February 2001
IMF Country Report No. 01/29

Albania: First Review Under the Third Annual Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criteria--Staff Report; Staff Statement; News Brief on the Executive Board Discussion; and Statement by Authorities of Albania

In the context of the First Review Under the Third Annual Arrangement Under the Poverty Reduction and Growth Facility for Albania and Request for Waiver of Performance Criteria, the following documents have been released and are included in this package:

- the staff report for the First Review Under the Third Annual Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criteria, prepared by a staff team of the IMF, following discussions that ended on **October 31, 2000,** with the officials of Albania on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on January 12, 2001.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff statement of **January 26, 2001,** updating information on recent economic developments.
- a News Brief summarizing the **views of the Executive Board as expressed during its January 26, 2001, discussion** of the staff report that completed the review.
- a statement by the authorities of Albania.

The document(s) listed below have been or will be separately released.

Letter of Intent by the authorities of the member country*
Supplementary Memorandum of Economic and Financial Policies by the authorities of the member country*
Technical Memorandum of Understanding*

*Included in Staff Report.

The policy of publication of staff reports and other documents by the IMF allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to Publicationpolicy@imf.org.

Copies of this report are available to the public from
International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623 7430 • Telefax: (202) 623 7201
E-mail: publications@imf.org • Internet: http://www.imf.org

Price: $15.00 a copy

International Monetary Fund
Washington, D.C.

ALBANIA

First Review Under the Third Annual Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criteria

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

Approved by Jacques R. Artus and G. Russell Kincaid

January 12, 2001

Contents

Appendix

Attachments

Attachment I Tables

I. Introduction

1. On June 9, 2000, the Executive Board concluded the 2000 Article IV consultation, approved the second review of the second annual arrangement under the Poverty Reduction and Growth Facility (PRGF), and endorsed the authorities' Interim Poverty Reduction Strategy Paper (I-PRSP). On June 29, the Board approved the authorities' request for a third annual arrangement under the PRGF, bringing the total amount of resources committed under the three-year arrangement to SDR 45.04 million. Discussions for the first review and a Supplementary Memorandum on Economic and Financial Policies took place in Tirana during October 19–31, 2000, and were preceded by a July 5–14 staff visit.[1]

2. At the time of Board approval of the arrangement, Executive Directors commended the authorities for their policies to maintain macroeconomic stability, which had resulted in favorable growth performance and zero inflation. They welcomed improvements in tax collection and encouraged the authorities to continue with their efforts to strengthen tax administration. Directors urged the authorities to proceed rapidly with structural reforms, in particular by improving governance further to ensure sustained growth and poverty reduction. In the financial sector, Directors pointed to the importance of accelerating preparations for the privatization of the Savings Bank.[2]

3. Confidence in Albania's political stability has been bolstered by the peaceful conduct of the local elections, the second round of which was held on October 15 and resulted in a victory for the ruling Socialist Party. International monitors described the election process as generally orderly and smooth. The largest opposition party has, however, not recognized the results. Parliamentary elections are scheduled for June 2001.

4. In the attached letter and the Supplementary Memorandum on Economic and Financial Policies (Attachment I), the authorities report on the progress in realizing program objectives and describe policies they intend to pursue during the remainder of the third-year program. All quantitative performance criteria and indicative targets for end-September were observed. The authorities are requesting waivers for the nonobservance of three structural

---

[1] The review mission comprised Messrs. Mates (head), Samiei, and Rother (all EU1), Ms. Psalida (PDR), Mr. Baldini (FAD), and Ms. Stephens (Staff Assistant, EU1). It was assisted by the resident representative, Mr. Treichel. Executive Director Mr. Faini was present at the beginning of the mission and Mr. Nardelli (ED's office) attended some of the meetings. The mission met with President Mejdani, Prime Minister Meta, Finance Minister Angjeli, Governor Cani, and other ministers and senior officials.

[2] Details of Fund relations are set out in Appendix I. Relations with the World Bank are covered in Appendix II.

performance criteria. The measures envisaged under two of these criteria have in the meantime been enacted, and the authorities are making progress toward the third one (announcing the privatization tender for the Savings Bank), with a view to meeting the conditions by June 2001 (see ¶27).

5. Macroeconomic data, although adequate for program monitoring, continue to suffer from serious deficiencies, especially in the real sector (Appendix III). The report on Albania's observance of standards and codes for data dissemination was submitted to the Executive Board on June 9, 2000. Two Article IV/Use of Fund Resources (UFR) staff reports have been published so far. The authorities have requested that this report be published as well.

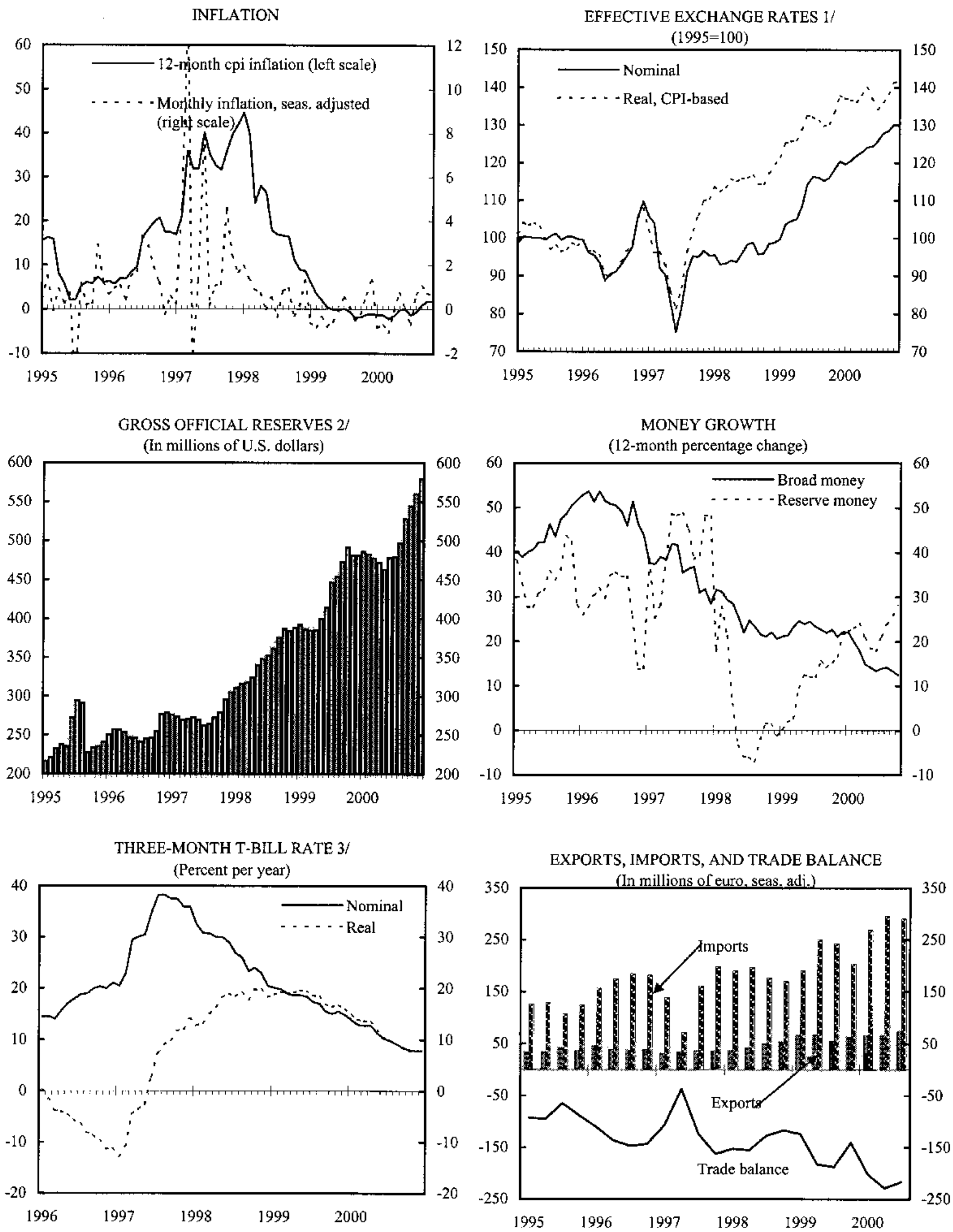
II. Performance Under the Program

6. **Available indicators of economic activity suggest that strong GDP growth continued into the second half of 2000.** Stronger-than-expected private investment and consumption have been fueled by a swift rise in private remittances, reflecting improved confidence in the economic and political environment. On the supply side, available data indicate better results in agricultural production than previously expected, owing to the recent high levels of investment in machinery and the increasing use of fertilizers. This, in addition to the indicators of activity in construction, transportation, and state-owned industry, as well as indirect data on private sector manufacturing activity, has warranted an increase in the projected GDP growth rate to about 7¾ percent in 2000, compared with 7 percent at the time of the Board meeting in June 2000 (Table 1 and Figure 1). Financial and fiscal indicators, particularly on the transaction demand for money and tax collections, provide further evidence of rapid output growth.

7. **Electricity shortages, however, are threatening the sustainability of rapid growth.** If adverse weather conditions continue in the months ahead, Albania may face very disruptive electricity shortages. Water reserves—the main source of power supply—are extremely low, despite the rationing of supplies to households.

8. **The balance of payments improved in 2000 owing to higher-than-projected private remittances and privatization inflows, which more than offset the somewhat higher deficit for trade in goods and services.** Measured in euro terms, exports are recovering rapidly from the Kosovo-related depressed levels in the second half of 1999, owing to the resumption of activity in the chromium and steel sectors, and the renewed strength of exports of textiles and shoes. The rise in recorded imports is even more pronounced, causing an increase in the trade deficit, but to a large extent this reflects more accurate import valuation and a reduction in smuggling. Owing to higher inflows of remittances, the current account deficit in 2000 is estimated to have declined by about 1 percentage point to 7 percent of GDP relative to 1999. Official transfers were 3 percentage points of GDP, while other capital flows amounted to about 5 percentage points of GDP. Official reserves in mid-December reached US$570 (about 4½ months of prospective imports of goods and services), comfortably above the program target.

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



Sources: 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 t-bill rate; the real rate is the nominal rate minus annualized filtered inflation.

9. **Inflation, despite some pickup in recent months, remains tamed, owing to restrained monetary conditions and productivity growth.** The annual inflation rate declined steadily from its peak in early 1998, and was persistently negative between mid-1999 and August 2000. Relative prices, however, continued to adjust. In particular, the CPI group comprising fuel, utilities, and rents rose during this period, while domestic food prices and prices of imported goods declined—the former reflecting rapid productivity growth in agriculture, and the latter, the steady appreciation of the lek against the euro. Inflation turned positive in September and rose to 1.9 percent in November (year-on-year), primarily as a result of higher oil prices. Electricity shortages could temporarily push the inflation rate higher in the coming months.

10. **The budget has been on track, with commendable revenue performance continuing through November.** Tax collections through November were about 28 percent higher than a year earlier, thanks solely to improvements in the efficiency of tax and customs administrations, as tax rates have remained unchanged or have been cut (maximum duty rate) (Table 1). Customs revenues have benefited from efforts to enhance valuation procedures and combat smuggling and corruption. The Internal Audit Unit reports, agreed under the program, have been produced regularly. Implementation of disciplinary measures has been delayed, but the authorities are trying to accelerate the process. The review of companies benefiting from special customs licenses, which revealed a large number of violations, has been expanded to all customs houses and was expected to be completed by end-2000. Tax evasion has also been reduced as a result of better cooperation between the two revenue administrations. In the area of internal tax collection, improved enforcement resulted in an increase in the number of registered active VAT and small business taxpayers by 17 percent and 28 percent, respectively, in the year to October 2000. The government decided to amend the law on profit tax holidays in future customs-free zones (as a prior action for the completion of the review). On the negative side, the high percentage of uncollected VAT revenues assessed at audits and delays in VAT refunds continue to be a major concern. The government is also coming under increasing pressures from potential investors for various tax breaks.

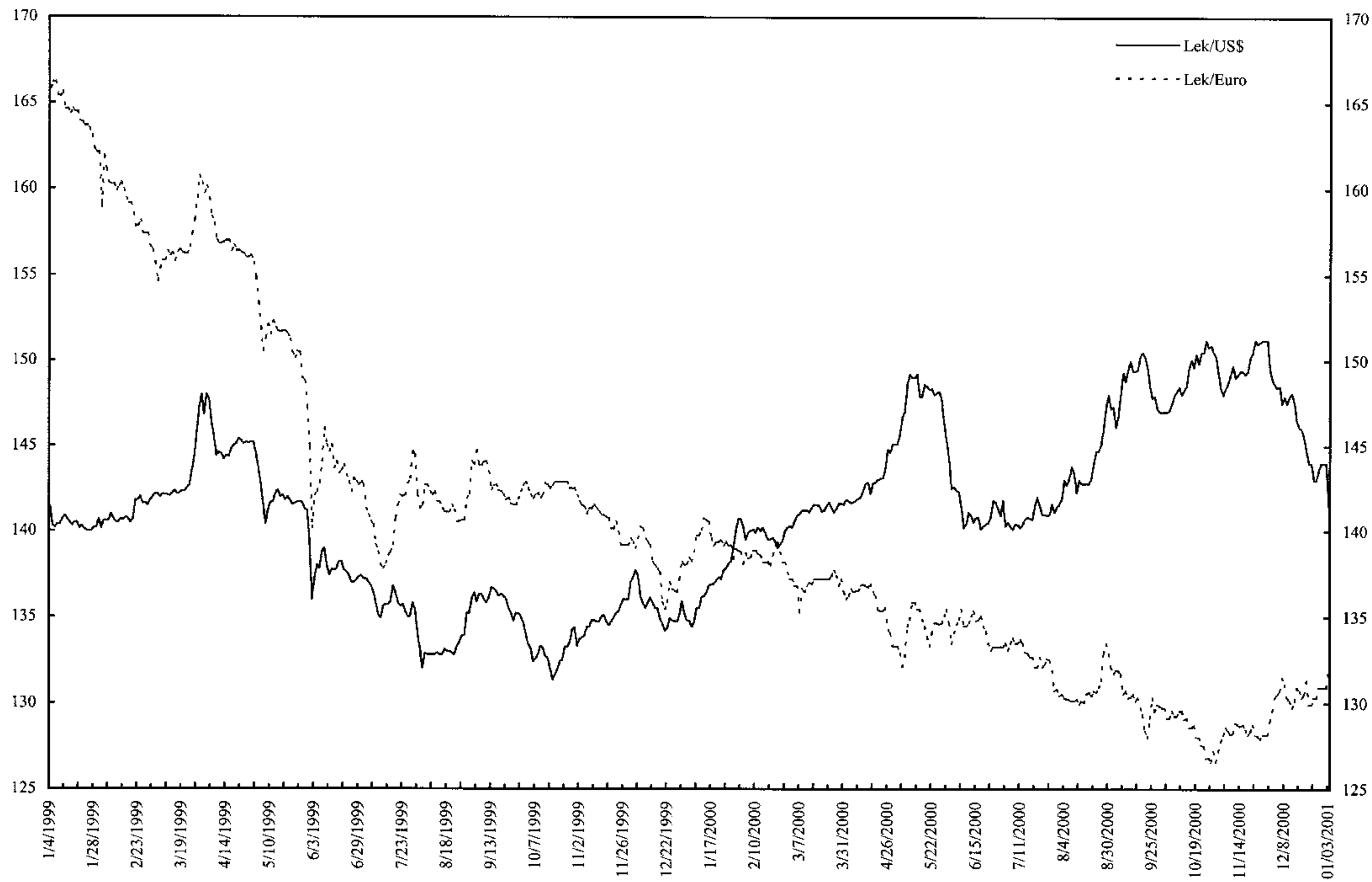
11. **Expenditure execution in the first three quarters of 2000 was broadly in line with the budget and seasonal patterns.** The supplementary budget (in October) reallocated resources from contingency reserves and from savings on interest payments for bank recapitalization to increased pensions and wages, and to a subsidy to the public electricity company, KESH—to increase electricity imports. The release in the last quarter of 2000 of the second tranche of the EU Kosovo-related grant was allocated for additional investment in infrastructure damaged during the Kosovo crisis, while investment in schools was higher as a result of the release of a foreign grant. To tighten budget execution, the government has contracted an international accounting firm, financed by a foreign grant, to undertake an expenditure-tracking exercise. However, insufficient progress has been made in improving coordination among ministries to enhance implementation and reporting of foreign-financed investment projects.

