

**Albania: Report on Observance of Standards and Codes—Fiscal Transparency**

This Report on the Observance of Standards and Codes on Fiscal Transparency for the **United States** was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on **June 25, 2003**. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of **Albania** or the Executive Board of the IMF.

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ALBANIA

**Report on the Observance of Standards and Codes (ROSC)  
Fiscal Transparency Module**

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June 25, 2003

**EXECUTIVE SUMMARY**

This report provides an assessment of fiscal transparency practices in Albania in relation to the requirements of the IMF *Code of Good Practices on Fiscal Transparency* based on discussions with the authorities and other organizations, the authorities' response to the IMF fiscal transparency questionnaire, and other sources of information. The IMF *Manual on Fiscal Transparency* (<http://www.imf.org/external/np/fad/trans/manual/>) should be consulted for further explanation of the terms and concepts discussed in this report.

Albania has made much progress in recent years in improving fiscal transparency and meets the standards of the fiscal transparency code in several areas. Progress has been particularly noteworthy in establishing clarity of responsibilities among different branches of government, coordinating budget and extrabudgetary activities, and publishing fiscal data in a timely way. Government accounting is relatively strong, final accounts are disclosed in a timely manner, and there is a well-established practice of external auditing of government activity.

Major improvements are required in the transparency and enforcement of tax laws and instructions to reduce discretion and corruption. There is an urgent need to review tax laws and instructions to make them consistent and eliminate provisions that are not well defined and thus subject to interpretation and discretion. Also, the government should make tax laws and instructions more widely available to taxpayers in a user-friendly way, and improve internal controls in tax and customs administration.

Substantial improvements are also necessary in budget preparation and the quality of budget documents. The appropriation structure of the annual budget should be expanded to cover object/economic classifications. There is a case for starting the budget process earlier, in part to allow more time for public and parliamentary debate, and to enable the government to prepare a budget with greater depth and breadth. The drafting of the Medium-Term Expenditure Framework should be fully integrated into the preparation process for the annual budget.

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## ABBREVIATIONS AND ACRONYMS

CFAA	Country Financial Accountability Assessment
GDC	General Directorate of Customs
EBRD	European Bank for Reconstruction and Development
FIAS	Foreign Investment Advisory Services
GFS86	1986 Government Finance Statistics Manual
GFS01	2001 Government Finance Statistics Manual
GDDS	General Data Dissemination System
GTD	General Taxation Department
IFC	International Finance Corporation
KESH	Korporata Elektroenergjitike Shqiptare
MoE	Ministry of Economy
MoF	Ministry of Finance
MTEF	Medium-Term Expenditure Framework
PRGF	Poverty Reduction and Growth Facility
NSSED	National Strategy for Socio-Economic Development
ROSC	Reports on the Observance of Standards and Codes
SOEs	State-owned Enterprises
SSAI	State Supreme Audit Institution
UNCTAD	United Nations Conference for Trade and Development
VAT	Value Added Tax

## I. INTRODUCTION<sup>1</sup>

1. This draft report provides an assessment of fiscal transparency practices in Albania against the requirements of the IMF Code of Good Practices on Fiscal Transparency. The assessment has two parts. The first part is a description of practice, prepared by the IMF staff on the basis of discussions with the authorities and their responses to the fiscal transparency questionnaire, and drawing on other available information. The second part is an IMF staff commentary on fiscal transparency in Albania.

## II. DESCRIPTION OF PRACTICES

### A. Clarity of Roles and Responsibilities

2. **General government is defined as in the Government Finance Statistics (GFS) Manual.** The definition of general government is in line with international standards (GFS86 and GFS01), encompassing the central government,<sup>2</sup> local governments,<sup>3</sup> and extrabudgetary funds.<sup>4</sup> Annual budget documents comprise central government revenue and expenditure, including transfers to local governments and extrabudgetary funds. Own revenue and associated expenditures of local governments and extrabudgetary funds are also included in the annual budget documents, but reflect only estimates which may differ from the subsequently approved budgets of the respective authorities. The authorities intend to adopt the methodology of the GFS01 for fiscal data compilation in the medium-term.

3. **Government activities are clearly distinguished from those of nonfinancial state-owned enterprises (SOEs) with the exception of some sectors.** Commercial activities of most nonfinancial SOEs are generally well distinguished from those of the government. However, SOEs hold monopolies in the electricity and water sectors and provide implicit and untargeted subsidies to households and enterprises (paragraph 20). Nonfinancial SOEs in the telecommunications, and transport sector (e.g., railways) undertake noncommercial activities for the government.

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<sup>1</sup> Discussions on fiscal transparency were held in Tirana during February 20-March 4, 2003. The staff team, comprising Ms. Simard and Messrs. Sarraf and Taube (all FAD), was supported by the IMF Resident Representative, Mr. Olters, and met with Finance Minister Kastriot Islami, and other officials from the Ministry of Finance, the Ministry of Economy, the Social Security Institute, the Supreme Audit Institution, the Prime Minister's Public Administration Department, the Ministry of Energy, and state-owned enterprises in the energy sector. It also met with the Ombudsman and representatives of the parliamentary Economy, Finance, and Privatization Committee, donors, NGOs, and research institutes.

<sup>2</sup> In the 2003 budget these include the Presidency, Parliament, the Council of Ministers, the State Supreme Audit Institution, the Ombudsman, 16 ministries, and 30 other government agencies, including judiciary institutions, tax and customs departments, Institute of Statistics, and other independent spending agencies.

