Euroization of the Economy and the Negative Impact of the Strengthening of the Local Currency on Exports and Other Economic Indicators in Albania

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Abstract

The Albanian economy is a small and open economy. As such, it is quickly influenced by the turbulence of the global, European, and regional economies. Economic theory emphasizes the link between the exchange rate, exports, the consumer price index, and the balance of foreign trade. The purpose of this article is to study the impact of the exchange rate, primarily at the export level, while also considering other economic factors within the framework of the overvaluation of the Albanian currency (ALL) against the currencies of partner countries, mainly the Euro. The overvaluation of the Albanian currency has led to discouraging exports and increasing imports, influencing the rise in the Consumer Price Index, meaning higher consumer prices. This is due to the fact that the Albanian economy is mainly dependent on imports. The empirical and econometric models used, along with the factors included in this study according to the hypotheses raised, are related to assessing the mutual relationships of the exchange rate with other economic factors for the time period 2018-2023. The results imply and depict the integrated relationship between the exchange rate and exports and other economic factors, as well as supporting the fact that the real exchange rate (RER) has deviated from its equilibrium level. The conclusions in this study confirm that an overvalued domestic currency has increased costs for operations conducted in the local currency ALL, reducing income for operations conducted in Euro and other currencies. This overvaluation of the domestic currency has resulted in losses for exporting companies, impacting the trade balance. Based on the findings in this study, it is crucial for financial institutions and policymakers to be consistent in monitoring the exchange rate, especially EUR/ALL, to improve the long-term relationships between the exchange rate, exports, and other economic factors.

Keywords: *Exchange Rate, Export Level, Trade Balance, Consumer Price Index.*

Introduction

In recent years, the Albanian economy has been facing a situation that cannot be considered as normal in the foreign exchange market of the domestic currency against foreign currencies, mainly the Euro. The overvaluation of the Lek, or in other words, the weakening of the Euro, requires a thorough analysis, primarily by economic experts, as some government institutions, in a hurried manner, have interpreted this overvaluation of the Albanian currency as a strengthening of the national economy, emphasizing some factors that have influenced both sides of the foreign exchange rate equation, where, in fact, the results of some economic indicators reflect the opposite with pronounced negative effects (Narayan, 2020).

Facing a significant loss from exports, which in 2023 reached around 225 million Euros due to the fall of the Euro exchange rate, confirms the impact that the overvaluation of the Albanian currency has had (Hoxha, 2023). Referring to the reality of the Albanian economy for the period 2018-2023, the negative consequences of disrupting this equilibrium through the overvaluation of the Lek are evident, damaging exports and, at the same time, the effects are felt in other sectors such as fashion businesses working with imported materials, tourism operators, and industries providing services contracted with foreign clients, which are exposing the weakening role of the Albanian economy in the region.

Before the experts, several questions can be raised:

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- Why is Albania in this situation in the foreign exchange market?

- Are there other factors, in addition to those officially declared, that explain this situation of the overvaluation of the ALL?

- What are the true consequences of the overvaluation of the ALL?

The overvaluation of the ALL is detrimental to the Albanian economy, and this should not be seen and treated only in terms of restraining domestic exports, but also in worsening the situation of manufacturing and fashion companies, as well as those companies engaged in trade with the euro while having their basic expenses in the ALL currency (Mansoor et al., 2020).

The facts indicate that these companies are more exposed to a risk that is already systematic and occurs due to their use of the ALL currency as operational expenses, with no alternative choice, as their activities are take place in Albania. Our analysis becomes even more complicated when it comes to the dominance of the euro, especially in transactions within the Albanian market.

Statistics show that around 60 percent of business transactions in the Albanian economy are conducted using the euro, especially in real estate sector, online transactions, the rental system, construction works, credit financing, and even in prices for hotels, restaurants, airplane tickets, furniture, etc. (Gjergji, 2023). This situation reinforces the idea suggested from the outset that in the Albanian economy, the primary transactions are not carried out in lek but in the euro currency. This is the main reason why the Albanian currency ALL has been overvalued, limiting it significantly even though it is the national currency.

This situation clearly indicates that the Albanian economy is naturally moving towards a process of euroization, which is not official but has been progressing rapidly, especially in the last ten years. It is the duty of the financial institutions in the country, primarily the Bank of Albania, to manage this phenomenon properly, as it reflects consequences not only with significant losses in exports but also has a noticeable impact on other economic factors in Albania.

The main concern today is the trade risk associated with businesses' exposure to a variety of risks during their trading activities, dealing with competition, technology, suppliers, customers, banks, taxes, and other factors. Managing this risk is not only a managerial problem but also a responsibility of the state.

