

Albania: Staff Report for the 2000 Article IV Consultation and Second Review Under the Second Annual Arrangement Under the Poverty Reduction and Growth Facility

This report was prepared by a staff team of the International Monetary Fund following discussions with the officials of Albania on economic developments and policies. The report was then considered by the IMF's Executive Board in the context of the IMF's periodic consultation with Albania, as required under Article IV of the IMF Articles of Agreement. The views expressed in the staff report itself are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF or of the authorities of Albania; a supplementary statement by IMF staff may also be included. The views of the Executive Board as expressed in the discussion of the Article IV consultation report and as summarized in a Public Information Notice (PIN) are also included. In addition, a statement by the member country authorities may be appended. Further background documentation prepared by IMF staff for the consultation may be published separately at a later date. The policy of publication of Article IV staff reports allows for the deletion of market sensitive information.

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ALBANIA

**Staff Report for the 2000 Article IV Consultation and
Second Review Under the Second Annual Arrangement
Under the Poverty Reduction and Growth Facility**

Prepared by the European I Department
(In consultation with other departments)

Approved by Robert Corker and G. Russell Kincaid

May 25, 2000

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I. INTRODUCTION

1. A mission visited Tirana during March 5-20 to hold the 2000 Article IV consultation discussions and to discuss: i) the interim Poverty Reduction Strategy Paper; ii) the second review under the second annual Poverty Reduction and Growth Facility (PRGF) arrangement; and iii) the third-year program under the PRGF arrangement.¹ Discussions were completed in Washington during the Spring meetings in April. Relations with the Fund are summarized in Appendix I.

2. The Executive Board completed the first review of the second annual arrangement under the PRGF on January 19, 2000. Executive Directors commended the authorities for their handling of the Kosovo refugee crisis, and their success in maintaining macroeconomic stability. Reiterating their views expressed at the conclusion of the Article IV consultation on June 14, 1999, Directors stressed the importance of improving tax administration with a view to providing sufficient resources for spending in key areas and meeting the deficit reduction target. They also emphasized the importance of completing privatization in the banking sector and accelerating it in other strategic sectors. Following the completion of the review, the cumulative disbursements reached SDR 30.93 million, which included a Kosovo-related augmentation of SDR 9.74 million, out of the total SDR 45.04 million committed under the three-year program.

3. In the attached letter, the authorities report on the progress under the program, request the completion of the second review under the second annual PRGF arrangement, and describe the economic policies they intend to pursue during the third annual program under the PRGF arrangement (Attachment I).² All performance criteria for end-March 2000 were observed (Tables 1 and 2). Moreover, the authorities have prepared an interim Poverty Reduction Strategy Paper (I-PRSP) (see EBD/00/41). In their joint assessment, the staffs of the Fund and IDA/World Bank have recommended the endorsement of the I-PRSP by the respective Executive Boards. The authorities intend to prepare a full PRSP by June 2001.

¹The mission met with President Meidani, Prime Minister Meta, Finance Minister Angjeli, Bank of Albania Governor Cani, and several other ministers and high officials. The staff team comprised Messrs. Mates (head), Samiei, and Rother (all EU1), Ms. Tamirisa (PDR), Mr. Baldini (FAD), and Ms. Phillips (Administrative Assistant, EU1). The resident representative, Mr. Treichel, assisted the mission. Mr. Nardelli from the Executive Director's office attended the concluding meetings. A number of World Bank staff also participated in the discussions.

² The request for the approval of a third annual arrangement will be submitted to the Board after the expiration of the second annual arrangement.

Table 1. Albania: Performance Criteria and Indicative Targets for 1999–2000
Cumulative Change from end-December 1998 1/

	End-June 1999 ^{2/}			End-Sept. 1999 ^{3/}			End-Dec. 1999 ^{2/}			End-March 2000 ^{3/}		
	Prog. 5/99	Adjusted Prog.	Actual	Prog. 5/99	Adjusted Prog.	Actual	Prog. 1/00	Adjusted Prog.	Actual	Prog. 1/00	Adjusted Prog.	Estimated
(In billions of lcks)												
1. Domestic credit to the government	10	5	3	19	16	12	26	25	26	32	33	28
2. Net domestic assets of the BoA	9	4	-6	13	10	-4	7	6	5	12	13	11
3. Tax revenues	29	29	29	50	50	47	67	67	64	84	84	83
4. Revenues collected by Customs Department	...	...	17	...	...	26	37	37	35	47	47	45
(In millions of U.S. dollars)												
5. Net international reserves of the BoA	-33	-8	70	-29	-18	89	73	77	99	56	48	103
6. Contracting or guaranteeing of non-concessional external debt with maturities 1-15 years	20	20	0	30	30	0	30	30	0	50	50	0
Of which: 1-5 years	5	5	0	5	5	0	10	10	0	10	10	0
7. Public and publicly-guaranteed external debt with maturities of up to 1 year	0	0	0	0	0	0	0	0	0	0	0	0

1/ For definitions see the Technical Memorandum of Understanding.

2/ Indicative targets.

3/ Performance criteria, except for tax and customs revenues, which are indicative targets.

Table 2. Albania: Remaining Structural Benchmarks under the Second Annual PRGF Arrangement

Measures and Deadlines		Status as of end-April 2000
1.	Select a buyer for Albania Mobile Communications (end-December 1999)	Revised under new MEFP
2.	Complete first registration in 1,350 cadastral zones by end-March 2000.	Expected for end-May
3.	Complete at least 4,500 agricultural land sales transactions by end-March 2000.	Full observance
4.	Maintain customs valuation reference file in line with market prices (throughout).	Full observance
5.	The internal audit units to produce weekly reports on violations of customs valuation rules and the Director General of Customs to take corrective actions and submit monthly reports to the Minister of Finance and Prime Minister on corrective actions taken (throughout).	Temporarily interrupted, resumed in May
6.	Reduce budgetary employment to below 126,000 by end-March 2000, and to below 124,000 by end-October 2000.	Reduction to 127,000 by end-March; to 124,000 projected for October
7.	Introduce a new GFS-based revenue classification and economic classification of expenditure (end-June 2000).	On track
8.	With respect to the Savings Bank: (i) institute transparent accounting practices and commercially-based fees for all fiscal agency and payments functions performed by the SB on behalf of the government (end-1999); (ii) prepare an analysis of the profitability of individual bank branches (end-March 2000); (iii) select a privatization advisor (end-April 2000); (iv) advertise for tenders (end-September 2000); (v) select a buyer (end-2000).	Continuing Full observance New date end-September, 2000 New date end-November, 2000 Revised
9.	Complete the implementation of the measures relating to the development of the treasury bill market agreed with MAE staff in July 1999 (end-March 2000).	Completed
10.	Present to parliament the privatization law for the fixed line telecommunications company (by end-February 2000) and select a buyer (by end-September 2000).	Part one completed
11.	Reorganize INSTAT and ensure that sufficient resources are provided for the development, compilation, and dissemination of statistics in line with international standards (end-June 2000).	On track

4. The World Bank has recently prepared an update of its Country Assistance Strategy, in which a stronger focus on poverty issues has been integrated into the Bank's sector operations in Albania. The second disbursement of the latest Structural Adjustment Credit is expected in the third quarter of 2000. The Bank is planning additional structural adjustment and lending operations that will support financial sector and public expenditure reforms in 2001. Appendix II summarizes Albania's relations with the World Bank.
5. The political situation remains stable, with the ruling coalition led by the Socialist Party firmly in power. The main opposition party, which has until recently threatened a boycott, has announced that it will participate in the local elections scheduled for September 2000. Parliamentary elections are scheduled to be held in May-June 2001.
6. The timeliness and quality of the macroeconomic data, although adequate for program monitoring, continue to suffer from serious deficiencies, especially in the real sector (Appendix III). Albania is participating in the preparation of the data dissemination component for a Report on Observance of Standards and Codes (ROSC), and has volunteered to be a General Data Dissemination System (GDDS) pilot country.
7. Albania maintains restrictions subject to Fund approval under Article VIII, Section 2(a), in the form of outstanding debit balances on inoperative bilateral payments agreements. The Fourth Amendment to the Fund's Articles of Agreement was ratified by parliament on July 15, 1999. Albania is participating in the pilot project for the voluntary release of Article IV reports; the 1999 staff report was published. The authorities have also requested the publication of the staff report for the 2000 Article IV consultation.

II. MACROECONOMIC DEVELOPMENTS AND PERFORMANCE UNDER THE PROGRAM

8. **Albania has experienced a period of relative tranquility over the past year, despite the Kosovo crisis.** The collapse of the pyramid schemes in early 1997 plunged Albania into a deep crisis, with public order breaking down, economic activity stalling, and the lek falling sharply. Subsequently, the government adopted a six-month program, supported under the Fund's post-conflict emergency policy, followed by a comprehensive three-year ESAF program. Economic activity rebounded in 1998, inflation fell sharply, and confidence in the lek recovered. The Kosovo crisis in March 1999 and the large influx of refugees placed a considerable strain on the country. However, the early end to the hostilities, together with generous external assistance and the authorities' cautious financial policies, allowed the economy to withstand the crisis. Macroeconomic stability was maintained, although structural reform suffered.
9. **Growth remained strong during 1999, with some indications of a weakening toward the end of the year.** GDP increased by 7¼ percent in 1999, benefiting from the Kosovo-related positive demand shock, particularly in the transport and service sectors, which grew by more than 10 percent (Table 3, and Figures 1 and 2). Investment was also

Table 3. Albania: Basic Indicators and Macroeconomic Framework, 1997-2003

	1997	1998	1999		2000 Proj.	2001 Proj.	2002 Proj.	2003 Proj.
			5/99 Prog.	Est.				
(Percent change)								
Real GDP	-7.0	8.0	8.0	7.3	7.0	8.0	8.0	8.0
Retail prices (avg.)	32.1	20.9	7.1	0.4	1.5	3.0	3.0	3.0
Retail prices (end-period)	42.1	8.7	7.0	-1.0	3.0	3.0	3.0	3.0
(In percent of GDP)								
Saving-investment balance								
Foreign saving 1/	12.1	6.1	11.9	8.0	8.4	7.8	7.1	6.4
Domestic saving	3.9	9.9	4.9	8.8	10.6	12.2	13.9	15.6
Public 2/	-8.6	-5.2	-7.8	-5.6	-2.9	-2.3	-1.4	-0.6
Private	12.5	15.1	12.7	14.4	13.6	14.5	15.3	16.2
Investment	16.0	16.0	16.8	16.8	19.0	20.0	21.0	22.0
Public	4.0	5.2	6.0	5.7	6.5	6.4	6.6	6.8
Private	12.0	10.8	10.8	11.1	12.5	13.6	14.4	15.2
Fiscal sector								
Revenues	16.9	20.3	20.9	21.3	22.5	22.3	22.7	23.3
Tax revenue	9.7	12.3	13.6	12.9	15.3	15.7	16.3	17.0
Expenditures	29.4	30.7	34.7	32.6	31.8	31.0	30.7	30.7
Non-interest	24.0	22.9	27.9	25.7	26.0	26.1	26.8	27.5
Non-interest current	19.9	17.7	21.9	20.0	19.5	19.7	20.2	20.7
Interest	5.5	7.8	6.8	6.9	5.9	4.9	3.9	3.2
Overall balance	-12.6	-10.4	-13.8	-11.3	-9.4	-8.7	-8.0	-7.4
Domestically financed balance 3/	-10.5	-6.4	-5.5	-5.2	-4.3	-3.5	-2.6	-2.1
Public Debt	68.9	60.1	64.1	62.1	70.6	70.8	69.4	67.2
Domestic 4/	35.8	32.9	35.9	36.5	41.0	40.3	38.8	36.9
External	33.1	27.2	28.2	25.5	29.7	30.4	30.6	30.3
Monetary indicators								
Broad money growth (in percent)	28.5	20.7	14.5	22.3	11.4	11.9	11.7	11.7
Private credit growth (in percent)	19.0	14.7	53.8	22.6	27.4	40.9	39.7	30.0
Velocity	1.72	1.92	1.94	1.73	1.67	1.66	1.66	1.66
Interest rate (3-mth deposits)	26.0	16.5	...	8.5	...	...	...	...
(In millions of U.S. dollars)								
External sector								
Trade balance 5/	-519	-621	-826	-663	-692	-728	-785	-838
(in percent of GDP)	-22.7	-20.4	-21.9	-18.0	-18.1	-17.4	-16.8	-16.1
Current account balance	-199	-98	-355	-152	-229	-240	-238	-238
(incl. official transfers; in percent of GDP)	-8.7	-3.2	-9.4	-4.1	-6.0	-5.7	-5.1	-4.6
Official transfers 5/	77	89	95	142	91	86	95	94
(in percent of GDP)	3.4	2.9	2.5	3.9	2.4	2.1	2.0	1.8
Current account balance	-276	-187	-450	-294	-320	-326	-333	-332
(in percent of GDP)	-12.1	-6.1	-11.9	-8.0	-8.4	-7.8	-7.1	-6.4
Gross international reserves	306	384	375	481	500	535	570	605
(in months of imports of goods and services)	3.8	4.2	3.7	4.9	4.6	4.5	4.3	4.2
(relative to external debt service)	14.0	21.8	13.9	29.1	17.4	12.0	9.5	10.3
(in percent of broad money)	23.0	22.6	19.7	22.3	22.2	21.3	20.3	19.3
Change in real effective exchange rate	0.3	18.3	...	12.5	...	...	...	...
Memorandum items								
Nominal GDP (in millions of lek)	341,716	460,631	542,461	506,205	545,847	607,288	677,295	755,252
Nominal GDP (in millions of U.S. dollars)	2,284	3,046	3,774	3,676	3,817	4,188	4,671	5,209

Sources: Albanian authorities and Fund staff estimates and projections.

1/ Current account excluding official transfers.

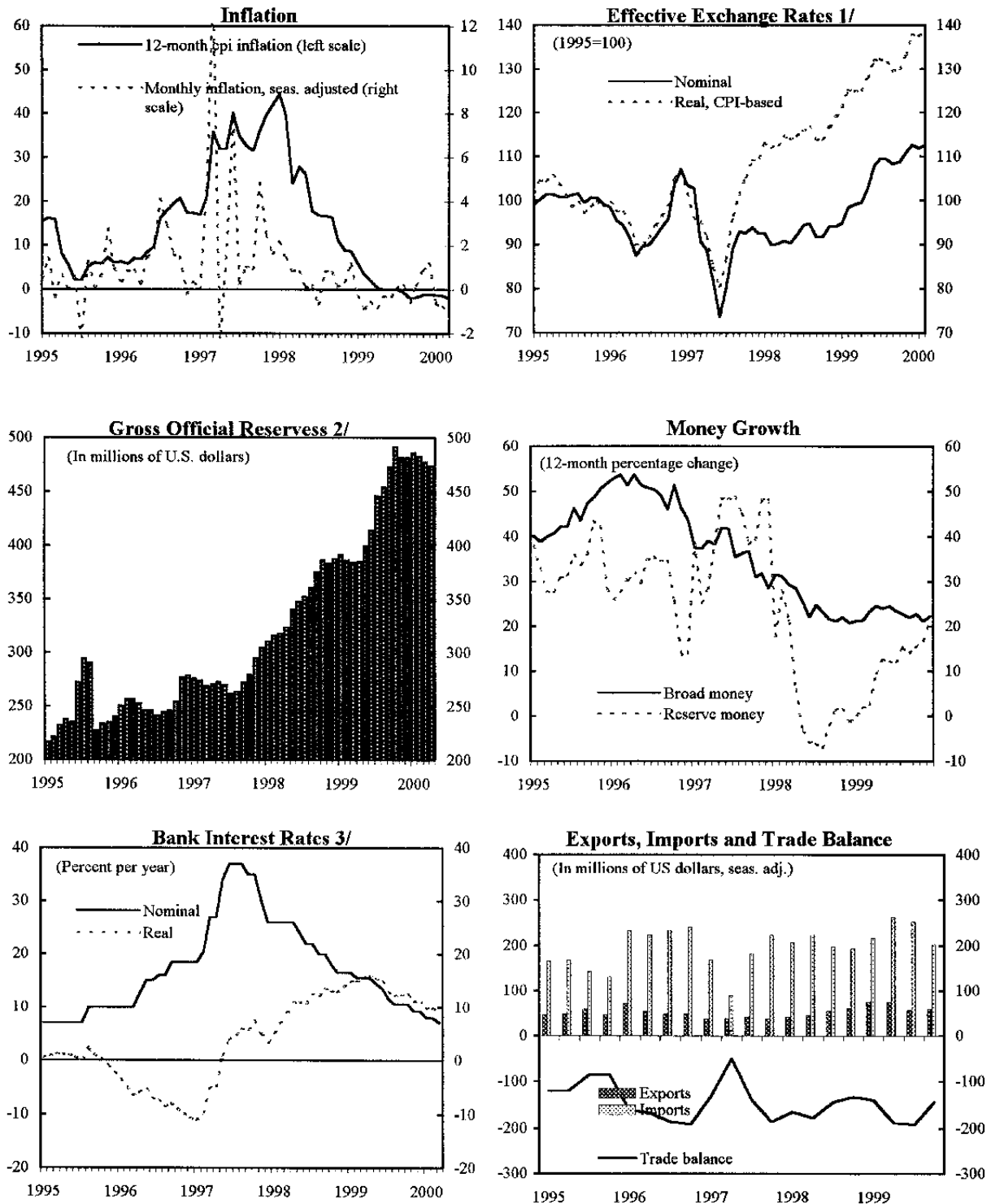
2/ Revenue minus current expenditure.

3/ Excluding privatization revenues.

4/ Including bonds for bank restructuring (Lek 7 bn for 1999; Lek 15 bn for 2000).

5/ For 1999 excluding imports of direct humanitarian aid related to the Kosovo crisis.

Figure 1. Albania: Monthly Economic Indicators, 1995-2000



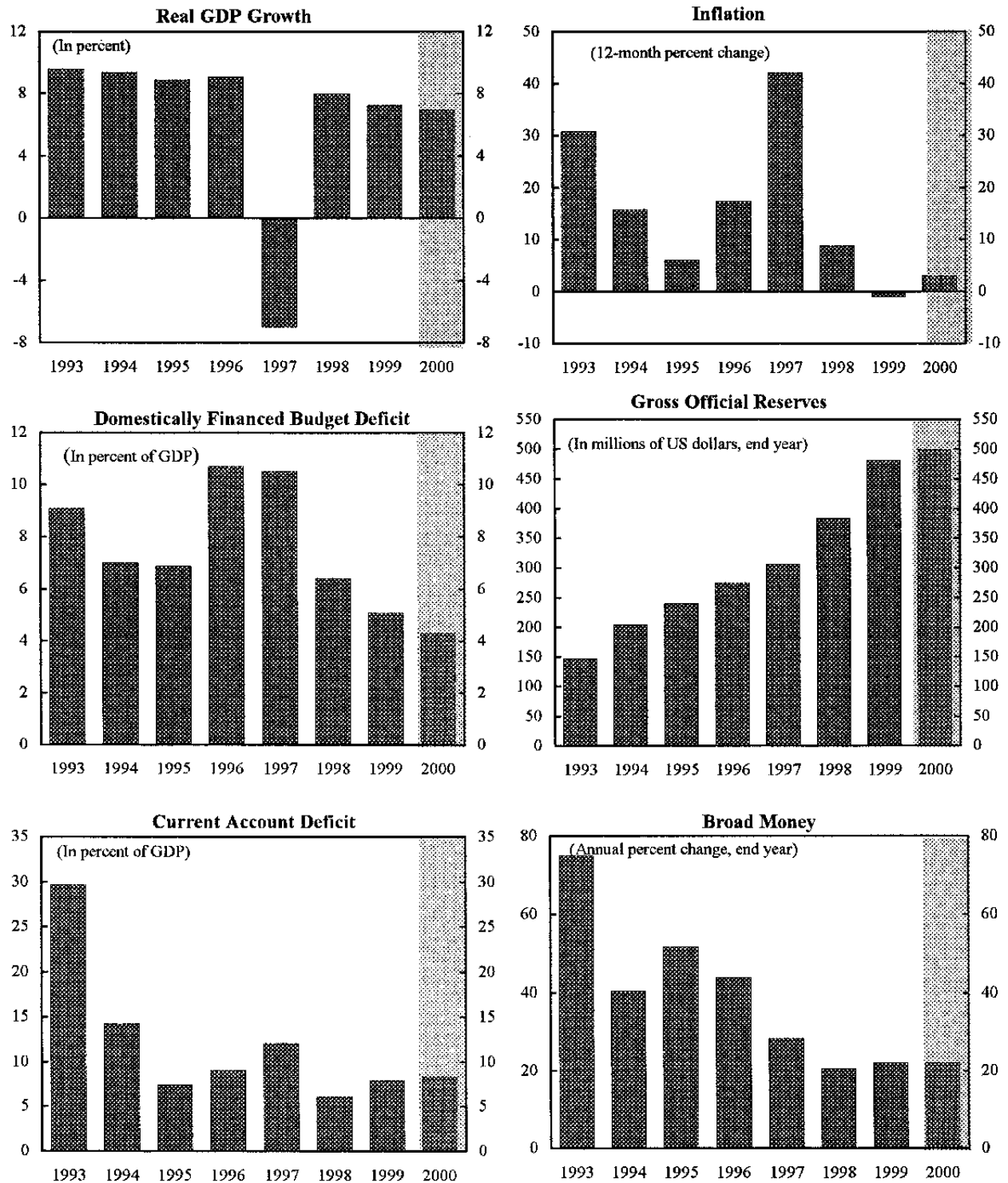
Source: Bank of Albania, Ministry of Finance, INSTAT, and Fund staff estimates.

