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Albania: 2002 Article IV Consultation and First Review under the Three-Year Arrangement under the Poverty Reduction and Growth Facility, and Requests for Modification and Waiver of Performance Criterion—Staff Report; Staff Statement; Public Information Notice and Press Release on the Executive Board Discussion; and Statement by the Executive Director for Albania

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2002 Article IV consultation with Albania, First Review under the Poverty Reduction Growth Facility and Requests for Modification and Waiver of Performance Criterion, the following documents have been released and are included in this package:

- a staff report for the combined 2002 Article IV consultation, first review under the three-year arrangement under the Poverty Reduction and Growth Facility, and requests for modification and waiver of performance criterion, prepared by a staff team of the IMF, following discussions that ended on **October 25, 2002**, 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 9, 2003**. 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 **February 26, 2003**, updating information on recent economic developments.

- a Public Information Notice (PIN) and a Press Release summarizing the **views of the Executive Board as expressed during the February 26, 2003 discussion** of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.

- a statement by the Executive Director for Albania.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Albania*
Memorandum of Economic and Financial Policies by the authorities of Albania*
Technical Memorandum of Understanding*
Selected Issues Paper and Statistical Appendix

*May also be included in the Staff Report

The policy of publication of staff reports and other documents 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.

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ALBANIA

Staff Report for the 2002 Article IV Consultation, First Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, and Requests for Modification and Waiver of Performance Criterion

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

Approved by Carlo Cottarelli and G. Russell Kincaid

January 9, 2003

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I. Introduction

1. Discussions for the 2002 Article IV consultation, a financing assurances review, and the first review under the Poverty Reduction and Growth Facility (PRGF) arrangement were held in Tirana during October 10–25, 2002.[1]

2. The last Article IV Consultation was concluded on July 13, 2001, and the PRGF arrangement (SDR 28 million—57 percent of quota), consistent with the authorities' November 2001 National Strategy for Socio-Economic Development (NSSED)[2] (HTTP://www.imf.org; and JSA, HTTP://www.imf.org), was approved on June 21, 2002. In the attached Letter of Intent and the supplementary Memorandum on Economic and Financial Policies (MEFP), the Albanian authorities request completion of the first review and a waiver for the nonobservance of a structural performance criterion. Albania's economic program is also supported by the World Bank through several sectoral lending programs and a Poverty Reduction Support Credit (PRSC) approved in June 2002. In October, the European Union invited Albania to start negotiations on a Stabilization and Association Agreement (SAA).

3. Protracted political skirmishes have affected policy implementation and the investment climate. However, the government formed in July 2002—the third since the June 2001 elections, and led by former prime minister Nano—was based on a broad agreement within the ruling socialist party. A new president was also elected by consensus in June. Nonetheless, policy-making remains politicized and governance weak, posing serious risks to the pace of reform.

4. Major deficiencies in macroeconomic data hamper policy formulation and evaluation, and were emphasized in the context of the Article IV discussions. But reporting has been adequate for program monitoring and surveillance. Albania participates in the GDDS, and a ROSC on data dissemination was prepared in June 2000. A fiscal ROSC is scheduled for early 2003. The July 2002 safeguards assessment noted that, in general, adequate safeguards were in place to manage Fund resources, including Fund disbursements.[3]

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[1] The staff team consisted of Messrs. Samiei (head), Martijn, and Ms. Vladkova-Hollar (all EU1), Ms. Ongley (PDR), and Mr. Davoodi (FAD), and was assisted by the resident representative, Mr. Olters. Mr. Cottarelli, EU1 Immediate Office reviewer for Albania, participated in Article IV discussions. The mission met with Prime Minister Nano, Finance Minister Islami, Bank of Albania Governor Cani, other ministries and officials, and representatives from the banking and business communities.

[2] Formerly, the Growth and Poverty Reduction Strategy.

[3] This notwithstanding, the assessment identified some improvements that the Bank of Albania (BoA) could make in the safeguards framework to enhance the integrity of its operations. BoA management has accepted the recommendations and expressed its

(continued...)

5. Albania maintains restrictions in accordance with Article XIV, in the form of outstanding debit balances on inoperative bilateral payments agreements, which were last reviewed in the 2002 Article XIV consultation.

