.

Graph 2: Average Institutional Quality
Source: World Bank Governance Indicators
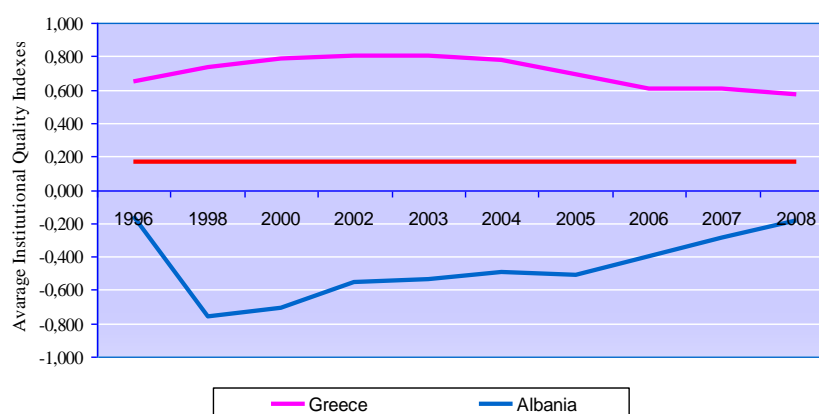
Anyway, although Greece outperforms Albania in the overall institutional development, there are three main points that must be highlighted:

Firstly, the discrepancy between the institutional quality indexes of these countries is decreasing continuously due to the improvement on the average Albanian index and the worsening on that of Greece.

Secondly, both countries suffer from the same illness – corruption. According to a recently published study by Katsios (2006), Greece has the largest "shadow economy" (untaxed income base) of any OECD country, which the author argues is related to the corruption of the Greek government through various channels. In 2006, Katsios estimates the Greek shadow economy at 28% of GDP. Tax avoidance, which relies on bribery to avoid prosecution, is a national pastime in Greece – the envelope used in the bribe even has its own name, the *"fakelaki,"* confirming the age-old adage that the Greeks "have a word for it." In addition, it is not a coincidence that Greece employed fraudulent accounting practices and derivatives trades to mask the size of its growing government debts (which is now far in excess of the debt-to-GDP ratios of other Euro zone countries).

Thirdly, both countries are able to address the challenge of corruption if they want to.

5. Does macroeconomic policy affect the outcomes of financial integration of Albania? Comparison with Greek macroeconomic quality and lessons drawn from the Greek crisis

The quality of domestic macroeconomic policies is significantly associated with the level and composition of inflows and exposure to crises. The Argentine crisis of 2001-02 demonstrates that even a prudential regulatory and supervisory system that effectively restricts risk taking may not be enough to prevent devastating crises if fiscal policy spins out of control. If fiscal imbalances become too large, governments resort to printing money to finance their deficits, and inflation will take off. When an economy experiences a high level of inflation, debt contracts that are often denominated in foreign currencies, will make the financial system more fragile because currency depreciation can trigger a financial crises. How effective are the macroeconomic policies in Albania and Greece to cope with the global financial crises?

The deep global economic crisis, which represents the major cost of financial integration, was felt in Albania testing the macroeconomic balances. Although the Bank of Albania pretend to have

pursued a prudent monetary policy by cutting the key interest rate by one percentage point, and increased liquidity injection, the macroeconomic fundamentals doesn't seem to be quite solid. In spite of the improvement in the ratio of budget deficit to GDP since the beginning of the period the current account to GDP has abruptly deteriorated from -10.38% in 2007 to -14.026% in 2009.[3]

In most general terms, this means that Albania has outlays on imports that are larger that its receipts from exports. This negative cash flow has to be financed by inflows of foreign capital, which in the current global situation risks vulnerability. It is often proven that developing economies suffer the costs of the crisis later than the developed one. Fortunately, the relatively low exposure of the Albanian financial system to international financial institutions, and to products that instigated the financial crises, has served up to the present as a shield for the Albanian economy. But, the future seems to be uncertain. Greece, one of the countries that have a great impact on the Albanian economy, is dramatically shrinking into an unavoidable economical regress. After years of discretionary fiscal policy and statistical frauds, Greece now faces \$303 billion foreign debt, a deteriorating macroeconomic outlook and benign economic growth prospects. Have the Greek macroeconomic policy helped to minimize the costs of the crisis or did it help to plant the seed that engendered the critical situation on the Greek economy?

