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ACTION EUR-01

INFO	LOG-00	AID-00	SMI-00	CEA-01	CIAE-00	COME-00	CTME-00
	INL-01	OASY-00	DODE-00	ITCE-00	SRPP-00	EB-01	EXME-00
	E-00	FBIE-00	INLB-01	FRB-00	H-01	TEDE-00	INR-00
	ITC-01	LAB-01	L-01	ADS-00	NSAE-00	NSCE-00	OMB-01
	OPIC-01	PM-00	SP-00	SSO-00	SS-00	STR-00	TRSE-00
	USIE-00	SA-01	SNIS-00	NISC-00	PMB-00	DRL-09	G-00

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FM AMEMBASSY TIRANA
TO SECSTATE WASHDC PRIORITY 9006
INFO AMEMBASSY ATHENS
USMISSION USVIENNA
AMEMBASSY BELGRADE
USLO SKOPJE
AMEMBASSY ROME
AMEMBASSY SOFIA

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TAGS: EFIN, ECON, EINV, EAID, AL
SUBJECT: ALBANIAN BANKING SYSTEM HANDICAPPED BY
INEFFICIENCY, CORRUPTION, AND INABILITY TO ENFORCE LOANS

SUMMARY

1. ALBANIA'S BANKING SYSTEM IS HANDICAPPED BY A
COMBINATION OF OUTMODED METHODS, LACK OF TECHNOLOGY,
CORRUPTION, AND THE NEARLY GENERALIZED INABILITY TO

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UNITED STATES DEPARTMENT OF STATE
REVIEW AUTHORITY: ERIC W. FLEISHER
DATE/CASE ID: 23 JAN 2003 200103209

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ENFORCE LOANS. WHILE SOME PARTS OF THE SYSTEM ARE AWASH IN CASH GENERATED BY OVERSEAS REMITTANCES AND THE COUNTRY'S INCREASINGLY LIVELY TRADE AND CONSUMER SECTORS, IMF-IMPOSED ANTI-INFLATIONARY LENDING RESTRICTIONS AND THE GOVERNMENT'S HUNGER FOR FUNDS THROUGH TREASURY-BILL ISSUES -- COMBINED WITH THE HIGH RISK ASSOCIATED WITH MAKING PRIVATE LOANS -- HAS KEPT MOST OF THIS MONEY OUT OF PRODUCTIVE INVESTMENTS. SLOW PROGRESS IS THE RULE OF THE DAY, BUT THE BANKING SECTOR HAS A LONG WAY TO GO BEFORE IT REACHES ACCEPTABLE STANDARD. END SUMMARY.

A BANKING SYSTEM FOR THE NINETEENTH CENTURY

2. IN MANY RESPECTS, ALBANIA'S STATE-RUN BANKING SYSTEM IS A RELIC OF THE PAST. WHILE COMPUTERIZATION HAS BEEN INTRODUCED IN MANY AREAS, THERE STILL IS NO EFFECTIVE CHECK-CLEARING SYSTEM. CREDIT CARDS, SUCH AS EUROCARD, HAVE NOW PENETRATED TO ABOUT 50 ALBANIAN CUSTOMERS -- NOT 50 PERCENT, BUT LITERALLY ABOUT 50 INDIVIDUALS, UP FROM 18 LESS THAN A YEAR AGO -- AND DEBIT CARDS ARE STILL ON THE PLANNERS' DESKS, AWAITING A PLANNED DEMONSTRATION.

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3. HIT BY STAGERING BAD LOANS, BROUGHT ON BY A POORLY DEVELOPED SENSE OF CREDIT RESPONSIBILITY AND A COURT SYSTEM THAT FOR THE MOST PART WILL NOT ENFORCE LENDERS' RIGHTS, SOME BANKS ARE INSOLVENT. OTHERS HAVE FIGHT THEIR WAY BACK FROM INSOLVENCY, BUT WILL REMAIN CRIPPLED BY THEIR NON-PERFORMING PORTFOLIOS FOR YEARS TO COME.