<sup>3</sup> In the 2003 budget these include 12 regional authorities, 65 urban municipalities, and 309 rural communes.

<sup>4</sup> In the 2003 budget these comprise the Social Security Fund and the Health Fund.

4. **Privatization procedures are generally well defined, but differ on a case-by-case basis for strategic enterprises, and they are not always widely disseminated to the public.** Guidelines for privatization procedures are detailed in various laws, decisions, and instructions.<sup>5</sup> Privatization parameters vary for each strategic enterprise and they are defined by law on a case-by-case basis, with a minimum six-month period between the publication of the law and the start of the privatization. Guidelines for the use of the privatization proceeds are generally straightforward, but not always widely disseminated to the public. Privatization proceeds are recorded in the budget as domestic financing and a share of these proceeds is earmarked for expenditure linked to privatization activities. While a 5 percent share is allocated to the National Agency for Privatization to cover costs for its own operations, a 20 percent share<sup>6</sup> accrues to a development fund for the restructuring of SOEs. The fund is managed by the Ministry of the Economy (MoE) and, since 1999, included in the budget as part of this ministry's allocation.

5. **The central bank is independent and does not carry out quasi-fiscal activities.** The role of the central bank is well defined and distinguished from government responsibilities in the Central Bank Law.<sup>7</sup> The Bank of Albania is the banker of the government, acts as its fiscal agent, organizes Treasury bill auctions, and maintains the single Treasury account for the government. Rules and regulations on the supervision and management of the central bank are well specified and do not allow the government to formally influence monetary policy for fiscal purposes.

6. **Albania has a reasonably well-developed and clear legislative and regulatory framework for economic activity, but enforcement needs to be improved. Corruption is perceived as a problem, including by businesses.** The legal and regulatory framework is well established in nonfinancial sectors, and there exists a law to fight corruption. However, the enforcement of laws requires improvement through strengthening of institutional capacity and reducing corruption and tax evasion.<sup>8</sup> Investment procedures are overly complex, lack clarity and transparency, and are perceived to be unfriendly to investors. Bureaucratic delays, discretionary and arbitrary treatment, and high costs, including frequent "unofficial

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<sup>5</sup> Law no. 8834 on the privatization of commercial companies in non strategic sectors, 24.09.98; Decision no. 416 on Law no. 8834, 30.09.98 (not included in the official gazette); Instruction for the Implementation of Decision no. 416, 09.07.98 (not included in the official gazette); Act no. 192 on capital value assessment criteria; Law No. 8306 on the privatization strategy of primary importance sectors.

<sup>6</sup> This share applies for non-strategic enterprises; it varies on a case-by-case basis for strategic enterprises.

<sup>7</sup> Law No. 8269, dated December 23, 1997. Information on the central bank can be found on its website [www.bankofalbania.org](http://www.bankofalbania.org).

<sup>8</sup> According to findings in the following report "Legal Assessment of Corruption in Albania", Institute for Contemporary Studies, February 2001.

payments,” are prevalent in tax and customs administration and in the process of providing building permits. These areas were examined by a recent World Bank study.<sup>9</sup>

7. **Government equity holdings have declined, but remain significant, and they are not well reported publicly.** While considerable progress in privatization has been made over the past 10 years, the government still has significant equity holdings, especially in strategic sectors (electricity, water, and telecommunications). The government currently holds equity in 131 enterprises, including 21 in which its share is below 50 percent. Data on government equity holdings and SOE financial operations were published a few years ago for the period 1996–98, and a report with data for the period 1999–01 is being prepared for publication.

8. **The allocation of responsibilities between the central and local governments, and their fiscal relations, are legally well defined.** The June 2000 Law on Organization and Functioning of Local Governments has defined the “exclusive responsibilities” of the regional authorities, the urban municipalities, and the rural communes; these entities enjoy fiscal autonomy in carrying out their exclusive responsibilities. This law also has clear provisions on the transfer of responsibilities from the central to local governments, on the determination of central/local “shared responsibilities,” and on delegated functions. Together with its implementation guidelines and the 2003 budget, the law contains sufficiently detailed and comprehensive legal provisions and formulae on revenue sharing arrangements, and on the determination of conditional and unconditional transfers from the central to local governments. The government is implementing its decentralization policy in a phased manner, based on sectoral policy statements and the absorption capacity of local governments.<sup>10</sup> Stringent borrowing requirements are in place for local governments through the Organic Budget Law;<sup>11</sup> local governments can only borrow from the central government.

9. **Roles of the executive, legislative, and judicial branches are for the most part clearly defined.** The role of the executive branch in conducting fiscal policy is clearly defined in both the Constitution and the Organic Budget Law, but the legislative branch has relatively little time to examine and approve the annual budget.<sup>12</sup> Although the constitution states the separate and balancing powers of the legislative, executive, and judicial branches of government (Article 7 of the Constitution), the independence of the judiciary is limited as one representative of the executive branch is a member of the High Council of Justice which can remove judges from office based on motives of professional insufficiency (Article 147,

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<sup>9</sup> Albania: Removing Administrative Barriers to Investment, Aide-Mémoire of Foreign Investment Advisory Service (FIAS) mission, World Bank, December 20, 2002.