12. **Monetary conditions have been eased in line with the program objectives** (see Figure 1 and Table 3). The removal of the minimum interest rate on three-month deposits in September completed the phased elimination of direct monetary policy instruments. From July 2000 onwards the Bank of Albania increased liquidity by extending direct credit to the budget and purchasing foreign currency privatization receipts, while allowing its liquidity-withdrawing rate to decline to 4½ percent in October. As a result, the three-month T-bill rate dropped by 3 percentage points between June and October, to about 7¾ percent (about 5-6 percent in real terms), a development that was also helped by the much larger participation of private banks and nonbank investors in T-bill auctions—more than doubling from 1999. Deposit interest rates—which, given the low level of private credit, remain the most relevant for influencing macroeconomic conditions—fell less (by about 1½ percentage points), largely as a result of the Savings Bank's efforts to defend its market share against increasing competition from private banks. In line with vibrant economic activity, transaction demand for money remained strong, with M1 expanding at an annual rate of 25 percent in October. Foreign currency deposits increased by 14 percent, while growth in time deposits slowed to 3 percent, in response to the decline in interest rates. Private sector credit has picked up, particularly in the construction sector and for housing. The exchange rate appreciated relative to the euro until October, but it has subsequently stabilized (Figure 2).

13. **The reform and privatization effort in the financial sector has continued.** After all legal technicalities were resolved, the National Commercial Bank was transferred to foreign investors in November 2000. Progress in privatizing the Savings Bank has been slower than envisaged under the program. The chief operating and accounting officers for the Savings Bank were appointed in September, after delays caused by the World Bank's procurement procedures, but the chief operating officer had to be replaced in November. Selection of the privatization advisor was delayed due to complications beyond the control of the government. Therefore, the privatization advisor could only be selected in December, breaching the end-September structural performance criterion, and postponing the announcement of the privatization tender (end-November performance criterion). On the positive side, the audit of financial statements for 1999 has confirmed that the bank's accounting practices comply with international standards. Moreover, the bank has continued to collect outstanding classified loans and to streamline its operations. It has also identified branches and offices that could be closed or transferred to the Post Office, which the authorities intend to accomplish before the privatization tender is announced.

14. **Enterprise privatization has proceeded well.** The sale of Albania Mobile Communications (AMC) for the unexpectedly high amount of US$86 million was completed in July. The government has recently received bids for a second mobile phone license. The transfer of the cement factory to foreign buyers has been completed. The government has announced the winners of tenders for four mid-size companies, with the sale of one company completed on October 4, a few days later than the end-September performance criterion for privatization in the enterprise sector. The privatization of two other enterprises was completed in November. Regarding the fixed line telecommunications provider, Albtelekom, a contract has been signed with the privatization advisor, but the audit of the company's 1999 results did not fully satisfy international standards because of problems in preparing an

Figure 2. Albania: Daily Exchange Rates, 1999-2001



Source: Albanian authorities.

inventory of fixed assets. In the petroleum sector, the action plan for the privatization of the service company, Servcom, was approved in June and the law on its privatization was passed in December 2000. Privatization of the strategic part of the company could be finalized by mid-2001.

15. **Other structural reforms have progressed more slowly.** After months of delay, office space has been allocated for the registry of movable collateralized property. Land registration is lagging, as the registration of remote and less accessible areas is increasingly difficult. A working group to prepare amendments to the social security law has submitted recommendations, but legislative approval will not take place before early 2001. The Council of Ministers recently tightened the licensing procedures for private enterprises to enforce the payment of social security contributions.

16. **The authorities are moving ahead with preparing a PRSP in mid-2001.** In September 2000, a U.K.-based development institute submitted a background study outlining possible strategies to engage civil society in the consultative process. The authorities also reached agreement with the Carter Center, to assist in organizing participation of civil society. A qualitative poverty assessment and a rural development strategy is under preparation in cooperation with the World Bank. The Medium-Term Expenditure Framework (MTEF) 2001-03, also prepared with assistance from the World Bank, has identified broad fiscal policy objectives and budget envelopes; spending on health and education is expected to be substantially increased over these three years. Priorities include primary healthcare and family doctors, construction of new schools in densely populated areas, and more training for teachers. However, compiling a preliminary poverty profile has been delayed because the data from the household income survey currently conducted with the assistance of the EU are not adequate owing to limited geographical coverage. The quantitative poverty profile will be available after the results of the Living Standards Measurement Survey are ready in December 2001 or early 2002.

III. Report on the Discussions

17. Discussions with the authorities focused on progress in preparing the PRSP, reaching understandings on a draft 2001 budget, undertaking immediate measures to address problems in the electricity sector, and continuing the structural reforms.

A. Progress in Preparing the PRSP

18. **The authorities were very enthusiastic about progress in preparing the PRSP.** They briefed the mission on the consultative process, involving representatives of civil society, private business, and local governments. To improve the participation of groups that might be skeptical of government initiatives, the Carter Center, which recently opened its office in Tirana, had approached representatives from various civil society institutions and groups and invited them to several workshops and advisory meetings. A National Civic Society Advisory Group is also scheduled to be established by January 2001. The EU representatives welcomed the PRSP process and viewed it as consistent with the forthcoming

Stabilization and Association Agreement. (The authorities invited all donors to a December conference at which a coordinating group of core donors was created under the auspices of the World Bank). The mission welcomed the authorities' efforts and noted that, should data deficiencies require a delay in preparing the PRSP, a second I-PRSP or a progress report could provide the basis for continued concessional assistance from the Bretton Woods institutions. The authorities indicated that they remained committed to producing the PRSP by mid-2001, which would be based on an updated poverty profile that will draw on a range of sources, including the 1998 Living Conditions Survey, the 2000 Household Budget Survey, the 2000 Agricultural Survey, the on-going qualitative poverty assessment, and administrative information from Government agencies. The results of a comprehensive Living Standard Measurement Survey, with its quantitative estimates of poverty profile, would be incorporated in an updated PRSP in 2002. Following public discussions on the PRSP in November, the authorities have changed the title of their document to the Growth and Poverty Reduction Strategy (GPRS).

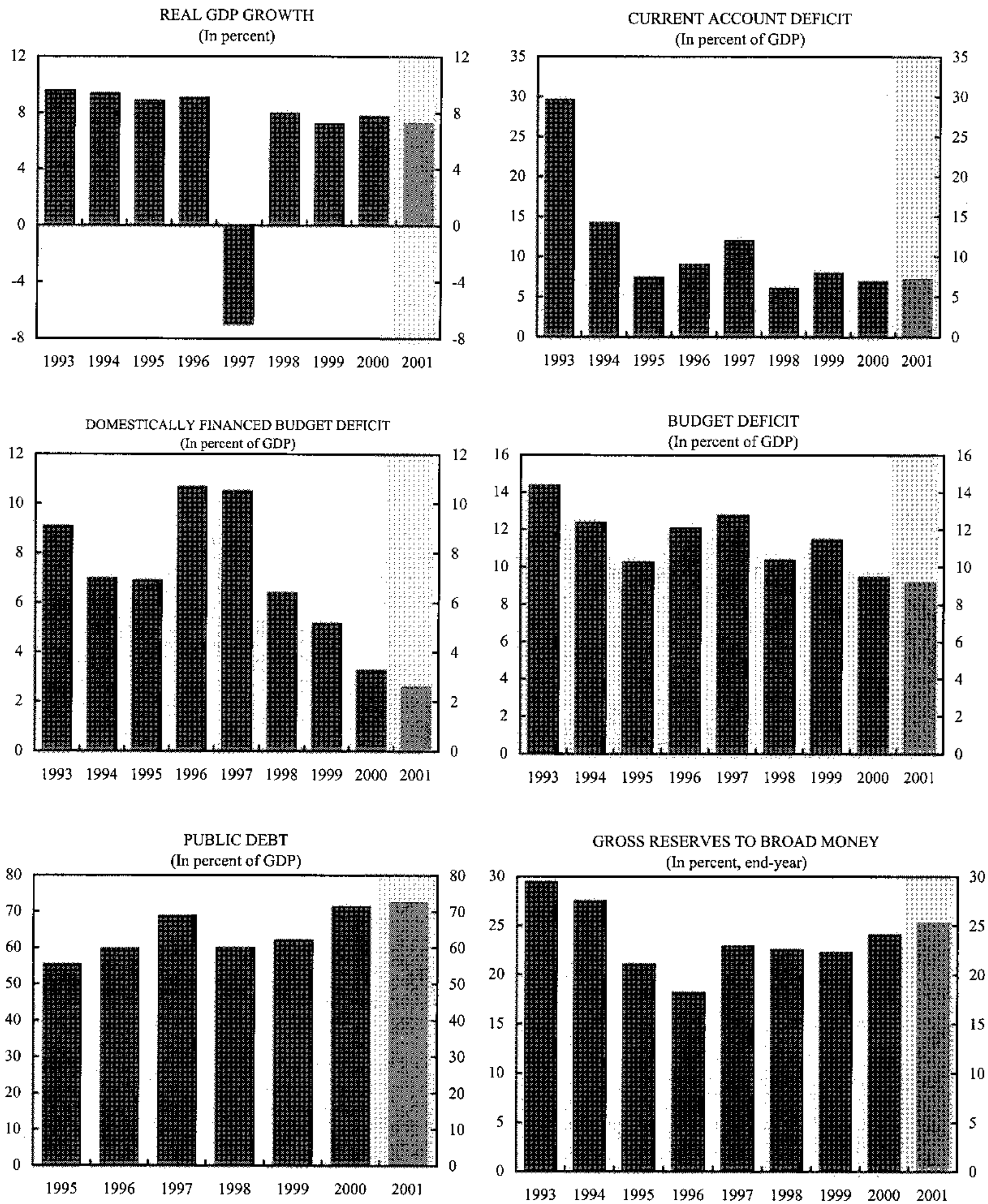
B. Macroeconomic Framework

19. **The authorities and the mission agreed that the macroeconomic framework for 2001 envisaged under the program remained broadly appropriate, although the precarious electricity situation increased the risks.** Real GDP growth is now projected at about 7¼ percent in 2001, while inflation is expected to rise to about 2½ percent (average), and the current account deficit is projected to remain broadly unchanged relative to 2000, at about 7¼ percent of GDP (Figure 3). This is consistent with fiscal consolidation of about ⅓ percentage point of GDP in 2001 (see Paragraph 21 below), and some further moderate relaxation of monetary conditions. The main parameters of the financial program are based on a conservative projection for velocity, sufficient scope for private sector credit growth, and a target for official reserves of about 4½ months of imports. These projections depend heavily on avoiding disruptive electricity shortages during the coming winter, and that, in case of adverse developments, the framework would need to be reviewed and appropriate corrective measures taken.

20. **The problems in the electricity sector, which have been caused by the extremely weak management of the electricity company, the unacceptably low efficiency in collecting bills, and the exceptionally high level of electricity theft, need to be addressed immediately.** The weak performance of the electricity company has also adversely affected donors' assistance in this sector, and led to a suspension of a World Bank project in 1998. The authorities acknowledged that they had been slow to address these problems, but pointed out that firm action had now been taken by appointing a new general manager of the company, acting forcefully against electricity theft—including by amending the provisions in the penal code—and standing ready to implement the proposals of the recently hired foreign consultants (MEFP, ¶23).[3] The mission urged the authorities to immediately seek an

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

Figure 3. Albania: Economic Developments and Prospects, 1993-2001 1/



Source: Albanian authorities and Fund staff estimates.

1/ Projected outcome for 2000 and program projections for 2001.

agreement with the World Bank on a strategy for the electricity sector as well as on emergency measures. Following the mission, the authorities invited a World Bank team to Albania, and in early December 2000 agreement was reached on a strategy, which includes specific quantitative targets for improving the main indicators of KESH's performance. The Bank organized a meeting with the donors involved in the electricity sector in Brussels on December 15, 2000, where the donors endorsed the government's strategy. To alleviate the shortages, the authorities have taken measures to boost electricity imports to the maximum technical level and to improve conditions for supplying liquefied gas, including by temporarily extending VAT exemption for gas in the January-April 2001 period. The government has also organized public awareness campaigns and decided to switch heating in all government offices to liquefied gas.

C. Fiscal Issues

21. **The budget for 2001 incorporates additional revenue efforts, cuts in duty rates and profit tax, measures to reduce tax distortions, and substantial improvements in the structure and execution of expenditure.** A reduction in the overall deficit is envisaged from 9.5 percent of GDP in the revised 2000 budget to 9.2 percent of GDP in 2001. Adjusted for the increase in the interest cost of bank restructuring, which reflects the recognition of the costs incurred in the past, the deficit will be reduced by about ½ percentage point. The proposed fiscal consolidation is appropriate in the context of the stable macroeconomic environment and the authorities' ambitious objective of raising public investment—to 7½ percent of GDP, more than half of which would be foreign-supported projects—and sectoral spending that reflects poverty-alleviating priorities established in the I-PRSP and the MTEF. The deficit target implies a government domestic borrowing requirement of 2.7 percent of GDP, over ¾ percentage point less than previously envisaged, owing to higher privatization receipts and the use of the resources from World Bank SAC in 2001. The deficit target is consistent with a further decline in interest payments relative to GDP. Gross public debt-to-GDP ratio would increase somewhat to 72½ percent of GDP, but in present value terms it would decline, owing to the highly concessional foreign financing of the budget. (For a discussion of medium-term fiscal sustainability, see Box 1.) The 2001 budget, consistent with the understanding reached with the staff, was approved by parliament on December 20 (a prior action for completion of the review).