Since the accession to the European Monetary Union, Greece's macroeconomic outlook has been deteriorated by volatile rates of inflation, high fiscal deficit and the extremely high public debt Even, compared to the other member of the EU, the ratio of public debt accounted for the highest figure. In 1996, Greece's inflationary outlook was improved since the central bank managed to target the inflation which, for the first time, decreased below two-digit level. Since the accession to the EMU, Greece failed to curb the ailing fiscal deficit and very high public debt. The convergence criteria require each country of the euro zone not to exceed the fiscal deficit by more than 3 percent of the GDP. In particular, Greece's terrible state of fiscal health was reflected in the high levels of current account deficit. According to the International Monetary Fund (IMF), the situation is expected to worsen with the current account balance deteriorated in (-9) percent of the GDP by the end of this year.

In the course of 2008, the annual GDP growth rate down to 2.9%, while in the first quarter of 2009 Greece's GDP expanded by only 0.3% compared to the previous quarter. For 2009 as a whole growth prospects appear gloomy, with recent forecasts ranging from a positive growth rate of 1.1% (Greek Ministry of the Economy and Finance, 2009) to a GDP contraction of 0.9% (European Commission, 2009). In the labour marker front, the unemployment rate picked up to 8.7% by March 2009 versus 7.2% in mid 2008 and is expected to increase further in the near future, in line with the slowdown in economic activity. In addition to one of the world's most terrible pension systems, Greece faces high burden of taxation, high government spending, burdensome corruption and highly regulated labour market. The country is likely to face a slow and cumbersome economic recovery that could probably last several years.

To quantify Albanian macroeconomic policy and to make comparison with that of Greece we employed the logarithm of inflation rate, Ln of GDP per capita (in USD unit), and budget deficits as a proxy of GDP for each country, based on statistics from 2000 to 2009. (See data on table 8, 9 and 10 and the line graphs below).

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[3] IMF, World Economic Outlook Database, April 2010

Table 8
Source: IMF, World Economic Outlook Database, April 2010

Years	Albania			Greece		
	Inflation	Annual Inflation Rate	Log Inflation	Inflation	Annual Inflation Rate	Log Inflation
2000	100	0.04	**2**	100	2.89	**2**
2001	103.121	3.12	**2.013**	103.654	3.65	**2.016**
2002	108.502	5.22	**2.035**	107.712	3.92	**2.032**
2003	111.045	2.34	**2.045**	111.412	3.44	**2.047**
2004	114.232	2.87	**2.058**	114.779	3.02	**2.060**
2005	116.930	2.36	**2.068**	118.778	3.48	**2.075**
2006	119.702	2.37	**2.078**	122.714	3.31	**2.089**
2007	123.218	2.94	**2.091**	126.385	2.99	**2.102**
2008	127.357	3.36	**2.105**	131.738	4.24	**2.120**
2009	*130.188**	2.22	**2.115***	*133.231**	*1.13**	**2.125**

*2009 forecasting from IMF

Inflation statistics are provided from IMF, World Economic Outlook Database, April 2010. Log inflation is calculated by the authors.