1/ Against the currencies of Albania's major trading partners. A rise in the graph indicates appreciation.

2/ The decline in September 1995 reflects payments associated with rescheduling of Albania's commercial bank debt.

3/ Three-month deposit rate; the real rate is the nominal rate minus annualized filtered inflation.

Figure 2. Albania: Economic Developments and Prospects, 1993-2000 1/



Source: Albanian authorities and Fund staff estimates.

1/ Program projections for 2000.

strong, as evidenced by a 30 percent surge in imports of equipment and machinery and a 15 percent increase in construction activity. Agricultural output, which still accounts for about a half of GDP, increased by 3½ percent in 1999, less than the 5 percent in recent years, which reflected Kosovo-related disruptions, but also the narrowing scope for rapid productivity gains, as the progress in consolidating land holdings remains modest. A decline in imports in the fourth quarter of 1999 suggests a possible weakening in domestic demand as the Kosovo effects unwound. Exports, which had grown strongly since early 1998, also fell in the third quarter of 1999 and remained sluggish thereafter, reflecting a loss of reprocessing contracts during the Kosovo crisis, a disruption in chromium production, and an unrecorded diversion of exports to Kosovo.

10. Inflation turned negative in early 1999, following a sharp appreciation of the lek. Relative to the euro, the lek appreciated by 13 percent between December 1998 and June 1999, and by an additional 4½ percent by March 2000. Strong productivity growth and the diversion of Kosovo-related aid imports to domestic markets have also contributed to the deflation. Despite the pickup in oil prices, the annual inflation rate was -1.7 percent in April 2000.

11. Official foreign reserves strengthened to a level much above the program target in 1999. The current account deficit widened to 8 percent of GDP in 1999, owing to higher imports resulting from the Kosovo crisis and somewhat lower remittances, but foreign assistance and other inflows allowed official reserves to strengthen by about US\$100 million, to US\$480 million, almost five months of imports of goods and services. The ratio of reserves to broad money, however, remained relatively modest, at about 22 percent.

12. Fiscal policy, in reaction to the Kosovo events, turned expansionary, but it broadly realized its deficit target under the program. The budget, which initially envisaged an unchanged general government deficit for 1999 of about 10½ percent of GDP, was amended in July to accommodate Kosovo-related spending (Table 4). In the event, the deficit reached 11¼ percent of GDP, with Kosovo-related expenditure amounting to about 1½ percent of GDP. Substantial Kosovo-related reconstruction projects, equivalent to about 4 percent of GDP, were also financed with foreign resources outside of the budget. The domestically financed deficit, the fiscal target under the program, was reduced from 6½ percent of GDP in 1998 to 5¼ percent of GDP in 1999.

13. The authorities did not succeed, however, in realizing the tax revenue target in 1999, which was one of the main objectives under the program. State budget tax revenue was about Lek 8.4 billion (1.7 percent of GDP) below the target in 1999, about half of which resulted from the effects of lower-than-projected inflation on domestic collections, and the effects of an appreciated exchange rate on customs collections. The other half reflected weaknesses in customs and domestic tax administration. In particular, VAT collections increased by only about 3 percent and customs collections fell by 2 percent, while an improvement was reported in collections of income taxes and excises. The tax revenue shortfall was partially compensated by larger-than-projected Bank of Albania (BoA) profit

Table 4. Albania: Government Revenue and Expenditure, 1995-2000
(in percent of GDP)

	1995	1996	1997	1998	1999 Budget	1999 Outturn	2000 Proj.
Revenue and grants	23.9	18.3	16.9	20.3	21.1	21.3	22.5
Tax revenue	13.5	10.7	9.7	12.3	13.6	12.9	15.3
Turnover tax/VAT	2.5	3.2	4.6	6.2	6.5	5.9	7.2
Excise taxes	5.1	1.8	0.6	1.1	1.3	1.4	1.7
Main direct taxes	2.1	2.2	1.2	1.5	1.9	2.2	2.4
Profit tax	1.1	1.2	0.7	0.9	1.0	1.2	1.1
Small business tax	0.4	0.3	0.1	0.2	0.2	0.2	0.3
Personal income tax	0.3	0.2	0.2	0.3	0.5	0.6	0.7
Property and local taxes	0.4	0.5	0.2	0.2	0.2	0.2	0.2
Customs duties	2.8	2.7	2.6	2.7	2.7	2.3	2.6
Other taxes	1.0	0.8	0.6	0.7	1.2	1.2	1.5
Social insurance contributions	4.1	4.5	3.8	3.4	3.4	3.6	3.6
Nontax revenue	6.2	3.0	3.3	4.5	4.0	4.8	3.5
Profit transfer from the BoA	2.6	1.4	2.4	3.6	2.9	3.5	1.9
Income of budgetary institutions	1.8	1.0	0.5	0.7	0.9	1.1	1.2
Other	1.8	0.7	0.4	0.3	0.3	0.3	0.4
Primary expenditure 1/	32.1	27.3	24.0	22.9	24.1	24.0	25.6
Current noninterest expenditure 1/	23.6	22.7	19.9	17.7	18.1	18.3	19.1
Personnel	8.2	8.2	7.5	6.2	5.8	6.1	5.9
Operations and maintenance	5.4	4.4	4.0	4.0	4.1	4.7	4.5
Direct subsidies	0.6	0.4	0.5	0.5	0.3	0.4	0.4
Social insurance	7.7	8.0	6.5	5.6	5.7	5.7	6.0
Social assistance	1.6	1.4	1.3	1.3	1.2	1.3	1.2
Other current expenditures	0.1	0.4	0.2	0.0	1.1	0.1	1.0
Investment 1/	8.5	4.5	4.0	5.2	6.0	5.7	6.5
Domestically financed	5.0	3.2	1.9	2.3	2.4	2.4	2.8
Foreign financed	3.5	1.3	2.1	2.9	3.6	3.3	3.7
Kosovo related costs 2/	...	...	...	...	2.6	1.6	0.4
Primary balance 1/	-8.2	-9.0	-7.1	-2.6	-3.1	-2.7	-3.1
Interest expenditure	2.2	3.1	5.5	7.8	6.8	7.0	5.9
Balance for financing (cash) 1/	-10.4	-12.1	-12.6	-10.4	-9.9	-9.7	-9.0
Financing:							
Domestic financing (cash)	6.6	11.0	10.8	6.4	5.7	5.3	5.0
Privatization revenues	0.1	0.2	0.3	0.0	0.6	0.2	0.6
Bank financing and other 3/	6.5	10.8	10.5	6.4	5.1	5.2	4.3
Foreign financing	3.8	1.1	1.8	4.0	6.9	6.0	4.4
Development finance	3.5	1.3	2.1	2.9	3.6	3.3	3.7
External budget support	0.3	0.0	0.0	1.4	3.8	2.9	1.0
Minus: Principal repayments (foreign)	0.0	0.3	0.3	0.3	0.5	0.2	0.3
Overall deficit (including arrears)	10.3	12.1	12.6	10.4	12.6	11.3	9.4
Memorandum items:							
Domestic financing (billion leka) 4/	14.6	30.8	36.9	29.7	30.9	27.1	27.2
Deficit with grants counted as revenues	...	...	12.0	9.0	...	8.7	8.4
External grants	...	...	0.5	1.4	...	2.6	1.0
Expenditures by function 5/							
Health	2.4	2.1	1.8	1.7	...	2.2	...
Education	3.8	3.4	3.3	3.0	...	2.9	...
Public order	2.3	2.0	2.5	2.0	...	2.3	...
Defense	2.2	1.7	1.3	1.2	...	1.3	...
Budgetary employment (year average, thousands)	161.3	151.0	151.0	141.0	133.4	133.4	126.7
GDP (billion leka)	224.7	281.0	341.7	460.6	542.5	506.2	545.8

Sources: Albanian authorities; and Fund staff estimates and projections.

1/ Excluding Kosovo related expenditures.

2/ Costs related to the influx of refugees from Kosovo after March 1999.

3/ Almost all of this is financed by the banking system. In addition, a very small amount of treasury bills is held by the state insurance company (INSIG) and the private sector.

4/ Including arrears and privatization receipts.

5/ The expenditure figures based on the functional classification are highly provisional. The Albanian authorities have only recently started work on the functional classification.

transfers, reflecting higher interest rates than projected, and one-time effects of switching from cash-based to accrual-based accounting, equivalent to Lek 2 billion (0.4 percent of GDP). Against this background, the end-December budget deficit target was broadly met by cuts in investment expenditure of about ½ percent of GDP.

14. **Tax collections substantially improved in early 2000, largely as a result of the measures agreed at the time of the October mission.** Measures that proved to be particularly effective included changes in key personnel in the major custom houses, better control of goods in transit, the intensification of internal audit procedures, revision to reference prices, and better collection of customs debts. Moreover, efforts to reduce smuggling bore fruit as evidenced by the increase in the reported volume of smuggling-sensitive imports and confirmed by members of the business community that had been adversely affected by smuggling. In domestic revenue collection, the number of VAT-registered taxpayers has been substantially increased, and compliance strengthened (MEFP, ¶13).³ Particularly good results were realized in the collection of car registration taxes, with the number of registrations increasing 40-fold. As a result, state budget revenue at end-March 2000 on a cumulative basis was only about Lek 1 billion below the indicative target under the program, compared with the Lek 3 billion shortfall at end-December 1999. Compared to the same (admittedly weak) period in 1999, tax collections in the first quarter of 2000 increased by about 40 percent, and were about 5½ percent more than envisaged in the budget. However, VAT refunds have been slow and there have been complaints in the business community about the assessments of advance payments under the income tax law.

15. **Monetary policy, which was arguably tighter than warranted in the first half of 1999, has since been more decisive in attempting to ease monetary conditions.** Until May 1999, the BoA was exceedingly cautious in cutting interest rates despite the strong upward pressure on the currency and the absence of inflationary pressures. Subsequently, it has halved minimum deposit rates (3- and 12-months) in several steps, to 7.0-8.0 percent in March 2000. The last interest rate cut, however, has not yet been followed by the largest bank, the Savings Bank. Growth in broad money, at about 20 percent in the year to February 2000, has continued to be strong, reflecting output growth and increased confidence in the banking system (Table 5). Growth in lek time deposits was lower, about 11 percent, reflecting in part cuts in interest rates.

16. **Financial market reform has been slower than expected.** The transfer of the National Commercial Bank (NCB) to foreign investors has been delayed by several factors, the latest being the investors' request for several put options in the contract. Regarding the Savings Bank, there has been some progress in streamlining its operations, resulting in a reported profit for 1999. Moreover, the government has started to pay appropriate fees for payment services performed by the bank. The appointment of a chief operating officer and a chief accounting officer through an international tender was delayed, owing to procurement

³ The symbol ¶ refers to the relevant paragraphs in the MEFP (Attachment I).

Table 5. Albania: Monetary Aggregates, 1998-2001
(In billions of leks unless otherwise indicated; end-period)

	1998	1999	1999	2000	2000	2000	2000	2001
	Dec.	Dec.	Dec. Prog. 05/99	March Estimate	June Proj.	Sept. Proj.	Dec. Proj.	March Proj.
Monetary survey								
Broad money	239.5	292.9	274.5	306.3	312.4	315.2	326.3	342.1
Currency outside banks	68.3	81.3	81.0	85.8	86.5	86.7	89.1	93.1
Deposits	171.2	211.5	193.5	220.5	225.8	228.5	237.2	249.1
Domestic currency deposits	130.9	158.3	148.0	164.3	167.1	168.6	175.1	183.6
Foreign currency deposits	40.3	53.2	45.5	56.2	58.7	59.9	62.2	65.5
M1	83.7	103.0	...	107.5	109.0	109.7	113.5	118.9
M2	199.3	239.7	...	250.0	253.6	255.3	264.2	276.6
Net foreign assets	83.0	100.1	82.6	102.4	104.9	107.2	109.4	113.9
Bank of Albania	35.9	46.9	32.9	46.6	46.8	48.1	49.9	51.4
Commercial Banks	47.1	53.1	49.7	55.9	58.1	59.1	59.5	62.5
Net domestic assets	156.5	192.8	191.9	203.8	207.5	207.9	216.9	228.2
Claims on government (net of deposits)	179.3	203.0	203.7	213.5	215.7	214.6	222.1	231.4
Claims on state enterprises and farms	2.8	1.7	3.3	1.7	1.7	1.7	1.7	1.7
Claims on the private sector	14.9	18.2	22.9	18.7	20.2	21.7	23.2	25.2
of which in leks	9.5	9.5	12.5	9.7	10.5	11.3	12.1	13.1
Other items, net	-40.5	-30.1	-38.0	-30.1	-30.1	-30.1	-30.1	-30.1
Monetary authorities								
Reserve money	89.9	109.3	105.6	114.9	116.4	116.9	121.1	126.7
Program NIR 1/	194.8	272.0	158.0	252.7	247.2	248.7	259.3	266.9
Program NDA 1/	62.5	72.5	83.4	80.7	83.0	83.3	86.0	90.6
Net credit to government	67.5	65.9	87.3	71.9	73.2	72.3	74.7	78.8
Memorandum items:								
Broad money growth during the year	20.6	22.3	14.5	4.6	6.7	7.6	11.4	4.9
Of which contribution of:								
Net foreign assets	7.4	7.1	-0.2	0.8	1.6	2.4	3.2	1.4
Net domestic assets	13.2	15.2	14.7	3.8	5.0	5.2	8.2	3.5
Claims on government	15.0	9.9	11.6	3.6	4.3	4.0	6.5	2.9
Annual broad money growth	20.6	22.3	14.5	22.3	18.1	14.7	11.4	11.7
Annual reserve money growth	-1.1	21.6	17.5	31.1	23.4	18.4	10.8	10.2
Annual M2 growth	22.8	20.3	...	21.6	17.3	15.3	10.2	10.6
Velocity (Quarterly GDP/BM)	51.3	44.1	51.6	43.7	43.5	43.2	42.9	42.9
Money multiplier (absolute values)	2.66	2.68	2.60	2.67	2.68	2.70	2.69	2.70
Currency/broad money (percent)	28.5	27.8	29.5	28.0	27.7	27.5	27.3	27.2
Deposits/broad money (percent)	71.5	72.2	70.5	72.0	72.3	72.5	72.7	72.8
Lek deposits/total deposits (percent)	76.5	74.8	76.5	74.5	74.0	73.8	73.8	73.7
FX deposits/broad money (percent)	16.8	18.2	16.6	18.4	18.8	19.0	19.0	19.1
US Dollar Exchange Rate (end of period)	140.8	135.2	145.0	140.0	142.0	145.0	145.0	145.0

Sources: Bank of Albania; and staff estimates.

1/ According to the definition in the Technical Memorandum of Understanding.

difficulties under the supporting World Bank project. Overall, Albania's banking system continues to be burdened with structural problems. The Savings Bank enjoys a near-monopoly position in the lek deposit and T-bill markets, reflected inter alia in a large spread between deposit rates, and T-bill rates, of about 5 percentage points for the same maturity. The share of private banks in the lek market remains meager (3-4 percent), despite its rapid growth in recent years. High lending rates, persistent deficiencies in the legal system and business accounting practices, and prudential restrictions on state-owned banks have kept private sector credit growth much below the program target.

17. While progress in structural reforms has been significant considering the Kosovo crisis, more needs to be done to create a market-friendly environment conducive to private investment.

- During 1999 and early 2000, progress was made in enterprise privatization, but no major foreign investment deal was brought to completion, in part owing to the Kosovo crisis and cabinet reshuffles. The process of liquidating, privatizing, or transferring to local authorities about 520 small and medium-size enterprises was completed, although it attracted limited interest among private investors and only 180 enterprises were fully privatized. A contract was signed for the transfer of copper mines to a foreign investor. A concession for a chromium mine and a smelter was awarded to an Italian company, which plans to invest US\$15 million over the next four years, as well as another concession for a phosphate plant. However, as of April 2000, foreign investors have not yet started operations in these facilities.
- The collateral law was approved by Parliament, but its effective implementation is pending the establishment of a registry at the Ministry of Finance. The 1996 bankruptcy law has remained ineffective owing to internal inconsistencies, and the authorities have started to prepare a new law. The execution of court decisions in civil cases is extremely weak, with almost three-fourths of the cases remaining unenforced. Mortgage lending is negligible, as the courts refuse to support claims against residences.
- In public administration, the government removed about 5,000 positions from the public sector payroll in 1999, and has removed a further 3,000 so far in 2000, reducing the total to about 127,000. The increase in the budget sector real wages over the past two years and progress in reviewing the salary structure have also likely contributed to increased efficiency and improved incentives in the public sector. The authorities also approved a new Civil Service Law, which is expected to be implemented in mid-2000 and are in the process of establishing a civil service commission. While the authorities have stressed their determination to eradicate corruption, graft reportedly remains widespread.
- The authorities have made progress in liquidating the assets of the former pyramid schemes and distributing the proceeds to former investors. Moreover, after much delay resulting from a contractual dispute, the foreign auditing companies have now completed their reports.

- Progress has been realized in land registration, with more than half of the agricultural land in use now registered, although the end-March 2000 target was not achieved. Direct indicators on land consolidation are lacking but the increasing number of transactions indicates progress in this area.

18. **Albania is one of the poorest countries in Europe, with poverty concentrated in its rural regions.** Its per capita GNP is the lowest in Southeastern Europe, amounting to US\$760 in 1997 according to the World Bank Atlas method, around two-thirds of that of the next poorest country in the region, FYR Macedonia. Judging from the limited data available from a 1996 household expenditure survey for areas excluding Tirana, the incidence of poverty appears to reflect mainly low national per capita income rather than unequal income distribution. Almost 90 percent of the poor live in rural areas, where the incidence of poverty among children also appears to be very high. As a result of large migrations since the last survey was conducted in 1996, urban poverty has also increased, as evidenced by the spread of slum-like communities around major cities and an increase in the number of street children. Health indicators are particularly worrisome, with infant mortality, maternal mortality, and below-5 mortality comparing very unfavorably with regional averages. And while Albania has succeeded in preserving almost full enrollment in basic schools and achieving full literacy except for the oldest cohorts of the population, enrollment at the secondary level has dropped by half since early 1990s. Budgetary expenditures on health and education have fallen since the transition began, and at 2.2 percent and 2.9 percent of GDP respectively in 1999, were substantially lower than in neighboring countries (Table 6).

III. REPORT ON THE DISCUSSIONS

19. **With macroeconomic performance broadly on track, discussions with the authorities focused on the additional structural reforms required for keeping the economy on a fast growth track, and on the government's plans to develop a comprehensive strategy for alleviating poverty.** The mission pointed out that the current rapid output growth, which partly reflected the continuing recovery from the 1997 disturbances and the demand shock related to the Kosovo crisis in 1999, will not be sustainable unless Albania accelerates the necessary reforms for establishing a modern market economy. The authorities concurred on the need to implement further reforms, particularly in view of their intentions to reduce the development gap relative to European countries and to join European associations. The government also intends to strengthen the focus of its policies on poverty alleviation, which will require a stronger revenue effort and higher spending on health, education, infrastructure, and other poverty-related programs.