22. The authorities' main revenue objectives include: (i) continuing efforts to enhance tax administration; (ii) reducing the import duty and profit tax rates; and (iii) improving the VAT refund system. The revenue target reflects the assessment further scope exists to upgrade the efficiency of tax administration, which, together with some increase in excises on alcohol and taxes on property transfer, should increase tax revenues by about 1¼ percentage points of GDP, more than compensating revenue losses of about ¾ percent from other tax-reducing measures. In this context the authorities expressed strong commitment to implementing the recommendations of the recent FAD technical assistance mission (¶13). In particular, the authorities expected substantial revenue effects from the strengthened large taxpayer unit; the upward adjustment in the VAT threshold, coordinated with an appropriate adjustment in the ceiling for turnover-based small business tax; and the introduction of fiscal stamps

Box 1: Medium-Term Fiscal Sustainability

The high economic and social returns of public expenditures combined with a still-limited capacity for taxation, are the key factors underlying Albania's temporary reliance on relatively large fiscal deficits. Improving the dilapidated infrastructure is a prerequisite for the rapid growth of the private sector; the persistence of governance issues demonstrates the importance of strengthening basic public institutions, including those for public order; and abundant evidence highlights the detrimental effects of underspending in social sectors, in particular in public health (see I-PRSP, EBD/00/41). Despite recent progress, the capacity to tax the economy remains constrained by various shortcomings in the administrative and governance area, and by the large share of agriculture and small enterprises in the economy.

The focus on revenue generation and the increase in public investment resulted in prudent fiscal policy over the 1998-2000 period , although it accommodated relatively large deficits. The increases in the tax revenue of 3¼ percentage points of GDP and in investment expenditure of 1½ percentage points of GDP have strengthened the structure of the budget. The rise in the public debt-to-GDP ratio, which has raised concerns about debt sustainability, reflects to a large extent highly concessional foreign financing and the recapitalization of banks for losses incurred in the past. Finally, despite the increasing debt ratio, interest payments have declined rapidly, owing to the reduction in domestic real interest rates and foreign financing on highly concessional terms.

Table: Fiscal Sustainability
(In percent of GDP)

	2000	2001	2002	2003	2004
Revenues	23.0	23.2	23.8	24.1	24.4
Non-interest expenditures					
(Real growth in percent)		9.3	6.1	5.9	7.1
Interest payments	5.8	4.6	4.0	3.9	3.8
(of which: foreign)	0.3	0.3	0.3	0.3	0.3
Primary balance	-3.7	-4.6	-3.8	-3.2	-2.9
Overall balance	-9.5	-9.2	-7.8	-7.1	-6.7
Financing	9.5	9.2	7.8	7.1	6.7
Privatization	1.8	1.7	1.5	1.3	1.3
Domestic borrowing	3.3	2.7	2.5	2.4	2.3
External financing	4.4	4.8	3.8	3.4	3.1
Debt stock	71.5	72.6	71.5	70.1	68.5
Domestic	42.4	41.3	39.9	38.5	37.1
External	29.1	31.3	31.6	31.6	31.4
Memorandum items:					
Net present value of public debt	60.5	59.1	56.6	54.2	51.8
GDP growth	7.8	7.3	7.0	7.0	7.0

The gradual fiscal consolidation envisaged over the medium term (2001-2004) will turn around the trend in the debt-to-GDP ratio. The ratio of the net present value of debt to GDP is projected to decline by 9 percentage points of GDP from 2000 to 2004 and the expensive domestic component would decline by about 5 percentage points of GDP. This projection assumes that rapid growth will continue as a result of macroeconomic stability and further progress in structural reforms. The projection assumes real domestic interest rates of about 7 percent, a level above the average for transition economies that have accomplished macroeconomic stabilization. Foreign financing will be restricted largely to loans on concessional terms and grants, in the recent ratio, keeping interest payments on foreign debt below 1/3 percent of GDP, and the debt service below 10 percent of exports. Privatization receipts are projected conservatively in light of the upcoming privatization of the telecommunications company and the Savings Bank. With the government deficit declining to about 6¾ percent of GDP in 2004, and an increase in the revenue-to-GDP ratio of 1½ percentage points, noninterest expenditure could grow by about 6½ percent in real terms. A lower GDP growth rate of 4 percent, with somewhat lower government deficits to keep the debt ratio unchanged, would still allow noninterest expenditure to grow by 3 percent annually. However, strong fiscal pressures, which would require expenditure cuts in real terms, would develop if (a) Albania loses its access to concessional foreign financing relative to recent levels, (b) GDP growth slows down, or (c) the target for improving revenue collections is not met.

(banderoles) on excisable products, combined with extensive action to suppress the evidently persistent smuggling of cigarettes. The mission, in consultation with the EU Customs Assistance Mission (CAM Albania), also identified further measures in the customs area (¶14). Moreover, as a prior action to complete this review, the profit tax holiday included in the recently approved Free Zones law would be removed to avoid possible adverse effects on tax morale, and to discourage rent-seeking and pressures for further exemptions. In a similar vein, the authorities agreed to resist pressure for special tax incentives from businesses. Instead, they have decided to reduce the profit tax from 30 percent to 25 percent, in line with the downward trend among other transition economies in the region. To address legitimate concerns of investors and exporters, the authorities will also change the procedures for VAT refunds (¶13). As previously agreed under the program, they will liberalize foreign trade further by reducing the maximum and minimum tariff rates from 18 percent to 15 percent, and from 5 percent to 2 percent, respectively, as of January 1, 2001.

23. **On the expenditure side, priorities in the 2001 draft budget reflect the objectives set out in the MTEF, in particular in relation to the sectors identified as important for growth and poverty alleviation (¶15-17).** Investment expenditures are set to rise substantially to about 7½ percent of GDP, reflecting higher spending on the network transport infrastructure and public utilities. (The involvement of foreign construction companies in the main infrastructure projects alleviates risks of capacity constraints for investment activity). On a functional basis, real resources for health and education are set to increase by 23 percent and 8½ percent, respectively. After extensive discussions, the rise in public sector wages and pensions was limited to 8 percent as of July 1, 2001 and a somewhat higher rise in military and police pay as of January 1, 2001, while the number of public employees would be cut by 2,400 positions (about 2 percent of total public employment). Overall, the budget wage bill will decline by 0.1 percentage point of GDP in 2001. The authorities based their support for the public sector wage adjustment on a substantial wage differential relative to the private sector—in the absence of private sector wage statistics, the mission confirmed this in contacts with the private sector—and difficulties in retaining qualified staff, confirmed by the high turnover at the level of central government public servants. In the context of the next MTEF (2002–04), the authorities will conduct a wage survey and use the results for setting principles for a medium-term wage policy. The draft budget allocates a Lek 3.4 billion subsidy for KESH—consistent with the understanding reached with the World Bank on a strategy for the electricity sector—with a view to ensuring conditions for the functioning of this company until its performance is improved by the implementation of the envisaged measures. It also allows for Lek 1.5 billion in interest costs in 2001 to recapitalize fully the Savings Bank by issuing T-bills at the end of 2000, in an amount of Lek 17 billion, to create conditions for successful privatization and to satisfy minimum capital requirements under the banking laws. Regarding the pension system, the authorities have requested assistance from the World Bank to develop their planned reform by end-2001. In response to the mission's concerns regarding the need to strengthen foreign-financed project implementation, the authorities enhanced the frequency and timeliness of information on foreign-financed capital expenditures. Given the uncertain environment in the period ahead, however, the authorities intend to use the fiscal reserve and contingency funds

sparingly and make the execution of specified expenditure items, in particular investment expenditure, conditional on revenue performance.

D. Monetary and Exchange Rate Policy

24. **The mission and the Bank of Albania (BoA) agreed that some further, albeit modest, scope for relaxing monetary conditions existed.** In the context of below-target inflation and overperformance in official reserves, the mission welcomed the relaxation in monetary conditions that has led to a significant decline in T-bill rates since July, but expressed concerns about the slow response of the deposit rates. In the BoA's view, the T-bill rate was set to decline further to about 7½ percent, a level broadly consistent with projected inflation in the 2-4 percent range (¶18). The mission did not dispute this view but noted that lower than targeted expected inflation would call for a further easing of interest rates. The BoA expected that the deposit rates would respond with some lag—an expectation that was confirmed by subsequent developments—but the BoA was not in favor of further large declines in deposit rates. This view was strongly supported by private banks. They pointed to the squeeze in the spreads over the U.S. dollar deposit rates, which were seen as important in thc Albanian retail market, particularly at a time when the U.S. dollar was appreciating. Accordingly, developments in the currency composition of deposits and term-structure of interest rates would be monitored closely to provide indicators a further decisions on monetary policy.

25. **Further measures to improving the effectiveness of indirect monetary policy instruments and to broaden the T-bill market were agreed.** The authorities confirmed that the central bank law would be amended to eliminate the restriction on repo operations with government paper, as such repos currently count as direct credit to government (¶18). The authorities also noted that, in consultation with MAE, they intended to move to a fixed repo rate system in early 2001. Reflecting concerns raised by commercial banks, the BoA will keep interest rates in its repo operations more stable. On broadening the T-bill market, the Ministry of Finance explained that more time was necessary to organize sales through post offices, but noted the success in increasing the participation of nonbank investors in auctions. To compensate for the delay in sales through post offices, small quantities of T-bills would be sold through the stock exchange at prices linked to the last primary auction. As for other areas, remuneration of required reserves has been implemented and the conversion of the government's nonmarketable obligations held by the BoA is expected to be completed by early 2001. In the context of relatively rapid private sector credit expansion, albeit from a low base, the BoA assured the mission that private banks satisfied prudential ratios with large margins and that the quality of their portfolios was effectively monitored by banking supervision.

26. **Revised financial targets for end-December 2000 and end-March 2001 were agreed, and monetary projections for the rest of 2001 were discussed.** According to the revised framework, broad money is projected to expand at an annual rate of about 11¾ percent by end-2001, on the assumption that velocity will cease to decline further, reflecting the effect of interest rate cuts on demand for time deposits. In line with the

government's projected domestic borrowing requirement of about 2.7 percent of GDP, the monetary program allows private sector credit expansion at a rate of about 32 percent. The target for official reserves is an increase to US$620 million by end-2001, equivalent to about 4½ months of imports and about 66 percent of reserve money.

E. Structural Policies

27. **The timetable for the privatization of the Savings Bank has been revised in light of recent delays and complications.** To ensure that the conditions for bank privatization were in place, two prior actions for completing this review were set: (i) to appoint the privatization advisor for the bank, and (ii) to recapitalize the bank fully by end-2000, which is also required by the banking law (¶21). (Both of these have now been met.) The authorities will also transfer the bank's fully provisioned bad loan portfolio to the appropriate agency by March 2001. The recent delays arising from the need to replace the chief operating officer and other complexities noted by investment banks make an extension in the timetable for announcing the privatization tender unavoidable (now set as a structural performance criterion for end-June 2001). In relation to other areas of financial sector reform, the law on deposit insurance has been drafted and is expected to be approved by March 2001. The establishment of a credit information bureau has now been postponed to end-2001, reflecting delays in finding a consultant.

28. **In the enterprise sector, the mission urged the authorities to maintain the privatization drive of recent months.** Following the conclusion of the privatization of the remaining medium-size companies by end-2000, the authorities are now negotiating with potential new investors in the copper sector and the remainder of the chromium sector (¶22). Plans for a concession to build and operate the passenger terminal at the Tirana airport are proceeding, and the process of privatizing Albtelekom is expected to be completed in the second half of 2001. In the oil sector, the sale of some of the smaller units in Servcom will be completed in early 2001, and progress with privatizing ARMO, the refinery is moving ahead (¶22).

29. **With regard to other areas,** the mission urged the authorities to push ahead with establishing the investment-advisory office and reviewed progress in establishing a mediation center for the resolution of commercial disputes. The preparation of the law on offices for the execution of court decisions and the bankruptcy law are on track and are scheduled for parliamentary approval by January 2001. The schedule for registering the remaining, less accessible, lands was revised.

30. **The authorities are continuing to make efforts to improve the quality and coverage of economic statistics.** The 2001 budget allocates another 20 permanent staff positions to INSTAT to enhance its capacities, including its ability to conduct the upcoming population census in April 2001 (¶25). Having started to publish a unit value index and a retail trade index, INSTAT intends to publish the PPI in early 2001, at which time the weights in the CPI basket are also slated to be revised. Preliminary estimates of the national accounts for 1996-98 are expected to be completed in the coming months, and published by

June 2001. The law on statistics, which has been drafted with assistance from the European Union, is expected to be ready for submission to parliament in early 2001.

F. External Sector

31. **The balance of payments position is expected to remain sustainable.** With foreign donors continuing to support exceptionally high investment needs for infrastructure, and foreign private investment responding positively to economic and institutional reforms, the current account deficit over the next several years is expected to decline only gradually from 7¼ percent of GDP in 2001 to 5¾ percent of GDP in 2004 (Table 4). Private remittances are expected to continue to grow steadily, while exports will rise as a result of foreign investment and integration of Albania into the regional economy, providing for gradual improvement in the trade account. Owing to the highly concessional terms of bilateral and multilateral support, foreign-debt-service payments will remain very low, below 10 percent of exports of goods and services. The resources required annually to close financing gaps in the period 2001-04, consistent with keeping the foreign reserves level at about 4½ months, are expected to be in the range of US$10-20 million. The current program is fully financed through the end of the program period (end-March 2001).

32. **The authorities briefed the mission on regularizing relations with external creditors.** Bilateral agreements were concluded with Paris Club creditors, Austria, France, Italy, and the Netherlands, an agreement in principle was signed with Japan, while arrears estimates were reconciled with Germany and Russia. Negotiations are also under way to clear arrears with non-Paris Club creditors, including Greece, Turkey, and some former CMEA members. The External Debt Committee has prepared a timetable and has formed working groups for reconciliation and rescheduling debt in arrears. It will continue to meet on a monthly basis 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) can be removed. The government actively aims to reconcile and reschedule debt in arrears with its remaining creditors and will seek at least comparable treatment from non-Paris Club creditors with similar outstanding claims on Albania.