4. TO SOME EXTENT, THREE PRIVATE OR SEMI-PRIVATE FOREIGN-OWNED BANKS HAVE FILLED THE COMMERCIAL BANKING GAP, BUT EVEN THESE HAVE BEEN RELUCTANT TO GET INTO LENDING. THESE THREE-- THE ARAB-ALBANIAN ISLAMIC BANK, THE BANKA ITAO-SHQIPTARE, AND THE KOSOVA-BASED DARDANIA BANK - CAN PROVIDE INTERNATIONAL FUNDS TRANSFERS AND HARD-CURRENCY ACCOUNTS (AS CAN SOME OF THE DOMESTIC BANKS AS WELL), BUT FOR THE MOST PART STEER CLEAR OF LENDING MONEY AND ISSUING CREDIT. THE BAHRAI-BASED DIRECTOR OF THE ARAB-ALBANIAN ISLAMIC BANK TOLD US THAT ONE MIGHT AS WELL "THROW YOUR MONEY IN THE SEA" AS MAKE A LOAN IN ALBANIA. OF THE THREE, ONLY THE ETHNIC-ALBANIAN DARDANIA HAS SEEN IT TO LEND TO ANY DEGREE ON THE LOCAL ECONOMY.

. MORE RECENTLY, AT LEAST THREE GREEK BANKS HAVE

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EXPRESSED INTEREST IN OPENING BRANCHES IN ALBANIA, AND ONE IS EXPECTED TO BE CHARTERED SOON. IN ADITION, AN AMERICAN FIRM BASED IN NEW YORK STATE ND POLAND -- ELBA, INC. -- PLANS TO OPEN A BRANC OF ITS "MIDWAY-MERCHANT BANK" HERE AND TO ENGAG IN LENDING AND LEASING ACTIVITIES. ALSO, CITIBAK RECENTLY VISITED ALBANIA, WITH AN EYE TOWARD ESTABLISHING A CORRESPONDING RELATIONSHIP WITH ONEOR MORE ALBANIAN BANKS. FOR NOW, CITIBANK HAS N PLANS TO OPEN A BRANCH HERE.

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THE PARALLEL SYSTM

6. TAKING ADVANTAGE OF SGNIFICANT INFLUXES OF CURRENCY, SEVERAL "INFORMA" BANKS HAVE BEEN OPERATING A "PARALLEL" SYSTEM. AMONG THE LARGEST OF THESE IS VEFA HOLDING COMPNY, WHICH ALSO MAINTAINS INTERESTS IN RETAIL, SHPPING, AND TOURISM SECTORS, AND ONE OPERATOR KNOWN COMMONLY AS "THE GYPSY WOMAN." IN THE CASE OF VEA, DEPOSITS GREW FROM ABOUT USD 30 MILLION IN AUGUST 1995 TO OVER USD 48 MILLION BY THE END OF THE YEAR, AND FUNDS CONTINUE TO POUR IN, INDUCED BY THE PROMISE OF 6 PERCENT PER MONTH IN INTEREST. WE HAVE HEARD REPORTS OF "THE GYPSY WOMAN" AND OTHER OPERATORS OFFERING AS MUCH AS 9 AND 12 PERCENT PER MONTH IN INTEREST.

7. THERE IS LITTLE DOUBT AMONG KNOWLEDGEABLE OBSERVERS THAT THESE ARE CLASSIC PONZI SCHEMES USING "NEW" DEPOSITS TO PAY OFF "OLD" INTEREST (WE KNOW OF ONE CASE WHERE A LOCAL OPERATOR IN KORCA WAS GRANTED A BANK LOAN SPECIFICALLY TO PAY OFF HIS INFORMAL-SECTOR "DEPOSITORS," AND THEN GET OUT OF THE BUSINESS). STILL, THE GOVERNMENT HAS TAKEN NO STEPS TO CONTROL THIS POTENTIALLY VOLATILE SECTOR. MEANWHILE, WE HAVE HEARD THAT VEFA HAS BEEN

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 AMEMBASSY ROME
 AMEMBASSY SOFIA

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SEEKING FUNDS FROM AS FAR AFIELD AS POLAND AND CANADA IN
 AN ATTEMPT TO KEEP UP ITS INTEREST PAYMENTS AND TO STAVE
 OFF THE INEVITABLE DAY OF RECKONING WHICH -- PARTICULARLY
 IF IT COMES FOR ANY OF THESE MAJOR OPERATORS IN THE RUN-
 UP TO THE ELECTIONS -- MIGHT CREATE A PARTICULARLY LARGE
 SCANDAL FOR THE GOVERNMENT TO FEND OFF.