A. The Poverty Reduction Strategy

20. **The authorities expressed enthusiasm for the new emphasis on poverty reduction under the program and made a determined effort to publicize the initiative and prepare an interim PRSP, in collaboration with the Bank and Fund staff.** The line ministries provided valuable information on the poverty profile in Albania, as well as proposals for improving government policies in this area. The interim PRSP includes an agenda for

Table 6. Albania: Social Indicators

	Latest single year			Same region/income group	
	1970-75	1980-85	1993-98	Europe & Central Asia	Lower- middle- income
POPULATION					
Total population, mid-year (millions)	2.4	3.0	3.3	474.7	886.5
Growth rate (percent annual average)	2.3	2.0	0.8	0.1	0.9
Urban population (percent of population)	32.8	34.8	40.4	66.2	57.7
Total fertility rate (births per woman)	4.7	3.4	2.5	1.6	2.5
INCOME					
GNP per capita (US\$)	..	..	810	2,200	1,740
Consumer price index (1995=100)	..	..	181	155	131
Food price index (1995=100)	..	..	190	..	..
SOCIAL INDICATORS					
Public expenditure					
Health (percent of GDP)	..	..	1.7	4.0	3.0
Education (percent of GNP)	..	..	3.1	5.1	4.9
Social security and welfare (percent of GNP)	..	..	6.0	8.8	..
Net primary school enrollment rate (percent of age group)					
Total	..	..	..	100	94
Male	..	..	..	100	95
Female	..	..	..	99	93
Access to safe water (percent of population)					
Total	..	92	76	..	..
Urban	..	100	97	..	..
Rural	..	88	70	..	..
Immunization rate (percent under 12 months)					
Mcasles	..	96	95	91	89
DPT	..	96	99	89	89
Child malnutrition (percent under 5 years)					
Life expectancy at birth (years)	..	..	8	..	..
Total	67	70	72	69	68
Male	65	67	69	65	65
Female	69	73	75	74	72
Mortality					
Infant (per thousand live births)	58	45	25	22	35
Under 5 (per thousand live births)	82	57	31	26	44
Adult (15-59)	..	..	..	..	..
Male (per 1,000 population)	190	140	171	283	244
Female (per 1,000 population)	113	82	95	120	137
Maternal (per 100,000 live births)	..	..	..	..	..

producing a preliminary poverty assessment by early 2001, which will then be used as an analytical background for policy formulation in the first PRSP by mid-2001. Moreover, in the context of the medium-term public expenditure framework (MTEF, 2001-2003), the budget priorities for 2001 are already being defined with an explicit focus on poverty issues.

B. The Macroeconomic Framework

21. **The macroeconomic framework agreed at the time of the first review remains broadly appropriate; however, reflecting the weaker demand at the end of 1999, GDP growth is now projected to be somewhat lower, at about 7 percent in 2000.** Structural reforms, in particular the completion of several important privatization projects, some of which include obligations of new owners to invest in new capacities, are expected to induce an increase in private investment activity in 2000, which in combination with improved consumer confidence, and supported by the easing of monetary conditions, should compensate for the withdrawal of the fiscal stimulus. Exports should benefit from completion of several privatization projects in the mining sector, as well as stronger demand growth in partner countries than in 1999. Recent deflationary pressures, which have also contributed to a downward revision in nominal GDP for 2000, are expected to subside with the pickup in domestic demand. Admittedly, there is a downside risk for output growth should private investment be weaker than projected, which could also be compounded by the effects of the lek's recent real effective appreciation on the trade balance (for an evaluation of competitiveness, see Box 1). In this context, the macroeconomic framework and the policy mix will be reassessed at the time of the first review under the program.

22. **Over the medium term, structural reforms and foreign direct investment should allow Albania to realize its potential output growth rate of about 8 percent.**⁴ While the possibilities for rapid productivity gains in the agricultural sector related to the transition have been largely exploited, land consolidation and improved rural infrastructure would allow higher growth rates than in 1999. Improvements in the legal framework, a better-functioning financial system, the privatization of the remaining state-owned enterprises, and improved infrastructure should attract private investment, including foreign direct investment (FDI). This should help Albania develop a modern industrial sector and strengthen its currently very weak export base (merchandise exports were equivalent to less than 8 percent of GDP in 1999), and gradually reduce its reliance on large private and official transfers.

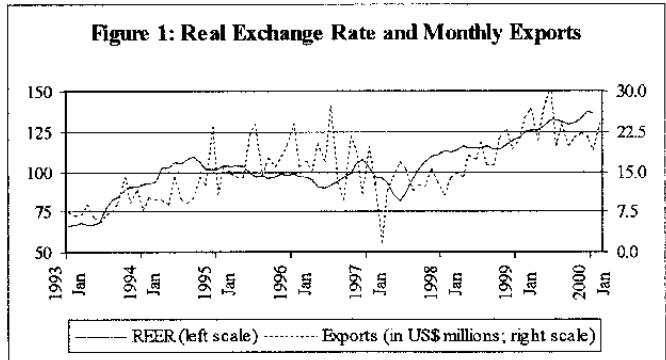
C. Fiscal Policy

23. **The authorities and the mission affirmed that there was no need to change the 2000 budget, as macroeconomic developments were broadly on track and the authorities remained committed to achieving the revenue goal.** The targeted reduction in the general government deficit of 2 percentage points of GDP in 2000 and in the

⁴ This is in line with the staff's earlier assessment (EBS/00/1, Appendix IV).

Box 1. Albania: Competitiveness

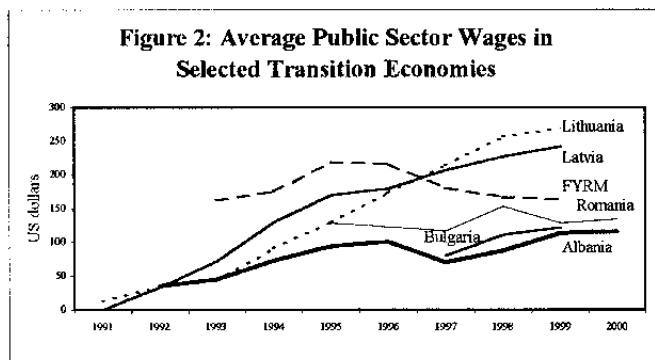
The continuing real appreciation of the lek and the recent mixed performance of exports raise the question whether Albania is facing an overvaluation of the exchange rate and, hence, a problem of competitiveness that could dampen growth. Over the past 15 months, the CPI-based real effective exchange rate appreciated by around 20 percent (Figure 1). Exports (in U.S. dollars) showed a steady upward trend between mid-1997 and mid-1999, but then fell and have since remained sluggish. However, their performance may still reflect the lingering effects of the Kosovo crisis, which led some investors to redirect production toward domestic consumption by the refugees, while at the same time demand for Albania's exports may have suffered owing to the perceived increase in country risk.



The long-run behavior of the exchange rate and exports provides no clear picture as to the potential loss of competitiveness. The real appreciation of the lek started with the transition to a market-based economy, likely reflecting an initial undervaluation as observed in other transition economies. A partial reversal began in mid-1994 and ended in mid-1996, when the exchange rate began a relatively stable upward trend that is continuing today, with the annual appreciation averaging 12½ percent since mid-1996. While this appreciation exceeds that in neighboring countries, data deficiencies and the short history of transition make it difficult to reach a conclusion on whether it still reflects the initial undervaluation. It should be noted that until the second half of 1999 the appreciation in the real exchange rate did not appear to affect exports. On the contrary, the positive trend in the exchange rate paralleled a rising trend in export volumes and the current account deficit has improved relative to GDP.

Other indicators of competitiveness also present ambiguous evidence. Productivity in the tradable goods sector has risen substantially: Land privatization unleashed large productivity gains in agriculture; moreover, the textile and shoe industries, Albania's main exporters, benefited from modern management and production techniques implemented by foreign investors. However, the domestic price ratio between nontradables and tradables has not increased in response to differential productivity growth, but has instead remained stable, which—from the demand perspective—indicates that internal competitiveness has not suffered. While Albania also has lower public sector wages compared with other transition economies in Europe, the difference vis-à-vis some of its neighbors in U.S. dollar terms is not large (Figure 2). (No data are available on productivity-adjusted private sector wages, which would allow a more complete analysis.) On the other hand, Albania's economy is to a large extent driven by informal activities, e.g., family-owned farms and businesses, where wages are sufficiently flexible to adjust to changes in competitiveness.

Over the medium term, nonprice structural factors may be more important for competitiveness than the exchange rate. These include regional stability, investment policies, governance, legal security, and access to financial services. Improvements in these areas, which are potentially large, should result in productivity increases and would thereby alleviate the effects of real appreciation.



domestically financed deficit (excluding privatization proceeds) of about 1 percentage point are in line with the medium-term objective of fiscal consolidation. Moreover, the rather ambitious target for raising state tax revenues by 2¼ percentage points of GDP in 2000 should allow the government to increase noninterest spending by about 1½ percentage points, excluding Kosovo-related expenditure.

24. **The authorities and the staff shared the view that further measures were needed to meet the revenue target, particularly in light of lower nominal GDP growth.** While acknowledging the progress in tax collection in early 2000, the mission pointed out that a further improvement in revenue performance is a crucial element of the PRGF-supported program. The mission also warned against relying on unsustainable measures or imposing disputable burdens on taxpayers, including delays in the reimbursement of tax refunds. Against this background, the authorities decided to implement the following measures for strengthening customs and tax administration:

- **Regarding customs,** the authorities will increase the number of staff and, with assistance from the EU Customs Administration Mission, organize training in both the internal audit and valuation units, the latter with a view to reducing excessive reliance on reference prices. The production of biweekly reports on the results of internal audit inspections and monthly reports on disciplinary actions recommenced on May 1, as a prior action for the completion of the second review (¶ 11).⁵ To provide better incentives, the authorities will implement the new remuneration system for customs officials, including a special bonus system and a new annual appraisal system for all customs officials. To curb the abuse of the special customs regime licenses for inward processing, all users of these licenses will be audited by end-2000.
- **Regarding domestic taxes,** the authorities plan to increase further the number of registered small business taxpayers, strengthen efforts to collect all new tax obligations of the state-owned electricity company KESH and the oil refinery, and collect tax arrears from other taxpayers (¶ 12). To address concerns in the business community, they will accelerate VAT reimbursements, and amend the VAT law, which currently does not set a deadline. In the same vein, the authorities will reimburse overpaid profit taxes on time, so as to improve the accountability of government institutions. Collection of social security contributions will be reinforced by introducing social security numbers for all individuals and by amending the law with a view to strengthening the authority of inspectors.

⁵ In February, the Customs Administration temporarily halted the production of these reports—a continuous structural benchmark under the program—because of the limited number of trained staff.

25. **The mission stressed the importance of protecting expenditures in priority areas, but argued that as long as revenue prospects remained uncertain, the 2000 budget should be executed with caution.** To provide some cushion against unexpected revenue shortfalls, the authorities indicated that they would strictly follow their monthly expenditure program, which would be reviewed at the time of the next staff visit in July, and limit spending from the reserve and contingency funds to emergency cases.

26. **Assuming that favorable macroeconomic developments continue, the fiscal target for 2001 would embody a reduction in the domestically financed deficit (excluding privatization proceeds) of about 1 percentage point of GDP.** This would be consistent with the targeted reduction in the government debt ratio under the medium-term fiscal strategy, and with the objective of reducing domestic borrowing at high real interest rates (see EBS/00/1). Improved tax collection should also enable the authorities to review the profit tax law and explore the possibility of introducing an investment tax credit in the 2001 budget. Over the medium term, the fiscal position appears sustainable, as public debt is expected to decline substantially, by 3½ percentage points of GDP between 2000 and 2003. The tax-to-GDP ratio would increase by about ½ percentage point of GDP a year, as the formal sector of the economy gains importance, which should allow the government to increase noninterest expenditure at about the same pace, with additional resources going primarily for poverty alleviation—including expenditures on health and education. The authorities noted that the first medium-term expenditure framework (MTEF) was expected to be completed by July 2000, with the assistance of the World Bank (¶16). Expenditure plans will be based on sector strategies for health, education, transport, public works, and social protection, which will explicitly include poverty reduction goals, some of which might be used to attract foreign funding.

D. Monetary and Exchange Rate Policy

27. **The authorities and the mission agreed that monetary policy should be geared towards an inflation outcome of about 2-4 percent, a level consistent with necessary relative price adjustments.** The mission argued for further interest rate cuts, as the continuation of deflationary pressures might adversely affect growth performance. Moreover, any consequent easing in the exchange rate would help competitiveness. As the velocity of the lek money stock has continued to decline, the recent faster growth in foreign currency deposits likely reflects a portfolio shift from foreign cash holdings into deposits, in line with improved confidence in domestic banks. The Bank of Albania officials were initially reluctant to proceed with a large interest rate cut, as they were concerned about the slower growth of lek deposits, an indicator which they assigned high importance, while they also felt constrained by the level of interest rates in Greece and Turkey. However, against the background of recent CPI figures, they lowered short-term rates by 1 percentage point, to 7 percent, in late March 2000. As there have been no adverse market reactions to this latest cut, the staff still sees scope for additional gradual cuts in interest rates. Monetary policy will continue to be managed in the context of a flexible exchange rate regime, with the BoA's interventions in the foreign exchange market limited to smoothing excessive short-term

fluctuations. The authorities concurred that upward pressure on the lek should trigger further interest rate cuts, and that if the pressures persist, they would consult with the staff.

28. **The mission extended the monetary framework for April 2000–March 2001.** As the continuation of strong money demand suggested that the process of remonetization after the 1997 crisis was not yet complete, the staff and the BoA revised upward the projections for broad and reserve money in 2000. The mission also revised downward the projections for private sector credit in light of slower-than-projected progress in banking sector reform and in improving the legal framework for business credit.

E. Structural Reform

29. **The mission stressed the utmost importance of reforms in the financial system, notably bank privatization and improvements in the institutional framework, for keeping the economy on a rapid growth path.** On the privatization of the NCB, the mission encouraged the authorities to reach a satisfactory agreement with investors as soon as possible. Regarding the Savings Bank, the mission reviewed the steps to ensure its timely and successful privatization (¶21). In particular, the mission urged the authorities to proceed with the hiring of a chief accounting officer and a chief operating officer, and encouraged them to request additional rapid assistance to improve the accounting practices in the bank, as this would likely be of crucial importance for a successful privatization. A preliminary analysis of the profitability of individual branches has been completed (a structural benchmark for end-March 2000). The mission agreed that the tender for the privatization advisor (a structural benchmark for end-March 2000) would be announced in June, as the resources provided by the World Bank for this purpose would not be available until then. The authorities accepted that the selection of the privatization advisor by end-September and the announcement of the privatization tender by end-November would be two structural performance criteria, and that the negotiations with potential short-listed investors would start in December (structural benchmark). The Savings Bank would by that time have been recapitalized to cover its negative capital of about Lek 12-15 billion (2-2 ½ percent of GDP); allowance for interest payments has already been made in the 2000 budget. The BoA would also prepare a draft law for deposit insurance by July 2000, with the aim of having it approved by end-2000 and implemented by the time of the SB's privatization. The authorities intend to take further steps to open up the insurance market.

30. **The mission examined progress in phasing out direct instruments of monetary policy and the reasons behind the limited participation of private banks in the T-bill and lek deposit markets.** The mission agreed with the authorities' plans to gradually remove the floors on deposit interest rates in state-owned banks (¶20). The mission advised against efforts to reduce T-bill rates by putting pressure on the management of the SB. Instead, it recommended that the spread be reduced by taking measures to strengthen competition in the market and to attract the interest of private banks and other investors, for example, by selling T-bills through tax and post offices and by better informing households and other potential investors about the possibilities of investing in T-bills. The authorities have implemented measures agreed with MAE to improve the T-bill market (end-March structural benchmark).

The mission also advised the authorities to implement an information campaign aimed at developing the T-bill market, as recommended by MAE. To encourage the entry of private banks into lek operations, the mission suggested that the BoA explore measures to improve the refinancing facilities based on T-bills and introduce remuneration of mandatory reserves to reduce bank intermediation costs. The authorities intend to replace the government's nonmarketable obligations to the BoA with marketable securities, with a view to boosting the BoA's capacity for open market operations. For prudential reasons, the BoA would continue to enforce lending limits on banks with a high proportion of nonperforming loans, including the two state-owned banks.

31. **In the enterprise sector, the mission urged the government to proceed rapidly with several privatization projects crucial to attracting foreign direct investment and enhancing overall investment activity.** In the telecommunications sector, the mission advised against any further delays in selecting a buyer for the Albanian Mobile Communications (AMC) and in preparing the second mobile phone license for auction (¶24). Regarding the privatization of Albtelecom, which has been delayed owing to difficulties in financing the privatization advisor by a foreign grant, the authorities have agreed to accelerate the process by putting into place the necessary legal framework and ensuring that the auditing of the 1999 financial statements is completed by June 2000 (structural benchmark). The authorities are strongly determined to privatize the five remaining mid-sized enterprises (the brewery, winery, dairy factory, pharmaceutical factory, and the cement factory), mostly with assistance from USAID (structural performance criterion, see ¶24). In the mining sector, the authorities are finalizing the lease contract for the copper company, and are working on the next steps for the privatization of a chrome smelter and a chrome mine by end-2000. In the oil sector, the authorities have undertaken to prepare by end-April an action plan for selling and liquidating parts of the loss-making oil drilling and service company, Servcom (structural benchmark), and completing their privatization or liquidation by end-2000. The mission also urged the authorities to continue, in coordination with the World Bank, to improve the management of the public electricity company, KESH.

32. **In discussing policies to attract FDI, the mission advised against relying on discriminatory fiscal incentives, and stressed instead the urgency of reinforcing good governance and law and order.** The mission convinced the authorities' not to implement their proposals for liberalizing the law on fiscal exemptions to grant incentives to foreign investors, which has only been used on a very limited basis so far. Instead it emphasized the importance of speeding up and improving administrative procedures for foreign investment and removing bureaucratic obstacles. In this context, the mission proposed that the authorities should, in cooperation with donors, establish a one-stop investment shop for foreign investors that would provide the services associated with the promotion and facilitation of FDI within the same agency. Foreign investors would also benefit from establishing a mediation center that could offer an alternative means of dispute resolution in commercial cases, as envisaged under a World Bank project. The mission supported the authorities' decision to create a free zone in Durres this year to provide foreign investors with a strategic location and adequate administrative and logistical support for their activities, but

it warned the authorities to implement appropriate safeguards and controls to prevent smuggling from the zone. The mission and the authorities were in full agreement that no exemptions from direct taxes should be provided to companies operating in the zone.

33. **In relation to other areas of structural reforms**, the mission reviewed progress in public administration, notably in establishing the civil service commission, and stressed its role in improving governance. The mission advised the authorities to combine the approval of the new bankruptcy legislation with a comprehensive program to train judges and other court officers in its implementation. It discussed the implementation issues related to the new collateral law with the foreign advisors and the business community, and urged the authorities to establish rapidly the registry for collateralized property. In discussing issues related to deficiencies in the legal system, the authorities pointed out that they would be receiving further assistance from the World Bank in revising the Anti-Corruption Action Plan, as well as implementing several measures to strengthen the enforcement of judicial decisions. To further the consolidation of private land holdings, the government agreed to continue with the registration of land at a rate of 150 cadastral zones per quarter (structural benchmark). The mission also urged the authorities to move ahead vigorously in completing the distribution of the assets of the former pyramid schemes.

34. **The mission emphasized the importance of improving the quality and coverage of economic data deemed necessary for macroeconomic management and the implementation of the poverty reduction strategy.** In particular, it urged the authorities to adhere closely to the timetable for the production of national accounts statistics agreed with STA, as well as to start compiling monthly data on output, employment, and wages in the private sector. The authorities are currently drafting a new law on statistics with EU assistance to provide a secure legal basis for the activities of INSTAT.

F. External Outlook and Policies, and Capacity to Repay the Fund

35. **Albania's external position remains sustainable.** With continuing large investment and reconstruction needs, the current account deficit is expected to remain broadly unchanged, at about 8 percent of GDP in 2000, and to be fully financed by projected inflows of official bilateral and multilateral support and foreign direct investment (Table 7). Additional inflows in the context of the Stability Pact are expected to pick up only in 2001 and thereafter. Small financing gaps are projected to open up in 2001 and to continue in the medium term. The external financing situation will be reassessed during the midyear review in November 2000. In the medium term, the current account deficit is projected to decline gradually as exports rise—in response to further improvements in security and public order, the investment climate, and continuing structural reforms—and private remittances grow steadily. There is considerable scope for foreign direct investment to rise.