G. A Successor Arrangement

33. **The authorities indicated their intentions to request a possible successor arrangement following the expiration of the current PRGF in July 2001.** The authorities expressed their appreciation for the cooperation of the Fund over the last several years, which had helped them create stable macroeconomic conditions, put the economy on a rapid growth path, and implement far-reaching structural reforms. They also reiterated their commitment to develop and implement a comprehensive poverty-reduction strategy that could be supported by a PRGF. The staff noted that with Albania's rising per capita income access under new possible arrangements would likely be a blend of PRGF and GRA resources.

IV. Staff Appraisal

34. **The authorities are making good progress in preparing a comprehensive poverty reduction strategy.** In particular, they have achieved commendable results in developing the consultative process; moreover, preparations for a qualitative poverty assessment and a rural development strategy are proceeding well. Regarding the timing of the PRSP, the authorities and the World Bank strongly believe that the benefits of completing the process in 2001—which is synchronized with the timing of the budget and would then provide a basis for more comprehensive policy formulation in 2002—outweigh the possible gains from waiting for higher quality poverty data that would be available from the household living standard survey in early 2002. Fund staff concurs. The authorities' proposal for changing the title of the document to Growth and Poverty Reduction Strategy, with a view to improving its public acceptability and strengthening the focus on growth, is welcome.

35. **Macroeconomic performance under the PRGF-supported program has continued to be strong and tax collection performance has been excellent.** The authorities have managed to keep inflation very low during the past three years, while the economy has grown rapidly and the official reserves position has improved. The agreed tax and customs measures are bearing fruit, with tax revenues increasing by about 2½ percentage points of GDP in 2000, owing to notable progress in fighting smuggling and corruption. All quantitative performance criteria and indicative targets for end-September 2000 were met, and indicative targets for end-December 2000 are also estimated to have been met.

36. **Failure to address problems in the electricity sector in a timely manner, however, has put the favorable macroeconomic performance at risk.** While the authorities have so far managed to minimize the adverse effects of these shortages, particularly for the enterprise sector, the situation is tenuous and it is essential that they implement forcefully and speedily all the measures envisaged in the revised strategy for the sector, as agreed with the World Bank. In particular, the efficiency in collecting electricity bills and eliminating theft needs to be improved.

37. **The draft 2001 budget sets appropriate targets for further strengthening tax administration and improving the structure of expenditure.** To address the concerns of the business community and improve relations with investors, the authorities will change the VAT refund system and reduce the profit tax rate consistent with the recent trend in transition economies, and reject pressures for the extension of various tax exemptions. The expenditure structure will improve as a result of increasing the highly needed investment in dilapidated public infrastructure and providing additional resources for public health. Over the medium term, the authorities will need to remain vigilant in further increasing revenue collection. Moreover, Albania's fiscal sustainability over the next three years will crucially depend on continued access to concessional foreign financing, the prospects for which currently appear very favorable. The authorities should make every effort to assure that all the measures on their side, required for the disbursement of foreign assistance are implemented on a timely basis.

38. **The recent relaxation in monetary conditions is consistent with the 2–4 percent inflation target, which creates sufficient scope for needed relative price adjustments.** The reduction in interest rates has also helped to mitigate appreciation pressures and stabilize the real effective exchange rate. If new information points to expected inflation falling below the target range, the BoA should consider some further reductions in interest rates. Regarding the conduct of monetary policy, the BoA should continue to improve the effectiveness of its indirect instruments of monetary policy.

39. **The authorities should persist in their preparations for the privatization of the Savings Bank and remain fully committed to the revised timetable.** A successful privatization will require close cooperation between the management of the Savings Bank and the Ministry of Finance to complete all the necessary preparatory work on time. Notably, the authorities should transfer bad loans to the collection agency as envisaged , and closely collaborate with the privatization advisors so that the tender for privatization can be announced by end-June.

40. **Regarding other structural reforms, the authorities need to maintain the privatization drive of recent months and complete the legislative reforms.** Indeed, they should move expeditiously and forcefully to privatize the telecommunications and oil sectors. The implementation of the new bankruptcy law and the law on the organization of offices for executing court decisions in civil cases will be crucial for making further progress in establishing the institutional framework required for a modern market economy.

41. **Overall, despite some delays in structural reforms and privatization in the financial sector, the authorities' policies continue to be on the right track.** The staff, therefore, recommends the approval of the authorities' request for waivers for nonobservance of three structural 2000 performance criteria and the completion of the first review of the third-year program under the PRGF.

V. Proposed Decision

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

1. Albania has consulted with the Fund in accordance with paragraph 2(d) of the third annual arrangement for the Republic of Albania under the Poverty Reduction and Growth Facility (PRGF) (EBS/00/111; 06/29/00) and paragraph 33 of the Memorandum of Economic and Financial Policies attached to the letter dated May 24, 2000 from the Prime Minister, the Minister of Finance and the Governor of the Bank of Albania to review the implementation of the program of economic and financial policies supported by the third annual arrangement under the PRGF.

2. The letter dated January 12, 2001 from the Prime Minister, the Minister of Finance and the Governor of the Bank of Albania (the "Letter"), together with the attached Memorandum of Economic and Financial Policies (the "Memorandum"), and the Technical Memorandum of Understanding (the "TMU"), shall be attached to the third annual arrangement under the PRGF for the Republic of Albania, and the letter dated May 24, 2000 from the Prime Minister, the Minister of Finance and the Governor of the Bank of Albania, together with its attached Memorandum on Economic and Financial Policies, shall be read as supplemented and modified by the Letter with its attached Memorandum and the TMU.

3. Accordingly,

(a) the performance criteria in paragraph 2(a)(i)–(vi) of the third annual arrangement for end-March 2001 shall be as set out in Table 1 attached to the Memorandum and as further specified in the TMU.

(b) a new paragraph 2(bb) shall be added to read as follows:

“(bb) if the Managing Director of the Fund finds with respect to the third loan that, by June 30, 2001, Albania has not carried out its intentions with regard to the announcement of a privatization tender for the Savings Bank as specified in paragraph 21 of the Memorandum”.

4. The Fund decides that,

(a) the first review contemplated in paragraph 2(d) of the third annual arrangement for Albania is completed; and

(b) Albania may request the disbursement of the second loan referred to in paragraph 1(b) of the third annual arrangement under the PRGF for Albania, notwithstanding the non-observance of the structural performance criteria in paragraph 2(b)(i) to (iii) of the third annual arrangement, on the condition that the information provided by Albania on performance under these criteria and on the implementation of the measures specified under A. of Table 2 of the Memorandum is accurate.

Table 1. Albania: Basic Indicators and Macroeconomic Framework, 1997-2001

	1997	1998	1999	2000 Prog. May 00	2000 Proj.	2001 Prog. May 00	2001 Proj.
				(Percent change)			
Real GDP	-7.0	8.0	7.3	7.0	7.8	8.0	7.3
Retail prices (avg.)	32.1	20.9	0.4	1.5	-0.2	3.0	2.5
Retail prices (end-period)	42.1	8.7	-1.0	3.0	1.5	3.0	3.0
				(In percent of GDP)			
Saving-investment balance							
Foreign saving 1/	12.1	6.1	8.0	8.4	7.0	7.8	7.3
Domestic saving	3.9	9.9	8.8	10.6	12.0	12.2	12.7
Public 2/	-8.8	-5.2	-5.8	-2.9	-2.9	-2.3	-1.7
Private	12.7	15.1	14.6	13.6	14.9	14.5	14.5
Investment	16.0	16.0	16.8	19.0	19.0	20.0	20.0
Public	4.0	5.2	5.7	6.5	6.7	6.4	7.5
Private	12.0	10.8	11.1	12.5	12.3	13.6	12.5
Fiscal sector							
Revenues	16.7	20.3	21.1	22.5	23.0	22.3	23.2
Tax revenue	9.5	12.3	12.7	15.3	15.6	15.7	16.1
Expenditures	29.4	30.7	32.6	31.9	32.6	31.0	32.4
Non-interest	24.0	22.9	25.6	26.0	26.8	26.1	27.8
Non-interest current	19.9	17.7	19.9	19.5	20.2	19.7	20.3
Interest	5.5	7.8	7.0	5.9	5.8	4.9	4.6
Overall balance	-12.8	-10.4	-11.5	-9.4	-9.5	-8.7	-9.2
Domestically financed balance 3/	-10.7	-6.4	-5.2	-4.3	-3.3	-3.5	-2.7
Public Debt	68.9	60.1	62.2	71.1	71.5	71.4	72.6
Domestic 4/	35.8	32.9	36.6	41.0	42.4	40.4	41.3
External (including publicly guaranteed)	33.1	27.2	25.6	30.1	29.1	31.0	31.3
Monetary indicators							
Broad money growth (in percent)	28.5	20.7	22.3	11.4	12.1	11.9	11.7
Private credit growth (in percent)	19.0	14.7	22.6	27.4	39.0	40.9	32.0
Velocity	1.72	1.92	1.73	1.67	1.63	1.66	1.61
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	-781	-728	-834
(in percent of GDP)	-22.7	-20.4	-18.0	-18.1	-20.8	-17.4	-21.2
Current account balance	-199	-98	-155	-229	-151	-240	-198
(incl. official transfers; in percent of GD	-8.7	-3.2	-4.2	-6.0	-4.0	-5.7	-5.0
Official transfers 5/	77	89	139	91	111	86	87
(in percent of GDP)	3.4	2.9	3.8	2.4	3.0	2.1	2.2
Current account balance	-276	-187	-294	-320	-262	-326	-285
(in percent of GDP)	-12.1	-6.1	-8.0	-8.4	-7.0	-7.8	-7.3
Gross international reserves	306	384	481	500	550	535	620
(in months of imports of goods and servi	3.8	4.2	4.1	4.6	4.4	4.5	4.6
(relative to external debt service)	14.0	21.8	29.1	17.4	22.4	12.0	14.9
(in percent of broad money)	23.0	22.6	22.3	22.2	24.3	21.3	25.4
Change in real effective exchange rate	0.3	18.3	12.5	...	6.0	...	
Memorandum items							
Nominal GDP (in millions of lek)	341,716	460,631	506,205	545,847	536,429	607,288	588,753
Nominal GDP (in millions of U.S. dollars)	2,284	3,046	3,676	3,817	3,751	4,188	3,925

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 24.4 bn for 2000).
5/ For 1999 excluding imports of direct humanitarian aid related to the Kosovo crisis.

Table 2. Albania: Government Revenues and Expenditures, 1997-2001
(In percent of GDP)

	1997 Outturn	1998 Outturn	1999 Outturn	2000 Revised Budget	2001 Budget
Total Revenue	16.7	20.3	21.1	23.0	23.2
I. Counterpart funds from commodity aid	0.1	0.0	0.0	0.0	0.0
II. Tax Revenue:	9.5	12.3	12.7	15.6	16.1
II.1 Tax revenues from Tax directorate and Customs	9.5	12.2	12.7	15.4	15.8
1. Turnover tax / VAT	4.6	6.2	5.9	7.3	7.5
2. Profit tax	0.7	0.9	1.2	1.1	1.4
3. Excise tax	0.6	1.1	1.4	1.7	1.9
4. Small business tax	0.1	0.2	0.2	0.3	0.4
5. Personal income tax	0.2	0.3	0.6	0.7	1.0
7. National taxes 1/	0.6	0.7	1.2	1.5	1.4
8. Customs duties	2.6	2.7	2.3	2.6	2.3
II.2 Property and local taxes	0.0	0.0	0.0	0.2	0.3
III. Social insurance contributions	3.8	3.4	3.6	3.7	3.8
1. Social insurance	3.6	3.2	3.3	3.3	3.5
2. Health insurance	0.3	0.3	0.3	0.3	0.3
IV. Non-tax revenue:	3.2	4.5	4.8	3.8	3.2
1. Profit transfer from BOA	2.4	3.6	3.5	2.0	1.5
2. Income of budgetary institutions	0.5	0.7	1.1	1.3	1.1
3. Other	0.3	0.2	0.2	0.6	0.6
Total Expenditure	29.4	30.7	32.6	32.6	32.4
I. Current Expenditure	25.4	25.5	25.2	25.4	24.4
1. Personnel cost	7.5	6.2	6.1	6.5	6.4
Wages and other personnel expenditures	6.0	4.8	4.7	5.1	5.0
a. Wages	6.0	4.8	4.7	4.7	4.8
b. Wage bonus from solidarity tax	0.0	0.0	0.0	0.4	0.2
Social insurance contributions	1.5	1.4	1.4	1.4	1.4
2. Interest	5.5	7.8	6.9	5.5	4.1
a. Domestic	5.3	7.6	6.8	5.2	3.7
b. Foreign	0.2	0.2	0.1	0.3	0.3
3. Operations & maintenance	4.0	4.0	4.7	4.4	4.6
a. general govt op. & maintenance	0.0	0.0	3.3	3.4	3.5
b. local (through grants)	0.0	0.0	1.1	0.8	0.8
c. local (own finance)	0.0	0.0	0.2	0.2	0.3
4. Subsidies 2/	0.5	0.5	0.4	0.5	0.9
a. subsidies for KESH (public electricity compan	0.0	0.0	0.0	0.0	0.6
b. others	0.0	0.0	0.0	0.0	0.3
5. Social insurance outlays	5.9	5.3	5.4	5.9	6.0
a. Social insurance	5.4	4.8	4.9	5.3	5.4
b. Other social insurance schemes	0.0	0.0	0.0	0.0	0.1
c. Health insurance	0.5	0.5	0.5	0.6	0.5
6. Other expenditures:	2.1	1.7	1.6	2.6	2.4
a. Unemployment insurance benefits	0.6	0.4	0.3	0.3	0.3
b. Social assistance 2/	1.3	1.3	1.3	1.3	1.1
c. Political prisoner compensation	0.1	0.0	0.0	0.0	0.0
d. Housing subsidy/other	0.1	0.0	0.1	0.0	0.0
e. Reserve Fund/contingency	0.0	0.0	0.0	0.9	1.0
II. Capital Expenditure	4.0	5.2	5.7	6.7	7.5
1. Domestically financed	1.9	2.3	2.4	2.9	3.5
a. from the budget	1.9	2.3	2.2	2.7	3.2
b. other	0.0	0.0	0.2	0.2	0.3
2. Foreign financed	2.1	2.9	3.3	3.7	4.0
III. Interest cost of bank restructuring	0.0	0.0	0.1	0.2	0.5
IV. Kosovo related costs	0.0	0.0	1.6	0.3	0.0
Cash Balance	(12.8)	(10.4)	(11.5)	(9.5)	(9.2)
Financing	12.8	10.4	11.5	9.5	9.2
Sources of financing					
Domestic Financing	11.0	6.4	5.4	5.0	4.4
- Privatization receipts	0.3	0.0	0.2	1.8	1.7
- Bank Financing and non banks	10.7	6.4	5.2	3.3	2.7
Foreign Financing	1.8	4.0	6.0	4.5	4.8
Budget support	0.0	1.4	2.9	1.0	1.0
World Bank	0.0	1.2	0.3	0.0	0.6
EU	0.0	0.2	0.4	0.3	0.0
Other	0.0	0.0	0.2	0.5	0.4
unidentified financing	0.0	0.0	0.1	0.0	0.0
Kosovo related financing	0.0	0.0	1.9	0.3	0.0
Development (gross)	2.1	2.9	3.3	3.7	4.0
minus: principal repayment	0.3	0.3	0.2	0.2	0.2
Memorandum Items:					
Financing (reconstructed from data below the line)	12.8	10.4	11.4	9.5	9.2
- Domestic financing (from data below the line)	11.0	6.4	5.4	5.0	4.4
- Foreign financing	1.8	4.0	6.0	4.5	4.8
discrepancy in financing (minus = overfinancing)	0.0	0.0	0.1	0.0	0.0
GDP (in millions of leks)	341,716	460,631	506,205	536,429	588,753
Primary balance (excluding central bank profit)	(9.6)	(6.1)	(8.0)	(5.7)	(6.1)
Non interest and domestically financed primary balance	(5.2)	0.3	(1.2)	(0.0)	(0.6)
Domestic. financed deficit (excl. foreign financed proje	10.7	7.5	8.2	5.8	5.2
Non interest expenditures	24.0	22.9	25.6	26.8	27.8
Expenditures by function as percentage of GDP 3/					
Health				2.7	3.1
Education				3.3	3.4

Notes:

1/ Includes solidarity tax and non tax revenue collected by Customs Department.

