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Project: Reducing Cash Transactions

Scoping of the Problem

I. Problem identification

What is the problem?

-High level of cash in the economy

The economic and financial stability of the Albanian economy has had significant ramifications even in the payment system. Despite fast improvements during the last five years the payment system still remains in an infantile / basic stage.

The level of cash in circulation in economy either in terms of monetary aggregates or domestic output still continues to be high. Consequently the level of cash transactions remains high. The high level of cash outside the banking system facilitates the informal economy, decreases the efficiency of monetary policy and might pose threat the financial stability.

- High costs and risks of managing high volumes of cash for banking system

Cash is often viewed as an expensive means of payment and it is usually assumed that electronic payment instruments and electronic payments are more cost efficient than paper-based equivalents. In this sense the Albanian retail payment system is used in a less efficient way.

The costs incurred by the Central Bank are related to the production, distribution and the operational management of cash (security, transport, administrative and maintenance costs).

Cash is distributed to the general public mainly via the ATM system or over the counter at bank or Postal offices. Transactions over the counter comprise not only withdrawals but also deposits of cash by the public. These transactions give rise to mainly fixed costs in terms of office space, personnel and security. ATM terminals are also associated with high fixed costs, but there are also variable costs that arise for replenishing of cash of the terminals and bilateral bank interchange fees. The latter, however, are pure transfers between banks and do not represent a real use of resources even though they generate to privates costs and revenues for individual banks.

- *Consequently, higher costs for the consumers.*

Albanian consumers do not pay directly costs when perform cash transaction as in general they do not pay any fees for the withdrawal of cash. The only explicit cost that consumers have in the use of cash is the fixed annual fee that they pay for the card that they use for ATM withdrawals. However, consumers also incur implicit costs related to cash payments although they are not aware of (the cost of holding liquidity and the cost of time at the cash register).

Why is the (self)-regulatory intervention necessary?

Various governmental institutions in the country have undertaken initiatives to curb the high level of cash in the economy. The scope of these institutions' interventions by (as to be expected) has been related to their mandate or legislative tasks i.e. Albanian government's main objective has been to reduce informal economy, one of Bank of Albania's objectives is to promote the normal function of the payment system.

Bank of Albania has been one of the first institutions to deal with the phenomenon of high level of the cash in circulation as one of its fundamental tasks defined by the law "On the Bank of Albania" is to promote and sustain the payment system. In addition high level of cash decreases the efficiency of monetary policy. In carrying out its tasks, Bank of Albania has played an intermediary role in the clearing and settlement of interbank payments.

In 2003 Bank of Albania in collaboration with other institutions initiate a campaign for the reduction of the use of cash in the economy¹. In addition to this campaign, in order to facilitate the interbank payments BoA has implemented:

- (i) the Albanian Interbank Payment System (AIPS) that settles systemically important payments (such as payments between settlement participants, bank-to-bank payments, including payments to and from the BoA; payments on government securities transactions, using the DVP mechanism; net transfers of funds requiring designated time settlement; and large-value customer payments. This is a system based on the core RTGS principles;
- (ii) The Albanian Electronic Clearing House System (AECH), an electronic clearing system owned and operated by BoA, in which files of bulk (high volume) low value payment instructions (both credit transfers and direct debits) are exchanged among banks and other credit institutions after the net positions have been settled through RTGS.

AIPS and AECH have automated the clearing service provided by the Bank of Albania to commercial banks for processing payments to their clients. The implementation of these systems improvements in the national payments system in terms of increasing speed, reducing cost and security increasing in their processing.

In addition, during the last two years the Albanian government has undertaken several legal and administrative initiatives to reduce cash transactions in economy with final objective to combat the informal economy.

¹ Some of the changes and amendments presented above were identifies during this campaign.