The Albanian monetary economy is closely related with two main currencies, the official currency Lek (ALL), and the euro. One is official but lacks the necessary authority, while the other has authority and territory but is not official. The monetary pressure exerted by the surrounding geographical economies, such as the eurozone economy and the European economy, is strong from a trade perspective.

In the circumstances of an established system that has already gained ground in the Albanian economy, the phenomenon of the overuse of Lek is an expected occurrence and will continue in the future. In this context, it is the duty of the Central Bank to act in accordance with the attributes granted by the law, to discourage the use of the euro in circulation through measures of administrative and regulatory nature, in line with its legal competencies.

In the Albanian reality, we have two types of exchange rates:

Fixed exchange rates, which are officially determined by the state and are relatively unchanging.

Flexible exchange rates determined by factors that constitute the supply and demand for the domestic currency in the market.

Figure 1. The impact of the real exchange rate on the Albanian economy
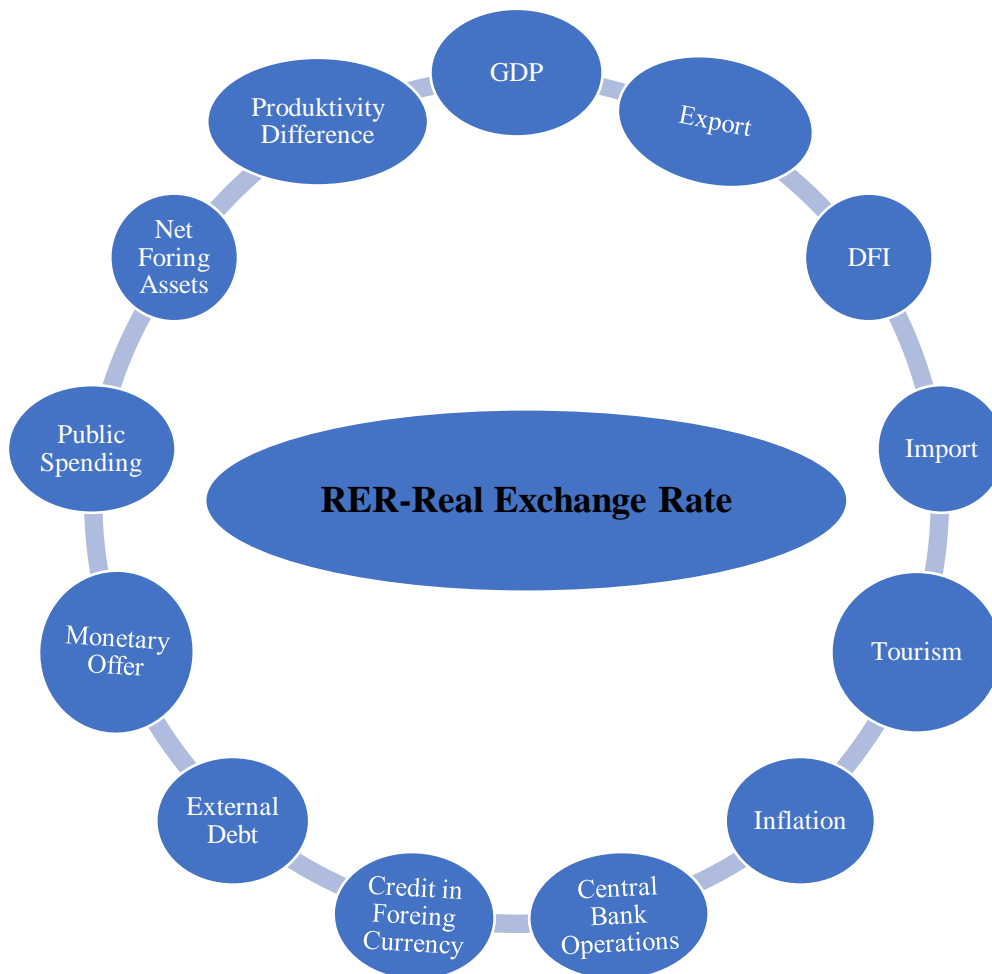
Source: authors

According to the data, the circulation of the euro in the Albanian market has reached historical records. In our local foreign exchange market, which takes place within the banking system and exchange offices, 7.9 billion euros were converted throughout the year 2022, with a slight emphasis also in 2023, where in just the first four months of the year, the exchanged value of the euro amounted to 2.432 billion euros, 186 million higher than the same period the previous year (Hoxha, 2023). The increase in the quantity of euros in circulation in recent years is higher than the progression of economic growth or its natural growth trend. The mismatch between imports-exports and exchange growth indicates that there is more Euro currency in circulation than the market demands.

Fluctuations in the exchange rate mainly occur due to the euro and other currencies entering the market through exports, remittances, foreign direct investments, tourism, but also due to the high frequency of supply and demand during and after national/local election seasons. In these cases, there are flows of the Euro currency into the market, where the law of supply and demand comes into effect (Bussière and Gaulier, 2020).