36. **The government is continuing its efforts to regularize relations with its external creditors.** It has reconciled estimates of arrears to Russia and Italy subject to the July 1998 Paris Club Agreement and will aim to conclude the respective bilateral agreements within a new deadline to be agreed with the Paris Club. The mission urged the authorities to expedite

Table 7. Albania: Balance of Payments, 1998-2004
(In millions of U.S. dollars)

	1998	1999	1999	2000	2000	2001	2002	2003	2004	First-year	Second-year	Third-year
		Prog.	Est.	Prog.	Proj.	Proj.	Proj.	Proj.	Proj.	PRGF period	PRGF period	PRGF period
		5/99		5/99							Est.	Prog.
I. Current account	-187	-450	-294	-356	-320	-326	-333	-332	-333	-269	-300	-327
Trade balance	-621	-1151	-846	-798	-692	-728	-785	-838	-892	-695	-853	-701
Exports	205	234	275	290	330	386	452	529	618	235	289	344
Imports	826	1,385	1,121	1,088	1,022	1,114	1,237	1,367	1,510	930	1,142	1,045
of which: Humanitarian aid related to the Kosovo	0	325	183	0	0	0	0	0	0	0	183	0
Services and income	-5	11	45	12	17	14	30	49	70	8	38	16
of which: Interest due	7	11	7	16	11	19	24	25	33	7	8	13
Private transfers	440	365	324	430	356	388	423	457	489	418	332	358
Official transfers related to the Kosovo crisis	0	325	183	0	0	0	0	0	0	0	183	0
II. Capital account	99	218	222	277	269	317	345	344	334	192	229	275
Official transfers 4/	89	95	142	80	91	86	95	94	94	164	129	90
Direct investment	45	43	51	100	92	106	113	116	110	49	61	96
Other capital including short-term flows	-88	-3	-44	0	-20	10	-1	0	0	-84	-38	-13
Short-term capital	0	0	0	0	0	0	0	0	0	0	0	0
Other financial flows (increase = -)	-88	-3	-44	0	-20	10	-1	0	0	-84	-38	-13
o/w Change in NFA of commercial banks (incr=-)	-88	-3	-44	0	-20	10	-1	0	0	-77	-34	-8
Official medium- and long-term loans (net) 1/	53	82	72	97	106	115	139	134	129	63	76	102
New borrowing	62	95	80	113	117	126	160	157	155	68	89	119
Amortization 1/	-9	-13	-8	-16	-11	-11	-21	-23	-26	-5	-13	-17
III. Errors and omissions	105	0	55	0	0	0	0	0	0	123	55	5
IV. Net balance = I+II+III	17	-232	-18	-80	-51	-9	12	12	1	46	-17	-48
V. Financing requirement = - IV	-17	232	18	80	51	9	-12	-12	-1	-46	17	48
Available financing	-17	30	18	-23	-13	-49	-50	-45	-45	-46	5	-32
Change in net reserves (increase = -)	-71	14	-79	-23	-13	-49	-50	-45	-45	-68	-81	-32
Change in gross reserves, (increase = -)	-78	9	-97	-15	-19	-35	-35	-35	-35	-83	-78	-23
Use of Fund Resources (net)	7	5	19	-8	6	-15	-15	-10	-10	14	-4	-9
Fund (ESAF/PRGF)	8	8	21	0	13	0	0	0	0	16	0	0
Repayments to Fund	-1	-4	-2	-8	-8	-15	-15	-10	-10	-2	-4	-9
BOP support	54	16	96	0	0	0	0	0	0	22	86	0
Changes in arrears (increase = +) 2/	-145	0	0	0	0	0	0	0	0	-145	0	0
Overdue debt forgiveness	0	0	0	0	0	0	0	0	0	0	0	0
Debt service relief (rescheduling)	145	0	0	0	0	0	0	0	0	145	0	0
Financing gap	0	202	0	102	64	58	37	33	44	0	12	80
Identified financing (provisional)	0	158	0	50	65	34	0	0	0	0	12	80
Memorandum items:												
Gross usable reserves	384	375	481	390	500	535	570	605	640	...	...	...
(months of imports of goods and services) 5/	4.2	3.7	4.9	3.7	4.6	4.5	4.3	4.2	4.0	...	...	...
Trade balance (percent of GDP) 4/	-20.3	-30.8	-23.0	-19.4	-18.1	-17.4	-16.8	-16.1	-15.6	...	...	...
Trade balance (percent of GDP) 5/	-20.3	-21.9	-18.0	-19.4	-18.1	-17.4	-16.8	-16.1	-15.6	-21.6	-22.9	-17.7
Current account (percent of GDP)	-6.1	-12.0	-8.0	-8.6	-8.4	-7.8	-7.1	-6.4	-5.8	-8.4	-8.0	-8.2
Debt service (percent of exports of goods and services)	6.2	7.6	3.9	9.7	6.4	8.6	9.8	8.1	8.1	...	...	...
External debt (percent of GDP) 3/	27	28	26	30	30	31	31	31	28	...	...	...
Merchandise exports (percent growth)	22.9	14.0	34.2	24.0	20.0	17.0	17.0	17.0	17.0	...	...	...
Merchandise imports (percent growth) 5/	20.6	28.3	13.5	2.6	9.0	9.0	11.0	10.5	10.5	...	...	...

Sources: Ministry of Finance; Bank of Albania; donors; and Fund staff estimates and projections.

1/ Excluding IMF.

2/ The figure for 1998 corresponds to the clearance of arrears to Russia and Italy as a result of the rescheduling of Paris Club debt in July 1998.

3/ Includes arrears.

4/ Includes imports (official transfers) related to the Kosovo crisis.

5/ Excludes imports (official transfers) related to the Kosovo crisis.

these negotiations. The authorities have prepared a timetable and formed working groups for reconciling and rescheduling debt in arrears with the aim of removing the remaining restrictions subject to IMF approval under Article VIII, including outstanding debit balances under inoperative bilateral agreements (¶130). Apart from these arrears, Albania's exchange system is free from restrictions on payments and transfers for current international transactions.

37. **Albania's trade regime is relatively open, and the country has made substantial progress toward accession to the WTO.** The authorities remain committed to reducing the maximum tariff rate to 15 percent in 2001 and to keeping the two other rates at 5 percent and 10 percent. Import licensing of fuels aimed at supporting the application of domestic technical standards will remain automatic and consistent with the principle of national treatment.

38. **Further progress needs to be made in monitoring external debt and absorbing aid.** With technical assistance from UNCTAD, the government will make an external debt and aid database fully operational by end-June 2000 and will ensure timely and accurate reporting of external debt, including commitments by state-owned enterprises. The authorities have provided adequate funds in the 2000 budget for reimbursement of VAT and customs duties and for land acquisition. To speed up project implementation, which has often been delayed by issues relating to land expropriation, time-bound planning will be introduced for land expropriation and the respective timetables will be announced to the public upon the start of projects.

39. **Albania should have no difficulties in servicing its obligations to the Fund (Table 8).** Reserve cover is projected to remain at the relatively comfortable level of more than four months of imports, the authorities have a good record in meeting debt service payments to the Fund, and prospects for international assistance on concessional terms are good. The debt/GDP ratio is projected to rise somewhat from 26 percent in 1999 to 30 percent in 2000 before declining to 28 percent by 2004. The debt service/exports ratio will gradually rise from 4 percent in 1999 to the still modest level of 10 percent in 2002, as payments to the Fund increase, peaking at 23 percent of quota in 2001. The debt service ratio will then taper off to around 8 percent by 2004.

IV. STAFF APPRAISAL

40. **The authorities are to be commended for their policies to maintain macroeconomic stability.** Prudent financial policies, in addition to foreign assistance, have allowed them to eliminate inflation, while at the same time achieving a strong growth performance. All the end-March 2000 quantitative performance criteria were met, confirming the favorable record under Fund-supported programs. However, the structural reform program has run into delays, although their causes are difficult to disentangle in light of the Kosovo crisis. The unfinished structural agenda remains challenging.

Table 8. Albania: Projected Payments to the Fund as at March 31, 2000
(In millions of SDRs)

	Overdue	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009 Beyond	Total
Obligations from existing drawings												
1. Principal												
a. Repurchases	0.0	0.0	4.4	4.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	8.8
b. PRGF/SAF Repayments	0.0	4.7	6.2	6.2	6.8	6.4	5.9	6.2	6.2	5.6	3.5	58.6
2. Charges and Interest 1/												
a. on Fund credit	0.0	0.6	0.6	0.4	0.2	0.2	0.1	0.1	0.1	0.0	0.0	2.3
b. on use of SDRs	0.0	-0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.4
Total obligations 2/ (percent of quota)	0.0	4.8	11.2	11.0	7.0	6.6	6.1	6.3	6.3	5.6	3.5	69.3
	0.0	9.9	23.1	22.6	14.4	13.5	12.4	12.9	12.8	11.6	7.1	142.2
Obligations from prospective drawings												
1. Principal												
a. Repurchases	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
b. PRGF/SAF Repayments	0.0	0.0	0.0	0.0	0.0	0.0	0.2	1.9	2.8	2.8	2.8	14.1
2. Charges and Interest 1/												
a. on Fund credit	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.5
b. on use of SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total obligations 2/ (percent of quota)	0.0	0.0	0.1	0.1	0.1	0.1	0.3	1.9	2.9	2.9	2.8	14.7
	0.0	0.0	0.1	0.1	0.1	0.1	0.6	4.0	5.9	5.9	5.8	30.1
Cumulative (existing and prospective)												
1. Principal												
a. Repurchases	0.0	0.0	4.4	4.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	8.8
b. PRGF/SAF Repayments	0.0	4.7	6.2	6.2	6.8	6.4	6.2	8.1	9.0	8.4	6.3	72.7
2. Charges and Interest 1/												
a. on Fund credit	0.0	0.6	0.7	0.4	0.3	0.2	0.2	0.2	0.1	0.1	0.0	2.8
b. on use of SDRs	0.0	-0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.4
Total obligations 2/ (percent of quota)	0.0	4.8	11.3	11.1	7.1	6.6	6.4	8.2	9.1	8.5	6.3	83.9
	0.0	9.9	23.2	22.7	14.5	13.6	13.1	16.9	18.7	17.4	13.0	172.3
Outstanding Fund credit 2/ (In millions of SDRs)	0.0	62.0	57.3	46.7	39.4	32.1	33.1	27.7	21.2	14.1	14.1	...
In percent of:												
Exports of goods		25.8	20.5	14.4	10.5	7.3	...	...	...	...	...	...
External public debt		7.4	6.1	4.5	3.5	2.8	...	...	...	...	...	...
Gross official reserves		17.0	14.8	11.4	9.1	7.1	...	...	...	...	...	...
GDP		2.2	1.9	1.4	1.1	0.8	...	...	...	...	...	...
Quota		127.3	117.6	95.8	80.8	65.8	...	...	...	...	...	...
Repurchases and charges due 2/ (In millions of SDRs)		4.8	11.3	11.1	7.1	6.6	6.4	8.2	9.1	8.5	6.3	4.5
In percent of:												
Exports of goods		2.0	4.0	3.4	1.9	1.5	...	...	...	...	...	...
External public debt		0.6	1.2	1.1	0.6	0.6	...	...	...	...	...	...
Gross official reserves		1.3	2.9	2.7	1.6	1.5	...	...	...	...	...	...
GDP		0.2	0.4	0.3	0.2	0.2	...	...	...	...	...	...
Quota		9.9	23.2	22.7	14.5	13.6	...	...	...	...	...	...

1/ Projections are based on current rates of charge, including burden-sharing charges where applicable, for purchases in the GRA, and on current interest rates for SAF, PRGF, and Trust Fund. The current SDR interest rate is assumed for net use of SDRs.

2/ Overdue obligations (if applicable) will be settled in full at close of business April 1, 2000.

41. **The authorities' policy framework for 2000 aims at continuing rapid growth and low inflation, based on cautious fiscal and monetary policies.** The 2000 budget provides for a reduction in the general government deficit of 2 percentage points of GDP, and in domestic financing of the deficit, excluding privatization proceeds, by about 1 percentage point, in line with the medium-term objective of fiscal consolidation. The Bank of Albania also continues to be conservative in interest rates and open market operations policies. Further reduction in interest rates is warranted in view of continued negative inflation and to support rapid growth. Now that minimum deposit rates have become less effective, the BoA should more actively use open market operations to influence short-term interest rates. This course of action would be even more appropriate if the lek comes under renewed appreciation pressures.

42. **The authorities have agreed to implement several new measures to improve the efficiency of both customs and domestic tax administration.** These measures are to be welcomed and should be implemented strongly. In light of the downside risks to revenues, in particular as a result of lower GDP projections, revenue performance should be monitored closely and, if necessary, additional measures be introduced in consultation with staff. At the same time, it is equally important that the authorities make timely repayments of tax credits, adhere strictly to legal provisions that protect taxpayers, and provide for the accountability of tax offices. The agreed program includes appropriate measures in these respects.

43. **A stronger commitment to financial sector reform is crucial to encourage private investment and establish a market-friendly environment.** The authorities should do their utmost to complete the sale of the NCB, and give the highest priority to privatizing the Savings Bank. Raising private sector credit requires tangible improvements in the legal framework for lending. The authorities should therefore move ahead rapidly to implement the new law on collateral and replace the bankruptcy law. There is an urgent need to take steps to develop the T-bill market further, including the adoption of measures to increase sales to the nonbank sector and to reduce reliance on the Savings Bank prior to its privatization.

44. **The authorities should vigorously pursue the remaining privatization program in the enterprise sector. Significant progress would signal a turning point, encouraging foreign direct investment.** The completion of the privatization of the NCB, AMC, and five medium-size enterprises will improve the image of Albania as a country open to foreign investment. Attracting FDI crucially depends on strengthening governance and law and order. The authorities should also remove bureaucratic obstacles to foreign investment, for example, through creating a one-stop shop for foreign investors, and ensure timely reimbursement of VAT. Relying excessively on fiscal concessions to attract FDI, on the other hand, could discourage domestic investors and reduce tax revenues.

45. **The authorities have shown a genuine enthusiasm toward developing a poverty reduction strategy as exhibited in the interim PRSP.** In addition to their plan for

developing a first PRSP by mid-2001, they are now involved in preparing their first medium-term expenditure framework which should define the 2001 budget priorities and focus on poverty issues. While acknowledging that a comprehensive poverty assessment and the design of appropriate policies will require more time to prepare, the authorities are encouraged to use the opportunity of their MTEF exercise to address those poverty issues that clearly require immediate action, particularly in public health, education and child care.

46. **Overall, the authorities' macroeconomic and structural policies are on the right track and the staff recommends the completion of the second review of the second annual PRGF arrangement.** Albania will continue to need extensive external financial support in the years ahead. The continuation of this support is justified by the policies set out in the attached Letter of Intent and MEFP, and the proposed poverty reduction strategy, as preliminarily outlined in the interim PRSP. It is recommended that, subject to the implementation of the agreed prior actions, the authorities' request for the third annual PRGF arrangement be approved immediately after the expiration of the second annual arrangement.

47. It is recommended that Albania remain on the standard 12-month Article IV consultation cycle.

V. Draft Decision

The following draft decision is proposed for adoption by the Executive Board:

1. The Republic of Albania has consulted with the Fund in accordance with paragraph 2(d) of the second annual arrangement under the Poverty Reduction and Growth Facility (PRGF) for the Republic of Albania (EBS/9984, Sup2, 6/18/99) and paragraph 34 of the supplementary memorandum of economic and financial policy, attached to the letter of the Prime Minister, the Minister of Finance, and the Governor of the Bank of Albania dated May 2, 1999.

2. The Fund decides that the second review contemplated in paragraph 2(d) of the second annual arrangement under the PRGF for the Republic of Albania is completed.

Table 9. Albania: Phasing of Disbursements Under the Second Review of the Second Annual and the Requested Third Annual PRGF Arrangements

(In millions of SDRs)

Projected Date of Board Meeting	Conditions	PRGF Disbursement
June 9, 2000	End-March 2000 performance criteria and end-year review under the PRGF.	2.354
June 20, 2000	Board approval of third annual arrangement under the PRGF, possibly on a lapse-of-time basis.	2.350
January 2001	End-September 2000 performance criteria and mid-year review.	4.705
June 2001	End-March 2001 performance criteria and end-year review.	4.705

ALBANIA: FUND RELATIONS
As of March 31, 2000

I. Membership Status: Joined: 10/15/1991; Article XIV

II. General Resources Account:	<u>SDR Million</u>	<u>%Quota</u>
Quota	48.70	100.0
Fund Holdings of Currency	54.18	111.2
Reserve position in Fund	3.36	6.9

III. SDR Department:	<u>SDR Million</u>	<u>%Allocation</u>
Holdings	65.25	N/A

IV. Outstanding Purchases and Loans:	<u>SDR Million</u>	<u>%Quota</u>
ESAF arrangements	58.60	102.3
First Credit Tranche	8.83	18.1

V. Financial Arrangements:

<u>Type</u>	<u>Approval Date</u>	<u>Expiration Date</u>	<u>Amount Approved (SDR Million)</u>	<u>Amount Drawn (SDR Million)</u>
PRGF	05/13/1998	05/12/2001	45.04	30.93
PRGF	07/14/1993	07/13/1996	42.36	31.06
Stand-by	08/26/1992	07/14/1993	20.00	13.13

VI. Projected Obligations to Fund:(SDR Million; based on existing use of resources and present holdings of SDRs):

	<u>Overdue</u>	<u>Forthcoming</u>				
	<u>03/31/2000</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
Principal		4.7	10.6	10.6	6.8	6.4
Charges/Interest		0.6	0.6	0.4	0.2	0.2
Total		5.3	11.2	11.0	7.0	6.6

VII. Exchange Rate Arrangement

On July 1, 1992 the Albanian authorities announced the removal of virtually all exchange and quantitative trade restrictions, unified the exchange markets, and adopted a floating exchange rate system (an independent float). The unified exchange rate stood at 137 lek per U.S. dollar on November 30, 1999.

VIII. Resident Representative

A Fund resident representative has been posted in Tirana since April 1993; Mr. Volker Treichel has held this position since January 1999.

IX. Technical Assistance

The Fund, other multilateral organizations and donors have provided extensive assistance for institutional development in Albania. The Fund alone has sent over 75 technical assistance missions to Albania since 1991. However, further institutional development is required in virtually every sector.

Albania: Relations with the World Bank Group

Background

1. Albania joined the World Bank Group in October 1991. Since then, the Bank has been actively involved in the design and implementation of Albania's reform program through its policy advice, lending operations, and technical assistance in various sectors. Beginning with the Critical Imports Project in 1992, the Bank to date has approved a total of 38 operations amounting to US\$523.0 million in credits, of which 14 are completed now. Under the current Bank portfolio (US\$347.0 million), 22 percent of the credits support adjustment, 21 percent agriculture, 38 percent infrastructure, 8 percent social sectors, and 11 percent technical assistance.

Current and medium-term initiatives

2. The Bank has been actively supporting Albania's economic recovery efforts after the 1997 crisis. The Rehabilitation Credit, approved by the Bank Board in December 1997, provided support for priority structural measures (resolution of the pyramid schemes and reform of the banking sector), and for alleviating the increased poverty and unemployment generated by the crisis. The Rehabilitation Credit was approved in parallel with the Recovery Program TA Project which is financing the implementation of the policy measures supported by the Rehabilitation Credit. In February 1998, the Bank Board approved the Private Industry Recovery Project, which provides political risk cover for commercial financing of productive activities. An Urban Land Management Project and Durres Port Project were also approved in 1998, and support priority infrastructure development. In addition, the Health Recovery and Development Project provides support in a priority area of the social sectors after the 1997 crisis.

3. The Bank's Country Assistance Strategy (CAS) for Albania was approved in 1998 and covers the period of 1998-2001. The CAS focuses on 3 strategic priorities: (i) Governance and institution building to help to establish an accountable, transparent and efficient state. The Bank will address these issues through a judicial and public administration reform project to be approved this fiscal year; (ii) Private sector development (including maintenance of macroeconomic stability, financial sector and enterprise reforms, and infrastructure improvement); and (iii) Human development and poverty alleviation. The Community Works Project was approved in January 1999, to assist rural communities with infrastructure and social infrastructure development. A CAS Progress Report was presented to the Board on March 21, 2000. While the CAS Progress Report continues to focus on the three strategic priorities outlined above, it places a renewed emphasis on poverty reduction, and in particular on its social underpinnings. At the same time, the Government has launched a participatory process to prepare a full scale Poverty Reduction Strategy Paper (PRSP) by mid 2001.