- On July 2007, the Albanian Government amended some articles in the Law on Taxation Procedures in the Republic of Albania that are in line with cash reduction initiative. The upper limit allowed to use cash for the purchase of goods and services was revised downward from 1,000,000 lek to 300,000 lek, but not more than 10% of the total purchases of that fiscal year / tax period. All the acquisitions above this amount should be paid through the banking system.
- On May 2007 the Council of Ministers issued a decree on the minimal reference monthly wage to be used in the computation of the social security, health insurance and tax contributions with the provision that contributions have to be paid to the respective state institutions through the banking system or the post office network.
- In addition to the legal aspect the General Directorate of Taxation is working for modernizing the payment procedures in order to facilitate the non-cash payment of the taxes. They are working on the implementation of an on-line payment system and on the reduction and the simplification of the procedures to be followed by the taxpayers.

Alternative to cash payments, such as payments through cards, also bear cost for the parties involved, but in general the efficiency in terms of time, speed and cost is higher.

In this landscape the banking community, through its own resources can compliment the actions undertaken until now and identify alternative routes that will lead to lower cash transactions, lower costs and higher efficiency.

II. Definition of policy objectives

General objectives:

To reduce the use of cash transactions in the economy, and:

- improve financial intermediation;
- promote greater efficiency in the financial sector.

Operational objectives:

- To identify actions and measures that will lead in the reduction of cash transactions and in the increase of alternative transactions
- To build public awareness on the benefits of using non-cash payment means.

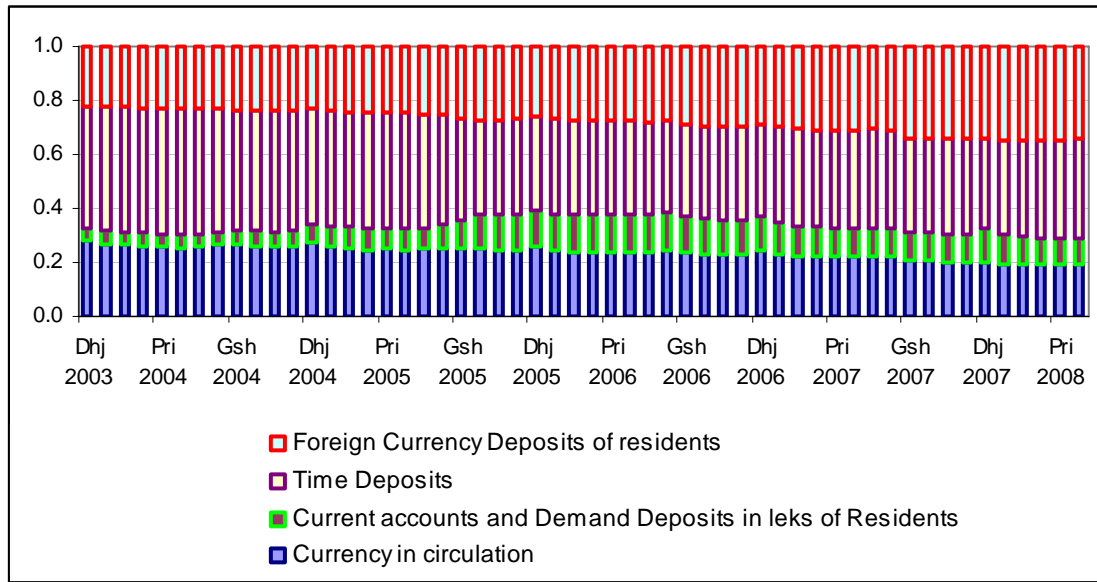
Specific objectives:

- To reach common understanding in the banking community to sign and implement the Protocol.
- To prepare an action plan for public awareness building

III. Development of the “do nothing”

Is seen from the following chart the currency in circulation makes up to 20% of the M3 aggregate, almost 3 times higher than the weight that this component has in EU member states (aggregate level).

Chart 1. M3 decomposition



Source: Bank of Albania.

During 2007 the AIPS system processes 45,480 transactions with a value of 3,744 mld lek that is 11% higher compared to the level of activity a year earlier. While in the AECH system during 2007 were processed 71,857 transactions with a value of 11.99 mld lek, nearly 56% higher compared to the activity during 2006.