All this description of the situation culminates in the legitimate concern of producers and exporters who, due to exchange rate fluctuations and the continuous devaluation of the currency, have been and continue to be harmed in their businesses. This is because the overvaluation of the Lek hampers the development of local production, such as in industry, agriculture, tourism, etc. If intelligent financial and economic

policies are not built, there is a risk that the country's economy will move towards a consumer society (Leu, 2011).

According to official data from INSTAT and the Bank of Albania (2023), as well as other press sources, it appears that the euro currency entering the market through exports, remittances, foreign direct investments, and tourism expenses amounts to 7.147 billion euros. These flows have mainly come from exports to European Union countries and Kosovo, totaling 3.01 billion euros, from tourists from European countries, Kosovo, and Balkan countries, totaling 2.463 billion euros, from emigrants' remittances amounting to 834 million euros, from foreign investments from European Union countries and Kosovo amounting to 698 million euros, and from operations in the domestic market by the Central Bank totaling 142 million euros.

Confirmed data reveals a difference between the amount of euros entering from documented sources (7.147 billion euros) and the euros converted into lek (7.9 billion euros). This difference amounts to approximately 753 million euros, which come from various sources, mainly through informal channels (Hoxha, 2023).

According to field expert, Selami Xhepa, the increase in euro flows has been accompanied by the overvaluation of the national currency during these years. The dynamics of the euro exchange rate have resulted in pronounced fluctuations. Over a 10-year period, there is an overvaluation of around 26% of the euro, creating disruptions in the currency market and negatively affecting, especially, export-oriented businesses.

The Impact of The Real Exchange Rate and the Trade Balance in Albania

To analyze the impact of the exchange rate of the local currency, we have examined a time period of six years (2018 – Q3-2023). Referring to this period, we have analyzed the trend of the trade balance, considering it in relation to the fluctuations of the exchange rate for this period, which has typically been characterized by a consistently negative current account balance with overall fluctuations showing an increasing trend. In this context, this period has also been accompanied by current transactions with a higher value, experiencing a faster growth compared to other components in the trade of goods and current transfer entries.

Regarding the trade balance, we observe a gradual decline until the year 2020. After this year, there is an accentuation of this situation, deepening the trade deficit in absolute figures. This situation has continued until the year 2022. After this year, there has been again a deepening of this trend, expected to continue into the following year (INSTAT 2023).

The deepening of the trade deficit in goods is a key factor that has influenced the expansion of the current account deficit. If we delve into our study of exports and imports of goods, we will notice that the coverage rate against imports has been relatively low throughout the entire period under consideration. Looking at the trade balance by goods group, we observe an almost consistent deficit in all categories of goods groups, and it is a deficit that has been gradually increasing from year to year. The growth in exports in the years 2021-2023, compared to imports, is justified by an increase in demand for investments. However, since there is a rapid increase in the import of consumer goods, this indicates that such growth is a consequence of the rising demand for consumption. On the other hand, we see that exports of goods are more concentrated in the textiles and construction materials group, where, in the case of textiles, the trade balance is positive throughout the period under consideration.

Research Problem

Economic theory tells us that there is a systematic relationship between the exchange rate of the local currency (ALL) and the trade balance (exports and imports): the overprice of the local currency (ALL) against foreign currencies, mainly the euro, since it is also the primary foreign currency in the Albanian economy. This leads to an increase in the presence of imported goods in the domestic market, while the

exported goods become less competitive in the foreign market, discouraging export promotion with a negative impact on the trade balance.

In these conditions, the exchange rate becomes an efficient regulatory mechanism for competition in international trade between different countries, and this is more pronounced among countries with a relatively significant weight in international trade. Of course, such a strong connection is expected to occur under conditions of perfect competition and accurately measured variables (meaning accurately measuring the actual trade volume and exchange rate existing in the market). However, given the still low weight of Albanian exports and their weak competitiveness in the international market, the fluctuation of the exchange rate between the local currency (ALL) and the euro will influence, not with the same intensity, the fluctuation of consumer prices and the country's trade balance.

In economic theory, it is also explained that there should be a positive relationship between the CPI, the exchange rate, and the trade balance: if the euro depreciates, in an economy where imports of consumer goods are significant, it is expected that goods and services will become cheaper, so, the CPI decreases. Additionally, when the trade balance deepens in favor of imports, especially for consumer goods, it is expected that the Consumer Price Index (CPI) will increase, leading to inflation. In this case, there is a kind of "import" of inflation, especially in cases where the prices of these goods outside the country increase. In this way, the increase in imports may occur not only due to the growth of the physical volume of imports but also due to their high value as a result of high import prices. The problem lies in the fact that these relationships have not been tested and evaluated for the Albanian economy, and, consequently, their effects are not recognized in this economy, departing from the framework of the positive linkage equilibrium.