2/ In 2001 expenditure on work incentive programs (lek 400 million) has been reclassified under subsidies.

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

Table 3. Albania: Monetary Aggregates

(In billions of leks unless otherwise indicated; end-period)

	1999 Dec.	2000 March	2000 June	2000 Sep. Proj. May 00	2000 Sept.	2000 Dec. Proj. May 00	2000 Dec. Proj.	2001 March Proj. May 00	2001 March Proj.	2001 Dec. Proj. May 00	2001 Dec. Proj.	2002 Dec. Proj. May 00	2002 Dec. Proj.
Monetary survey													
Broad money	292.9	295.4	299.8	315.2	311.7	326.3	328.2	342.1	334.7	365.2	366.8	407.8	400.6
Currency outside banks	81.3	83.4	85.6	86.7	92.0	89.1	95.2	93.1	96.4	97.5	105.3	108.5	110.6
Deposits	211.5	212.0	214.3	228.5	219.8	237.2	233.0	249.1	238.3	267.7	261.5	299.3	290.0
Domestic currency deposits	158.3	155.2	157.2	168.6	156.7	175.1	168.0	183.6	171.6	196.5	185.4	221.5	205.0
Foreign currency deposits	53.2	56.7	57.1	59.9	63.0	62.2	65.0	65.5	66.7	71.2	76.1	77.8	85.0
M1	103.0	103.9	107.3	109.7	112.9	113.5	116.9	118.9	118.4	126.4	129.3	141.8	135.8
M2	239.7	238.7	242.8	255.3	248.7	264.2	263.2	276.6	268.0	294.0	290.7	330.0	315.6
Net foreign assets	100.1	98.7	102.4	107.2	121.8	109.4	125.8	113.9	129.2	122.3	141.8	137.9	150.9
Bank of Albania	46.9	47.0	52.5	48.1	63.6	49.9	67.5	51.4	70.2	56.7	78.2	63.8	83.3
Commercial Banks	53.1	51.7	49.9	59.1	58.2	59.5	58.3	62.5	59.0	65.6	63.6	74.1	67.6
Net domestic assets	192.8	196.7	197.5	207.9	190.0	216.9	202.5	228.2	205.5	242.9	224.9	269.9	249.6
Claims on government (net of deposits)	203.2	205.3	210.3	214.6	210.8	222.1	219.2	231.4	220.2	238.6	233.8	252.6	249.1
Claims on state enterprises and farms	1.7	1.6	1.6	1.7	1.6	1.7	1.6	1.7	1.7	1.7	1.7	1.7	1.7
Claims on the private sector	18.2	19.8	21.1	21.7	23.5	23.2	25.3	25.2	27.3	32.7	33.4	45.7	43.1
of which in leks	9.5	9.4	9.5	11.3	9.5	11.1	9.9	12.1	10.9	17.0	12.3	23.8	17.1
in foreign currency	8.7	10.3	11.6	10.4	14.0	12.1	15.4	13.1	16.4	15.7	21.1	21.9	26.0
Cumulative change at unchanged exchange rates	1.7	1.4	2.8										
Other items, net	-30.3	-30.0	-35.6	-30.1	-46.0	-30.1	-43.6	-30.1	-43.7	-30.1	-44.0	-30.1	-44.3
Monetary authorities													
Reserve money	109.3	108.8	111.2	116.9	124.2	121.1	127.6	126.7	129.5	133.6	141.5	148.9	150.7
Program NIR 1/	271.8	273.4	267.8	248.7	336.4	259.3	347.3	266.9	366.3				
Program NDA 1/	72.6	71.9	75.0	83.3	78.8	86.0	80.6	90.6	80.0				
Memorandum items:													
Broad money growth during the year	22.3	0.9	2.4	7.6	6.4	11.4	12.1	4.9	2.0	11.9	11.7	11.7	9.2
Of which:													
Net foreign assets	7.1	-0.5	0.8	2.4	7.4	3.2	8.8	1.4	1.0	4.0	4.9	4.3	2.5
Net domestic assets	15.2	1.3	1.6	5.2	-1.0	8.2	3.3	3.5	0.9	8.0	6.8	7.4	6.7
Claims on government	9.9	0.7	2.5	3.9	2.6	6.5	5.5	2.9	0.3	5.1	4.5	3.8	4.2
Domestically bank-financed deficit						19.1	16.0			16.5	14.7	14.0	15.2
in percent of GDP						3.5	3.0			2.7	2.5	2.1	2.3
Cumulative change in banks' NFA during the year		-1.5	-3.3	6.0	5.0	6.3	5.2	3.0	0.7	7.3	5.3	10.5	4.0
Annual broad money growth	22.3	17.9	13.4	14.7	13.4	11.4	12.1	11.7	13.3	11.9	11.7	11.7	9.2
Annual reserve money growth	21.6	24.1	17.9	18.4	25.9	10.8	16.7	10.2	19.0	10.4	10.9	11.4	6.5
Annual growth in private sector credit	22.6	20.8	29.7	30.8	41.8	27.4	39.0	34.7	38.0	40.9	32.0	39.7	29.0
Annual M1 growth	23.0	30.4	22.9	21.1	24.7	10.2	13.5	10.6	14.0	11.3	10.6	12.2	5.0
Annual M2 growth	20.3	16.1	12.3	15.3	12.3	10.2	9.8	10.6	12.3	11.3	10.4	12.2	8.6
Velocity (Quarterly GDP/BM)	44.0	44.9	44.8	41.9	42.4	42.9	41.9	42.9	42.0	43.1	42.2	42.9	41.9
Currency/Broad Money ratio	27.8	28.2	28.5	27.5	29.5	27.3	29.0	27.2	28.8	26.7	28.7	26.6	27.6
Currency/deposit ratio	38.5	39.4	39.9	37.9	41.8	37.6	40.8	37.4	40.4	36.4	40.3	36.2	38.1
Deposits/broad money	72.2	71.8	71.5	72.5	70.5	72.7	71.0	72.8	71.2	73.3	71.3	73.4	72.4
Foreign currency deposits/total deposits	25.2	26.8	26.6	26.2	28.7	26.2	27.9	26.3	28.0	26.6	29.1	26.0	29.3
Gross reserves in U.S. dollars	481.8	477.0	477.5	480.0	536.8	500.0	550.0	512.0	570.0	535.0	620.0	570.0	640.0
in percent of broad money	22.2	22.6	22.6	22.4	25.3	22.2	25.1	21.7	25.5	21.2	25.4	20.3	24.0
US Dollar Exchange Rate (end of period)	135.2	140.2	141.8	147.0	147.0	145.0	150.0	145.0	150.0	145.0	150.0	145.0	150.0
Euro Exchange Rate (end of period)	138.0	136.4	133.3										

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	2000	2000	2001	2001	2002	2003	2004
		Est.	Prog. 5/00	Proj.	Prog. 5/00	Proj.	Proj.	Proj.	Proj.
I. Current account	-187	-294	-320	-262	-326	-285	-306	-302	-293
Trade balance	-621	-846	-692	-781	-728	-834	-874	-916	-963
Exports	205	275	330	272	386	305	351	400	452
Imports	826	1,121	1,022	1,054	1,114	1,139	1,224	1,316	1,415
o/w: Humanitarian aid related to the Kosovo crisis	0	183	0	0	0	0	0	0	0
Services and income	-5	46	17	-5	14	-1	-15	-10	3
o/w : Interest due	7	7	11	9	19	19	25	26	33
Private transfers	440	324	356	524	388	550	583	624	667
Official transfers related to the Kosovo crisis	0	183	0	0	0	0	0	0	0
II. Capital account	99	219	269	319	317	308	339	349	335
Official transfers	89	139	91	111	86	87	88	91	91
Direct investment	45	51	92	143	106	144	125	133	123
Other capital including short-term flows	-88	-44	-20	-32	10	-32	-1	0	0
Short-term capital	0	0	0	0	0	0	0	0	0
Other financial flows (increase = -)	-88	-44	-20	-32	10	-32	-1	0	0
o/w Change in NFA of commercial banks (incr=-)	-88	-44	-20	-32	10	-32	-1	0	0
Official medium- and long-term loans (net) 1/	53	72	106	97	113	109	126	124	120
New borrowing	62	80	117	106	126	118	149	147	146
Amortization 1/	-9	-8	-11	-9	-11	-9	-22	-23	-26
III. Errors and omissions	105	52	0	0	0	0	0	0	0
IV. Net balance = I+II+III	17	-23	-51	56	-9	24	33	47	42
V. Financing requirement = - IV	-17	23	51	-56	9	-24	-33	-47	-42
Available financing	-17	23	-13	-57	-49	-84	-54	-59	-64
Change in net reserves (increase = -)	-71	-79	-13	-57	-49	-84	-54	-59	-64
Change in gross reserves, (increase = -)	-78	-97	-19	-69	-35	-70	-40	-50	-55
Use of Fund Resources (net)	7	19	6	12	-15	-14	-14	-9	-9
Fund (ESAF/PRGF)	8	21	13	19	0	0	0	0	0
Repayments to Fund	-1	-2	-7	-7	-15	-14	-14	-9	-9
BOP support	54	96	0	0	0	0	0	0	0
Changes in arrears (increase = +) 2/	-145	0	0	0	0	0	0	0	0
Debt service relief (rescheduling) 3/	145	5	0	0	0	0	0	0	0
Financing gap	0	0	64	0	58	60	21	12	22
Identified financing (provisional)	0	0	64	0	34	51	0	0	0
Remaining gap	0	0	0	0	24	10	21	12	22
Memorandum items:									
Gross usable reserves	384	481	500	550	535	620	660	710	765
(months of imports of goods and services) 4/	4.2	4.1	4.6	4.4	4.5	4.6	4.5	4.6	4.6
Trade balance (percent of GDP) 5/	-20.3	-23.0	-18.1	-20.9	-17.4	-21.2	-20.7	-19.6	-18.8
Trade balance (percent of GDP) 4/	-20.3	-18.0	-18.1	-20.9	-17.4	-21.2	-20.7	-19.6	-18.8
Current account (percent of GDP)	-6.1	-8.0	-8.4	-7.0	-7.8	-7.3	-7.3	-6.5	-5.7
Debt service (percent of exports of goods and services)	6.2	3.9	6.4	4.8	8.6	7.4	9.5	7.9	8.2
External debt (percent of GDP) 6/	27	26	30	29	31	31	32	32	29
Merchandise exports (percent growth)	23	34	20	-1	17	12	15	14	13
Merchandise imports (percent growth) 4/	21	13	9	12	9	8	8	8	8

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/ The figure for 1999 corresponds to the deferral of interest payments granted by Paris Club creditors because of the Kosovo crisis.

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

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

6/ Includes arrears.

ALBANIA: FUND RELATIONS
As of November 30, 2000

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

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

III. SDR Department:	SDR Million	%Allocation
Holdings	60.57	N/A

IV. Outstanding Purchases and Loans:	SDR Million	%Quota
ESAF arrangements	59.35	121.9
First Credit Tranche	8.82	18.1

V. Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
PRGF	05/13/1998	07/31/2001	45.04	35.63
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):

	Overdue	Forthcoming				
	11/30/2000	2000	2001	2002	2003	2004
Principal		0.7	10.6	10.6	6.8	6.4
Charges/Interest		0.3	0.7	0.4	0.2	0.2
Total		1.0	11.3	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 149.5 lek per U.S. dollar on November 30, 2000.

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 40 operations amounting to US$549.6 million in credits, of which 18 are completed now. Under the current Bank portfolio (US$323.6 million), 14 percent of the credits support adjustment, 18 percent agriculture, 43 percent infrastructure, 9 percent social sectors, and 16 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 Emergency Road Repair Project (December 1999) is providing 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 Durres, Fier, Lezhe and Saranda. The Legal and Judicial Reform Project and the Public Administration Reform Project, both approved in March 2000, will help to strengthen Albania's weak institutional and governance capacity, including its ability to enforce laws and regulations. The Education Reform Project, approved in May 2000, will assist the Ministry of Education in planning and managing the delivery of education services. Further, the Financial Sector Institutional Building Technical Assistance, approved in June 2000, will assist Government in furthering the implementation of key areas of its financial sector strategy, including completion of its bank privatization program, improving financial infrastructure, and privatization of the insurance sector. In FY01, the Bank has approved a Trade and Transport Facilitation in South East Europe project, which is part of a regional program aimed at strengthening and modernizing the customs administrations.