CORRUPTION STILL RAMPANT

 8. CORRUPTION REMAINS A POWERFUL DETERRENT TO
 PROGRESSIVE DEVELOPMENT OF THE BANKING SECTOR, AS IT HAS
 BEEN IN OTHER BUSINESS SECTORS AS WELL. A PEACE CORPS
 OFFICIAL RECENTLY TOLD US THAT A VOLUNTEER ASSIGNED TO
 WORK WITH AN ALBANIAN BANK, WHEN ASKED WHAT HE WAS

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GETTING OUT OF HIS JOB, REPLIED, "I'M LEARNING A LOT ABOUT CORRUPTION." OTHER AMERICAN BUSINESS ADVISORS HAVE TOLD US THAT INEFFICIENCY AND LACK OF EMPLOYEE INITIATIVE -- INCLUDING EXTENDED "COFFEE BREAKS" AND "NO-SHOW" JOB POSITIONS -- ARE AS BIG A PROBLEM AS OVERT CORRUPTION.

9. CORRUPTION ALSO EXTENDS TO THE JUDICIARY, AND REPORTS OF MAGISTRATES ACCEPTING "CONSIDERATIONS" FOR THEIR RULINGS ARE COMMONPLACE. AS A RESULT, IT OFTEN IS IMPOSSIBLE FOR BANKS TO ENFORCE LOANS AGAINST CUSTOMERS WHO KNOW THE JUDGE PERSONALLY OR HAVE PUT IN A BRIBE. AND IN MANY CASES, MAGISTRATES SIMPLY ARE RELUCTANT TO PUT NON-PAYING FAMILIES OUT OF THEIR HOMES, SOMETIMES

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QUOTING CONFLICTING PORTIONS OF ALBANIAN PROPERTY LAW TO DEFEND THEIR DECISIONS. IN FACT, THE PRESS IN THE FALL OF 1995 REPORTED EXECUTION OF THE FIRST 14 FORECLOSURES -- OUT OF THOUSANDS OF DEFAULTS -- ON PROPERTIES AROUND THE COUNTRY. THIS WAS CONFIRMED BY THE GENERAL MANAGER OF THE NATIONAL SAVINGS BANK, BEDRI COLLAKU, WHO TOLD US THAT NO JUDGE IN TIRANA AND MOST OTHER MAJOR TOWNS WILL ENTERTAIN A FORECLOSURE. AS A RESULT, THE BANK WAS FORCED TO GO "MAGISTRATE SHOPPING" TO CARRY OUT FORECLOSURES WHERE IT APPEARED JUDGES WOULD BE AMENABLE TO SUCH JUDGMENTS. SO FAR, THAT REMAINS A FEW ISOLATED LOCALES SCATTERED THROUGH MOSTLY RURAL AREAS.

AWASH IN CASH

10. GIVEN A RETURN IN CONFIDENCE ON THE PART OF ALBANIANS IN THE NATIONAL CURRENCY, THE LEK, AND IN THE RELATIVE SECURITY OF THE BANKING SYSTEM IN GENERAL, DEPOSITS IN SOME BANKS HAVE SOARED. COLLAKU TOLD US THAT HIS BALANCE SHEETS OFTEN JUMP BY UPWARDS OF USD 13 MILLION PER MONTH AND -- PREVENTED BY STRICT NEW LENDING STANDARDS -- WAS FORCED TO INVEST MUCH OF THIS CASH ABROAD SINCE IT COULD NOT SAFELY BE LENT OUT DOMESTICALLY. HE ALSO LAMENTED IMF RULES THAT PUT CEILINGS ON DOMESTIC LENDING, AN ARGUMENT DISPUTED BY IMF LOCAL REPRESENTATIVE FRANZ DREES, WHO INSISTS THAT THE SAVINGS BANK AND OTHERS NEVER HIT THEIR QUARTERLY CEILINGS AND THAT GROWING GOVERNMENT T-BILL ISSUES EAT UP MOST EXCESS CASH IN THE SYSTEM.