Methodology and Methods

The methodology used in this research article is econometric and statistical modeling, primarily employing regression models with two or more variables. The data were collected from the Bank of Albania and INSTAT for the time period from 2018 to 2023.

- *The Data Sources* consist of a combination of primary and secondary data. Primary research is supported by data collected mainly through meetings with business representatives in the export sector, while secondary data are the result of information obtained through official channels and literature.

- *Data Processing* is based on the use of various econometric and statistical methods such as SPSS, Excel, descriptive analysis, cross-tabulation tables using analysis and representation methods, as well as correlation analysis between variables.

- Research methods in this study include multivariable methods along with factor analysis, regression techniques, correlation, and forecasting techniques. Multivariable methods are employed to discover relationships resulting from the interaction and interdependence of key variables at the same time. On the other hand, factor analysis helps identify relationships between variables and forms "evaluation points" (factors) for these variables.

- Study period: The study was conducted in the period from January to November 2023.

Formulas Used

- *Calculation of Weights Wi:*

$$Wi = \frac{(Xi + Mi)}{\sum_{i=1}^{n} (Xi + Mi)}$$

Where:

Xi and Mi = the level of exports and imports with the partner country *i*,

$\sum_{i=1}^{n}(Xi + Mi)$ = the total level of exports and imports of Albania.

- *Trade Opening*

$$OPEN = \frac{EXP + IMP}{GDP}$$

Where:

o **Open =** Market opening

o **EXP=** Exports

o **IMP=** Impots

o **GDP=** Gross Domestic Product

The variables considered are the following three:

- The Euro exchange rate with the local currency ALL, expressed in the exchange rate of ALL/EUR.

- The trade balance expressed as the difference between exports and imports.

- The Consumer Price Index (CPI) expressed as a percentage.

Study Results Analysis

The exchange rate has served as a "beam" for Albanian exports, given that exports represent the basic sector, which trades beyond its borders, generates cash flows in the country's economy, and provides stimulation for continuous economic development. This definition by the American economist Robert Solow (1987), Nobel Prize winner in Economic Sciences in 1987, along with the arguments of researchers Helpman and Krugman that exports help poor countries and those with small markets benefit from economies of scale, becomes more significant when addressing the foreign trade balance in Albania (Arnold, 2010).

There exists a close relationship between the exchange rate and foreign trade in general, and exports in particular. The results in this study indicate that while income is the main driver of trade flows in Albania, the exchange rate plays a crucial role in promoting export growth and import substitution. The depreciation of the euro and the strengthening of the (ALL) for the studied period have primarily harmed exporting companies, as they earn revenue from selling products in euros, while their operating expenses are in lek. The losses resulting solely from this effect for the year 2022 amount to around 20% of their income.

The table below provides a more complete overview of the progress of the circulation of goods and the exchange rate of EUR with ALL and CPI.

Table 1. Flow of Goods in Foreign Trade (2018 – Q3-2023)

Million ALL					
Year	**2018**	**2019**	**2020**	**2021**	**2022**	**Q3-2023**
Export (FOB)	310 436	298 792	271 955	368 769	486 784	371 123
Import (CIF)	641 466	649 118	605 262	800 718	950 381	723 356

| Trade Balance	-331 030	-350 327	-333 307	-431 949	-463 597	-352 233
Trade Volume	951 901	947 910	877 217	1 169 487	1 437 165	1 094 479
The Percentage of Coverage	48,4	46,0	44,9	46,1	51,2	49.0
Exchange rate	118,80	122,99	123,60	122,44	118,92	110,19
Consumer Price Index - CPI	2.025	1.408	1.625	2.050	6.725	4.854

Source: INSTAT and Bank of Albania (2023)

Processed by authors

The data from the Institute of Statistics (INSTAT) show that in the month of November 2023, the total value of exported products fell to less than 27.5 billion ALL from over 35 billion in August of the previous year. The loss in this case is calculated to be around 72 million euros (INSTAT, 2023).

Mainly, the negative trend has been influenced by the exchange rate, but other markets have also offered lower prices than Albanian exporters, reducing demand for domestic products. Only towards European Union countries, in the period from January to August 2023, Albanian companies exported 22 billion ALL less. In this context, what makes the situation even more concerning is the fact that the decline in exports is affecting almost all categories of goods. INSTAT data (2023) show that in the period from January to August 2023, there were fewer exports of mineral products, textiles, wood products, exchange equipment, and food sold in foreign markets.