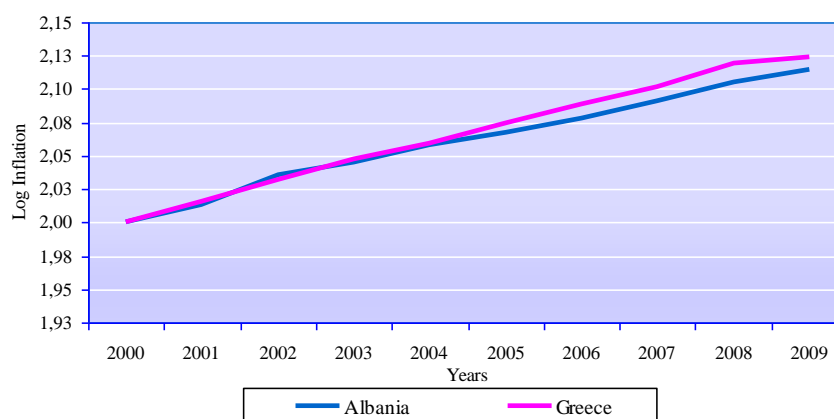*Graph 3: Monetary Policy*

Source: IMF

Table 9
Source: IMF

	Albania	Greece
	General government balance (in percent of GDP)	General government balance (in percent of GDP)
2001	-13,7	-4,5
2002	-13,7	-4,8
2003	-5,05	-5,7
2004	-8,33	-7,5
2005	-3,46	-5,1
2006	-4,32	-2,8
2007	-3,51	-3,6
2008	-2,49	-5
2009*	*-3,51**	*-6,4**

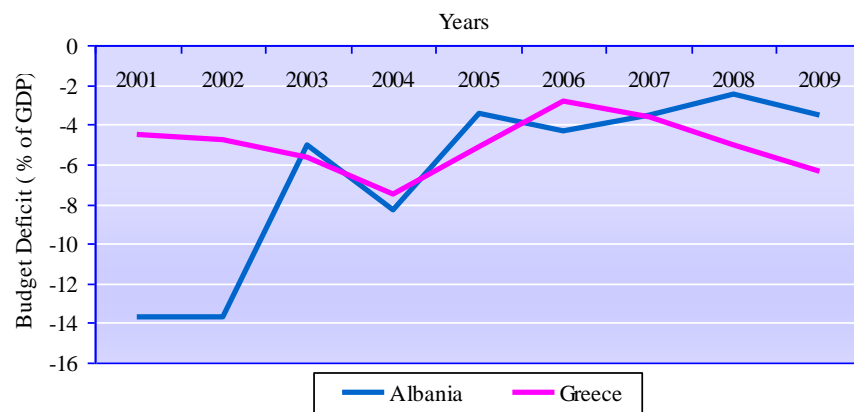**2009 forecasting from IMF*

*Graph 4: Fiscal Policy*
Source: IMF

Table 10
Source: IMF

Years	Albania		Greece	
	GDP per capita	Ln of GDP per capita	GDP per capita	Ln of GDP per capita
2000	1990	7.6	11661	9.4
2001	1327	7.2	11950	9.4
2002	1440	7.3	13446	9.5
2003	1835	7.5	17587	9.8
2004	2341	7.8	20926	9.9
2005	2611	7.9	22253	10.0
2006	2893	8.0	24146	10.1
2007	3446	8.1	28145	10.2
2008	4089	8.3	32105	10.4
2009*	*3680**	*8.2*	*30304**	*10.3*

Unit: USD*Forecasting from IMF

GDP per capita statistics are provided from IMF. Ln GDP per capita is calculated by the authors

Graph 5: LN of GDP per capita

Source: IMF
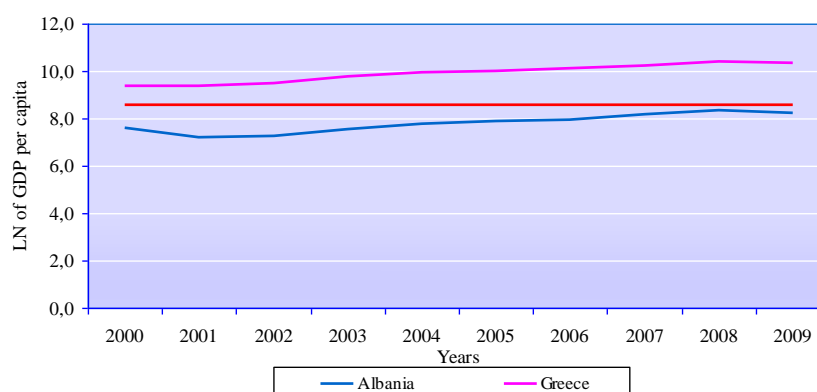
At a glance we can see that there is an overall upward trend of the log inflation and Ln of GDP per capita, and as well a fluctuating tendency in the rate of budget deficits. On closer inspection of the data it can be observed that there is a significant discrepancy between the macroeconomic indicators of Albania and Greece, which is summarized and explained as follows:

Firstly, although the annual inflation rate is maintained at around 3% in both countries, the line graph shows that the inflation rate in Greece exceeded that of Albania in 2003 and stands higher with approximately three points. Secondly, budget deficit in Albania has experienced high fluctuations; but the overall trend seems to be abruptly increased, that is a good sign. Different from Albania, the ratio of budget deficit to GDP in Greece peaked at about minus 3% in 2006, after reaching an all time low of approximately -7.5% in 2004 and is experiencing a sharp deterioration up to the present. This drastically worsening is caused mainly from the average increases in unit

labour costs and prices, that diminished substantially Greek current account and from the dramatically rise in the interest cost burden as genuine concerns about fiscal sustainability combined with speculation and misinformation to dramatically raise the rate of interest on new Greek government bonds. Thirdly, Ln GDP per capita lies above the minimum threshold level, which stands at 8.569, whereas the Albanian figures do not meet this standard.

Apparently, one of the main causes of Greek catastrophe is the macroeconomic weakness. An old Greek proverb says: "Shame to those that cry and do not know the reason why." As Greek "cry" and Albania and all the Europe feel the threat from the economic crisis of Greece, let us not forget that the macroeconomic quality really matters for determining the outcomes of the integration process.

6. Trade openness as a threshold in the process of financial integration of Albania and Greece.

Trade integration seems to play a significant role in mitigating the adverse growth effects of financial crises and in facilitating recoveries from crises. The costs of financial crises depend on the degree of openness of an economy since less open economies have to go through larger contractions of aggregate demand and larger changes to the real exchange rate change to adjust to large shocks. Trade integration could help a developing economy to export its way of recession since the depreciation of the exchange rate will lead to more incomes from exports. How efficient is the trade integration of Albania in utilising benefits of its financial integration?

Albania was admitted as a member of World Trade Organisation, within the frame of multilateral commercial system, in September 2000. So, in this way, the country trading policies are presently anchored by the regulator system of the global trade, which makes these policies more transparent and reliable. The Free Trade Agreement with the Region countries have facilitated and liberalised the trade between Albania and these countries. Within the frame of European integration in 2003, Albania initiated the negotiations in order to endorse the Association Stabilisation Agreement and on 12-th December this agreement was endorsed in Luxemburg. Consequently, trade integration between Albania and the EU has increased considerably. The value of exports and imports of goods and services soared to 90.6% of GDP in 2008, compared to 56.6% of GDP in 2000 (see table 11). Albania continues to be an import-oriented economy with total imports accounting for 59.4% of GDP, almost twice as much as the percentage of exports. The export remains small, narrow, and undiversified, based mainly on raw or rough materials, due to a lack of price competitiveness, poor infrastructure, and a challenging business environment. How far away is trade integration of Albania from that of Greece, which is a member of the EU?

In spite of the participation in the EU, the openness of the Greek economy remains relatively low. This is largely attributable to the relatively poor export of goods performance of the country. The difficulty of Greek exports of goods to penetrate foreign markets, on the one hand, and the easy penetration of foreign goods into the domestic market on the other, constitute problems that may have many explanations. They both reflect the persistence of structural weaknesses of the Greek economy, which have been primarily responsible for keeping the competitiveness of Greek products rather low. This, in turn, means that Greece's participation in the EU and the creation of the single market did not lead to substantial structural changes as to make the combination of quality and price of Greek exports of goods attractive to international markets. This might be the result of: (a) adverse relative factor cost developments per unit of output, (b) inadequate intra-industry trade flows which are usually related to higher specialization, product diversification and economies of scale, (c) inadequate inward foreign direct investment which usually transfers new technology, (d) long term problems of the educational system and its relationship to the needs of the economy, (d) problems related to goods and labour market structure, and (e) an interventionist public sector which inhibits innovation and entrepreneurship.
Table 11 and the line graph below represents trade openness of Albania and Greece assessed as the ratio of the sum of imports and exports of goods and services to the relevant GDP, covering a period from 2000 to 2008.