11. WHILE THE IMF AGREEMENT HAS LAPSED AND BANKS

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ESSENTIALLY ARE FREE TO DO AS THEY PLEASE, THE OLD RULES
ARE FOR THE MOST PART STILL BEING OBSERVED ON THE PREMISE
THAT A NEW IMF AGREEMENT EVENTUALLY WILL EMERGE. MUCH OF
THE AGREEMENT STRUCTURE AIMS AT KEEPING INFLATION -- NOW
DOWN TO VIRTUAL-ZERO -- AT BAY. COLLAKU ARGUES THAT THE
RULES FORCE THE BANKS INTO AN UNPROFITABLE CONUNDRUM,
PAYING INTEREST RATES IN SOME CASES OVER 14 PERCENT TO
ATTRACT FUNDS THAT THEY CANNOT ABSORB, AND THEN CHARGING
EQUIVALENTLY HIGH INTEREST RATES ON T-BILLS AND THE FEW
LOANS THEY ARE MAKING, LEAVING VIRTUALLY NO MARGIN FOR
OPERATING COSTS AND PROFIT. IN ESSENCE, EVERY LEK TAKEN
IN OR LENT OUT COMMITS THE BANKS TO UNPROFITABILITY FOR
THE TERM OF THE DEPOSIT OR INSTRUMENT.

BASKET CASES

12. SOME BANKS IN THE SYSTEM ARE BEST DESCRIBED AS BASKET
CASES. FOR INSTANCE, OBSERVERS REPORT THAT THE STATE-
OWNED RURAL COMMERCIAL BANK IS IN SUCH HOPELESS SHAPE
THAT IT MOST LIKELY WILL HAVE TO BE SHUT DOWN. THE IMF,
ACCORDING TO DREES, IS HOPING A FRENCH OR ITALIAN BANK
WILL COME IN TO TAKE OVER THE AILING OPERATION, ALTHOUGH
IT PROBABLY WILL TAKE A CASH INDUCEMENT FROM THE
GOVERNMENT FOR THEM TO DO SO. OTHER BANKS, SUCH AS THE

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SAVINGS BANK, ARE DOING BETTER, IN PART THANKS TO MUCH
TIGHTENED LENDING STANDARDS AND SOME PROGRESSIVE
PROCEDURAL INNOVATIONS. GENERAL MANAGER COLLAKU HAS TOLD
US THAT HE PERSONALLY AND THOROUGHLY INSPECTS AND
INVESTIGATES PROSPECTIVE COMMERCIAL BIDDERS BEFORE
APPROVING NEW LOANS, AND MORTGAGE SEEKERS HAVE TOLD US OF
EXTENSIVE BACKGROUND CHECKS BEFORE BEING APPROVED FOR 15-
PERCENT MORTGAGE LOANS ON TERMS NOW AS LONG AS 20 YEARS.
STILL, GIVEN THE CURRENT STATE OF THE JUDICIAL SYSTEM,
ANY LOAN REMAINS, AT BEST, AN EDUCATED GAMBLE.

COMMENT

13. UNTIL THE JUDICIAL SUPPORT SYSTEM COMES TO A CLEAR
POSITION IN FAVOR OF ENFORCING LENDERS' RIGHTS, AND THE
ALBANIAN SOCIAL VIEW OF CREDIT AS A RESPONSIBILITY
MATURES, THE BANKING SYSTEM PROBABLY WILL CONTINUE TO
REMAIN HAMSTRUNG. COMBINED WITH A LACK OF MODERN BANKING
TECHNOLOGY -- AS BASIC AS A CHECK-CLEARING SYSTEM --
INTERNAL CORRUPTION AND INEFFICIENCY, DISAGREEMENT OVER
APPROPRIATE LENDING CEILINGS, AND INTEREST RATES ON BOTH
SIDES OF THE LEDGER THAT LEAVE NO OPERATING OR PROFIT
MARGIN, PROBLEMS WITH ALBANIA'S BANKING SYSTEM APPEAR

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ENTRENCHED FOR YEARS TO COME. WHILE CURRENT AND
PROSPECTIVE PRIVATE BANKS COMING ON THE SCENE MAY HELP IN
CERTAIN AREAS -- PRIMARILY IN THE COMMERCIAL BANKING
SECTOR -- THEY FACE, AND WILL CONTINUE TO FACE, SOME OF
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THE SAME HURDLES NOW ENCOUNTERED BY THEIR STATE-OPERATED
COLLEAGUES. THE SITUATION IS WELL TERMED BY AMERICAN AND
FOREIGN ADVISORS STRUGGLING WITH THE SYSTEM AS "A MESS,"
AND FURTHER SERIOUS INDUSTRIAL AND TRADE DEVELOPMENT WILL
SUFFER AS A RESULT.

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