Figure 2. Dynamics of the Euro/ALL Exchange Rate
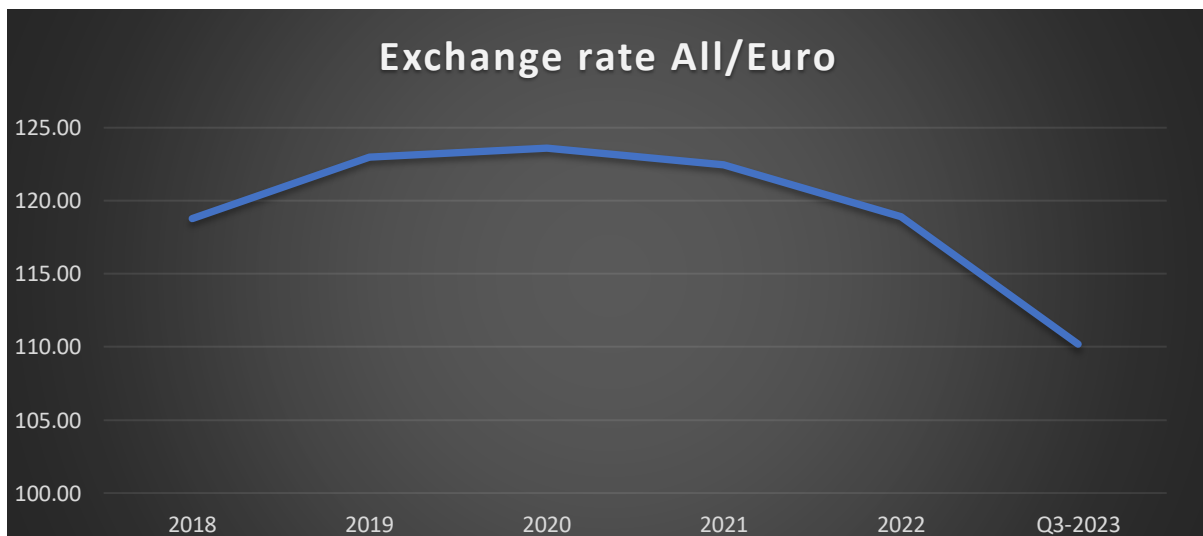
Source: Bank of Albania; Processed by authors

Indicator Trends: The data proves that the exchange rate (of EUR) has a generally negative dynamic, as the chart above illustrates.

The trend of the euro's decline against the lek has been on a downward trajectory for some time. It was expected that this trend would be further reinforced. Currently, this monetary amount of the foreign currency also comes due to the positive performance of tourism. While this is considered a positive development for tourism, it puts extraordinary pressure on the national currency, creating serious concerns for the economy, which have actually been present for some time.

On the other hand, these exchange rate developments also have a negative effect on the tourism sector itself because all operators with previous contracts tied to the euro earn less as the purchasing power of this currency has decreased. Meanwhile, an increase in tourist packages in the coming years to compensate for the currency depreciation effect will be accompanied by tourism losses. In this sense, we have raised concerns for some time that monetary authorities should pay more attention to the exchange rate (Xhepa, 2023).

The impact of the depreciation of the euro in the export sector will continue to be concerning. The impact extends beyond exports because the entire domestic manufacturing industry that competes with the import sector is under extraordinary competitive pressure, as imports can enter the domestic market at a much more competitive price than local production. This means that the effects of the exchange rate will be felt much more in the coming years.

On its part, the Bank of Albania has been and remains consistently committed to creating a monetary and financial environment that is as secure, sustainable, and transparent as possible, in the interest of the sustainable development of the economy. According to the Governor of the Bank of Albania, Gent Sejko (2023), the banking sector in Albania has long been offering instruments such as forward contracts, which provide protection against strong and undesirable movements in the exchange rate. He emphasizes that the Bank of Albania remains ready to support the production sector for export, providing training and expertise for the use of these instruments (Sejko, 2023).