STATUS OF BANK GROUP OPERATIONS IN ALBANIA

Statement of IDA Credits
(As of November 30, 2000)

Credit No.	Fiscal Year	Borrower	Project	US$ Million (Less Cancellations) Credits	Undisbursec
26100	1994	Albania	Durres Water Supply	11.6	0
26590	1995	Albania	Health Services Rehabilitation	12.4	0.2
27320	1995	Albania	Rural Roads	15	0.3
28260	1996	Albania	Power Transmission and Distribution	29.5	17.1
28460	1996	Albania	Forestry	8	4.3
28880	1996	Albania	National Roads	25	6.8
30160	1998	Albania	Recovery Program for Technical Assistance	5	0.9
30380	1998	Albania	Private Industry Recovery	10.3	5.7
30660	1998	Albania	Land Development	10	8.6
30670	1998	Albania	Health Recovery and Development	17	14.5
30680	1998	Albania	Durres Port	17	12.9
31640	1999	Albania	Community Works	14	8.2
32310	1999	Albania	Structural Adjustment Credit	45	23.8
32320	1999	Albania	Irrigation & Drainage II	24	17.8
32530	1999	Albania	Microcredit	12	8.8
33030	2000	Albania	Emergency Road Repairs	13.7	11.5
33220	2000	Albania	WS Urgent Rehabilitation	10	8.8
33270	2000	Albania	Legal/Judicial Reform	9	8.1
33280	2000	Albania	Public Admin Reform	8.5	7.7
33430	2000	Albania	Education Reform	12	10.9
33620	2000	Albania	Financial Sect. IBTA	6.5	6
34270	2001	Albania	Trade & Trans Facil in SE Eur	8.1	7.9
Total				**323.60**	**190.80**

	Active projects	Closed Projects	Total
Total Disbursed:	114.6	223.60	338.20
Of which: Repaid	0.0	0	0
Total Now Held by IDA	323.6	226.00	549.6
Total Amount Sold	0.0	0	0
Of which: Repaid	0.0	0	0
Total Undisbursed	190.8	1.00	191.8

Statement of IFC Investments
(As of October 30, 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$8.3 million has been disbursed) and a US$80 million loan (up toUS$30 million for IFC's account) commitment pending approval; and (iii) an equity investment of approximately US$1.1 million in FEFAD Bank, a microfinance bank established to onlend to micro and small enterprises. A US$2.2 million equity commitment for the National Commercial Bank has been approved.

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. 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 the preparation of the data dissemination module in the Report on Observance of Standards and Codes (ROSC). The ROSC was circulated to the Executive board in June 2000. Albania participates in the General Data Dissemination System (GDDS), and a complete set of GDDS 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 *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 of May 2000 assisted the INSTAT in finalizing the development fo the PPI for Albania. It was expected that the publication date for the official PPI would be May 2001 when the first quarter of price data for 2001 and complete sales turnover data for 2000 would be available.

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 multisector mission of February 1999 worked with 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. A national accounts statistics mission is scheduled to visit Albania during January 31–February 13, 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 has started again. 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 the 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 to 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 sheet 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. Subsequently, the legal framework has been changed to permit the authorities to require reporting by the SCA.

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. 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. Efforts were being made to extend the time series of monetary data on a consistent basis. As the privatization process of the National Commercial Bank has been completed, its implications for monetary statistics will need to be reviewed.

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 financial 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 January 2, 2001)

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Governmt. Balance	GDP/GNP	External Public Debt/Debt Service
Date of Latest Observation	Nov. 30	Nov. 30	End-Oct.	End.Oct.	End-Oct.	Dec. 21	Nov.	Sep.	Sep.	End-Nov.	1999	Sep.
Date Received	Nov. 30	Nov. 30	Dec. 21	Dec. 21	Dec. 21	Dec. 21	Dec. 11	Dec. 11	Dec.	Mid-Dec.	Mid-2000	Dec.
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	E-mail	E-mail	E-mail/ Pouch	E-mail/ 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, January 12, 2001

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

Dear Mr. Köhler,

1. The authorities of the Republic of Albania held discussions with Fund staff during October 19-31, 2000 in the context of the midterm review of the economic program supported by the third annual arrangement under the Poverty Reduction and Growth Facility (PRGF). The program is on track, with all end-September 2000 quantitative performance criteria observed. The privatizations of two mid-sized enterprises were completed on October 4, 2000 and the privatization advisor for the Savings Bank was appointed in December (both end-September performance criteria). The tender for privatization of the Savings Bank (an end-November performance criterion) has been delayed in light of the complexities noted by investment banks and other delays outside the control of the government of Albania. Based on the completion of the measures under the first two performance criteria (albeit with a short delay) and our continuing efforts in privatizing the Savings Bank, we request waivers for the nonobservance of the three structural performance criteria.

2. The attached Supplementary Memorandum of Economic and Financial Policies (MEFP) describes our economic program and key policy measures for the period ahead. In particular, we have reached understandings with Fund staff on the 2001 budget and on measures for the privatization of the Savings Bank. We have already implemented the three prior actions for the completion of the review. Based on the performance of the program to date and our proposals for the period ahead as described in the MEFP, we request the completion of this review.

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

Sincerely yours,

/s/	/s/	/s/
Ilir Meta Prime Minister	Anastas Angjeli Minister of Finance	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 MIDTERM REVIEW OF THE THIRD ANNUAL ARRANGEMENT UNDER THE PRGF

I. Introduction

1. **The favorable performance of Albania's economy has continued in 2000, benefiting from our efforts to maintain macroeconomic stability and implement policies in line with the PRGF supported program.** GDP growth is now estimated at about 7¾ percent in 2000, somewhat higher than expected earlier, thanks to strong domestic demand resulting from improved business confidence and rapid growth in private remittances. Inflation has remained subdued, reflecting prudent financial policies, productivity growth, and the continued strength of the exchange rate relative to European currencies. In a virtuous circle, low inflation has in turn helped maintain strong demand for the lek. Exports, which were adversely affected by the Kosovo crisis in 1999, have started to recover, and will strengthen further with the resumption of activity in the chromium and steel sectors, following their transfer to foreign investors, and increased exports of textiles and shoes, reflecting improved regional stability. The current account deficit in 2000 is estimated to have declined as a share of GDP relative to 1999, with private transfers more than offsetting the higher trade deficit. This, together with the continuing support of foreign donors for our development programs and increased privatization receipts, has strengthened the balance of payments position. The Bank of Albania's (BoA) official reserves are at a comfortable level of about 4½ months of imports.

2. **We have achieved impressive results in improving revenue collection in 2000.** By implementing measures to improve customs and tax administration agreed under the PRGF, we have been able to boost tax collection by about 30 percent relative to 1999 without increasing any tax rate, while reducing maximum import duty rate from 20 percent to 18 percent on January 1, 2000. We have reduced smuggling and corruption, improved the valuation of imports, accelerated the collection of customs debt, and strengthened the discipline of companies operating under special customs regimes. Better cooperation between tax and customs administrations has also been effective in fighting tax evasion. In the internal tax administration, major efforts to improve enforcement have resulted in an increase in the number of registered active taxpayers of VAT and small business tax by 17 percent and 28 percent, respectively, compared with 1999.

3. **Expenditure priorities have been realized while keeping the deficit below the program ceiling.** The original budget foresaw a strong increase in expenditure on public investment as well as health and education. In the revised budget we raised investment in roads and schools, in connection with the release of a foreign grant, and increased expenditure on operations and maintenance. The second tranche of the EU Kosovo-related grant has been approved, and we are using the proceeds to finance investment in infrastructure damaged during the Kosovo crisis. We have met the end-September

performance criteria on domestic financing of the deficit, and we are confident that the end-December indicative target will also be met (Table 1).

4. **We have implemented further measures to improve expenditure management.** To strengthen expenditures control, we have signed a contract with an international auditing firm for an expenditure tracking exercise, which is now underway. Moreover, in the 2001 budget we have introduced a more detailed economic classification of expenditure, including adjustment of the government chart of accounts, and have appropriately trained the staff members of the Ministry of Finance (MoF) and spending agencies.

5. **Macroeconomic stability and rising confidence have allowed the BoA to relax monetary conditions and gradually reduce interest rates.** The repo rate declined significantly, to about 4¾ percent in October; the three-month T-bill rate to about 7¾ percent; and the deposit rate for the same maturity at the Savings Bank with some lag, to 6¾ percent, with prospects for further declines of deposit rates in the months ahead. Moreover, the last direct instrument of monetary policy, the minimum interest rate on three-month deposits, was eliminated in September and the BoA now relies primarily on open market operations in conducting monetary policy. Nonbank participation in the T-bill market has also increased significantly. Declining interest rates and a better business climate have led to higher private sector credit growth, particularly in the construction sector and for housing. Some banks have reportedly reduced lek lending rates recently.

6. **We have made substantial progress in structural reforms, although some privatization measures have been delayed.** In the enterprise sector, we have successfully sold Albanian Mobile Communications and two mid-sized companies. We will complete the sale of the remaining three mid-sized companies over the next few months. We have announced the tender for the second mobile phone license; approved an action plan for privatizing Servcom and submitted to parliament the law on the privatization of the strategic part of that company; and provided office space for the registry for collateralized property. The 1999 audit of Albtelekom according to international standards could not be completed, however, owing to difficulties in preparing an inventory of the company's fixed assets, an issue that will be addressed in the company's 2000 audit. In the banking sector, we have transferred the National Commercial Bank (NCB) to foreign investors, but preparations for privatizing the Savings Bank are behind schedule. Specifically, the chief accounting and operating officers were appointed with some delay in October, as was the privatization advisor in December. On the positive side, the audit of the 1999 financial statements for the Savings Bank has confirmed their compliance with international standards. The bank has continued to collect outstanding classified loans. It has further reduced its payroll and has identified branches that could be transferred to the post office or closed. Table 2 provides information on the status of structural reform under the program.

7. **The preparation of a poverty reduction strategy is proceeding well, following the completion of the interim Poverty Reduction Strategy Paper (PRSP).** The U.K.-based Institute for Development Studies (IDS) carried out a stakeholder analysis and provided the government PRSP Working Group, which is composed of 21 deputy ministers and

department heads, with options for a participatory process. This process has now been elaborated and was presented to a broad cross-section of the Albanian society at a two–day workshop in early November. The Carter Center has agreed to assist the government in the facilitation of civil society participation. An information and media campaign was launched in November 2000, with support from UNICEF, to raise the public's awareness of the process.

II. THE GOVERNMENT'S POLICIES

A. Objectives

8. **The government's objectives are to maintain the economy on a strong sustainable growth path and reduce the poverty of those most in need**. To achieve these objectives we have to preserve macroeconomic stability, deepen the process of structural reform, attract foreign investment, and strengthen government programs for alleviating poverty.

9. **We will demonstrate our commitment to poverty alleviation in a PRSP that will be prepared by mid-2001, with the participation of civil society representatives and foreign donors.** The participatory process has several components, including (i) a dialogue with civil society advisory groups in the context of the Medium-Term Expenditure Framework (MTEF) in the sectors of health, education, labor and social affairs, and agriculture; (ii) a dialogue with the representatives of private businesses; and (iii) a dialogue between the central and local governments. In cooperation with the World Bank, we will formulate a new Rural Strategy, through a participatory process, which will ensure that issues of rural poverty and development are fully addressed in the PRSP. The PRSP will present our long-term poverty alleviation goals and the intermediate indicators that will be monitored to assess progress toward achieving these goals. The cost implications of poverty reduction will be integrated fully and transparently into the budget. Work has also started on an updated poverty assessment based on both quantitative and qualitative data. Following the 2001 population census in April, the World Bank will help us in establishing a poverty profile based on a Living Standard Measurement Survey, the results of which will be available in early or mid-2002 and will be used for an updated PRSP in 2002.

10. **Macroeconomic policy for 2001 will aim at supporting strong GDP growth as well as maintaining low inflation and a prudent level of official reserves.** To achieve the growth target of about 7¼ percent, we will continue forcefully with reform and privatization in the financial and enterprise sectors, and approve a prudent 2001 budget that further strengthens revenue collection and allows for increased spending on investment, health, and education. We expect that inflation will rise to a range of 2–4 percent, a level that will allow smooth relative price adjustments characteristic of a rapidly growing economy. External reserves are expected to remain at the comfortable level of 4½ months of imports. We are aware that the realization of these targets depends heavily on our success in normalizing electricity supply by implementing the measures specified in paragraph 23. We will monitor

developments closely and stand ready to discuss with Fund staff appropriate revisions in the macroeconomic framework if necessary. Specific targets for 2001 are tabulated below.

	1999	2000	2000	2001	2001
		Prog. May-00	Proj.	Prog. May-00	Proj.
GDP growth (in percent)	7.3	7.0	7.8	8.0	7.3
Inflation (average; in percent)	0.4	1.5	-0.2	3.0	2.5
End-period gross official reserves	481	500	550	535	620
(In millions of U.S. dollars)					
(In months of imports of goods and services)	4.1	4.6	4.4	4.5	4.6
External current account deficit	8.0	8.4	7.0	7.8	7.3
(In percent of GDP)					
General government deficit	11.5	9.4	9.5	8.7	9.2
excluding foreign-financed projects	8.2	5.7	5.8	4.5	5.2
of which domestic borrowing	5.2	4.3	3.3	3.5	2.7
(In percent of GDP)					

B. Fiscal Policy

11. **We will continue with gradual fiscal consolidation while pursuing our objectives of raising public investment and spending on poverty-related programs.** The 2001 budget envisages an overall budget deficit of 9.2 percent of GDP, down from about 9.5 percent in the revised 2000 budget. Excluding foreign-financed investment projects, the deficit will decline from 5.8 percent to 5.2 percent of GDP. Domestic borrowing requirements will be limited to Lek 15.8 billion (2.7 percent of GDP), which is consistent with substantial scope for growth in private sector credit (about 32 percent). As the privatization receipts are likely to exceed the conservatively estimated amount of 1.7 percent of GDP, we expect to have more leeway for reducing domestic borrowing than envisaged under the budget. If these proceeds turn out to be more than ¾ percentage point of currently projected GDP for 2001 above the budgeted amount, we will discuss with the staff, in the context of negotiating a possible new arrangement, the appropriate use of these proceeds. In line with the ceilings envisaged under the program (see Table 1), foreign borrowing will be limited largely to resources provided on concessional terms by international organizations and bilateral donors. To address the risks of weaker-than-expected revenue performance, we will use the reserve and contingency funds sparingly, implement several investment projects only if line ministries meet their targets for collecting fees, and stay ready to cut other investment expenditure and expenditure on operation and maintenance, if necessary. The 2001 budget, consistent with the understanding reached with the staff, was approved by parliament in December (a prior action for completing this review).