In average daily are processed with:

AIPS - 183 transactions, with a total daily value of 15.1 mld lek,

AECH - 290 transactions, with a total daily value of 48 mil lek.

Chart 2. Types of transactions and the relative weights, 2007.

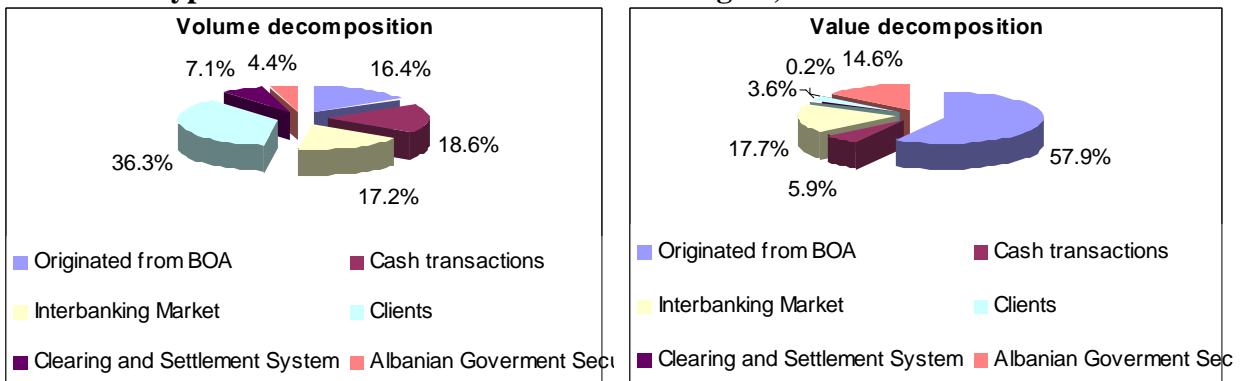
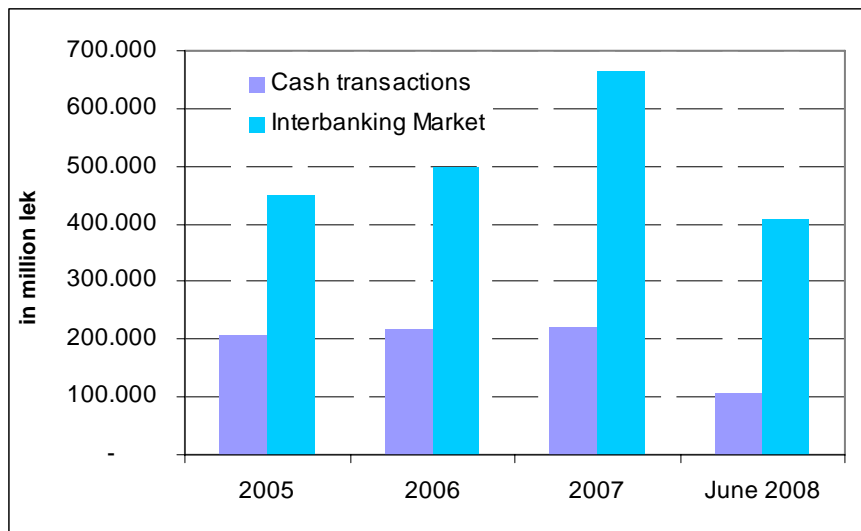


Chart 3. The evolution of cash and interbanking transactions 2005 –June 2008.



Source: Bank of Albania

As result the level of involvement of the banking system in the payment system of the economy has increased and the level of currency outside the banking system is gradually falling but still is far from the international / European standards.

IV. Alternative Policy options

The alternative policy option (to the status quo) to further reduce the volumes of cash transactions within the banking system is the establishment of a common policy among banks that will target:

- a. the reduction of cash transaction by creating disincentives for cash use; combined with
- b. the increase of non-cash transactions by creating incentives for the costumers to use alternatives to cash.”