<sup>10</sup> For example, water supply and sewerage management is at an advanced stage of transfer from central to local governments; and in the 2003 budget several activities of pre-university education and primary health care services have been delegated to local governments.

<sup>11</sup> Law No. 8379 of July 29, 1998.

<sup>12</sup> The Council of Ministers has up to November 20 to submit to parliament the budget for the following year (Article 22 of the Organic Budget Law).

op.cit.). A legislative committee oversees the conduct of fiscal policy, but is limited in doing so by institutional capacity constraints.

10. **The legal and administrative framework for fiscal management has improved significantly through the Organic Budget Law, but needs to be strengthened in a few areas.** The Organic Budget Law has comprehensive but not always adequate provisions for budget preparation, approval, and execution, as well as for government borrowing and debt, budget accounting, inspection, auditing, violations, and penalties. Remaining shortcomings relate to the budget calendar, the appropriation structure, and the insufficient coverage and lack of detail in annual budget documents. These issues are discussed in detail in Section B.

11. **Mechanisms for the coordination and management of the budget and extrabudgetary funds are well defined with the exception of donor-financed activities.** There are two extrabudgetary funds which represent jointly about 20 percent of general government expenditure.<sup>13</sup> The deficit in these funds is covered by transfers from the government budget. Until recently, the management of foreign-financed government activities has suffered from the absence of a legal framework, with the result that spending agencies using foreign funds have not reported regularly to the MoF.<sup>14</sup> A new instruction has established clear guidelines, seeking to remedy this situation and allowing a better separation of foreign grants and loans in the budget and fiscal reports (paragraph 35).<sup>15</sup>

12. **The financial sector is dominated by one state-owned bank, which impairs competition.** The banking sector continues to be dominated by the Savings Bank which is 100 percent state-owned. While this bank remains constrained in its lending operations, it holds a large share of household deposits and Treasury bills. Its activities therefore can impair competition and have an impact on interest rates. In the insurance sector, the government is soon going to sell 40 percent of equity of the largest state-owned company (INSIG) to the International Finance Corporation (IFC) and the European Bank for Reconstruction and Development (EBRD), thus starting the pre-privatization process.

13. **While tax legislation and regulations are mostly clear, some provisions are not properly defined, which fosters discretionary practices. Furthermore, legislative provisions are not always observed.** Box 1 provides examples substantiating the assessment. Tax and customs officials face conflicting objectives between complying with the law and meeting revenue targets, which were, until this year, not perceived to be based

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<sup>13</sup> The social insurance fund is covered by Law No. 7703 on social insurance in the Republic of Albania, dated 11.05.93 and amendments covered by laws up to Law No. 8889, dated 25.04.02. The health insurance fund is covered by Law No. 7870, dated 13.10.94, and Law No. 8961, dated 24.10.02.

<sup>14</sup> These expenditures accounted for 10 percent of total government spending and 2.8 percent of GDP in 2002.

<sup>15</sup> Instruction No. 8, dated 17.02.03 on the Evidence, Registering, Spending and Reporting of Foreign Financing Within the Frame of Projects and Agreements with Foreign Donors.



### Box 1. Examples of Nontransparent Tax Procedures

The determination of dutiable import values by the customs administration is a good example of improperly defined provisions in Albanian tax laws, in this case the Customs Code, and illegal practices that foster a chain reaction of discretionary behavior by customs and tax officials. The Customs Code specifies conditions under which the price actually paid for goods when sold for export to Albania's customs territory is not recognized as a valid base for customs tariff and other tax valuation ("conditions or considerations for which a customs value may not be determined with respect to the goods being valued" (Article 34.1.b)). Under such circumstances, customs officials may determine the dutiable import value by using alternative valuation methods. Although customs authorities are forbidden to use reference prices (minimum values) to determine the dutiable base (Article 36 f), they are reportedly not complying with this provision (Albania: Removing Administrative Barriers to Investment, FIAS Aide-Mémoire, December 20, 2002). At the same time, officials from the General Taxation Department (GTD) invoke the illegitimacy of reference prices to determine the dutiable base for the VAT on imported inputs, and refuse a full refund of VAT paid on these inputs assessed on the basis of reference prices. VAT is refunded based on the GTD's assessment of the actual import value of inputs.

A second example of an improperly defined tax provision that might lead to a discretionary interpretation of the VAT law is to include in the dutiable base for the VAT on imports expenses incurred in delivering the goods to the first destination after importation (Article 26 (4a)). Such expenses are usually not included in the VAT assessment, as their determination leaves room for interpretation.

A third example is the VAT treatment of the construction sector. The leasing of land and buildings is exempt from the VAT (Article 20), but inputs for construction projects are not. As a result, under the law no VAT paid on construction inputs would be reimbursed. To circumvent this problem, operators in the construction sector have concluded an arrangement with the tax authorities which is supported by Section 6.1 of the Instruction to the Value Added Tax Law. This stipulates that the VAT paid on construction inputs can be claimed back against the VAT owed on work in progress, the value of which is defined as "the taxable value above which the VAT will be calculated at the amount of 20 percent." This provision is open to interpretation, in particular when companies do not declare the value of their projects by themselves and the determination of the value is left to tax inspectors.

Although SOEs are required by law to pay taxes as other enterprises, at least one such company (Albpetrol) has tax arrears without being subject to the usual recovery procedures applied to other taxpayers.