Figure 3. Dynamics of Albanian Exports (2018 - Q3-2023)
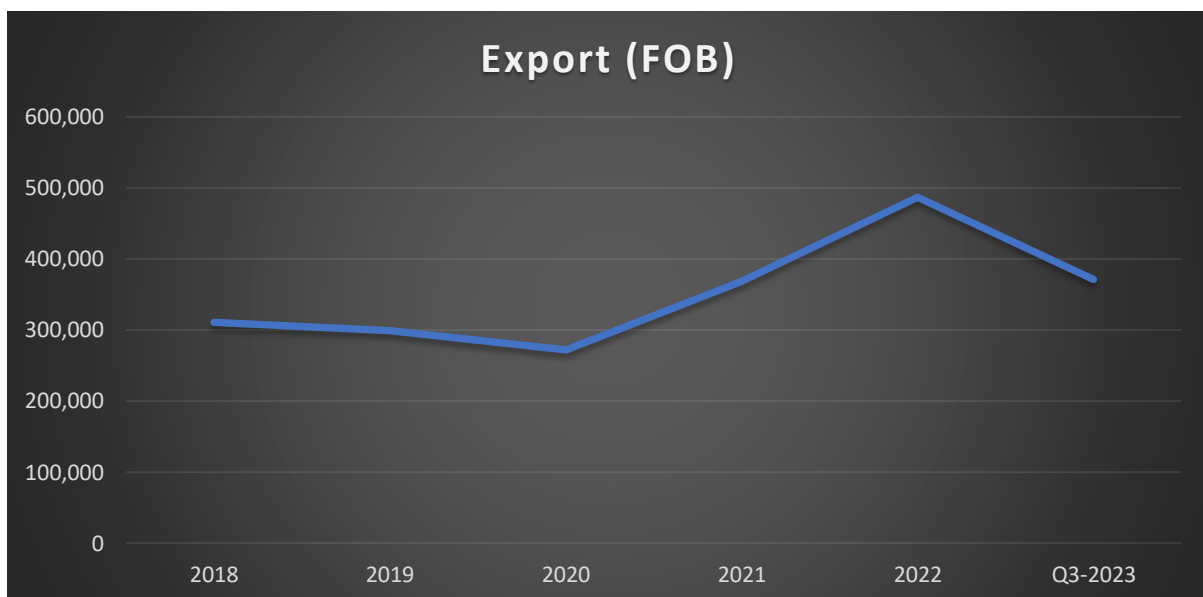
Source: INSTAT; Processed by authors

Trend Analysis: From the data, it appears that the dynamics of exports exhibit continuous fluctuations, consistently remaining in negative terms, as seen in figure 3.

Along with foreign direct investments, tourism, and remittances, the revival of exports is considered crucial for the Albanian economy. The trade balance represents one of the dominant elements in the current account, and its significance lies in providing information regarding trade exchanges with other countries. As such, it allows us to identify production and consumption power, domestic and foreign demand, trends, as well as information on which countries Albania is closely connected to economically and which sectors require careful reforms.

The export and import of goods are not only the essence of a large and successful business but also contribute to the growth and expansion of national economies. Therefore, in these circumstances, enterprises in this sector, along with economists, join forces with the aim of saving exports.

According to official data from INSTAT (2023), the year 2023 witnessed a decline in exports by a rate of minus 8.6 percent compared to the same period one year earlier. The main losers of the overvaluation of the national currency are exporters because, when the domestic currency is overvalued, exports become more expensive for foreign buyers, making domestic products less competitive in the global market. This leads to a reduction in market share, a decrease in profits, job losses in export-oriented industries, and results not only in economic challenges but also in social consequences.

According to Albanian finance expert Arben Malaj (2023), if a country's economy has a large trade deficit, an overvalued currency can worsen it. Mitigating the non-positive effects of the overvaluation of the lek imposes negative effects on exporters. These consequences impose a dual approach that combines monetary and fiscal policies.

The largest decline is noticed in the product groups of textiles and footwear, wood and paper products, as well as chemical and plastic products. Only the outsourcing sector, which works with imported materials, has about 75 thousand employees and represents around 40 percent of Albanian exports (Malaj, 2023). Beyond the economic impact, the most feared prediction is that this situation could generate a social impact with people exiting the job market, which is challenging to integrate into other sectors later on. The depreciation of the euro is a serious concern because its effects will be felt in the coming years.

Figure 4. Dynamics of CPI (2018 - Q3-2023)
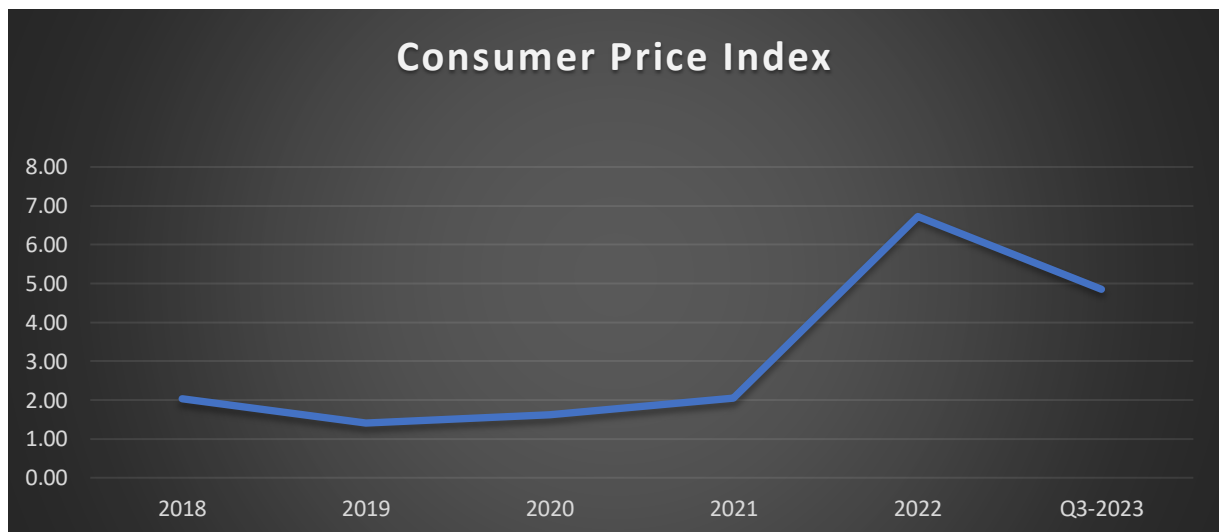
Indicator Trends: As illustrated in the above figure, from the data, it appears that the dynamics of the Consumer Price Index are positive and follow an almost linear line with systematic changes.