4. Since the Kosovo crisis and the large influx of refugees, the Bank has put more immediate emphasis on support to the social sectors, especially health and education, and on

emergency interventions in infrastructure like transport, water supply and sanitation. The Bank's activities in response to the crisis aimed mainly at long-term development objectives rather than short-term relief, and included cooperation with other donors, especially non-governmental organizations, in areas of relief and humanitarian assistance. The Public Expenditure Support Credit of US\$30 million, approved in May 1999, is an example of efforts to support Albania's budget and the government's ability to coordinate and direct international aid. Furthermore, in June 1999, the Irrigation II Project, a Structural Adjustment Credit, a Microcredit Project and supplementary financing for the ongoing Community Works Project, which supports Albanian communities most affected by the influx of refugees, were approved by the Board. The recently approved Emergency Road Repair Project (December 1999) will provide assistance in rehabilitating roads damaged by heavy traffic during the crisis. The Water Supply Urgent Rehabilitation Project (February 2000) will rehabilitate components of the water supply systems which are in a state of disrepair in the cities of Durrës, Fier, Lezhe and Saranda. The Legal and Judicial Reform Project and the Public Administration Reform Project, both approved on March 21, 2000, will help to strengthen Albania's weak institutional and governance capacity, including its ability to enforce laws and regulations. Additional operations in the education and financial sectors are currently at an advanced stage of preparation and are scheduled for Board presentation in the fourth quarter of the fiscal year.

STATUS OF BANK GROUP OPERATIONS IN

Statement of IDA

(As of March 31, 2000)

Credit No.	Fiscal Year	Borrower	Project	US\$ Million (Less Cancellations)	
				Credits	Undisbursed
26100	1994	Albania	Durres Water Supply	11.6	2.2
26460	1995	Albania	Technical Assistance for Tax Administration	4.0	1.4
26520	1995	Albania	Irrigation Rehabilitation	10.0	0.0
26590	1995	Albania	Health Services Rehabilitation	12.4	3.6
27320	1995	Albania	Rural Roads	15.0	0.7
27950	1996	Albania	Agroprocessing Development	6.0	1.8
28260	1996	Albania	Power Transmission and Distribution	29.5	18.1
28460	1996	Albania	Forestry	8.0	4.7
28880	1996	Albania	National Roads	25.0	11.9
30160	1998	Albania	Recovery Program for Technical Assistance	5.0	1.9
30380	1998	Albania	Private Industry Recovery	10.3	6.8
30660	1998	Albania	Land Development	10.0	9.4
30670	1998	Albania	Health Recovery and Development	17.0	16.3
30680	1998	Albania	Durres Port	17.0	15.2
31640	1999	Albania	Community Works	9.0	7.9
31641	1999	Albania	Community Works Supplement	5.0	4.2
31970	1999	Albania	Public Expenditures Support	30.0	0.0
32310	1999	Albania	Structural Adjustment Credit	45.0	25.1
32320	1999	Albania	Irrigation & Drainage II	24.0	22.1
32530	1999	Albania	Microcredit	12.0	11.2
33030	2000	Albania	Emergency Road Repairs	13.7	13.3
33220	2000	Albania	WS Urgent Rehabilitation	10.0	9.8
33270	2000	Albania	Legal/Judicial Reform	9.0	8.9
33280	2000	Albania	Public Admin Reform	8.5	8.5
Total				347.0	205.0

	<u>Active projects</u>	<u>Closed Projects</u>	<u>Total</u>
Total Disbursed:	134.3	175.1	309.4
Of which: Repaid	0.0	0.0	0.0
Total Now Held by IDA	347.0	176.0	523.0
Total Amount Sold	0.0	0.0	0.0
Of which: Repaid	0.0	0.0	0.0
Total Undisbursed	205.0	1.5	206.5

Statement of IFC Investments

(As of March 31, 2000)

There are three IFC operations in Albania: (i) a US\$1.2 million loan to SEF Eurotech, a cement bagging company near the port of Durres; (ii) the Patos Marinza Project for enhanced oil recovery, consisting of a US\$28.5 million equity commitment (of which about US\$7 million has been disbursed) and a US\$80 million loan (up to US\$30 million for IFC's account) commitment pending approval; and (iii) an equity investment of approximately US\$1.0 million in FEFAD Bank, a microfinance bank established to onlend to micro and small enterprises. A US\$2.25 million equity commitment for the National Commercial Bank is pending approval.

Albania: Statistical Issues

Albania has made significant progress in improving its statistical database with extensive technical assistance, including from the Fund. The multisector statistics mission of February 1999 secured the agreement of the authorities on an action plan for each of the major statistical areas, identifying the concrete steps and timetable for improving Albania's macroeconomic statistics. In spite of the Kosovo crises, the authorities have thus far made progress in implementing the action plan. The Council of Statistics has been established and its constitution and functions have been ratified. However, much still remains to be done. In particular, a system of national accounts needs to be set up.

STA has chosen Albania as a focus country for enhanced technical assistance. The multisector statistics mission in February 1999 was followed by money and banking statistics, government finance statistics, and national account statistics missions that were completed in late 1999. A resident national accounts advisor has assisted INSTAT in establishing a compilation system for producing GDP estimates. STA also has selected Albania as a pilot country for Eastern Europe in the preparation of a full set of information on the national statistical system (metadata) and in the preparation of the data dissemination module in the Report on Observance of Standards and Codes (ROSC). As a result of a General Data Dissemination System and ROSC mission conducted in December 1999, a complete set of metadata for the external, financial, fiscal, and real sectors, as well as for the socio-demographic indicators, has been prepared. In addition, a comprehensive summary of plans for improving data compilation and dissemination across all statistical sectors (including socio-demographic sector) has been articulated. The authorities have been implementing this plan in accordance with the agreed timetable.

Real sector

STA has provided considerable technical assistance to Albania on price statistics. The consumer price index (CPI) constructed by the statistical institute (INSTAT) meets international standards. It is reported regularly for publication in the Albania page in the *International Financial Statistics (IFS)*. Technical assistance from STA on a producer price index (PPI), that had been stalled during the civil disorder, resumed recently. The STA mission on PPI visited Tirana during March and June 1998 to assist in the collection of PPI data. In view of the high non-response rate for the enterprises selected for PPI price collection, the mission recommended that an expanded sample be obtained. A PPI mission is currently in the field (May 4-17) to finalize the PPI compilation.

In the absence of official national accounts aggregates since 1990, Fund staff have relied on their own estimates during consultations with the authorities. These estimates are based on very partial data on (gross) agricultural output, activity in state industrial production, and extremely limited information on private sector activity. The STA multi sector mission of February 1999 has worked with the INSTAT in developing a work program for the compilation of national accounts statistics.

A STA resident advisor on national accounts assisted the INSTAT from July to December 1999 to establish a compilation system for producing GDP estimates using existing and new data sources. As a result, preliminary annual GDP estimates for 1996-1998 using both the production and expenditure approaches at current and constant prices were produced during the assignment. However, these data do not include estimates for the underground economy. In addition to coverage problems, these estimates suffer from the poor quality of the source data and the lack of appropriate price indicators for deflating current price estimates. To improve basic data sources, the mission recommended changes to the design of new surveys and advised the authorities on establishing a framework within which the collaboration among government agencies involved in statistics could be institutionalized. The mission provided on-the-job training and conducted a series of seminars on national accounts statistics. A work program has been agreed, which should allow the INSTAT to disseminate improved GDP estimates by mid 2001.

The trade statistics missions in 1992 and 1993 improved data compilation up to international standards. However, data collection suffered extensively during the 1997 crisis as a number of customs posts were damaged or destroyed, and there was most likely a large temporary increase in the volume of unreported transactions. After some delays due to the Kosovo crisis, the compilation and dissemination of foreign trade indices was anticipated by the end of 1999. Plans for improving the quality of trade statistics include the forthcoming introduction of the Automated System of Customs Data (ASYCUDA) with EU assistance.

Government finance

Albania reported fiscal data (for 1995) for the first time in 1996 for publication in the 1996 *Government Finance Statistics Yearbook* and *IFS*. In March 1998, the authorities started to publish a new quarterly bulletin of government statistics. The STA multisector statistics mission in February 1999 worked to upgrade the quality of the data reported in this publication to GFS standards and to develop a system for the regular and timely reporting of data to the Fund. Data for 1997 and 1998 have since been supplied to the Fund for inclusion in the 1999 *GFS Yearbook*. Considerable improvement in collection of data on disbursement of foreign loans and grants has been achieved under the technical assistance provided by UNCTAD. A foreign debt database has been established and is nearly operational, requiring only auditing for final implementation.

Monetary accounts

The existing data compilation framework conforms with the Fund's methodology, and data are compiled on a timely basis. However, the establishment of savings and credit associations (SCAs), which are not required by law to report balance sheets data to the BoA, could pose potential problems for the quality and timeliness of monetary data. The multisector statistics mission recommended that the coverage of monetary statistics be expanded to include the accounts of the SCAs as soon as data become available.

The new plan of accounts for the commercial banks has been implemented. The commercial banks started reporting balance sheet data to the BoA in June 1999 on revised reporting forms prepared by the BoA. There seem to be few problems. The recent money and banking statistics mission assisted the BoA in revising the reporting forms with a view to reducing the reporting burden of the commercial banks and ensuring consistency of the data reported to the various departments of the BoA.

The government has agreed to recapitalize the National Commercial Bank (NCB), to transfer the entire loan portfolio to the Loan Collection Agency, and to transfer the NCB's share holdings in Italian-Albanian Bank and Arab-Albanian Islamic Bank to the Ministry of Finance. The implications of these transactions for monetary statistics will need to be reviewed after the details have been finalized.

Balance of payments

The data compiled by the BoA are methodologically sound, although some of the estimates needed to be refined. The BoA has established data compilation procedures based on the classification system of the fifth edition of the IMF's *Balance of Payments Manual*. The BoA reports quarterly data to STA on a regular and timely basis. However, problems remain in the areas of service transactions and remittances and in the monitoring of capital account transactions and external debt. These problems could be addressed by strengthening existing data sources and improving estimation methods.

Albania: Core Statistical Indicators
(as of May 8, 2000)

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/GNP	External Public Debt/Debt Service
Date of Latest Observation	Apr.24	Apr.24	End-Mar	End-Mar	End-Feb.	Apr. 20	End-Mar	Feb.	Dec. 1999	End-Mar	1998	Jan.
Date Received	Apr.24	Apr.24	Apr.21	Apr.21	Apr.21	Apr.24	Apr.10	Apr.	Apr.	Mid-Apr.	Mid-1999	Apr.
Frequency of Data	Daily	Daily	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Quarterly	Weekly	Annual	Quarterly
Frequency of Reporting	Daily	Daily	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Variable	Weekly	Annual	Variable
Frequency of Publication	Daily	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Variable	Variable	Annual	--
Source of Update	BoA	BoA	BoA	BoA	BoA	BoA	INSTAT	Customs/ BoA/INSTAT	BoA	BoA/MoF	Govt. Agencies	MoF/ Donors
Mode of Reporting	Fax	Fax	Fax	Fax	Fax/ Pouch	Fax/ Pouch	Fax	Fax/ Mission	Mission	Fax	Mission	Mission
Confidentiality	UR	UR	UR	UR	UR	UR	UR	UR	UR	UR	UR	UR

List of abbreviations:

BoA: Bank of Albania
 MoF: Ministry of Finance
 INSTAT: Statistical Agency of the Republic of Albania
 UR: Unrestricted use

Tirana, May 25, 2000

Mr. Horst Köhler
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Köhler:

1. The authorities of the Republic of Albania have continued to pursue policies that are being supported by the second annual arrangement under the Poverty Reduction and Growth Facility (PRGF). Inflation has been effectively reduced to zero while GDP increased by about 7¼ percent in 1999 and is expected to grow at a similar rate in 2000. Structural reforms and progress in improving tax administration have also continued. As a result of measures taken since the midyear review, revenue performance has improved significantly and smuggling has been curtailed. All end-March 2000 quantitative performance criteria were met, and we are confident that the three prior actions agreed with the staff will be implemented by June 7, 2000. We, therefore, request that the end-period review under the second annual arrangement be completed.

2. Based on the Interim Poverty Reduction Strategy Paper (I-PRSP), which has been separately submitted to the IMF and the World Bank, the attached Supplementary Memorandum on Economic and Financial Policies describes our economic program and key policy measures supporting our request for the third annual PRGF arrangement for the program period April 2000–March 2001. In particular, we have reached understandings with the Fund staff on further measures to improve tax administration and strengthen revenue performance. We are also making every effort to ensure a satisfactory conclusion of the sale of the National Commercial Bank, proceed with the privatization of the Savings Bank, and complete six important privatization projects in the enterprise sector.

3. The Government and the Bank of Albania believe that the policies outlined in the attached memorandum are adequate to achieve the targets of the program, but in consultation with the IMF, will take any further measures that may become necessary for this purpose during the program period. In addition, the authorities will provide the IMF with such information as the IMF may request in connection with the implementation of the policies and objectives of the program.

Sincerely yours,

/s/
Ilir Meta
Prime Minister

/s/
Anastas Angjeli
Minister of Finance

/s/
Shkëlqim Cani
Governor, Bank of Albania

SUPPLEMENTARY MEMORANDUM ON ECONOMIC AND FINANCIAL POLICIES OF THE GOVERNMENT OF THE REPUBLIC OF ALBANIA FOR THE COMPLETION OF THE SECOND REVIEW UNDER THE SECOND ANNUAL PRGF ARRANGEMENT AND FOR THE THIRD ANNUAL PRGF ARRANGEMENT

I. INTRODUCTION

1. **Macroeconomic performance over the past year has been favorable.** During 1999, GDP increased by 7¼ percent, owing in part to the Kosovo-related demand shock. Growth exceeded 10 percent in the construction and service sectors and remained robust in the industrial and agricultural sectors. More recent evidence indicates that strong growth is continuing in 2000. The annual inflation rate fell sharply early in 1999 and has remained negative ever since, reflecting the substantial strengthening of the Lek in 1998 and the first half of 1999, as well as the effects of the diversion of aid-related imports into domestic markets. The current account deficit widened by about 2 percentage points in 1999, to 8 percent of GDP, owing to higher imports resulting from the Kosovo crisis. However, the balance of payments position remained strong, reflecting foreign assistance and private inflows, and external reserves increased by about US\$100 million in 1999.

2. **The fiscal outcome was broadly as envisaged under the program in 1999, although tax revenues were below the target.** The overall general government budget deficit in 1999 widened by 1 percentage point relative to 1998, to about 11.3 percent of GDP reflecting Kosovo-related expenditures of about 1½ percent of GDP. Domestic financing of the budget deficit, excluding privatization proceeds, at 5.2 percent of GDP was about 1¼ percentage points lower than in 1998. Total tax revenue in 1999 fell short of the target, with particular weaknesses in custom duties and VAT only partially offset by good performance in collecting excises and income taxes. The tax revenue shortfall was compensated by higher-than-expected profit transfers from the Bank of Albania (BoA) and lower expenditures resulting from delays in project implementation. Weakness in revenue collection in the last quarter of 1999 was responsible for the fact that net domestic financing of the budget at end-December 1999 was by about Lek 1.6 billion (0.3 percent of GDP) above the indicative target under the revised program.

3. **Revenue performance has improved significantly in the first quarter of 2000, largely as a result of measures taken following the midyear review.** Since November, we have implemented a number of important measures, including the continuous updating of reference prices for imports, strengthening the anti-smuggling units at customs, improving controls on goods in transit, introducing regular internal audits and taking disciplinary actions where necessary. Moreover, we have introduced secured VAT invoices, taken measures to enforce the registration of wholesale traders, and established cross-checking of VAT returns with customs data. These measures have already resulted in a reduction in smuggling and a significant improvement in revenue performance in the first quarter of 2000, when the tax collections were higher by a remarkable 40 percent than in the same—admittedly weak—period of 1999. As a result, cumulative revenues since January

1999 came out only around Lek 1 billion below the end-March 2000 target, compared to some Lek 2.5 billion at end-1999. The new law on fiscal procedures, in force since March 2000, provides a sound legal basis for the relationship between taxpayers and the authorities.

4. **Monetary policy was loosened gradually during 1999, but private sector credit growth remained slow.** In early 1999, monetary policy was constrained by concerns caused by the Kosovo crisis. Subsequently, minimum deposit interest rates, currently the main monetary policy instrument, were gradually reduced, from 15.0-15.5 percent in May 1999, to 7.0-8.0 percent in March 2000. Expansion in private sector credit was much below the projections throughout 1999 and early 2000, despite the efforts to improve the legal framework and accounting practices in the enterprise sector. Moreover, credit growth was affected by the unforeseen delay in the privatization of the National Commercial Bank (NCB). Strong growth in broad money continued at about 20 percent in the year to February, reflecting the rapid output growth and increased confidence in the banking system. The performance criterion on the Bank of Albania's net domestic assets for end-March 2000 was met.

5. **We have made substantial progress in structural reforms over the past year despite the adverse effects of the Kosovo crisis.** In the enterprise sector, we have liquidated, privatized, or transferred to local authorities about 520 small and medium-size enterprises; prepared the transfer of several mines and a production facility in the chromium sector, and completed the transfer of the copper mines to foreign investors; and made substantial progress in preparing Albania Mobile Communications (AMC) for privatization. In the financial sector, we approved the law for the privatization of the Savings Bank (SB) and are close to completing the sale of the NCB; and we are preparing the implementation of the law on collateralized transactions to make the legal framework for private sector credit more effective. In the area of public administration, we approved the civil service law and removed about 5,000 positions from the budget sector payroll in 1999 and a further 3,000 so far in 2000, lowering the size to about 127,000 employees. We have also made progress in liquidating the assets of the pyramid schemes and have started distributing the proceeds to former investors.

II. THE GOVERNMENT'S MACROECONOMIC AND STRUCTURAL POLICIES

A. Objectives

6. **Our main objectives are to maintain the economy on a rapid growth path, reduce the development gap relative to the European average, improve overall living standards, and reduce the poverty of those most in need.** We are aware that to achieve these objectives we have to preserve macroeconomic stability, deepen the process of structural reforms, improve governance, and strengthen efforts to attract foreign investment. We will therefore continue to conduct our policies in the framework of a PRGF arrangement for the period April 1998-March 2001, for which the IMF provides financial support. The remainder of this memorandum details the macroeconomic and structural policies for the period ahead. We believe that these policies will be sufficient to achieve the program

objectives, but will take additional measures and seek new understandings with the IMF should the program diverge from its specified targets.

7. **To better focus our policies toward poverty alleviation, we are preparing a comprehensive poverty reduction strategy, which will be incorporated in a Poverty Reduction Strategy Paper (PRSP) to be approved by the government by mid-2001.** This strategy will build upon our achievements in this area, particularly in relation to social assistance, education, land reform, and rural development—made in the context of policies developed with assistance from the World Bank and other international organizations and bilateral donors—and will also cover health, infrastructure, and other sectors. To strengthen the effectiveness and public support of our poverty-alleviating policies, we will organize a broad consultative process that will include representatives of civil society groups, local communities, poor people themselves, and foreign donors. The steps for arriving at a full-fledged PRSP are described in the interim PRSP, approved by the government in April, which also includes a three-year macroeconomic framework and a policy matrix as agreed with the Fund and World Bank staffs.

8. **Macroeconomic policies for 2000 and 2001 will aim at supporting rapid GDP growth as well as maintaining low inflation and a prudent level of official reserves.** To achieve the growth target of about 8 percent, we intend to proceed rapidly with structural reforms, improve governance, and complete the privatization process as described below. While some macroeconomic indicators currently suggest a downside risk for the targeted growth rate in 2000, structural reforms, in particular the completion of several important privatization projects, are expected to induce a pick-up in private investment and growth. Regarding inflation, after the unwinding of special factors in 1999, we expect that it will increase to about 2-4 percent, a level consistent with relative price adjustments characteristic of a rapidly growing economy. External reserves are expected to remain at 4½ months of imports. Specific targets for 2000 and 2001 are tabulated below.