Finally, with high barriers to entry for using the tax appeals process (an appellant is required to pay 100 percent of the tax liability prior to the appeal), provisions are nontransparent as there is conflicting information about whether it is legitimate or not for the tax authorities to accept "frozen" bank account deposits as a payment of liability before initiating an appeal.<sup>1</sup>

<sup>1</sup>References: Law No. 9880, dated 12.12.02, on some changes in Law No. 8560, dated 22.12.02 "On Tax Procedures in the Republic of Albania", Instruction No. 2, dated 13.04.00 for Tax Procedures; Customs Code of the Republic of Albania; Law No. 8979 dated 12.12.02 on some additions and changes in Law No. 8438 dated 28.12.98 "on Income Tax" with relevant amendments, instruction for income tax; Law No. 7928, dated 27.04.95 "Value Added Tax", Instruction on Value Added Tax, Law No. 8714, 15.12.00, on some supplements and amendments to the VAT law, Decision No. 49, dated 26.01.01, for the deferral scheme of VAT payment and definition of the exporters that benefit the reimbursement of VAT within 30 days, Law No. 8845, dated 11.12.01 on some additions and amendments to the VAT law; Law No. 8978 dated 12.12.02 on local small business tax, Law No. 8982 on the system of local taxes; Instruction No. 2 dated 05.02.01 for small business tax.

on realistic forecasts. Inadequate compliance with procedures in the General Directorate of Customs (GDC) and General Taxation Department (GTD) is facilitated by a lack of internal controls. Efforts are under way by the GTD to improve public accessibility to tax laws and instructions.<sup>16</sup> Following one or more steps of internal appeals, taxpayers can challenge government decisions related to taxation by eventually appealing to the courts. However, judicial decisions on tax appeals are not published.

14. **An advanced legal and procedural framework is in place for the civil service and other public sector staff, but the civil service code is not adequately observed at local government level.** The November 1999 Law on the Status of Civil Servant contains comprehensive provisions for establishing professionalism, independence, integrity, and political neutrality, and duties and rights of the civil servants. Rules on hiring, promoting, suspending, and dismissing staff are also transparent and well defined. However, the law applies only to about 3,000 central government and 5,000 local government civil servants. Moreover, no formal mechanism exists to ensure the full implementation of this law by local governments. Many staff of the central government and public agencies, such as teachers and health staff, are not covered by this law as they have their own codes of conduct.

## **B. Public Availability of Information**

15. **The budget documents cover all general government fiscal activities, but with insufficient detail.** The budget is approved on the basis of summary tables with spending agencies' total recurrent, and separately, total investment expenditure. Although tables with data on functional classification as well as a program and broad object/economic classifications are provided to parliamentarians for their information, these are not approved by parliament and thus not legally binding (paragraph 23). Similarly, investment projects are not listed in the budget individually with detailed allocations for each spending agency.<sup>17</sup> During budget execution, fiscal data with detailed economic and program classifications are not published, but available from the MoF's Treasury and Debt Department. The 2003 budget provided a better assessment of the revenue impact of new policy measures than previous budgets. However, there is still room for improvement; the 2003 budget, for example, did not include a proper estimation of the impact of the reduction in social insurance contribution rates. Revenue data are generally presented in the budget documents only in aggregate form (paragraph 35).

16. **Defense expenditures are comprehensively recorded in the budget document.** All of these expenditures are appropriated under the Ministry of Defense, and they are subject to the same accounting and auditing rules as other spending.

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<sup>16</sup> Tax laws and instructions are generally published in the official gazette. In addition, a few months ago the GTD established an office of tax information to improve the public's access to information, including pamphlets. A pamphlet on the VAT is ready and one on excise taxes is under preparation.

<sup>17</sup> The budget is published in the government gazette and on the MoF's website (<http://www.minfin.gov.al/>).

17. **The budget documents disclose the main fiscal aggregates for one year prior to the budget and forecasts of some variables for the two years following the budget year.** The draft budget is generally finalized by the government in November, and it includes estimates for the previous fiscal year and the main fiscal aggregates for the current year based on the nine-month outturn. For some indicators data expressed as a share of GDP are also presented in the budget documents.<sup>18</sup> The final and audited outturn for the earlier years is not provided, which deprives the public of the opportunity to assess performance relative to previous budgets. The budget documents contain references to the Medium-Term Expenditure Framework (MTEF), including forecasts of key budget aggregates for the two years following the budget year. These, however, may not be relevant any more at the time the annual budget is finalized as the MTEF is prepared by the MoF prior to the annual budget.

18. **Only limited information on contingent liabilities is included in the budget documents.** The annual budget documents include a maximum amount allowed for the issuance of new guarantees for external borrowing by SOEs in the course of the budget year. The MoF has not issued guarantees to SOEs on borrowing from domestic financial institutions in recent years, but no formal procedures are in place to govern the issuance of such guarantees. Other important contingent liabilities, such as the costs of future pension liabilities or privatizations, are not reflected in the budget documents. Moreover, none of the MTEF documents published in Albania over the past few years has addressed the issue of contingent liabilities. Information on future debt service obligations, including those related to guaranteed debt, is readily available from the MoF's Treasury and Debt Department upon request.