12. **We will make further efforts to strengthen both customs and tax administration to compensate for envisaged tax rate cuts and to meet the 2001 revenue target.** The 2001 budget incorporates a rise in the tax revenue to GDP ratio by over ½ percentage point of

GDP, while the profit tax rate is reduced from 30 percent to 25 percent. The maximum import tariff rate as of January 1, 2001 will be cut from 18 percent to 15 percent, and the lowest tariff rate from 5 percent to 2 percent. To encourage tourism, we will also reduce the border tax for foreigners. For road safety and environmental reasons, we will restrict imports of very old cars, improve valuation of used cars, but will continue to tax new cars at the top duty rate. We realize that at this stage we cannot reduce the Solidarity Tax further. To reduce pressures on granting fiscal exemptions, as a prior action for completing this review we will amend the free trade zone act to abolish the profit tax holiday. Moreover, we will clearly instruct our negotiators for the water supply project in Elbasan and for the airport terminal to reject any tax incentive demands from potential investors.

13. **Regarding internal tax collection, we have decided to implement the following measures:**

- We will amend the VAT law by December 2000 to increase the VAT threshold from Lek 5 million to 8 million, and adequately adjust upward the ceiling for the small business tax, with an overall positive effect on revenues. The carry-forward period for VAT credit claims will be shortened from six months to one month for exporters. For all taxpayers, we will adapt auditing process so that audits commence as soon as a VAT return indicating a credit is received. We will introduce a statutory time limit of two months (one month for exporters) for the release of VAT refunds, with interest payment in cases of late release, and will discontinue the practice of releasing refunds in installments. Moreover, for large investment projects, we will approve a deferred payments system for VAT on imports of machinery and other equipment.

- The budget will provide adequate resources to improve VAT operations—especially collection, refund, and audit—and extend the computerized VAT administration system to other main cities (Elbasan, Fier, Korça, Lushnje, Shkoder, and Vlore) by March 2001. We will expand the current system of selected cross-checking of VAT invoices.

- To improve its performance, the Large Taxpayers Unit (LTU) will report directly to headquarters as of July 1, 2001. All large firms (with a turnover above Lek 200 million) with their seat in Tirana will file and pay their tax liabilities in the LTU as of January 1, 2001. The March 1998 ministerial decision to split large enterprises' filing and payment of VAT liabilities in the district offices where their branches are located will be repealed as of January 1, 2001. We will review the LTU procedures and organization, update the manuals prepared for the VAT, and develop manuals for income tax, profit tax, and excise tax procedures by end-2001. An integrated computer system to support the work of the LTU will be developed by March 2002. We will provide suitable office facilities for the LTU by end-September 2001 (structural benchmark).

- We will amend the VAT regulation and require all retailers in hotels, restaurants, and several other sectors to issue VAT invoices for all sales (currently, these are issued only for transactions above Lek 10,000). By June 1, 2001 we will complete a study on mandatory introduction of cash registers at the retail level.

- We will introduce more secure excise stamps (banderoles) for cigarettes and alcohol as of January 2001, and implement the action plan to curb smuggling in cigarettes as agreed between the tax administration, the police force, and the Ministry of Defense as of November 1, 2000.

- We will impose an excise on import and production of alcohol, in addition to those on alcoholic beverages.

- To improve relations with taxpayers, we will ensure that tax officers strictly follow the rules prescribed under the profit tax law on advance payments and will reimburse taxpayers after the submission of final returns within the statutory deadlines. With support from the German and British governments and the Fiscal Affairs Department of the Fund, we are continuing the training program to educate selected tax officials, who will in turn function as trainers in the Tax Department.

14. **In the area of customs administration, we will continue with the implementation of measures introduced in 2000.** To further streamline customs administration and to augment revenue, notwithstanding the planned cuts in import tariffs, we will take the following measures:

- The Internal Audit Unit (IAU) will produce monthly reports on the implementation of valuation methods. Based on these reports, the Director General will take corrective measures, to address the issues raised by the IAU and send a monthly report on these measures to the Minister of Finance.

- We will implement an annual appraisal system for all customs personnel by end-December 2000, in consultation with the customs assistance mission of the European Union (CAM-A). We expect that this measure—along with the reward and bonus schemes implemented in mid-2000—will contribute to further lowering corruption and raising the professionalism and commitment of the customs personnel.

- We will continue to control companies benefiting from special import licenses and impose sanctions on those found in violation of the customs code. While the number of companies controlled through end-September fell slightly short of the agreed target, we will finalize the control of all companies before the end of the year.

- We will further strengthen collaboration with the customs administration of neighboring countries in the area of post-clearance control.

15. **The expenditure program under the 2001 budget reflects the government's priorities for investment and social expenditure as developed in the 2001–03 MTEF.** Non-interest expenditure is set to increase from 26.8 percent to 27.8 percent of GDP in 2001,

reflecting additional revenue efforts and lower interest outlays. Investment expenditure (excluding Kosovo-related reconstruction) is projected to rise from 6.7 percent of GDP in 2000 to 7.5 percent of GDP in 2001, equivalent to a 17 percent increase in real terms. Expenditure on health and education is set to rise by 23 percent and 8½ percent in real terms, respectively. Regarding social assistance, in line with the World Bank's recommendations, targeting of the main program will be based on the recently completed review of the eligibility data, with expenditure in this category declining from Lek 4.8 billion in 2000 to Lek 4.6 billion in 2001, while allocations for the handicapped go up from Lek 1.8 billion to Lek 2.2 billion. The budget emphasizes improvements in the volume and efficiency of operations and maintenance expenditures, including outlays for foreign-funded projects. It also allocates an average 8½ percent nominal rise in budgetary wages and pensions as of July 1, in view of significant differentials with private sector wages and difficulties in retaining personnel—with an additional 10 percent on January 1 for military and police wages, partly offset by a decline in the Solidarity Tax earmarked for bonuses to the police force. At the same time budgetary employment will be cut by 2,200 staff by end-June and another 200 by end-October, in part through attrition, while maintaining the quality of public services. Fifty civil servants will be hired according to the new civil service law before the end of 2000—a crucial condition for the disbursement of the second tranche of the World Bank SAC. To improve the control of budget execution, as a matter of priority the Ministry of Economic Cooperation and Trade will accelerate the frequency and speed of collecting information on disbursements of foreign-financed capital expenditure and reporting these data to the Ministry of Finance.

16. **We will continue developing the MTEF with assistance from the World Bank.** In early 2001, we will conduct an employment survey to obtain the necessary data for assessing the appropriateness of the current level and structure of wages in the public, compared with the private sector. On that basis, we will formulate our medium-term public sector wage policies and priorities. Moreover, we will make the computerized database on all public sector employees fully functional by September 2001.

17. **We will request assistance from the World Bank in designing a comprehensive reform of the pension system by end-2001, with a view to enhancing its financial sustainability.** In particular, we will review contribution rates and ceilings of the social insurance system to create higher participation of the private sector. Also, we will assess the sustainability of the rural pension scheme and identify measures to reduce the large gap between contributions and benefits. Regarding immediate measures, in tandem with the approval of the 2001 budget we will amend the social security law and obligate all enterprises to file information on their payroll to the social security system on a monthly basis. The authority of inspectors in charge of collecting social security contributions will also be strengthened.

C. Monetary and Exchange Rate Policies

18. **The BoA will continue to conduct monetary policy with the objective of keeping inflation low.** Since three-month T-bill rates have declined to a level broadly consistent with

projected inflation and the deposit rates are expected to decline further, the BoA will now focus on fine-tuning its open market operations, with a view to keeping interest rates in its primary auctions more stable. The BoA will over time, and in consultation with MAE, move to a fixed repo rate system. The central bank law will be amended by end-May 2001 so that it does not restrict BoA purchases of government paper through repo operations, thus widening its scope for open market operations through reverse repo operations. The government will convert the remaining component of its nonmarketable obligations to the BoA into marketable securities by March 2001. To broaden the T-bill market further, the BoA will consider selling small quantities of T-bills to nonbank buyers outside of the auctions. The BoA will continue to strengthen its supervisory capabilities through regular monitoring of the activities of banks and annual on-site inspections.

19. **The BoA will continue to conduct its monetary operations in the context of a flexible exchange rate regime while smoothing excessive fluctuations.** In its policy assessments, the BoA will take into account the balance between the lek's exchange rate against the euro—the principal determinant of external competitiveness—and that against the dollar—the main foreign currency used for financial transactions.

20. **The monetary program for 2001 is consistent with a reserves-to-import ratio of about 4½ months, private sector credit growth of 32 percent, and domestic bank financing requirements of the budget deficit of 2.7 percent of GDP.** Assuming that velocity remains broadly unchanged, following its decline in 1999 and 2000, reserve money growth is projected to slow down to 11 percent by end-2001, and broad money growth to about 11¾ percent. The targets for NIR, NDA of the BoA, and net credit to government for end-December 2000 and end-March 2001 have been revised to incorporate recent developments. The projected increase in private sector credit is in line with the program's objectives and, given the low base (around 4 percent of GDP) and the conservative lending policies followed by commercial banks, is not expected to cause prudential concerns.

D. Structural Policies

21. **We remain committed to financial sector reform through privatizing the Savings Bank and improving the institutional framework.** We have appointed a privatization advisor for the Savings Bank and are moving ahead with preparations for the privatization tender, which will be announced by end-June 2001 (structural performance criterion), postponed from end-November 2000. We will fully recapitalize the bank before the end of 2000 by issuing T-bills (prior action for completing the first review), with interest cost for the budget of 0.3 percent of GDP in 2001. We will also prepare the transfer of the bad loan portfolio to the appropriate agency by March 2001. We are currently registering the bank's real estate assets, and will perform due diligence on the bank. The law on deposit insurance is expected to be approved by parliament by March 2001 and implemented by September 2001. Following delays in establishing the credit information bureau, we have now designed a plan for setting it up with help from a foreign donor by end-2001. The registry of collateralized claims will be fully functional by December 2000. We will also be vigilant in enforcing laws preventing illegal activities by quasi-financial institutions.

22. **In the area of enterprise reform, we will maintain the privatization drive of the recent months.** We will conclude negotiations with potential new investors in the copper and chromium sectors, and sell the Burrel smelter and the Bulqize mine by end-2000. In the oil sector, the law on the privatization of the strategic part of Servcom was approved by parliament in early December, while the remaining smaller units will also be privatized or liquidated by the end of the year. With regard to ARMO, we have divided the company into smaller units and will proceed with preparations for the privatization of the strategic units as soon as the contract with IMI, the investment advisor for strategic projects, becomes operative again. We will also privatize seven hotels by September 2001. We will move forward with privatizing Albtelekom with a view to completing the process in the second half of 2001. The plans for a concession to build and operate the passenger terminal at Tirana airport are proceeding and tender invitations for the selection of investment consultants were issued in December.

23. **Given the worsening electricity situation and its impact on the economy, we will start implementing a comprehensive package of reforms of the electricity company (KESH).** Now that we have appointed new management, we have established quarterly targets for collecting bills and reducing theft and will use with determination the recently established electricity police force in achieving these targets. Meeting these targets will permit resumption of the Bank's assistance to the sector, which was suspended owing to insufficient improvement in collecting payment for electricity bills and reducing losses. We will also expedite the implementation of a number of other foreign-financed investment projects, which will expand our capacity to produce and import electricity, and will work actively with the Italian company ENEL to improve the management of KESH. We have allocated a subsidy in the budget to enable KESH to import electricity on a timely basis so as to reduce shortages in peak seasons until the proposed measures improve its financial performance.

24. **We will proceed with our efforts to improve the legislative environment and to remove obstacles to efficient private economic activity.** To make procedures for the approval of foreign direct investment projects more transparent and accessible, we are preparing in cooperation with donors the establishment of an investment promotion agency. We expect to send three important laws to parliament in December (the bankruptcy law; the law on mediation of business disputes, together with the necessary amendments to the civil and civil procedures code; and the law on the organization of executing court decisions in civil cases), and expect their parliamentary approval by March 2001. We will continue with the registration of land holdings despite the increasing difficulty of registering the remaining land.

25. **To improve the quality and coverage of economic statistics, we are committed to further strengthening INSTAT, the central statistical agency.** In the 2001 budget, we will allocate another 20 permanent staff positions to INSTAT to strengthen its capacities, including its ability to conduct the upcoming census in April 2001. Having started to publish a unit value index and a retail trade index, INSTAT intends to publish the PPI in early 2001 at which time also the weights in the CPI basket are also to be revised. Preliminary estimates

of the national accounts for 1996-98 are expected to be completed by end-2000, and publication of the final accounts by mid-2001. The law on statistics, which has been drafted with assistance from the European Union, is expected to be ready for submission to parliament in early 2001.

E. External Sector Policies and Program Financing

26. **With the envisaged foreign support, we expect that the balance of payments position will remain sustainable.** With investment and infrastructure needs remaining large, the current account deficit is expected to remain broadly unchanged, at around 7 percent of GDP in 2001. In the medium term, the current account deficit is projected to decline as exports rise as a result of foreign investment, which would expand in response to economic and institutional reforms. Moreover, private remittances are expected to continue to grow steadily. Inflows of foreign direct investment and, primarily, concessional bilateral and multilateral support, are expected to finance the current account deficit, although small financing gaps are projected to open up in 2001 and to continue in the medium term.

27. **We will continue to regularize our relations with external creditors.** The government has made progress with Paris Club creditors by recently concluding bilateral agreements with Austria, France, Italy, and the Netherlands, while it has reconciled estimates of arrears to Russia. The External Debt Committee (dealing with Paris Club and non-Paris Club debt) has prepared a timetable and has formed working groups for reconciliation and rescheduling of debt in arrears. It will continue to meet on a monthly basis 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) can be removed. The government actively aims to reconcile and reschedule debt in arrears with its remaining creditors and will seek at least comparable treatment from non-Paris Club creditors with outstanding similar claims on Albania.

III. Program Monitoring and Possible Successor Arrangement

28. During the second half of the third annual PRGF arrangement, the program will be monitored based on indicative targets for end-December 2000, and quantitative performance criteria and indicative targets for end-March 2001, which have been set on a cumulative basis from end-December 1999 (Table 1). Details on the monitoring of indicative targets and quantitative performance criteria are set out in the Technical Memorandum of Understanding that accompanied the request for the third annual arrangement (Attachment I to the Memorandum dated May 25, 2000, attached to EBS/00/111). Structural performance criteria and benchmarks are set out in Table 2. 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, apart from obligations for which a rescheduling is expected.

29. In the context of our commitment toward approving and implementing a comprehensive poverty reduction strategy and the country's balance of payments needs, we

intend to request a successor arrangement that could be approved immediately following the completion of the current arrangement.