Table 11
Source: World Bank

Year	Albania			Greece		
	Exports of goods and services (% of GDP)	Imports of goods and services (% of GDP)	Trade Integration (Exports + Imports)/GDP	Exports of goods and services (% of GDP)	Imports of goods and services (% of GDP)	Trade Integration (Exports + Imports)/GDP
2000	19	37	56	25	38	63
2001	21	39	60	24	37	61
2002	20	47	67	21	35	56
2003	21	46	67	20	33	53
2004	22	43	65	22	32	54
2005	22	46	68	22	31	53
2006	25	49	74	23	33	56
2007	28	55	83	23	34	57
2008	31	59	90	23	32	55

 Although the significant rise in the trade openness of Albania compared to the level of Greece, they both stand noticeably far below from the minimal threshold condition which accounts for 160.2%.

Graph 6: Trade Openness
Source: World Bank
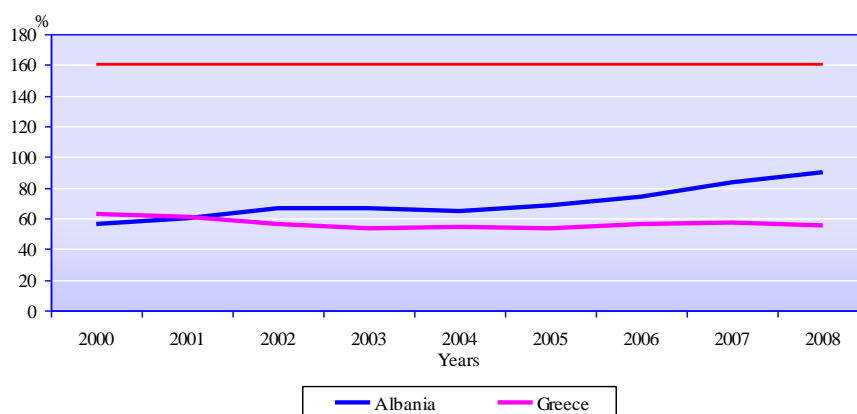
Obviously, trade integration of Albania and Greece represents an unrealised condition for a successful financial integration. Low exports will not fully benefit from the domestic currency depreciation, and so far can not outweigh any economic deficit created in crises situation like the current one.

7. Conclusions and Policy Recommendations

Utilising the benefits of financial integration is one of the greatest challenges that emerging and developed economies are facing today. Financial sector development, institutional quality, trade openness and the quality of macroeconomic policies seem to be represented as threshold conditions that must be satisfied in order to fully utilise the outcomes of financial integration. Albania, as many other emerging economies, appears to not meet these certain conditions, whereas Greece

outperforms Albania regarding financial sector development, institutional quality and macroeconomic development, but lags behind it in the level of trade integration. Hence, it should be admitted that:

i) Firstly, Albania is "institutionally challenged". Deficiencies in the institutional quality, due mainly to the prevalence of the corruption, have weakened the quality of the Albanian institutions. In this way it is necessary to build a political will to support institutional development. Apparently, institutional development remains future challenge for Albania in order to make financial integration a force for good. It is necessary for the Albanian Government to foster public interest instead of politician's ones, and to really implement its well-known policy "with clean hands". Meanwhile, reducing "the shadow economy" in the Greece by declining corruption and promoting transparency and strong supervision represent great challenges for this EU member country.

ii) Secondly, Albanian financial depth is considerably far away of the minimal financial threshold, demonstrating that financial sector development is not capable to promote the best of financial integration. Opening up financial market to the outside world will not magically makes Albania rich. It requires effective prudential and supervision. Regarding future financial development of Greece, it is really important to manage credit risk and competitive pressures, to diversify funding sources, and also to limit state influence on the banking system.

iii) Thirdly, macroeconomic policies pretend to be cautious in both countries, but the evidences do not promise the same. Significant increase in the deficit of the current account and the rise in the logarithm of the inflation don't demonstrate strong macroeconomic fundamentals. Establishing budget rules that increase transparency and promoting price stability should be the main focus on the macroeconomic policies in both countries.

iv) Finally, trade openness of Albania and Greece represents an unrealised condition for a successful financial integration. Low exports will not fully benefit from the financial integration. An export orientation policy will be highly beneficial to the overall economy. It is highly recommendable especially for Greece to be able to raise competition, in order to stimulate higher productivity and subsequently higher growth rates.

To conclude, Albania and Greece must take responsibility for their own fate in this integrated world.

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