19. **Tax expenditures are generally not presented to parliament or published, but the customs department has estimated of the costs of exemptions from customs duties. A full assessment of the costs of explicit and implicit tax exemptions and concessions is not available, but the GDC has undertaken an analysis of revenue foregone from customs exemptions. The costs of tax relief measures are thus not rigorously accounted for and not subject to scrutiny by parliament and the public, limiting transparency and accountability.**

20. **Quasi-fiscal activities in the electricity and water sectors have declined in recent years, but are still sizable. Analysis of these activities in the electricity sector is available, but not included in the budget documents.** As indicated above, SOEs continue to hold monopolies in the electricity and water sectors. In addition to explicit budgetary subsidies, they provide sizable implicit and untargeted subsidies to households and enterprises. These are primarily provided through tariffs that are below cost recovery and the accumulation of payment arrears of users, which in turn trigger tax arrears of energy companies. However, over the past 2–3 years these quasi-fiscal activities have been reduced primarily through increases in electricity and water tariffs. For KESH, an action plan agreed with the World Bank is in place, aiming at restructuring, privatization, and annual tariff increases. This should result in a further reduction in quasi-fiscal activities over the next few years. Also, efforts are underway to clear the substantial amount of government-enterprise

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<sup>18</sup> These are supported by background tables with selected fiscal data for five years preceding the budget year.

and inter-enterprise payment arrears, a large share of which is associated with KESH and the water companies. While offsetting of arrears does not appear to be prevalent, the existence of inter-enterprise arrears and tax arrears offers scope for such nontransparent and economically inefficient practices. The government has undertaken an analysis of quasi-fiscal activities in the electricity sector, but this has so far not been documented in budget documents.

21. **Aggregate data on gross government debt is published, while information on its financial assets is not publicly available.** The MoF's Department of Treasury and Debt uses the UNCTAD debt management system and has the capacity to provide detailed debt stock and financing flow data. However, only aggregate debt data are included in the government's quarterly bulletin on fiscal statistics.<sup>19</sup> A presentation of debt according to maturity is not available. This is of particular concern considering the size of the debt stock (64 percent of GDP at end-2002, more than half of which was domestic debt) and debt service expenditure (12 percent of total government spending in 2002). A draft law on the government's strategy for resolving external debt arrears has been submitted to parliament, but is not yet included in the parliament's agenda.

22. **Quarterly fiscal data are published in a timely manner, and intentions for more frequent and website disclosure of budget execution reports exist.** In addition to submitting final annual accounts to parliament (paragraph 34), the MoF publishes a quarterly bulletin on fiscal statistics in a timely manner (5–8 weeks after the end of the quarter) with relatively detailed monthly data for the general government. An advance release calendar for the publication of the quarterly bulletins is published. The MoF intends to begin publishing this bulletin on its website by September 2003 at the latest, and start reporting fiscal data to the public on a monthly basis.

### C. Open Budget Preparation, Execution, and Reporting

23. **The annual budget presentation and the budget documentation and classification do not fully meet international standards.** The budget process follows a regular timetable, which however starts too late as the budget circular is generally issued only in July. Also, the budget calendar leaves parliament and the general public only one month to analyze and debate the draft budget, which is considered insufficient by parliamentary representatives and others. The executive branch may transfer up to 10 percent of the approved budget of any spending agency to another with approval from the Council of Ministers, but without consulting parliament. The central government budget appropriation structure is unduly limited. The budget includes a GFS86-based functional classification at the main category levels, as well as a broad object/economic classification. Also, a program classification is presented, but without noting program objectives and their operational context. None of these classifications has appropriation significance (paragraph 15) and budget allocations can be changed during the budget execution within spending agencies' total allocations. A more detailed object/economic classification is used for monitoring

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<sup>19</sup> Republic of Albania Ministry of Finance, Fiscal Statistics of Government, Quarterly. Published information includes the level of debt reported at quarterly intervals, the breakdown of government debt between securities, loans and deposits, and a presentation of debt by domestic and foreign creditors.

budget execution and accounting. Since the appropriation structure is very aggregated, the final accounts follow the same pattern. Following parliamentary approval, the budget summary tables are gazetted, but supporting documents and tables on the budget as presented to parliament are not subsequently published.

24. **The overall balance of general government is the main indicator of the fiscal position in the budget; it is monitored on a monthly basis.** The general government balance is currently the main fiscal indicator used in the budget and monitored on a monthly basis during budget execution. The primary balance, the domestic balance, and the public debt stock are other key indicators that are tracked with the same frequency. Subnational government activity is growing as a share of government expenditure (6 percent of total spending in 2002) due to decentralization. Detailed revenue and expenditure data for local governments are available to the MoF on a monthly basis, and these data are published in summary form in the MoF's quarterly bulletin on fiscal statistics.

25. **Progress in revenue forecasts has been made in the 2003 budget, but disclosure of projections of macroeconomic indicators and revenue is limited.** Forecasts of selected macroeconomic indicators such as the rates of growth of GDP and inflation are presented in the budget document, but not in sufficient detail and without adequate explanations. Macroeconomic forecasts for budgetary purposes are mainly prepared by the Macroeconomic Department of the MoF and discussed by an ad-hoc committee involving representatives of the Ministry of Finance, the Ministry of Economy, the Institute of Statistics, and the central bank. Prior to the 2003 budget, revenue projections seem to have been influenced to a large degree by normative considerations such as deficit and revenue targets. As a result, their reliability was often limited, undermining the credibility of the budget with line ministries, the parliament, and the general public. Revenue forecasts are prepared by an ad-hoc committee comprising the Secretary General, Deputy Ministers, Directors, and Cabinet Advisers of the MoF. Also, the MoF is in the process of establishing a tax revenue forecasting unit. The revenue forecasts in the 2003 budget have improved in quality and realism, but there is further room for strengthening revenue projections, which are also not explained in sufficient detail in the budget documents.