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 2/
	Prog.	Adj. Prog.	Actual	Prog.	Adj. Prog.	Actual	Rev. Prog.	Rev. Prog.
				(In billions of Lek)				
1. Ceiling on domestic credit to the government	10	13.6	9.6	18	16.1	10.9	24	29
2. Ceiling on net domestic assets of the BOA	10	13.6	2.4	11	13.8	6.2	8	8
3. Indicative target for tax revenues	38	38	38.2	60	60	59.5	82	103
4. Indicative target for revenues collected by Customs Department	21	21	20.9	32	32	32.9	47	57
				(In millions of US Dollars)				
5. Floor for net international reserves of the BOA	-25	-51.8	-4	-24	-44.5	64.6	75	94
6. Ceiling on contracting or guaranteeing of non-concessional external debt with maturities 1-15 years	20	20	9.8	40	40	24.6	60	60
Of which: 1-5 years	5	5	0	5	5	0	10	10
7. Ceiling on public and publicly-guaranteed external debt with maturities of up to 1 year	0	0	0	0	0	0	0	0

1/ The performance criteria and indicative targets envisaged under the program, and their adjustors, are defined in the Technical Memorandum of Understanding.
2/ Performance criteria, except for tax revenues and revenues collected by the Customs Department, which are indicative targets.

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

A.	**Prior actions**	
1.	Pass 2001 budget consistent with the PRGF program.	Done.
2.	Appoint privatization advisor for the Savings Bank, and recapitalize the bank by issuing marketable securities.	Done.
3.	Amend the free-zone act to abolish the profit tax holiday.	Done.
B.	**Structural Performance Criteria**	
1.	Finalize privatization of AMC and two out of five mid-sized enterprises (end-September 2000).	Not met; completed on October 4
2.	Appoint privatization advisor for the Savings Bank (end-September 2000).	Not met; has become a prior action.
3.	Announce tender for privatization of the Savings Bank (end-November 2000).	Postponed to end-June 2001.
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 corrective actions taken (throughout)—revised as item D.4. below.	Done; changed to monthly IAU reports as of October 2000; disciplinary and other corrective management actions being taken.
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.	Partially done; 13 reviews completed by end-June, 141 by end-September.
3.	Approve amendments to the Social Security Law (end-September 2000).	Delayed; expected by December 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)—revised as item D.5. below.	A tender for the privatization advisor announced in August 2000; negotiations delayed, see item B.3 above.
5.	Complete process of converting government's nonmarketable obligations to the Bank of Albania into marketable securities by end-September 2000.	Ongoing; about half transferred to date; Expected to be completed by March 2001.
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—revised as item D.6. below.	Registration of 1426 cadastral zones completed by end-June 2000, and 1501 by end-September 2000.

7.	Sell or lease the Burrel smelter and the Bulqize mine (end-December 2000).	On track
8.	Prepare an action plan for selling or liquidating SERVCOM (end-June 2000), and privatize or liquidate the company (end-December 2000).	Action plan prepared in June 2000; privatization for non-strategic part on track for December; end-June 2001 for strategic part.
9.	Audit the 1999 financial statements of Albtelecom (end-June 2000).	Discrepancies with respect to international accounting standards found in the 1999 audit will be taken care of in the 2000 audit.
10.	Make the registry of collateralized property fully functional (end-June 2000).	Expected December 2000.
11.	Make the credit information bureau fully operational (end-December 2000).	End-December 2001 due to difficulties with finding an appropriate consultant.
12.	Approve in parliament the new bankruptcy law fully consistent with the law on collateralized transactions (end-December 2000).	Council of Ministers will send law to parliament in December 2000, expected to be approved in January 2001.
13.	Submit to parliament the law on offices for the execution of court decisions in civil cases (end-December 2000).	Council of Ministers will send law to parliament in December 2000, expected to be approved in January 2001.

D. New Structural Benchmarks (added at time of First Review of Third Annual Arrangement)

1. Complete the privatization of three SME's (brewery, dairy, winery) by end-December 2000.
2. Establish an operational mediation center by July 2001.
3. Fully implement an annual appraisal system in the customs department (by end-2000).
4. Internal Audit unit to produce monthly reports on the valuation of imports and the Director-General to produce at least four monthly reports (September-December 2000) covering corrective measures that were taken based on the reports of the IAU.
5. Complete due diligence for the Savings Bank, including registration of fixed assets by May 2001.
6. Complete first-time registration in 1,590 cadastral zones by end-December 2000, and in 1,680 cadastral zones by end-March 2001.

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 billion was held by the Bank of Albania, Lek 104.3 billion by commercial banks, and Lek 5.6 billion 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 Lek 135.2 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 encumberments), 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 Lek 135.2 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 Lek 135.2 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 25 billion.

E. External Debt and Arrears

14. The term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows: (i) loans, i.e., advances of money to obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and (iii) leases, i.e., arrangements under which

property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property. Arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

15. 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. **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.

16. 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.

17. 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.

INTERNATIONAL MONETARY FUND

NEWS BRIEF

FOR IMMEDIATE RELEASE

News Brief No. 01/10
FOR IMMEDIATE RELEASE
January 26, 2001

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

IMF Completes Albania Review and Approves US$6 Million Credit Tranche

The Executive Board of the International Monetary Fund (IMF) today completed the first review of the third annual arrangement under the Poverty Reduction and Growth Facility (PRGF)[1] for Albania. As a result, Albania will be able to draw up to SDR 4.7 million (about US$6 million) from the IMF.

The three-year PRGF arrangement was approved on May 13, 1998 (see Press Release No. 98/18) in a total amount of SDR 45 million (about US$58 million), of which Albania so far has drawn SDR 35.6 million (about US$46 million).

---

[1] On November 22, 1999, the IMF's concessional facility for low-income countries, the Enhanced Structural Adjustment Facility (ESAF), was replaced by the Poverty Reduction and Growth Facility (PRGF), and its purposes were redefined. It was intended that PRGF-supported programs will in time be based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners, and articulated in a Poverty Reduction Strategy Paper (PRSP). This is intended to ensure that each PRGF-supported program is consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. At this time for Albania, pending the completion of a PRSP, a preliminary framework has been set out in an interim PRSP, and a participatory process is underway. It is understood that all policy undertakings in the interim PRSP beyond the first year are subject to reexamination and modification in line with the strategy that is to be elaborated in the PRSP. Once completed and broadly endorsed by the Executive Boards of the IMF and World Bank, the PRSP will provide the policy framework for future reviews under this PRGF arrangement.
PRGF loans carry an annual interest rate of 0.5 percent and are repayable over 10 years with a 5½ year grace period on principal payments.

Following the Executive board's discussion of the review, Shigemitsu Sugisaki, Deputy Managing Director and Acting Chairman, said:

"The Albanian authorities have been successful in maintaining macroeconomic stability, with GDP growing at about 7 percent, inflation at 2 percent, and external reserves rising to a comfortable level. They have also made progress in structural reform, particularly in relation to enterprise privatization.

"Consistent with the need for a progressive reduction in the budget deficit, the authorities have achieved significant improvements in tax collection in 2000. Revenues rose by about 2½ percentage points of GDP compared with 1999, reflecting the effects of strengthened administration and governance. The 2001 budget envisages further efforts in this area, as well as measures to contain and prioritize expenditures. Monetary policy continues to aim at maintaining low inflation.

"The authorities are determined to address the wide-ranging problems in the electricity sector and have reached an agreement with the World Bank on a strategy to reform the sector.

"They are continuing with their program of structural reform and, despite recent delays and complications, are making every effort to complete the privatization of the Savings Bank in 2001.

"The authorities are committed to developing a comprehensive poverty reduction strategy through an open consultative process by mid-2001," Mr. Sugisaki said.

Statement by the IMF Staff Representative
January 26, 2001

This statement reports on recent developments since the issuance of the staff report (EBS/01/4). The staff appraisal remains appropriate and the staff reaffirms its recommendation that the Executive Board complete the first review under the third annual arrangement.

Year-on-year inflation rose from 1.9 percent in November to 4.2 percent in December, reflecting almost entirely a supply-induced surge in the price of fruits and vegetables, which have an exceptionally high share in the CPI. Excluding these items, inflation was 2.4 percent, in line with the program target range of 2-4 percent. Moreover, preliminary estimates for prices in Tirana during January indicate that the price of fruits and vegetables has declined since end-December. The staff, however, has advised the Bank of Albania to monitor the situation closely.

Regarding fiscal policy, preliminary data indicate that cumulative tax collection for 2000 reached Lek 81.7 billion, compared with the indicative target of Lek 82 billion. Final data are usually revised upward. Moreover, the end-December domestically financed deficit is estimated to have been within the program target.

In the monetary area, 12-month T-bill rates have declined further, to 11¾ percent (compared with around 12½ percent during the mission), while 3-month rates have remained broadly unchanged at around 7¾ percent. The end-December targets for the Bank of Albania NIR and NDA have both been met. External reserves, at US$607 million in end-December, were well above the projected US$550 million, in large part because of the disbursement of the World Bank SAC on December 26. The exchange rate has remained stable relative to the euro, with some seasonal weakening in early January.

Favorable weather conditions together with efforts to increase imports, reduce electricity theft, and promote the use of liquefied gas have removed the immediate threat of an electricity crisis. To achieve the target for improving collections agreed with the World Bank as a condition for reactivating the Bank's sector lending program, the authorities have established an interministerial committee on energy headed by the Prime Minister, which has been meeting regularly and following the situation closely. In cooperation with the Bank, the authorities are also identifying critical projects and additional measures in the electricity sector for which they could seek additional assistance from the donor community.

In the area of structural reforms, the privatization advisor for the Savings Bank started work on January 8. The authorities have received three offers for the second GSM license, two of which are for the amount of US$25 million. The government has also completed negotiations to grant a concession to a Turkish company to take over a number of copper mines and invest up to $US20 million.

Statement by Riccardo Faini, Executive Director for Albania
January 26, 2001

Macroeconomic performance

Macroeconomic performance has remained strong over the second half of 2000, with GDP growth somewhat stronger than projected and fiscal accounts broadly in line with the program. The 2001 budget calls for increased investments, in order to improve the country's infrastructure, and for increased expenditures for health and education. It is also noteworthy that the government agreed to limit the planned increase in public sector wages and pensions to 8 percent, while at the same time continuing to reduce the number of public employees. As a result, notwithstanding the wage increase, the budget wage bill is set to decline by 0.1 percentage points of GDP.

Most importantly, significant improvement was achieved in tax collection. After falling repeatedly short of program targets, tax revenues recorded a robust pick-up that over a 12 month period led to a 28 percent increase in November. Basically, the authorities' efforts in this area, which were strongly urged by Executive Directors during past Board meetings, are beginning to pay off. In their action, the authorities are benefiting from the help of continuing technical assistance from the Fund and other external donors. An increased emphasis on combating smuggling, corruption, and tax evasion determined a boost in tax collection in the absence of any increase in tax rates. Tax rates remained in fact unchanged or were reduced in some cases. The closing figures for tax directorate and customs revenues for 2000 should confirm the ongoing trend, recording a remarkable increase of 2.5 percentage points of GDP for the year. Nevertheless, as stated in Box 1 of the staff report, further progress in this area is key to reduce the country's reliance on large fiscal deficits and improve fiscal sustainability.

Some concerning signs have emerged with regard to inflation. The latest figures for CPI, obtained for the period after the mission was in Tirana, show that inflation, which had been consistently low over the program period despite vigorous economic growth, jumped significantly in December, slightly exceeding 4 percent. It is still premature to say with certainty what the origins for this increase were, as the staff and the authorities are still looking carefully into possible causes. The information they have given us points to an unusually strong seasonal increase in the price of vegetables, that was partly reversed during January. Perhaps the ongoing energy crisis also played a role, but no evidence exists at the moment. However, the Bank of Albania is closely monitoring the situation, with a view to keeping inflation within the targeted range of 2 to 4 percent.

Developments in the financial sector

The Bank of Albania has been cautiously easing monetary conditions. This policy has accompanied the ongoing changes in the financial market, which needs to be further developed. Other participants – both banks and nonbanks – have substantially increased their participation in the Treasury bill primary market, allowing for more competition on the demand side at auctions, which are still dominated by the Savings Bank. The participation of new investors in the T bill market is likely to continue, in light also of the persistently strong private remittances that, as domestic political and financial stability consolidates, will be increasingly re-directed toward investment opportunities at home. A well developed financial market is also instrumental to the central bank's strategy to continue in the shift to indirect monetary policy tools.

As acknowledged in the staff report, progress in privatizing the Savings Bank has been slower than envisaged under the program. As a result, the authorities are seeking a waiver of performance criteria. The task of privatizing the Savings Bank, with its widespread branch network and strong position in the market, is proving more difficult than originally projected. However, the commitment of the authorities remains unchanged. I would also like to point out that, after meeting the prior actions set for the present review, and when further measures stipulated in the program will have been taken, the bank will be more attractive to potential private investors.

Structural reforms and other issues

With regard to structural reform, I would start by noting that two of the three Performance Criteria for which a waiver is being sought were enacted shortly after the deadline.

Much progress was achieved in the area of privatization, with an extremely satisfactory deal being reached on the sale of the mobile telephone company, while the privatization process for the sale of the fixed line company is off to a good start. In the mobile telecommunications area there is ground for further positive developments, as other companies seem keen to acquire new licenses. The authorities have also proceeded expeditiously with their privatization plans in the sector of medium-size enterprises.

As mentioned in the staff report, a strong effort is ongoing, thanks also to technical assistance from the Fund, to improve the quality and coverage of economic statistics. However, the authorities are mindful that other initiatives need to be completed, in particular the process of land registration and the reform of social security.

Common to several other countries in Eastern Europe, Albania has been experiencing an electricity shortage over the past months. The problem has become increasingly recurrent, to the point that staff is now concerned that the shortage could be a threat to economic growth. Some improvement in electricity supply has been registered over the past few weeks, but this could be short-lived, resulting simply from favorable weather conditions. Unfortunately, the situation is not likely to benefit from a structural improvement any time soon. Decades of negligence in the management of the electricity sector, together with a widespread aversion among the population to paying electricity bills, have left the national company KESH unequipped to deal with the requirements of a modern economy and in need of profound restructuring. Both the generation and distribution sectors will have to be substantially improved. A stronger effort will be needed to collect payments, as outstanding arrears are still substantial and undermine the company's financial position. The government is aware of the importance of this challenge, and many initiatives are being taken to restructure the electricity sector in collaboration with the World Bank and several other external donors. Meanwhile, more funds have been allocated for imports of energy and measures to reduce electricity consumption are being taken by the government.

The staff report in its introduction rightly draws attention to the smooth conduct of local elections, held last October, and their implication for the country's political stability. Whereas much remains to be done in Albania to enhance the rule of law, internal security, and an environment conducive to business, it is important to point out that the Organization for Security and Cooperation in Europe recognized that the electoral process was fair.

Conclusion

Once again, on behalf of the authorities, I would like to stress the commitment to the implementation of the program. Albania has had a long-standing and fruitful relationship with the Fund and intends to maintain its solid track record.