	1998	1999		2000		2001
		Proj. 5/99	Est.	Proj. 5/99	Proj.	Proj.
GDP growth (in percent)	8.0	8.0	7.3	8.0	7.0	8.0
Inflation (average, in percent)	8.7	7.0	0.4	5.5	1.5	3.0
End-period gross official reserves (In millions of U.S. dollars)	384	375	481	390	500	535
(In months of imports of goods and services)	4.2	3.7	4.9	3.7	4.6	4.5
External current account deficit (In percent of GDP)	6.1	12.0	8.0	8.6	8.4	7.8
General government deficit	10.4	13.8	11.3	7.8	9.4	8.6
Of which domestically financed (In percent of GDP, excl. priv. receipts)	6.4	4.9	5.2	3.8	4.3	3.5

B. Fiscal Policy

9. **We will continue the policy of gradual fiscal consolidation.** The 2000 budget envisages an overall budget deficit of 9¼ percent of GDP, down from about 11¼ percent in 1999. It projects the domestically financed deficit to decline from 5.2 percent of GDP in 1999 to 4¼ percent in 2000 excluding privatization receipts, which will cover another ½ percent of GDP. In line with the ceilings envisaged under the program (see Table 1), foreign borrowing will be limited largely to resources provided on concessional or close to concessional terms by international organizations and bilateral donors. Assuming that the overall macroeconomic framework will remain as projected, further fiscal consolidation is foreseen for the 2001 budget, with the domestic deficit declining by close to another percentage point of GDP. We expect that the overall deficit will not be larger than 8½ percent of GDP. We agree that the passage by parliament of a satisfactory 2001 budget will be a condition for completing the midyear review of the program under the third annual PRGF arrangement.

10. **Despite the recent improvements in tax performance, we are aware that further progress is required in both customs and tax administration to meet the ambitious revenue target for 2000.** The budget incorporates an increase in the tax revenue to GDP ratio by about 2¼ percentage points of GDP without increasing tax rates. Achieving the revenue target is central to the implementation of the budget and the collections by the Tax and Customs Directorates will therefore be monitored by quarterly indicative floors.

11. **In the area of customs administration, we will implement the following measures:**

- Starting May 1, the internal audit unit has re-commenced the production of bi-weekly reports on the results of internal audit inspections, and the Director General will take disciplinary actions and submit monthly reports to the Minister of Finance. (While the internal audit unit has continued inspections to control the implementation of the valuation principles, the production of reports was discontinued owing to the need for further training of the staff.) Submission of the reports for May constitutes a prior action for the completion of the second review of the second annual arrangement, while their subsequent regular submission will be a continuous structural benchmark. Moreover, since end-March we have filled 10 vacant positions in the regional internal audit units, and are currently organizing training for all 16 officials in the internal audit units, with the assistance of the EU Customs Assistance Mission (CAM-Albania). We will also prepare precise terms of reference for internal auditing.
- To address the substantial problems in the implementation of import valuation principles, we are introducing a training program for 60 officials in the valuation units at the local, regional, and central level, which will be completed by end-May (prior action), when we will also prepare a manual on valuation. The central valuation unit will also start collecting statistics on the implementation of the various valuation methods.

- In cooperation with CAM-Albania, we are also in the process of reviewing the structure of the post-clearance control units, and implementing measures to strengthen their personnel structure and improve the cooperation with customs administrations of neighboring countries. We expect that these measures will result in a significant increase in the number of post-clearance cases successfully processed.
- We are implementing the new system of remuneration of customs officials as agreed with CAM. By end-May, we will reward some 50 customs officials for seizure of smuggled goods. We have also issued instructions so that the special bonus system can be implemented in June. Moreover, by end-May, we will issue instructions on a new annual appraisal system for all customs officials.
- We will continue with the accelerated collection of customs debt, where we have recently achieved good results by raising monthly collections from Lek 10-15 million on average in 1999, to Lek 100 million in January and February.
- With a view to curbing the abuse of the special customs regime licenses for inward processing, the Customs Directorate will audit the users of these licenses by end-2000 and apply fines or withdraw licenses in accordance with the customs code. Quarterly targets for completing these reviews will be structural benchmarks under the third annual arrangement. By end-June we will have completed the audit of 16 companies, by end-September of 151 companies and by end-December the control of all 396 enterprises that currently benefit from these licenses. The completion of the control of the ten largest licensed companies by end-May is a prior action for the completion of the second review of the second annual arrangement.

12. With regard to the Tax Directorate, we are implementing the following measures:

- We plan to increase the number of registered small business taxpayers from the current number of 25,000 to 30,000 by the end of 2000.
- In the area of internal revenue collection, the Tax Directorate will collect all new tax obligations of the state-owned electricity company, KESH, and the oil refinery. The Directorate will also strengthen efforts to collect tax arrears from other taxpayers.
- With support from the World Bank and the IMF's Legal Department, we are conducting a special training program to educate selected tax officials, who will in turn function as trainers in the Tax Department.
- With a view to improving the accountability of government institutions and building the trust of taxpayers, the Tax Directorate will strengthen its efforts to reimburse VAT in a timely manner. Moreover, we will amend the VAT law by December 2000 so as to introduce a binding time schedule for all reimbursements. We also intend to

request technical assistance from the Fiscal Affairs Department of the Fund on further improvements in the VAT collection.

- In a similar vein, the Tax Directorate will strictly follow the rules prescribed under the profit tax law on the advance payments of profit tax and will promptly reimburse taxpayers after the submission of final returns.

13. **We are proceeding with efforts to widen participation in the social security system.** To improve the administration of social security benefits and reduce opportunities for evasion, we have started to introduce social security numbers for all individuals and expect to finalize the process by early 2001. Moreover, amendments to the social security law, which we expect to submit to parliament by end-October, will include measures to strengthen the authority of inspectors in collecting contributions (structural benchmark).

14. **The expenditure program under the 2000 budget reflects the government's priorities for investment and social expenditures.** Total expenditure is set to decline from 32.6 percent of GDP in 1999 to 31.8 percent of GDP in 2000, reflecting the fading of Kosovo-related spending and lower interest outlays. Investment expenditures, on the other hand, are projected to rise from 5.7 percent of GDP in 1999 to 6.4 percent of GDP in 2000, equivalent to a 20 percent increase in real terms. Expenditures on health and education are set to rise by 9 percent and 8 percent in real terms, respectively. The budget allows for an 8 percent nominal increase in budgetary wages on July 1, while pensions are set to rise by 10 percent. At the same time budgetary employment has been cut by 3,000 staff by end-March and will be cut by another 3,000 by end-October, in part by moving budgetary institutions into the non-budgetary sector and by cutting unfilled vacancies, while maintaining the quality of public services.

15. **As the sustainability of the recent improvement in revenue collection remains to be proven, we will execute the 2000 budget with prudence.** We have prepared a monthly expenditure program designed to provide some cushion for any unexpected revenue shortfall, which will be reviewed at the time of the next staff visit in July. In particular, we are committed to limit spending from the reserve and contingency fund in the budget to exceptional cases.

16. **We are putting in place a medium-term expenditure framework (MTEF) with assistance from the World Bank, which will be used in the formulation of expenditure priorities in the 2001 budget.** Sector working groups in line ministries are currently preparing expenditure plans based on sector strategies for health, education, transport, public works, and social protection that will explicitly include poverty reduction goals. We intend to complete the first MTEF for 2001-03 by July 2000. We will continue with the public expenditure tracking exercise now that the donors have resolved outstanding legal issues about financing. Assuming that we are successful in strengthening tax administration and improving the efficiency of collection, for the 2001 budget we will review the profit tax law and explore—with assistance from the IFC—the possibility of introducing an investment tax credit to strengthen incentives for private investment.

17. **We are also taking additional steps to improve the accuracy and transparency of fiscal management.** Past reports regarding foreign-financed project expenditure in the budget have proved unreliable. The government will improve the coordination through monthly updates on the disbursements of foreign-project-related loans and grants submitted by the Ministry of Economic Cooperation and Trade to the Ministry of Finance. As of the 2001 budget, preparation of the investment budget will be integrated into the regular budgeting procedures in the Ministry of Finance. Moreover, to enhance transparency, we have taken measures to improve cash management and prevent unintended negative balances in our account with the SB. The government is also taking all the necessary steps to introduce a GFS-based economic expenditure classification by end-June, in time for the 2001 budget preparations.

C. Monetary and Exchange Rate Policies

18. **The BoA will continue to conduct monetary policy with a view to ensuring low inflation consistent with the overall macroeconomic objectives.** Minimum deposit interest rates for the state-owned banks will continue to be set based primarily on an assessment of price developments, the demand for lek deposits, and conditions in the foreign exchange market. In deciding on interest rates in the period ahead, the BoA will not feel constrained by moderate variations in the exchange rate and will continue to conduct its monetary operations in the context of a flexible exchange rate regime. Intervention in the foreign exchange market will be limited to smoothing short-term exchange rate fluctuations while ensuring that NIR targets are met.

19. **The monetary program is consistent with the domestic financing of the budget deficit of 4¼ percent of GDP in 2000 and private sector credit growth equivalent to 1 percent of GDP.** The sharp decline in velocity experienced in 1999, associated with a stock adjustment in the demand for bank deposits since 1998, is projected to slow down during 2000, with lek money growing at about 12 percent, compared with 20 percent in 1999, and the broad money aggregate, which includes foreign currency deposits, at 12 percent, compared with 22 percent in 1999. In our view, rapid growth in deposits, including foreign currency deposits (some 19 percent of M3) in 1999, reflects increased confidence in domestic banks. End-September 2000 and end-March 2001 ceilings and floors for, respectively, NDA and NIR of the BoA, and ceilings on net credit to the government are performance criteria for the midyear and end-year reviews of the third annual PRGF arrangement.

20. **The BoA is phasing out instruments of direct monetary control.** In consultation with Fund staff, the Bank is considering removal of floors on deposit interest rates in state-owned banks. Moreover, to increase BoA's capability to conduct open market operations, the government will convert its nonmarketable obligations to the BoA into marketable securities by September (structural benchmark). The BoA is also exploring ways to follow activities in the informal financial sector on a more systematic basis through interviews and surveys. For prudential reasons, the BoA will continue to enforce lending limits on banks with a high proportion of nonperforming loans.

D. Structural Policies

21. **We remain committed to reforming the financial sector through a combined agenda of privatization and improvements in the institutional framework.** Regarding the NCB, we will negotiate bona fide about the put options recently requested by the investors (Kent Bank, the EBRD, and the IFC). We will also stand ready to fully recapitalize the NCB as soon as the privatization contract has been signed. Regarding the SB, we will continue with the preparations for privatization by end-2000, with assistance from the World Bank. For this purpose, we have appointed an advisor from the U.S. Treasury to the management board of the bank. With assistance from the World Bank, we will appoint a chief operating officer and a chief accounting officer by June 2000. The tender for the privatization advisor will be announced in June (structural benchmark), the contract with the advisor will be signed by end-September (structural performance criterion for the first review of the third annual arrangement), the tender for privatization will be announced in November (structural performance criterion for the first review of the third annual arrangement), and the negotiations with selected potential buyers will start in December (structural benchmark). Regarding other measures for the SB, we will renew the governance contract with the management by end-May. We will also take other steps to improve accounting in the bank, including by hiring foreign advisors with the assistance of the World Bank. We will recapitalize the bank by end-2000, and the BoA will prepare a draft of the law on deposit insurance by July 2000. Regarding the state-owned insurance company INSIG, we will prepare it for privatization with assistance from the World Bank by mid 2001. We will also take further steps in opening up the insurance market and review the legislative framework for the insurance industry.

22. **We will implement measures to increase the participation of private banks and other investors in the T-bill and lek deposit markets, and to facilitate the development of financial markets.** The BoA has completed the implementation of the measures agreed with MAE staff in July 1999 for strengthening the functioning of primary auctions, improving the marketability of T-bills, and fostering the development of a secondary market for government securities. The BoA will continue to take steps to enhance the development of the T-bill market, including strengthening transparency of the T-bill auctions, exploring measures to improve the refinancing facilities based on T-bills, and introducing remuneration of mandatory reserves to reduce bank intermediation costs. Moreover, the Ministry of Finance and the BoA will explore possibilities for improving access of nonbank investors to the T-bill market, including sales through tax and post-offices. As recommended by MAE, we will introduce a campaign for better informing households and other potential investors about possibilities for investing in T-bills. We are preparing for the introduction of a deposit insurance scheme, the timing of which will be decided in consultation with Fund staff. To improve the payments system, the BoA is working on implementing a real-time gross settlement system.

23. **To improve the legal framework for private sector credit, we will take all the measures required for the implementation of the law on secured transactions, approve new laws on bankruptcy and offices for execution of court decisions, and make the**

credit information bureau fully operational. Specifically, we will provide the required space and resources for the computerization of the registry for collateralized property, which will be fully functional as of July 1, 2000 (structural benchmark). Moreover, all tax administration claims will be immediately registered with the office to avoid subsequent interference with private claims. To strengthen the execution of court decisions in civil cases, we will submit to parliament a law on offices for execution of court decisions in civil cases by end-2000 (structural benchmark). Training of the judiciary in commercial issues by the consulting company will continue over the next 12 months. We are also preparing a new bankruptcy law that will be approved in parliament by December 2000 (structural benchmark) and will ensure that it is fully consistent with the law on secured transactions. We are currently working closely with a bilateral donor to transfer the credit information bureau to private hands and make it fully operational by end-2000 (structural benchmark). To facilitate private sector credit growth, the BoA is also embarking on an information campaign to improve communication between private banks and the business community.

24. **In the area of enterprise privatization, we will strive to complete several projects which, in addition to the immediate benefits of privatization, will have an important signal value for attracting the interest of foreign investors in our country.** In the enterprise sector, we intend to complete the privatization of Albania Mobile Communications (AMC) and five mid-size enterprises (the brewery, winery, dairy, pharmaceutical factory, and the cement factory). Regarding the AMC, we have approved a detailed time schedule, according to which the contract should be closed by June 2000. Regarding the other projects, we have completed all preparatory work with the assistance of the privatization advisor, approved all appropriate decrees, and initiated the resolution of related issues of land ownership and claims by employees. The completion of the privatization of AMC and two of the five SMEs by end-September will be a structural performance criterion for completion of the first review of the third-year arrangement. We will also implement in collaboration with the World Bank an action plan to take two school-book publishing and distribution houses to the point of sale.

25. **In the mining and oil sectors, we will continue with the privatization of the remaining largest enterprises.** We intend to either sell or lease the Burrel smelter and the Bulqize mine by end-2000 with assistance from the privatization advisor (structural benchmark). In the oil sector, the Ministry of Public Economy will prepare by end-June an action plan for selling and liquidating parts of the loss-making oil drilling and service company, Servcom (structural benchmark). By July we will split this company into smaller units, which will be privatized by end-2000 (structural benchmark). With regard to the refinery ARMO, we will proceed with the preparations for its privatization as soon as the contract with IMI, the investment advisor for strategic projects, becomes operative again.

26. **We will proceed with the preparation for the privatization of Albtelecom, which has been delayed owing to difficulties in disbursing the grant for financing the services of the privatization advisor for strategic projects.** Until this issue has been resolved and to avoid further delays, we have requested a complete auditing of the 1999 Albtelecom financial statements by an internationally recognized auditing firm, to be completed by June 2000

(structural benchmark). Moreover, in cooperation with the EBRD, we are exploring the possibility of reviewing the tariff structure, implementing appropriate changes, and introducing a new system of accounting by December 2000 (structural benchmark). We are aware that delays in privatization will likely reduce the value of the company, and will therefore strive to complete the process by mid-2001.

27. We will proceed with our efforts to create an institutional and legislative environment more conducive to foreign direct investment (FDI) and remove obstacles to the conduct of efficient private economic activities in Albania. In cooperation with the World Bank we will establish by September 2000 a mediation center that will offer an alternative means of dispute resolution in commercial cases and are currently preparing the necessary amendments to the civil and civil procedures code. In order to make procedures for the approval of FDI projects more transparent and accessible to foreign investors, we will explore in cooperation with donors the establishment of a one-stop investment shop, which would provide the services associated with the promotion and facilitation of FDI within the same agency. In addition, we will create an industrial park in Durres as a free zone to provide foreign investors with a strategic location and adequate legal, administrative, and logistical support for their activities. To further the consolidation of private land holdings, the government will continue with the registration of land at a rate of 150 cadastral zones per quarter (structural benchmark).

28. To improve quality and coverage of economic statistics, we are committed to strengthening INSTAT, the central statistical agency. We will continue to implement the work program for each of the major statistical areas that was prepared in collaboration with the multisector statistics mission from the IMF in early 1999. In the 2001 budget, we will allocate another 20 permanent staff positions to INSTAT to strengthen its capacities. To establish national accounts, INSTAT will proceed with implementing the recommendations of the resident technical advisor submitted in December 1999, envisaging first results for internal use by end-2000 and the publication of national accounts by mid-2001. A central office will be set up within INSTAT for the compilation and analysis of enterprise balance sheet data and three additional staff positions will be created by end-June. To improve the short-term monitoring of real economic developments, INSTAT has started to compile indices on construction costs as well as on turnover in retail trade, which will be published quarterly, starting in the second quarter of 2000. Within the second half of the year it will also start to publish a unit value index and a production volume index covering private sector activity, the latter on a monthly basis. INSTAT will cooperate with the upcoming PPI mission from the IMF with a view to beginning publication of a quarterly PPI by end-July, and will request a similar mission that will assist in reviewing CPI weights with the aim of publishing a revised index in early 2001. The government is further committed to drafting a new law on statistics with assistance from the European Union in line with the requirements of the fundamental principles of statistics as set out by the UN. The law will provide a secure legal basis for the activities of INSTAT and will, in particular, prescribe penalties for companies not complying with the reporting requirements.

E. External Sector Policies and Program Financing

29. **There are no immediate concerns about balance of payments sustainability.** With investment and reconstruction needs remaining large, the current account deficit is expected to remain broadly unchanged, at 8¼ percent of GDP in 2000. In the medium term, the current account deficit is projected to decline as exports rise in response to foreign investment, which is expected to benefit from improvements in public order and economic reforms. Moreover, private remittances are expected to grow steadily. The current account deficit in 2000 is fully financed on the basis of projected inflows of foreign direct investment and official bilateral and multilateral support.¹ Small financing gaps are projected to open up in 2001 and to continue in the medium term. The external financing of the program will be reassessed at the time of the mid-year review.

30. **We will continue to regularize our relations with external creditors.** The government has reconciled estimates of arrears to Russia and Italy subject to the July 1998 Paris Club Agreement and will aim to conclude the respective bilateral agreements within the new deadline to be agreed upon with the Paris Club. The External Debt Committee has prepared a timetable and has formed working groups for reconciliation and rescheduling of debt in arrears. It will continue to meet monthly to monitor progress toward regularizing relations with external official and commercial creditors so that the remaining restrictions subject to IMF approval under Article VIII, Section 2(a), in the form of outstanding debit balances under inoperative bilateral payments agreements can be removed. By end-2000, the government aims to reconcile and reschedule debt in arrears to Russia, Italy, Turkey, Hungary, Czech Republic, Slovak Republic, Romania, Greece, Bulgaria and Poland. The government will seek at least comparable treatment from non-Paris Club creditors with outstanding similar claims on Albania.

31. **The open and liberal trade policy will continue.** Since 1998 the top tariff rate has been cut in two steps from 30 percent to 18 percent, and a further cut to 15 percent is foreseen for 2001, reducing the unweighted average tariff rate to about 13 percent from about 15 percent at the start of reforms. The government intends to maintain the current simple and transparent structure of three non-zero tariff rates and not introduce any new quantitative restrictions on exports or imports. Import licensing of fuels aimed at supporting the application of domestic technical standards will remain automatic and consistent with the principle of national treatment.

32. **We will seek to improve aid absorption and monitoring.** We have provided adequate funds in the 2000 budget for reimbursement of VAT and customs duties and for land expropriation. To improve transparency and to speed up project implementation, time-bound planning will be introduced for land expropriation and the respective timetables will

¹ Financing commitments include support from the World Bank, the EU, as well as remaining bilateral Kosovo-related pledges and a Paris Club debt service deferral.

be announced to the public upon the start of projects. With technical assistance from UNCTAD, the government will make an external debt and aid database fully operational by end-June 2000 and will ensure timely and accurate reporting of external debt, including commitments by state-owned enterprises.