26. **A general statement on medium-term fiscal policy objectives is included in the budget documents,** but this is not accompanied by indicative quantitative medium-term fiscal targets.<sup>20</sup> Also, medium-term fiscal policies are discussed in the MTEF, but this is not formally approved by parliament. The budget documents contain neither a discussion nor estimates of fiscal sustainability, which is a key exercise considering the level of debt and vulnerabilities of the fiscal framework to changes in macroeconomic indicators.

27. **Estimates of new policy initiatives and ongoing operations are not well distinguished in budget documents.** The costs of new recurrent activities, if any, are not well separated in all cases from ongoing operations. While changes to the wage bill and energy subsidies were relatively well documented in the 2003 budget, a number of other new

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<sup>20</sup> This is perhaps explained by the uncertainty that resulted from the need to revise revenue projections for 2002 and 2003.

policy initiatives and measures were presented without a clear statement on their quantitative budgetary impact. Less costly new initiatives are integrated and budgeted within the existing expenditure programs. On the investment budget, estimates of new projects can, in principle, be well distinguished from ongoing projects. However, since investment projects are not individually presented in the budget documents, this distinction cannot be demonstrated. Details on the investment budget are presented to parliament, but not provided in the budget documents. In the absence of formal guidelines and procedures, the budget documents do not explain how projects are prioritized in the investment budget, and they do not include an assessment of recurrent cost implications of new investment projects.

28. **Analysis of sensitivity of the budget estimates to changes in economic variables is limited and not published, while main fiscal risks are not discussed in the budget documents.** Although inflation is projected as a range, the budget documents do not provide a sensitivity analysis of the impact of changes in the inflation rates to fiscal indicators. The 2003 budget contains some discussion of exchange rate risks, and it appears to be based on a cautious exchange rate assumption as the upper bound of a range is used for calculating debt service payments. The budget documents generally do not contain a thorough discussion of fiscal risks, including contingent liabilities.

29. **Objectives of major policies are announced, but actual progress is not reported against these objectives.** The explanatory section of the budget documents presented to parliament discusses a number of policy objectives for broad functions, mainly in the context of sectoral policies. Progress on achieving these objectives is, however, not reported in the final accounts. Moreover, the program classifications that are introduced for information in the budget documents do not have any statements on the programs' objectives, and, therefore, no reports can be prepared on their performance.

30. **Internal audit is not yet well developed, but recent legal changes offer an opportunity to strengthen it. The internal controls function is very weak.** The February 2003 law on The Internal Audit of the Public Sector provides improved regulations governing the work of internal audit units in all Ministries, seeking to improve internal audit which currently focuses mainly on the compliance function. The new law also specifies that the Internal Audit Directorate in the MoF, in addition to undertaking ex-post audits of all agencies and departments associated with this ministry, is entrusted with the task of providing technical assistance and issuing guidelines to internal audit units in other ministries. The internal controls function is generally weak in central government agencies.<sup>21</sup>

31. **The treasury accounting system is capable of producing complete and detailed monthly reports on general government activities.** A cash-based accounting system of revenue and expenditure, introduced by the Treasury and Debt Department of the MoF in all spending agencies of the central and local governments, is producing detailed and reconciled monthly reports through its 36 district offices and the central treasury office.<sup>22</sup> These reports

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<sup>21</sup> This confirms the finding of the World Bank's Country Financial Accountability Assessment (CFAA), 2002.

<sup>22</sup> Transactions of extrabudgetary funds are reported to the MoF separately; they are not part of the treasury.

(continued... )

are based on budget classifications, and also constitute the basis for the government final accounts submitted to parliament and the State Supreme Audit Institution (SSAI). In parallel, a substantially modified accrual accounting and reporting system exists in spending agencies, which aims at the preparation of annual balance sheets of each spending agency. Individual balance sheets are later compiled by the MoF to prepare the total balance sheet of the government. These annual reports are not submitted to the MoF in a timely manner, thus preventing the MoF from a timely compilation of the government balance sheet. These accounts seem to have a limited usage within the government and the general public. The government intends to integrate the two parallel accounting and reporting systems, but recognizes that this could be a costly process.

32. **Formally, the tax and customs administrations are given adequate legal protection from political interference, but this protection is undermined by improperly defined tax provisions.** The laws state that the tax and customs administrations shall exercise their duties independently from other central and local government bodies<sup>23</sup> and that other government bodies are prohibited from interfering in its functions. The General Director of Taxation is appointed and discharged by the Prime Minister upon proposal from the Minister of Finance.<sup>24</sup> The Minister of Finance appoints four of the seven members of the Tax Appeals Commission, including one from the MoF.<sup>25</sup> This commission has the authority to review, among other tax appeals, cases of improper conduct by tax officials, and decide on their outcome by open vote.<sup>26</sup> Similar rules apply to the customs administration. However, a number of improperly defined provisions in tax laws and instructions allow political interference into the operations of the tax and customs administrations (see Box 1).