Table 2. The Impact of the "Exchange Rate" on the "Trade Balance"

Variable	Coefficient	Standard Error	t	Problem
Con.	-1554.6	246.7437	-4.4834	0.004
Rate/Course	-4.2678	2.7853	-1.5323	0.176
R	0.28125	Moving Average Variable		-2068.9
Ri Adjusted	0.16146	Standard Error of the Variable		268.9182

SE of the Regression	246.2534	Akaike Information Criterion (AIC)	-56.2517
SCM	363844.4	Schwarz's Criterion Model	-56.3311
Log Likelihood	-54.2517	Standard.F	0.96593
Stand.d	1.3836	Prob.(Standard.F)	0.1765

Source: Authors

Using the data from table 2, we can also construct the regression equation with two variables that expresses the relationship between the trade balance and the exchange rate:

Y = -1554.6 -4.2678*X

⇒ **Con** = -1554.6 → this value shows that if the exchange rate were 0 then the trade balance would be (-1554.6).

⇒ **B** = (-4.2678*X) → shows that if the exchange rate were to decrease by 1 unit, the value of the trade balance would decrease by 4.26 million EUR.

Regardless of the interpretation of these coefficients, it should be emphasized that the trade balance does not significantly depend on the exchange rate. We reach this conclusion because the value of the coefficient of determination, which in our case is $r^2 = 28\%$, indicates that the regression does not explain the data well, although it is observed that with the decrease in the exchange rate, the balance tends to increase, and vice versa.

Since the study shows that the exchange rate does not significantly affect the trade balance, we can assert that it does not have a meaningful impact on the balance of payments either. If the exchange rate were to influence the trade balance, for example, by increasing or decreasing it, this effect would also be reflected in the increase and decrease of the balance of payments.

Table 3. The Impact of the "Exchange Rate" on the "CPI"

Variable	Coefficient	Standard Error	t	Problem
C	5.7349	22.9237	0.25017	0.811
Course	0.74954	0.17205	4.3565	0.005
R	0.75980	Moving Average Variable		105.4250
Ri Adjusted	0.71977	Standard Error of the Variable		7.3120
SE of the Regression	3.8707	Akaike Information Criterion (AIC)		-23.0283
SIC	89.8950	Schwarz's Criterion Model		-23.1078
Log Likelihood	-21.0283	Standard.F		0.9795
Stand.d	1.4733	Prob.(Standard.F)		0.005

Y = 5.7349 + 0.74954 *X

Considering that $r^2 = 75\%$, we can claim that CPI stylistically depends on the exchange rate. This implies that with a 1 lek increase in the exchange rate, it is expected that CPI will increase by 0.75%.

The question that arises is: Is the exchange rate effective in the strategy of promoting exports and improving the trade balance?

In theory, the overvaluation of the domestic currency Lek discourages exports and encourages imports, leading to an increase in the trade deficit. However, in the Albanian economy, there is no systematic fulfillment of this relationship for several reasons:

Firstly, the Albanian economy is an open economy and relies mainly on trade, not producing enough for its needs. Secondly, the overvaluation of the domestic currency Lek does not necessarily mean a decrease in the competitiveness of Albanian products in the global market. This is because competitiveness depends not only on the nominal exchange rate but also on the real exchange rate. The real exchange rate is the ratio of price indices in respective countries and is given by the formula:

$$RER = \text{NER } \frac{\text{CPI} *}{\text{CPI}}$$

Where:

- **RER =** Real Exchange Rate

- **NER** = Nominal Exchange Rate

- **CPI* =** Consumer Price Index of the countries that use the Euro currency

- **CPI =** Consumer Price Index of the country

The increase in the Real Exchange Rate (RER) expresses the improvement in competitiveness, while the Nominal Exchange Rate (NER) represents the nominal exchange rate of the Lek against the Euro. Thus, a decrease in NER will cause a decrease in the real exchange rate, but, on the other hand, there is an increase in the Consumer Price Index (CPI). Therefore, competitiveness will not decrease as much as the nominal exchange rate.