III. PROGRAM MONITORING

33. During the third annual ESAF arrangement, the program will be monitored based on quantitative performance criteria and indicative targets for end-September 2000 and end-March 2001 (the latter to be set at the time of the first review), and indicative targets for end-June and end-December 2000, and end-March 2001, set on a cumulative basis from end-December 1999 (Table 1), and structural performance criteria and benchmarks (Table 2). The government will conduct with the IMF a mid-year review of the program no later than end-January 2001, and an end-year review to be completed no later than end-June 2001. The quantitative targets include: (i) a floor on the net international reserves (NIR) of the BoA; (ii) a ceiling on the net domestic assets (NDA) of the BoA; (iii) a ceiling on domestic bank and non-bank credit to the general government (NCG), including extra-budgetary funds; (iv) a ceiling on the contracting or guaranteeing by the public sector of new non-concessional medium- and long-term external debt in the maturity range of 1-15 years, with a subceiling on the contracting or guaranteeing of new non-concessional external debt in the maturity range of 1-5 years; and (v) a ceiling on the stock of outstanding short-term external debt, with the exception of normal import-related credits. Details on the monitoring of indicative targets and quantitative performance criteria are set in the Technical Memorandum of Understanding (Attachment I to this Memorandum). The NIR floor will be adjusted upward and the NDA and net credit to government (NCG) ceilings downward for any excess in balance of payments or external budget financing above program projections and/or any shortfall of the Kosovo-related budget expenditure from program projections. The NIR floor will be adjusted downward and the NDA and NCG ceilings upward to the extent that there is any shortfall in balance of payments or budget financing from program projections and/or any excess of the Kosovo-related budget expenditure from program projections, with the proviso that the downward adjustment to the NIR floor shall not exceed US\$50 million and the upward adjustment to the NDA and NCG ceilings shall not exceed the lek equivalent of US\$50 million. The ceilings on NCG will also be adjusted downward for any excess in privatization receipts over the program levels (Table 1). A substantial deviation of the NIR from program projections or larger variability of the exchange rate will trigger consultations with the IMF staff. Collection of tax revenue will be monitored on the basis of quarterly indicative floors on total and customs revenues. During the program period, Albania will not impose or intensify exchange restrictions on current transactions or import restrictions for balance of payments reasons, and will not accumulate new external payments arrears, except for obligations for which a rescheduling is expected.

Table 1. Albania: Quantitative Performance Criteria and Indicative Targets for 2000-2001 1/
Cumulative Changes from end-December 1999

	End-June 2000	End-Sept. 2000 2/	End-Dec. 2000	End-Mar. 2001 3/
(In billion of leks)				
1. Ceiling on domestic credit to the government	10	18	24	30
2. Ceiling on net domestic assets of the BOA	10	11	14	18
3. Indicative target for tax revenues	38	60	82	103
4. Indicative target for revenues collected by Customs Department	21	32	47	57
(In millions of US dollars)				
5. Floor for net international reserves of the BOA	-25	-24	-13	-6
6. Ceiling on contracting or guaranteeing of non-concessional external debt with maturities 1-15 years	20	40	60	60
Of which: 1-5 years	5	5	10	10
7. Ceiling on public and publicly-guaranteed external debt with maturities of up to 1 year	0	0	0	0

1/ Adjustments to performance criteria and indicative targets envisaged under the program are described in the Technical Memorandum of Understanding.

2/ Performance criteria, except for tax revenues and revenues collected by the Customs Department, which are indicative targets.

3/ Performance criteria are to be set at the time of the first review.

Table 2. Albania: Prior Actions for Completion of the Second Review of the Second Annual PRGF Arrangement, and Structural Performance Criteria and Structural Benchmarks under the Third Annual PRGF Arrangement

A. Prior Actions

1. Establish a procedure whereby the internal audit unit would produce at least two bi-weekly reports on the implementation of customs valuation rules and the Director General of Customs to take disciplinary actions and submit a monthly report to the Minister of Finance on disciplinary actions taken.
2. Complete review of the 10 largest companies benefiting from special customs regime licenses with a view to curbing abuse.
3. Complete training program for 60 officials in the valuation units at the local regional, and central level.

B. Structural Performance Criteria

1. Finalize privatization of AMC and two out of five mid-sized enterprises (end-September 2000).
2. Appoint privatization advisor for the Savings Bank (end-September 2000).
3. Announce tender for privatization of the Savings Bank (end-November 2000).

C. Structural Benchmarks

1. Internal audit unit to continue to produce bi-weekly reports on the implementation of customs valuation rules and the Director General of Customs to take disciplinary actions and submit monthly reports to the Minister of Finance on disciplinary actions taken (throughout).
2. Complete reviews of 16 special customs regime licenses for inward processing by end-June 2000, 151 by end-September 2000, and 396 by end-December 2000.
3. Approve amendments to the Social Security Law (end-September 2000).
4. With respect to the Savings Bank, announce a tender for the privatization advisor (end-June 2000); start negotiations with selected buyers (end-December 2000).
5. Complete process of converting government's nonmarketable obligations to the Bank of Albania into marketable securities by end-September 2000.

6. Complete first-time registration in 1,500 cadastral zones by end-June 2000, in 1,650 cadastral zones by end-September 2000, in 1,800 cadastral zones by end-December 2000, and in 1,950 cadastral zones by end-March 2001.
7. Sell or lease the Burrel smelter and the Bulqize mine (end-2000).
8. Prepare an action plan for selling or liquidating SERVCOM (end-June 2000), and privatize or liquidate the company (end-December 2000).
9. Audit the 1999 financial statements of Albtelecom (end-June 2000).
10. Make the registry of collateralized property fully functional (end-June 2000).
11. Make the credit information bureau fully operational (end-December 2000).
12. Approve in parliament the new bankruptcy law fully consistent with the law on collateralized transactions (end-December 2000).
13. Submit to parliament the law on offices for the execution of court decisions in civil cases (end-December 2000).

ALBANIA

TECHNICAL MEMORANDUM OF UNDERSTANDING

This memorandum defines the quantitative benchmarks and performance criteria established in the Memorandum of Economic and Financial Policies for 2000-01 (MEFP).

A. Net Domestic Credit to the Central Government

1. For the purposes of the program, the **central government** covers the State Budget (including the Kosovo account), the Social Security Institute (SSI), and the Health Insurance Institute (HII).
2. **Net domestic credit to the government (NCG)** is defined as the sum of credits in lek and in foreign currency, except for onlending of foreign project loans to all parts of the central government as defined above, including Treasury bills and bonds, less the sum of central government deposits with the banking system (but excluding foreign currency deposits related to foreign financed projects), and the deposits of the SSI and the HII. Credits comprise bank loans and advances to the government, holdings of government securities, due but unpaid interest, and negative balances in government accounts with banks. The component of the domestic credit to government in the form of securities will be calculated based on data on their outstanding stock valued at issue price, with the adjustment for the amount held by the units of central government as defined above (in particular, the SSI and the HII). Data on other components of credit to government will be reported by the BoA based on monetary statistics.
3. Those components of net credit to the government denominated in **foreign currencies** are to be valued at the relevant market rates at the time of issue or redemption. Sales of Treasury bills will be counted excluding the discount. Reported repayments of Treasury bills and other government securities will not include interest payments, either as coupon interest or the discount.
4. According to the above definition, the level of **net domestic credit** to government was Lek 154.65 billion on December 1, 1999. On the liabilities side this was composed of (i) total outstanding T-bills at issue price in the amount of Lek 145.5 billion, of which lek 35.6 was held by the Bank of Albania, lek 104.3 by commercial banks, and lek 5.6 by nonbank institutions; (ii) other government lek securities, loans, and other claims on government in the amount of Lek 22.8 billion. On the asset side it was composed of (i) central government deposits (excluding social security funds) in the amount of Lek 5.8 billion; and (ii) social security and health insurance deposits and T-bill holdings in the amount of Lek 7.9 billion. The Bank of Albania will inform the staff about any revisions in this data based on final monetary accounts for 1999.
5. The **limits on the change in net domestic credit to the government** will be cumulative from the end of December 1999.

B. Net Domestic Assets

6. The **net domestic assets (NDA) of the Bank of Albania** are defined as the difference between reserve money—defined as the sum of currency issue (less lek notes and coins held by the Bank of Albania) and commercial bank reserves held by the Bank of Albania—less the net international reserves of the Bank of Albania (Section C), with all foreign currency assets and liabilities valued in local currency for program monitoring purposes at an exchange rate of 135.2 leks per U.S. dollar. Under this definition, the level of the NDA was Lek 72.5 billion as of December 1, 1999. The NDA limits will be cumulative changes from end-December 1999 and will be monitored from the accounts of the Bank of Albania.

C. Net International Reserves

7. **Net international reserves (NIR)** of the Bank of Albania consist of gross international reserves, which are readily available (i.e. liquid and marketable and free of any pledges or encumbrances), controlled by the Bank of Albania and held for the purpose of meeting balance of payments financing needs, intervention in exchange markets, and other purposes, net of foreign liabilities, both expressed in U.S. dollars, and net of foreign currency reserves of commercial banks held at the Bank of Albania. Foreign liabilities shall be defined as liabilities to nonresidents contracted by the Bank of Albania, irrespective of their maturity. They include IMF purchases and disbursements; and all arrears on principal or interest payments to commercial banks, suppliers, or official export credit agencies

8. During this program, for monitoring purposes, the exchange rates of the SDR and non-dollar currencies will be kept at their end-December 1999 levels and holdings of monetary gold will be valued at SDR 35 per ounce. Excluded from gross international reserves are holdings of nonconvertible currencies, claims on nonresident financial institutions denominated in nonconvertible currencies, and other claims, which are not readily available. Excessive exchange rate variability—that would require consultation with the staff—is defined as a change in the average euro rate in either direction of over 5 percent over a period of one month, or 7½ percent over a period of three months.

D. Adjusters

9. The NCG, NDA, and NIR targets are defined based on the assumption that the lek equivalent of **foreign budgetary and/or balance of payments financing** (excluding project and commodity loans, and excluding US\$20 million BoP loan from the European Union that will be treated as foreign borrowing by the BoA for the purpose of the Program), converted at the program monitoring exchange rate of 135.2 lek per U.S. dollar, will amount, on a cumulative basis, from January 1, 2000 to:

End-June 2000	US\$55 million
End-September 2000	US\$55 million
End-December 2000	US\$55 million
End-March 2001	US\$66 million.

In cases when total foreign financing exceeds (falls short) of this projection, the target for the net domestic credit to the government and the net domestic assets of the Bank of Albania will be adjusted downward (upward), and for the net international reserves upward (downward), with the proviso that the upward adjustment to the NCG and NDA ceilings and the downward adjustment to the NIR floor should not exceed the lek equivalent of US\$50 million, converted at the program monitoring exchange rate, of Lek 135.2 per U.S. dollar.

10. The NIR floor will be adjusted upward (downward) and the NCG and NDA ceilings adjusted downward (upward) by any amount by which the lek equivalent of the **Kosovo-related budget cost** (converted at the program monitoring exchange rate of 135.2 lek per U.S. dollar) is lower than (exceeds) the amounts assumed under the program, on a cumulative basis, from January 1, 2000, to

End-June 2000	US\$15 million
End-September 2000	US\$15 million
End-December 2000	US\$15 million
End-March 2001	US\$15 million.

11. The NCG ceiling will be adjusted downward for any excess in **privatization proceeds** over the programmed levels, on a cumulative basis, from January 1, 2000, to

End-June 2000	Lek 1.4 billion
End-September 2000	Lek 2.8 billion
End-December 2000	Lek 3.5 billion
End-March 2001	Lek 4.9 billion.

12. The NDA ceilings will be also adjusted to reflect the impact of any change in the required reserve ratio of commercial banks with the Bank of Albania.

13. The ceilings on net credit to the government will be adjusted upward for any new issuance of government instruments for recapitalization of banks, up to the amount of Lek 20 billion.

E. External Debt and Arrears

14. The limit on debt of **1–15 years applies to** the contracting or guaranteeing by the government or the Bank of Albania, or by state-owned enterprises, of new nonconcessional external debt with an original maturity of more than one year and up to and including 15 years, **with sublimits** on external debt with an original maturity of more than one year and up to and including five years. The coverage of debt includes financial leases and other instruments giving rise to external liabilities, contingent or otherwise, on nonconcessional terms. **Excluded** from the limits are changes in indebtedness resulting from refinancing credits and rescheduling operations (including the deferral of interest on commercial debt), credits extended by the IMF, and credits on concessional terms, defined as those with a grant element of 35 percent or more calculated using the OECD Commercial Interest Reference Rates (CIRRs) for January 16–February 5, 2000. Debt falling within the limit shall be valued in U.S. dollars at the exchange rate prevailing at the time the contract or guarantee becomes effective.

15. The limit on **short-term debt applies** to the stock of short-term debt contracted or guaranteed by the government or the Bank of Albania, or by state-owned enterprises, with an original maturity of up to and including one year. **Excluded** from the limit are changes in indebtedness resulting from rescheduling operations (including the deferral of interest on commercial debt), and normal import-related credits. Debt falling within the limit shall be valued in U.S. dollars at the exchange rate prevailing at the time the contract or guarantee becomes effective.

16. The prohibition on the accumulation of new **external payments arrears applies** to the change in the stock of overdue payments on short-term debt in convertible currencies with an original maturity of up to and including one year (spot, money market, letters of credit, and others) and medium- and long-term debt contracted or guaranteed by the government, public agencies, the Bank of Albania, from their level at end-December 1999. Accumulation of arrears arising from interest on the arrears stock outstanding as of December 1, 1999 is excluded from the prohibition on the accumulation of any new arrears.

F. Tax Revenues

17. Collection of total and the customs department tax revenue will be monitored on the basis of quarterly indicative floors. Tax revenues are defined as revenues collected by the central tax department and/or the customs department.

G. Monitoring and Reporting Requirements

18. Performance under the **program will be monitored from information supplied monthly to the Fund by the Bank of Albania and the Ministry of Finance.** The following information will be communicated monthly to the Fund by the Ministry of Finance: the summary fiscal table, including the overall budget deficit, on a cash and commitment basis, their issuance of Treasury bills including gross value and cash received, and privatization receipts; and by the Bank of Albania; the balance sheets of the Bank of Albania, and the consolidated accounts of the commercial banks; the monetary survey; the net domestic credit to the government; the NFA of the Bank of Albania; the foreign exchange cashflow of the Bank of Albania, including the level of official reserves; daily average exchange rates; trade flows; periodic updates of balance of payments estimates; information on the contracting and guaranteeing of new debt; information on the stock of short-term debt; and information on all overdue payments on short-term debt and on medium- and long-term debt. To ensure transparency and accountability in the use of budgetary funds for humanitarian relief, all financial aid donated to the government to cover relief efforts will be deposited in a special budgetary account in the Savings Bank—the **Kosovo Account**, and reports on the use of budgetary funds from this Account will be provided bi-weekly to the Fund by the Ministry of Finance.

Table 1. Albania: Basic Indicators and Macroeconomic Framework, 1997-2003

	1997	1998	1999 Est.	2000 Proj.	2001 Proj.	2002 Proj.	2003 Proj.
(Percent change)							
Real GDP	-7.0	8.0	7.3	7.0	8.0	8.0	8.0
Retail prices (avg.)	32.1	20.9	0.4	1.5	3.0	3.0	3.0
Retail prices (end-period)	42.1	8.7	-1.0	3.0	3.0	3.0	3.0
(In percent of GDP)							
Saving-investment balance							
Foreign saving 1/	12.1	6.1	8.0	8.4	7.8	7.1	6.4
Domestic saving	3.9	9.9	8.8	10.6	12.2	13.9	15.6
Public 2/	-8.6	-5.2	-5.6	-2.9	-2.3	-1.4	-0.6
Private	12.5	15.1	14.4	13.6	14.5	15.3	16.2
Investment	16.0	16.0	16.8	19.0	20.0	21.0	22.0
Public	4.0	5.2	5.7	6.5	6.4	6.6	6.8
Private	12.0	10.8	11.1	12.5	13.6	14.4	15.2
Fiscal sector							
Revenues	16.9	20.3	21.3	22.5	22.3	22.7	23.3
Tax revenue	9.7	12.3	12.9	15.3	15.7	16.3	17.0
Expenditures	29.4	30.7	32.6	31.8	31.0	30.7	30.7
Non-interest	24.0	22.9	25.7	26.0	26.1	26.8	27.5
Non-interest current	19.9	17.7	20.0	19.5	19.7	20.2	20.7
Interest	5.5	7.8	6.9	5.9	4.9	3.9	3.2
Overall balance	-12.6	-10.4	-11.3	-9.4	-8.7	-8.0	-7.4
Domestically financed balance 3/	-10.5	-6.4	-5.2	-4.3	-3.5	-2.6	-2.1
Public Debt	68.9	60.1	62.1	70.6	70.8	69.4	67.2
Domestic 4/	35.8	32.9	36.5	41.0	40.3	38.8	36.9
External	33.1	27.2	25.5	29.7	30.4	30.6	30.3
Monetary indicators							
Broad money growth (in percent)	28.5	20.7	22.3	11.4	11.9	11.7	11.7
Private credit growth (in percent)	19.0	14.7	22.6	27.4	40.9	39.7	30.0
Velocity	1.72	1.92	1.73	1.67	1.66	1.66	1.66
Interest rate (3-mth deposits)	26.0	16.5	8.5	...	...	...	...
(In millions of U.S. dollars)							
External sector							
Trade balance 5/	-519	-621	-663	-692	-728	-785	-838
(in percent of GDP)	-22.7	-20.4	-18.0	-18.1	-17.4	-16.8	-16.1
Current account balance	-199	-98	-152	-229	-240	-238	-238
(incl. official transfers; in percent of GDP)	-8.7	-3.2	-4.1	-6.0	-5.7	-5.1	-4.6
Official transfers 5/	77	89	142	91	86	95	94
(in percent of GDP)	3.4	2.9	3.9	2.4	2.1	2.0	1.8
Current account balance	-276	-187	-294	-320	-326	-333	-332
(in percent of GDP)	-12.1	-6.1	-8.0	-8.4	-7.8	-7.1	-6.4
Gross international reserves	306	384	481	500	535	570	605
(in months of imports of goods and services)	3.8	4.2	4.9	4.6	4.5	4.3	4.2
(relative to external debt service)	14.0	21.8	29.1	17.4	12.0	9.5	10.3
(in percent of broad money)	23.0	22.6	22.3	22.2	21.3	20.3	19.3
Change in real effective exchange rate	0.3	18.3	12.5	...	...	...	...
Memorandum items							
Nominal GDP (in millions of lek)	341,716	460,631	506,205	545,847	607,288	677,295	755,252
Nominal GDP (in millions of U.S. dollars)	2,284	3,046	3,676	3,817	4,188	4,671	5,209

Sources: Albanian authorities and Fund staff estimates and projections.

1/ Current account excluding official transfers.

2/ Revenue minus current expenditure.

3/ Excluding privatization revenues.

4/ Including bonds for bank restructuring (Lek 7 bn for 1999; Lek 15 bn for 2000).

5/ For 1999 excluding imports of direct humanitarian aid related to the Kosovo crisis.