33. **The legislature generally reviews budget execution around mid-year as part of the revised budget presentation, but legally the government is not required to present a formal mid-year review to parliament.** Each year since 1999, the government has presented a revised budget to parliament in the middle of the year and provided the legislature in this context with a review of budget execution through mid-year. The quarterly statistical bulletin also provides detailed data on a regular basis to the public, allowing parliamentarians and others to monitor budget execution. However, according to the Organic Budget Law, the government is only required to present a formal mid-year review of budget execution to the Council of Ministers, but not to parliament.

34. **Audited final accounts are available in a timely manner.** The MoF prepares final accounts by the MoF relatively soon after the end of the fiscal year and the SSAI starts analyzing these accounts early. As a result, audited final accounts also become available

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<sup>23</sup> Law No. 8560, For tax procedures in the Republic of Albania, dated 22.12.98, Article 23.1.

<sup>24</sup> Article 7 of Law No. 8560 and Article 14 of the Customs Code.

<sup>25</sup> The other three members are nominated from the business community by the Chamber of Commerce.

<sup>26</sup> Instruction No. 2, For tax procedures, dated 22.12.99, Section 1.3.

timely, i.e., nine or ten months after the end of the fiscal year. For example, the preparation of the 2001 final audited accounts was completed in September and published in October 2002. The audited final accounts are disseminated widely through hard copy publication and the SSAI's website.<sup>27</sup>

#### **D. Assurances of Integrity**

35. **Budget data are mostly reliable, but the variance between budget and actual outturn of main fiscal aggregates is not well analyzed, and there is no distinction between foreign grants and loans.** Although the overall balance target is approved by parliament as an upper limit,<sup>28</sup> it is not a meaningful and reliable variable for two reasons. First, due to the lack of distinction between foreign grants and loans, all foreign grants are included in foreign financing. As a result, the overall balance as measured from below the line can deteriorate due to higher-than-expected foreign grants. Second, since the target is defined on a cash basis, it can be achieved by accumulating payment arrears, although this does not appear to have been the case in recent years. While monitoring of budget execution during the fiscal year appears adequate (paragraphs 24 and 37), the analysis of the variance between annual budget projections and actual outturns for several years back is not undertaken systematically and regularly. Prior to the 2003 budget, revenue projections have tended to be too optimistic and the estimation of the revenue impact of new tax measures has been inadequate, thereby limiting the reliability of revenue data (paragraph 15). However, significant progress in these areas has been achieved in the preparation of the 2003 budget.

36. **Accounting policy statements are included in the final accounts, but not in the budget documents.** Because it is generally known that the final accounts are cash-based, no statement of accounting policy is included in the budget documents. The practice of a parallel modified accruals accounting system is well documented and reflected in the balance sheet reports of individual spending agencies and the government's annual balance sheet report.

37. **The process of accounts reconciliation and fiscal reporting is mostly effective.** As noted in paragraph 31, accounts reconciliation and reporting of budget execution by the treasury system is well established, but not always timely. Monthly reconciled reports are available within 20 days after the end of each month, and final annual accounts are compiled four months after the end of the fiscal year. Debt stock and financing flow data are available on a monthly basis, but they are not easily reconcilable.

38. **External audit is independent from the executive.** The independence of external audit from the executive is well established through the 1997 Law on the State Supreme Audit Institution. The chairman of the external audit institution reports directly to parliament, which appoints him or her upon proposal from the President of the Republic for a term of seven years, with the possibility of reappointment. The chairman enjoys the same immunity as a high court member, and has full access to information. In addition to auditing

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<sup>27</sup> <http://members.albaniaonline.net/klsh>.

<sup>28</sup> Organic Budget Law, Article 20.2.



government final accounts, the external audit institution has a detailed annual audit program of central government agencies, extrabudgetary funds, and SOEs. The external audit institution is well equipped and staffed. Quarterly reports on its routine auditing functions are published in hard copy and on the institution's website. However, there is no independent external audit of local governments reporting to their legislature.

39. **The legislature follows up on external audit reports.** The auditing reports are submitted to the Economy, Finance, and Privatization Committee and the Legal Committee of parliament. These committees debate the reports and call the chairman of the SSAI and relevant government officials to testify on the reports and findings of the SSAI. Further legal actions is referred to the judiciary, if necessary. The audit reports are also discussed in parliament.

40. **External scrutiny of macroeconomic and fiscal projections is permitted, but limited reflecting the absence of published assumptions and methodology as well as institutional capacity constraints outside the government.** There is currently little independent review of macroeconomic and fiscal forecasts, not even at the parliamentary level. This primarily reflects the absence of published assumptions and methodology, but is also due to capacity constraints of parliament as well as local research institutes and others. However, recently both parliament and local NGOs have intensified their monitoring and scrutiny of the government's economic and fiscal policies, which should also result in more intensive debate by the general public.<sup>29</sup>

41. **The national statistics office is an independent institution.** At present, the Institute of Statistics operates on the basis of a 1993 law, but a new draft law has been approved by the Council of Ministers and is being submitted to parliament. There are no political pressures or influence in the Institute's operations. Moreover, the draft law reconfirms the independence of the statistical office in accordance with EU standards. Fiscal data is provided to the Institute by the MoF. In addition to hard copy publications, the institute's major statistics are accessible through its website.<sup>30</sup> Albania is a participant in the IMF's General Data Dissemination System (GDDS) and the government continues to improve its national statistical systems, using the GDDS as guidance.