The increase in the Real Exchange Rate (RER) expresses the improvement in competitiveness, while the Nominal Exchange Rate (NER) represents the nominal exchange rate of the Lek against the Euro. Thus, a decrease in NER will cause a decrease in the real exchange rate, but, on the other hand, we have an increase in the Consumer Price Index (CPI). Therefore, competitiveness will not decrease as much as the nominal exchange rate.

The increase in the price of domestic products does not automatically mean a narrowing of the trade deficit. With the increase in the price of domestic goods expressed in foreign currency, real income from exports will increase. In circumstances where imports remain constant, the result would be negative for Albania, and the trade deficit would deepen.

In the figure above, the nominal exchange rate of ALL against the Euro is presented, as well as the real exchange rate calculated according to the formula above. The trend of the real exchange rate in Albania during the transition period indicates a relatively strong tendency of overvaluation of the real local currency ALL, which means a decrease in the competitiveness of Albanian goods in the international market.

This confirms the fact that the demand and supply for exports in the Albanian economy are not elastic, aligning with the demand for imported goods, which also lacks elasticity concerning prices. Additionally, this has rendered the policy of lowering prices through changes in the exchange rate ineffective. If we add to this the high profit margins of importing traders, the process becomes even more challenging to analyze.

In conclusion, it can be said that changes in exchange rates are not effective for the Albanian trade. To improve the trade deficit, changes in the trade structure are needed. Improving the trade balance cannot be achieved through the short route of reducing imports. In fact, imports of capital goods should be encouraged rather than reduced. Attempts to reduce the import of basic goods would not be fruitful, but any effort to replace imports with domestically produced goods of the same quality would be beneficial. A

positive step would be to encourage the manufacturing and agricultural sectors for the export of these products.

Efforts for sustainable import substitution through economic restructuring and creating a conducive environment for private business align with initiatives to boost exports. Encouraging exports can be considered, in the long term, as the primary path to improving the trade balance.

Conclusions

Albania, over the past three decades, has consistently experienced a negative trade balance, which also contributes to the current account deficit. This is because the trade balance is a key component of the current account. Despite the reduction in the import-export ratio, the trade deficit has remained the primary factor influencing the current account deficit. Regarding the empirical assessment, some of the key conclusions drawn from the analysis are as follows:

The level of consumer prices in Albania is significantly influenced by the exchange rate between the Euro and the local currency, the Lek. This is due to the substantial weight that consumer goods hold in Albanian imports.

Trade balance, contrary to what would be expected on theoretical grounds, does not seem to be influenced so systematically by the exchange rate. This has occurred because competition in the Albanian economy is not yet fully developed in the regional, European, and wider markets. This calls for more in-depth studies to be clarified.

The level of consumer prices depends to some extent, although not significantly, on the trade balance. This can be explained by the fact that Albania's trade balance is negative, and the change in prices in the global arena is transferred through imports to the level of consumer prices in Albania in what is known as imported inflation.

Regarding the effectiveness of the exchange rate, the overvaluation of the Albanian currency, Lek, has not been effective in increasing exports. In addition, it can be said that this overvaluation has not been effective even for Albanian trade and improving the trade deficit. These distortions need to be addressed through changes in the trade structure.

It is important that currency exchanges be conducted exclusively by banks and licensed exchange agencies, accompanied by the necessary documents for the currency exchange transactions.

Recommendations

It is important for professionals in financial, economic, and legal institutions to study the economic and financial effects resulting from the uncontrolled circulation of currencies in the domestic market.

The results of the study and the opinions of economic specialists suggest considering the possibility of conducting all transactions within the country using the local currency ALL, without allowing transactions with other currencies such as euro, dollar, etc., which currently constitute about 60% of economic and financial circulation in Albania. This would improve economic control through the use of the local currency ALL.

Currently, in the short term, we recommend the conditioned use of foreign currencies in the domestic market, and their conversion to be the prerogative of Albanian banks and licensed exchange units, as a transitional phase.

Monitoring and overseeing the exchange rate can be a tool to keep the acceptable level of consumer prices under control, therefore, it should perhaps be used especially when there are significant fluctuations in the local currency Lek.

Monitoring and observing the exchange rate can be a tool to keep the acceptable level of consumer prices under control; therefore, this tool may be used, especially when there are significant fluctuations in the local currency Lek.

To assess the relative role of the exchange rate in the trade balance, we would recommend a comprehensive study and evaluation of the factors influencing the trade balance, as well as an analysis of how competition functions in foreign trade.

For the improvement of the trade balance, we should not choose the short-term path of reducing imports since imports, especially those of capital goods, should be encouraged rather than reduced.

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