Table 2. Albania: Government Revenues and Expenditures, 1995-2000
(in percent of GDP)

	1995	1996	1997	1998	1999 Budget Jul-99	1999 Outturn Apr-00	2000 Budget
TOTAL REVENUE (PLUS GRANTS)	23.9	18.3	16.9	20.3	21.1	21.3	22.5
I. Counterpart funds from commodity aid	1.1	0.1	0.1	0.0	0.0	0.0	0.0
II. Tax Revenue:	13.5	10.7	9.7	12.3	13.6	12.9	15.3
1. Turnover tax / VAT	2.5	3.2	4.6	6.2	6.5	5.9	7.2
2. Profit tax	1.1	1.2	0.7	0.9	1.0	1.2	1.1
3. Excise tax	4.6	1.8	0.6	1.1	1.3	1.4	1.7
4. Small business tax	0.4	0.3	0.1	0.2	0.2	0.2	0.3
5. Personal income tax	0.3	0.2	0.2	0.3	0.5	0.6	0.7
6. Property and local taxes	0.4	0.5	0.2	0.2	0.2	0.2	0.2
7. National taxes 1/	1.5	0.8	0.6	0.7	1.2	1.2	1.5
8. Customs duties	2.8	2.7	2.6	2.7	2.7	2.3	2.6
III. Social security contributions	4.1	4.5	3.8	3.4	3.4	3.6	3.6
1. Social insurance	3.8	4.2	3.6	3.2	3.1	3.3	3.3
2. Health insurance	0.3	0.3	0.3	0.3	0.3	0.3	0.3
IV. Non-tax revenue:	5.1	2.9	3.2	4.5	4.0	4.8	3.5
1. Profit transfer from BOA	2.6	1.4	2.4	3.6	2.9	3.5	1.9
2. Income of budgetary institutions	1.8	1.0	0.5	0.7	0.9	1.1	1.2
3. Other	0.7	0.6	0.3	0.2	0.3	0.2	0.4
TOTAL EXPENDITURE	34.3	30.3	29.4	30.7	33.6	32.6	31.9
I. Current Expenditure	25.8	25.8	25.4	25.5	24.7	25.2	24.6
1. Personnel	8.2	8.2	7.5	6.2	5.8	6.1	5.9
a. Wages	6.5	6.4	6.0	4.8	4.4	4.7	4.6
b. Social insurance contributions	1.7	1.8	1.5	1.4	1.4	1.4	1.4
2. Interest	2.2	3.1	5.5	7.8	6.6	6.9	5.5
a. Domestic	2.0	2.9	5.3	7.6	6.4	6.8	5.2
b. Foreign	0.2	0.2	0.2	0.2	0.2	0.1	0.3
3. Operations & maintenance	5.4	4.4	4.0	4.0	4.1	4.7	4.5
4. Subsidies	0.6	0.4	0.5	0.5	0.3	0.4	0.4
5. Social insurance outlays	6.2	7.2	5.9	5.3	5.3	5.4	5.7
a. Social insurance	6.1	6.7	5.4	4.8	4.8	4.9	5.1
b. Health insurance	0.1	0.5	0.5	0.5	0.5	0.5	0.5
6. Other expenditures:	3.1	2.5	2.1	1.7	2.6	1.6	2.6
a. Unemployment insurance benefits	1.1	0.8	0.6	0.4	0.3	0.3	0.3
b. Social assistance	1.6	1.4	1.3	1.3	1.2	1.3	1.2
c. Political prisoner restitution	0.2	0.2	0.1	0.0	0.0	0.0	0.0
d. Housing subsidy	0.0	0.1	0.1	0.0	0.0	0.1	0.0
e. Other (incl. contingency)	0.0	0.0	0.0	0.0	1.0	0.0	1.0
II. Capital Expenditure	8.5	4.5	4.0	5.2	6.0	5.7	6.5
1. Domestically financed	5.0	3.2	1.9	2.3	2.4	2.4	2.8
a. from the budget	4.9	3.1	...	2.3	2.2	...	2.6
b. other	0.1	0.1	...	0.0	0.2	...	0.2
2. Foreign financed	3.5	1.3	2.1	2.9	3.6	3.3	3.7
III. Bank restructuring costs	0.0	0.0	0.0	0.0	0.3	0.1	0.4
IV. Kosovo related costs	0.0	0.0	0.0	0.0	2.6	1.6	0.4
CASH BALANCE	-10.4	-12.1	-12.6	-10.4	-12.6	-11.3	-9.4
FINANCING	10.4	12.1	12.6	10.4	12.6	11.3	9.4
Domestic	6.6	11.0	10.8	6.4	5.7	5.3	5.0
Privatization receipts	0.1	0.2	0.3	0.0	0.6	0.2	0.6
Bank financing and other	6.5	10.8	10.5	6.4	5.1	5.1	4.3
Foreign	3.8	1.1	1.8	4.0	6.9	6.2	4.4
Development (gross)	3.5	1.3	2.1	2.9	3.6	3.3	3.7
Budget support	0.3	0.0	0.0	1.4	3.8	3.1	1.0
World Bank	0.0	0.0	0.0	1.2	0.3	...	0.6
EU	...	0.0	0.0	0.2	0.6	...	0.0
Other	...	0.0	0.0	0.0	0.2	...	0.0
Kosovo related financing	0.0	0.0	0.0	0.0	2.8	1.9	0.4
Minus: Principal repayments	0.0	0.3	0.3	0.3	0.5	0.2	0.3
Memorandum items:							
GDP (in millions of leks)	224,746	280,998	341,716	460,631	542,461	506,205	545,847
Primary balance (excluding central bank profit)	-10.8	-10.4	-9.5	-6.1	-8.6	-7.8	-5.5
Balance with grants as revenue	...	...	-12.0	-9.0	...	-8.7	-8.4
Foreign financed extra-budgetary projects 2/	1.9	4.1	1.0	0.6	...	4.7	4.3

Source: Albanian authorities; and staff estimates.

1/ Includes non tax revenue collected by Customs Department.

2/ Equals difference between project finance data from BoP and budget.

Table 3. Albania: Monetary Aggregates
(In billions of leks unless otherwise indicated; end-period)

	1998	1999	2000	2000	2000	2000	2001
	Dec.	Dec.	March Estimate	June Proj.	Sept. Proj.	Dec. Proj.	March Proj.
Monetary survey							
Broad money	239.5	292.9	306.3	312.4	315.2	326.3	342.1
Currency outside banks	68.3	81.3	85.8	86.5	86.7	89.1	93.1
Deposits	171.2	211.5	220.5	225.8	228.5	237.2	249.1
Domestic currency deposits	130.9	158.3	164.3	167.1	168.6	175.1	183.6
Foreign currency deposits	40.3	53.2	56.2	58.7	59.9	62.2	65.5
M1	83.7	103.0	107.5	109.0	109.7	113.5	118.9
M2	199.3	239.7	250.0	253.6	255.3	264.2	276.6
Net foreign assets	83.0	100.1	102.4	104.9	107.2	109.4	113.9
Bank of Albania	35.9	46.9	46.6	46.8	48.1	49.9	51.4
Commercial Banks	47.1	53.1	55.9	58.1	59.1	59.5	62.5
Net domestic assets	156.5	192.8	203.8	207.5	207.9	216.9	228.2
Claims on government (net of deposits)	179.3	203.0	213.5	215.7	214.6	222.1	231.4
Claims on state enterprises and farms	2.8	1.7	1.7	1.7	1.7	1.7	1.7
Claims on the private sector	14.9	18.2	18.7	20.2	21.7	23.2	25.2
of which in leks	9.5	9.5	9.7	10.5	11.3	12.1	13.1
Other items, net	-40.5	-30.1	-30.1	-30.1	-30.1	-30.1	-30.1
Monetary authorities							
Reserve money	89.9	109.3	114.9	116.4	116.9	121.1	126.7
Program NIR 1/	194.8	272.0	252.7	247.2	248.7	259.3	266.9
Program NDA 1/	62.5	72.5	80.7	83.0	83.3	86.0	90.6
Net credit to government	67.5	65.9	71.9	73.2	72.3	74.7	78.8
Memorandum items:							
Broad money growth during the year	20.6	22.3	4.6	6.7	7.6	11.4	4.9
Of which contribution of:							
Net foreign assets	7.4	7.1	0.8	1.6	2.4	3.2	1.4
Net domestic assets	13.2	15.2	3.8	5.0	5.2	8.2	3.5
Claims on government	15.0	9.9	3.6	4.3	4.0	6.5	2.9
Annual broad money growth	20.6	22.3	22.3	18.1	14.7	11.4	11.7
Annual reserve money growth	-1.1	21.6	31.1	23.4	18.4	10.8	10.2
Annual growth in private sector credit	14.7	22.6	14.3	24.2	30.8	27.4	34.7
Annual M1 growth	-8.7	23.0	34.9	24.9	21.1	10.2	10.6
Annual M2 growth	22.8	20.3	21.6	17.3	15.3	10.2	10.6
Money multiplier (absolute values)	2.66	2.68	2.67	2.68	2.70	2.69	2.70
Currency/broad money (percent)	28.5	27.8	28.0	27.7	27.5	27.3	27.2
Deposits/broad money (percent)	71.5	72.2	72.0	72.3	72.5	72.7	72.8
Lek deposits/total deposits (percent)	76.5	74.8	74.5	74.0	73.8	73.8	73.7
FX deposits/broad money (percent)	16.8	18.2	18.4	18.8	19.0	19.0	19.1
Gross reserves in U.S. dollars	388.0	481.8	477.0	480.0	480.0	500.0	512.0
as percent of broad money	22.8	22.2	21.8	21.8	22.1	22.2	21.7
US Dollar Exchange Rate (end of period)	140.8	135.2	140.0	142.0	145.0	145.0	145.0

Sources: Bank of Albania; and staff estimates.

1/ According to the definition in the Technical Memorandum of Understanding.

Table 4. Albania: Balance of Payments, 1998-2004
(In millions of U.S. dollars)

	1998	1999	1999	2000	2000	2001	2002	2003	2004	First-year	Second-year	Third-year
		Prog. 5/99	Est.	Prog. 5/99	Proj.	Proj.	Proj.	Proj.	Proj.	PRGF period	PRGF period	PRGF period
I. Current account	-187	-450	-294	-356	-320	-326	-333	-332	-333	-269	-300	-327
Trade balance	-621	-1151	-846	-798	-692	-728	-785	-838	-892	-695	-853	-701
Exports	205	234	275	290	330	386	452	529	618	235	289	344
Imports	826	1,385	1,121	1,088	1,022	1,114	1,237	1,367	1,510	930	1,142	1,045
o/w: Humanitarian aid related to the Kosovo crisis	0	325	183	0	0	0	0	0	0	0	183	0
Services and income	-5	11	45	12	17	14	30	49	70	8	38	16
o/w: Interest due	7	11	7	16	11	19	24	25	33	7	8	13
Private transfers	440	365	324	430	356	388	423	457	489	418	332	358
Official transfers related to the Kosovo crisis	0	325	183	0	0	0	0	0	0	0	183	0
II. Capital account	99	218	222	277	269	317	345	344	334	192	229	275
Official transfers 4/	89	95	142	80	91	86	95	94	94	164	129	90
Direct investment	45	43	51	100	92	106	113	116	110	49	61	96
Other capital including short-term flows	-88	-3	-44	0	-20	10	-1	0	0	-84	-38	-13
Short-term capital	0	0	0	0	0	0	0	0	0	0	0	0
Other financial flows (increase = -)	-88	-3	-44	0	-20	10	-1	0	0	-84	-38	-13
o/w Change in NFA of commercial banks (incr=-)	-88	-3	-44	0	-20	10	-1	0	0	-77	-34	-8
Official medium- and long-term loans (net) 1/	53	82	72	97	106	115	139	134	129	63	76	102
New borrowing	62	95	80	113	117	126	160	157	155	68	89	119
Amortization 1/	-9	-13	-8	-16	-11	-11	-21	-23	-26	-5	-13	-17
III. Errors and omissions	105	0	55	0	0	0	0	0	0	123	55	5
IV. Net balance = I+II+III	17	-232	-18	-80	-51	-9	12	12	1	46	-17	-48
V. Financing requirement = - IV	-17	232	18	80	51	9	-12	-12	-1	-46	17	48
Available financing	-17	30	18	-23	-13	-49	-50	-45	-45	-46	5	-32
Change in net reserves (increase = -)	-71	14	-79	-23	-13	-49	-50	-45	-45	-68	-81	-32
Change in gross reserves, (increase = -)	-78	9	-97	-15	-19	-35	-35	-35	-35	-83	-78	-23
Use of Fund Resources (net)	7	5	19	-8	6	-15	-15	-10	-10	14	-4	-9
Fund (ESAF/PRGF)	8	8	21	0	13	0	0	0	0	16	0	0
Repayments to Fund	-1	-4	-2	-8	-8	-15	-15	-10	-10	-2	-4	-9
BOP support	54	16	96	0	0	0	0	0	0	22	86	0
Changes in arrears (increase = +) 2/	-145	0	0	0	0	0	0	0	0	-145	0	0
Overdue debt forgiveness	0	0	0	0	0	0	0	0	0	0	0	0
Debt service relief (rescheduling)	145	0	0	0	0	0	0	0	0	145	0	0
Financing gap	0	202	0	102	64	58	37	33	44	0	12	80
Identified financing (provisional)	0	158	0	50	65	34	0	0	0	0	12	80
Memorandum items:												
Gross usable reserves	384	375	481	390	500	535	570	605	640	...	...	...
(months of imports of goods and services) 5/	4.2	3.7	4.9	3.7	4.6	4.5	4.3	4.2	4.0	...	...	...
Trade balance (percent of GDP) 4/	-20.3	-30.8	-23.0	-19.4	-18.1	-17.4	-16.8	-16.1	-15.6	...	...	...
Trade balance (percent of GDP) 5/	-20.3	-21.9	-18.0	-19.4	-18.1	-17.4	-16.8	-16.1	-15.6	-21.6	-22.9	-17.7
Current account (percent of GDP)	-6.1	-12.0	-8.0	-8.6	-8.4	-7.8	-7.1	-6.4	-5.8	-8.4	-8.0	-8.2
Debt service (percent of exports of goods and services)	6.2	7.6	3.9	9.7	6.4	8.6	9.8	8.1	8.1	...	...	...
External debt (percent of GDP) 3/	27	28	26	30	30	31	31	31	28	...	...	...
Merchandise exports (percent growth)	22.9	14.0	34.2	24.0	20.0	17.0	17.0	17.0	17.0	...	...	...
Merchandise imports (percent growth) 5/	20.6	28.3	13.5	2.6	9.0	9.0	11.0	10.5	10.5	...	...	...

Sources: Ministry of Finance; Bank of Albania; donors; and Fund staff estimates and projections.

1/ Excluding IMF.

2/ The figure for 1998 corresponds to the clearance of arrears to Russia and Italy as a result of the rescheduling of Paris Club debt in July 1998.

3/ Includes arrears.

4/ Includes imports (official transfers) related to the Kosovo crisis.

5/ Excludes imports (official transfers) related to the Kosovo crisis.



INTERNATIONAL MONETARY FUND

Public Information Notice

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DEPARTMENT

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700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes Article IV Consultation with Albania

On June 9, 2000, the Executive Board concluded the Article IV consultation with Albania.¹

Background

The Kosovo crisis in March 1999 and the large influx of refugees placed a considerable strain on the country. However, the early end to the hostilities, together with generous external assistance and cautious policies, allowed the economy to withstand the crisis. GDP increased by 7¼ percent in 1999; inflation has been negative since mid-1999, following a sharp appreciation of the lek; and official foreign reserves strengthened to a level much above the authorities' target for 1999.

Macroeconomic policies have been in line with the program supported by the Second Annual PRGF Arrangement. The domestically financed deficit was reduced from 6½ percent of GDP in 1998 to 5¼ percent of GDP in 1999, only slightly above the target. Tax revenues, however, were about 1¼ percent of GDP below the program, reflecting lower inflation and weaknesses in tax administration. Since the beginning of 2000, tax collection has substantially improved as a result of measures implemented in late 1999. Monetary policy has been gradually relaxed over the past 12 months, with the Bank of Albania cutting the minimum deposit interest rates by half in several steps, to 7.0-8.0 percent in March 2000. Growth in broad money has continued to be strong, reflecting output growth and increased confidence in the banking system.

Progress in structural reforms has been significant considering the Kosovo crisis. The process of privatizing about 520 small and medium-size enterprises was completed, contracts were signed for the transfer of copper and chromium mines to foreign investors, and albeit with delay, the authorities recently signed agreement with investors on the privatization of the National Commercial Bank. Progress in preparing the Savings Bank for privatization has, however, been limited. The Bankruptcy

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. In this PIN, the main features of the Board's discussion are described.

law has remained ineffective, and the implementation of the collateral law has been delayed to mid-2000. In the area of public administration, the government removed about 5,000 positions from the budget payroll in 1999, and a further 3,000 in the first quarter of 2000. A new Civil Service Law is expected to be implemented in mid-2000.

Albania is the poorest country in Southeastern Europe, with poverty concentrated in its rural regions. Judging from the limited data available, the incidence of poverty appears to reflect mainly low per capita income rather than unequal income distribution. Health indicators compare unfavorably with regional averages, and while almost full literacy has been preserved, enrollment at the secondary education level has dropped by half since the early 1990s. The government has recently approved an Interim Poverty Reduction Strategy Paper, in which it sets out its preliminary priorities for reducing poverty.

Executive Board Assessment

Executive Directors commended the Albanian authorities for their policies to maintain macroeconomic stability, which have helped to achieve a favorable growth performance while keeping inflation close to zero. Directors supported the authorities' policy framework for the remainder of 2000, which aims at continuing rapid growth and low inflation, based on cautious fiscal and monetary policies. While some delays in structural reforms took place as a consequence of the Kosovo crisis, Directors stressed the importance of strengthening the momentum of structural reform and of improving governance to assure sustained, rapid economic growth and poverty reduction.

Directors welcomed recent improvements in tax collection, and the authorities' commitments to combat fraud and enhance the efficiency of both customs and tax administration. They stressed that revenue performance should be monitored closely and, if necessary, additional measures introduced in consultation with the staff. At the same time, Directors underscored the importance of timely refunds of tax credits, the accountability of tax offices, and the implementation of regulations that provide for the protection of complying taxpayers. Improving public administration capacity and institution building in general was also considered essential to facilitate the implementation of the structural reform program.

Directors commended the authorities' prudent monetary policy, which has contributed to keeping inflation low. However, they saw some scope for further easing in monetary conditions in the period ahead, in light of the absence of inflationary pressures and the significant strengthening of the lek against the currencies of major trading partners during the past year.

Directors emphasized that a stronger commitment to financial sector reform would be crucial in encouraging private investment and establishing a market-friendly environment. They welcomed the completion of the sale of the National Commercial Bank and encouraged the authorities to give the highest priority now to privatizing the Savings Bank. Directors noted that rapid improvements in the legal framework for lending, including through the implementation of the

new law on collateral and replacement of the bankruptcy law, will be required in order to stimulate the growth of credit allocated to the private sector.

They urged the authorities to pursue vigorously the enterprise privatization program in order to encourage foreign direct investment. Directors noted that attracting long-term foreign capital will also depend crucially on strengthening governance and improving law and order. Removing bureaucratic obstacles to foreign investment—for example, through creating a one-stop shop for new investors—will also help. They also encouraged the authorities to continue their efforts to create an open and liberal trade and exchange system.

Directors welcomed the authorities' efforts to develop a poverty reduction strategy as exhibited in the interim Poverty Reduction Strategy Paper (PRSP), and encouraged them to press ahead with defining their poverty alleviation policies in a full PRSP. They also urged the authorities to address in the meantime those poverty issues that require immediate action, particularly in public health, education, and child care.

Directors recommended that the authorities endeavor to improve the quality and coverage of economic statistics.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board. As part of a pilot project, the staff report for the 1999 Article IV consultation with Albania is also available.

Albania: Selected Economic Indicators

	1996	1997	1998	1999 Est.
	(Percent change)			
Real GDP	9.1	-7.0	8.0	7.3
Retail prices (avg.)	12.7	32.1	20.9	0.4
Retail prices (end-period)	17.4	42.1	8.7	-1.0
	(In percent of GDP)			
Fiscal sector				
Revenues	18.6	16.9	20.3	21.3
Expenditures	30.3	29.4	30.7	32.6
Overall balance	11.7	-12.6	-10.4	-11.3
Domestically financed balance 1/	10.6	-10.5	-6.4	-5.2
Public Debt	59.9	68.9	60.1	62.1
Domestic 2/	30.7	35.8	32.9	36.5
External	29.2	33.1	27.2	25.5
Monetary indicators				
Broad money growth (in percent)	43.8	28.5	20.7	22.3
Interest rate (3-mth deposits)	18.5	26.0	16.5	8.5
	(In millions of U.S. Dollars)			
External sector				
Trade balance 3/	-692	-519	-621	-663
(in percent of GDP)	-25.7	-22.7	-20.4	-18.0
Current account balance 4/	-245	-276	-187	-294
Gross international reserves	275	306	384	481
(in months of imports of goods and service)	3.1	3.8	4.2	4.9
Memorandum items				
Nominal GDP (in millions of lek)	224,745	341,716	460,631	506,205
Nominal GDP (in millions of U.S. dollars)	2,422	2,284	3,046	3,676

Sources: Albanian authorities and IMF staff estimates and projections.

1/ Excluding privatization revenues.

2/ Including bonds for bank restructuring (Lek 7 bn for 1999; Lek 15 bn for 2000).

3/ For 1999 excluding imports of direct humanitarian aid related to the Kosovo crisis.

4/ Including official transfers.