### III. IMF STAFF COMMENTARY

42. **Albania has made much progress in recent years in improving fiscal transparency and meets the standards of the fiscal transparency code in several areas.** Responsibilities among different branches of government are clearly defined, and government operations are generally well distinguished from activities of the central bank, and, in most cases, public financial institutions and SOEs. The mechanisms for the coordination of budget and extrabudgetary activities are well defined. Budget accounting is

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<sup>29</sup> In 2002, one local NGO published a "Citizen's Guide to the Budget" in Albanian and English in hard copy and on its website ([www.alb-ppfi.org](http://www.alb-ppfi.org)).

<sup>30</sup> <http://www.instat.gov.al>.

relatively strong. Final accounts are disclosed in a timely way, and there is a well-established practice of external auditing of government activities. The Organic Budget Law is of commendable quality in many aspects, but should be strengthened to improve the process of budget preparation and the coverage and depth of budget documents, as outlined in greater detail below. Substantial progress has also been made in recent years in budget monitoring and reporting. The government publishes timely fiscal data on the general government in commendable detail in a quarterly statistical bulletin, and intends to improve this reporting further through website disclosure and monthly statistical bulletins.

43. **However, shortcomings exist in the transparency of tax laws and instructions, and in budget preparation and the quality of budget documents.** Although tax laws are generally well drafted, a number of them contain specific provisions that are ambiguous and inconsistent with those of other laws. This allows discretion and fosters corruption. Taxpayers are not sufficiently informed about tax laws and instructions, in particular those that change frequently (e.g., import regulations). On budget preparation, a key problem is the inadequate level of detail in the budget appropriation structure which provides the executive with too much discretionary power. Also, the budget preparation process is relatively short, leaving insufficient time for parliament and the general public to analyze the draft budget. Coverage and depth of budget documents are limited in various aspects, including macroeconomic context, fiscal policy objectives, fiscal sustainability analysis, and the coverage of quasi-fiscal activities. Finally, the preparation of the MTEF is not well integrated with that of the annual budget.

44. **The following recommendations relating to the transparency of tax legislation and procedures are of high priority:**

- The government should review tax laws and supporting instructions to ensure consistency between them and eliminate improperly defined provisions that are subject to interpretation and discretion.
- Audit and control procedures in the General Taxation Department and the General Directory of Customs should be strengthened.
- Tax revenue forecasts should be prepared on a tax-by-tax basis and by using statutory tax rates and realistic estimates of tax bases.
- The government should include instructions on tax procedures in pamphlets distributed to taxpayers, and ensure their wide dissemination.
- All tax laws and instructions should be published timely and widely, including on websites.
- Tax appeals procedures should be strengthened and barriers of entry for appellants should be lowered.

- Taxpayers' access to information should be improved by publishing, while preserving taxpayer anonymity, the decisions of the tax appeals commission and judicial rulings on tax matters.
- The authorities should prepare and publish a tax expenditure analysis, demonstrating to parliament and the general public the costs of providing tax concessions.

**45. On budget preparation and quality, the staff suggests to give high priority to the implementation of the following recommendations:**

- The appropriation structure in the budget document should be expanded as soon as possible to cover object/economic classifications of recurrent expenditure programs and investment projects.
- Following the introduction of the expanded budget appropriation structure, any transfer exceeding 10 percent from one expenditure item within a recurrent program or investment project and from one program to another, as well as from one investment project to another, should be submitted for approval to parliament.
- The current practice of allowing transfers in the appropriation of one spending agency to another by up to 10 percent of the total with consent of the Council of Ministers but without approval of parliament should be reformed. No such transfers should be allowed without parliamentary approval.
- Foreign grants should be separated from foreign loans in the presentation of the budget and in fiscal reports, with foreign grants being shown together with revenue above the line and foreign loans, as is the case now, below the line. Progress on separating foreign grants and loans will require intensive follow-up by the authorities on the implementation of the recently issued instruction on the reporting of foreign grant and loan financed projects (paragraph 11).
- To allow more time for budget preparation at the administrative stage, the budget process should start significantly earlier in the year (e.g., April) than is now the case.
- To provide more opportunity for public scrutiny and parliamentary debate, the draft budget should be submitted to parliament earlier than mid-November as is currently the case. The government could also consider discussing key budget parameters at an early stage with the parliamentary Economy, Finance, and Privatization Committee.
- The preparation of the MTEF should be better integrated into the annual budget cycle, and the discussion of medium-term perspectives and projections should be incorporated into the annual budget. This would give parliament the opportunity to discuss the MTEF, while ensuring consistency between medium-term and annual projections.
- The budget documents should provide more macroeconomic context, a fuller analysis of fiscal objectives and policies, a fiscal sustainability analysis, and more detailed

estimates of contingent liabilities and quasi-fiscal activities in the electricity and water sectors.

- The government should present to parliament a mid-year budget review, which should also be published, including on the MoF's website.

46. **Other recommendations:**

- The government should publish a summary report on its equity holdings and the financial operations of SOEs at least once per year.
- The authorities should develop formal guidelines and procedures for evaluating and prioritizing projects included in the investment budget.
- As local government activities are set to expand further, it would be useful to consider a more detailed reporting on these activities in the government's statistical bulletin on fiscal data.
- External audit of local government operations should be undertaken by the Supreme Audit Institution and results should be reported to local government councils.