II. Background

A. Growth and Poverty Reduction During Transition

6. **Sound financial policies and market reforms during most of the 1990s have fostered growth and macroeconomic stability.** Albania has progressed toward a market economy, with the development of a new legal system; the privatization of all small- and medium-sized enterprises, and of many larger entities; land reform; and trade liberalization. Progress has also been made on several indicators of governance (see tabulation), but much remains to be done. While the absence of national accounts and other data deficiencies preclude a fulsome analysis (Box 1), annual GDP growth is estimated to have fluctuated within a 5–10 percent range—except in 1997, when activity was disrupted by the pyramid scheme collapse.

Box 1. Data Issues

Albania's macroeconomic database falls short of international standards, although, with extensive technical assistance (see Appendix III), significant progress has been made. The May 2000 ROSC mission outlined the key remaining deficiencies. It is especially important to strengthen the coverage of source data to capture formal and informal economic activities. This box identifies relevant key data issues concerning macroeconomic statistics.

- **The first official GDP data (1998–2000) are expected to be published in early 2003.** These estimates are based on very limited source data and show large discrepancies between expenditure and production estimates (about 5 percent of GDP on average).
- **There are no reliable and comprehensive private sector activity and investment data.** A quarterly index of retail sales, based on tax records, has been compiled since 2001. However, the index might not offer a satisfactory estimate in the case of Albania, because its results vary with collection efforts. Other sectoral activity indicators (for example, electricity consumption, private sector telecommunications activity, and building permits) also suffer from large collection lags. In addition, structural improvements, while welcome, impede annual comparison.
- **Data on external private transactions are also deficient.** There are no official data on FDI or private external debt; tourism surveys require further refinement; and the methodology for estimating workers' remittances is highly deficient.
- **Central government budget** (except for foreign-financed projects) **and monetary statistics** are generally adequate.
- **While regular and timely data on consumer and producer price indexes are available, comprehensive data on wage statistics are lacking.**
- **Socio-demographic indicators are scarce.** However, the authorities are using the NSSED to develop a system of monitoring and evaluating progress against systematic poverty indicators.

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commitment to implementing the measures outlined in the report. Staff continues to monitor the status of implementation of these recommendations with the BoA.

Table. Albania: Indicators of Governance and Regional Comparators 1/

	Voice and Accountability		Political Stability		Government Effectiveness		Regulatory Quality		Rule of Law		Control of Corruption	
	1997/98	2000/01	1997/98	2000/01	1997/98	2000/01	1997/98	2000/01	1997/98	2000/01	1997/98	2000/01
Albania	48.3	53.5	14.3	25.6	21.9	20.3	21.2	35.3	15.8	27.4	8.4	32.7
Regional Averages 2/												
Eastern Europe	63.2	69.4	57.7	56.5	48.9	50.9	51.7	53.8	52.8	57.1	50.3	54.9
Former Soviet Union	31.8	31.3	36.3	30.5	18.6	20.5	16.2	14.5	28.5	25.9	17.4	21.1

Source: D. Kaufmann and A. Kraay, Growth Without Governance (2002); and World Bank Interactive Governance Webtool.
1/ Figures indicate percentages of countries worldwide that rate below the selected country for each governance indicator. Higher scores indicate a better governance outcome.
2/ Averages are simple arithmetic averages.

7. **Nonetheless, poverty remains pervasive,** with per capita income in 2001 in the order of US$1,200. A 1998 survey found that one in every two families was living on less than US$2 a day. Poverty is concentrated in rural areas, and compounded by inadequate basic social services, including health care, and utilities. It has motivated large-scale seasonal and permanent emigration, with the ensuing remittances providing an informal safety net. The authorities' NSSED seeks to address these problems.

8. **Moreover, growth has been unbalanced, and its sustainability is not ensured.** Growth has been supported by high external inflows (totaling about 20 percent of GDP since 1995) and, in part, reflected transitional catch up. It has been concentrated in the construction and services sectors. As external inflows taper off, growth increasingly needs to be supported by an expansion of tradables, in particular industry and mining. However, investment in these sectors is hindered by administrative barriers—reflecting general weaknesses in governance and law enforcement, and widespread corruption—resulting in a large underground economy.[5] Inadequate infrastructure exacerbates these constraints, in particular, the underdeveloped financial and transportation systems and severe power outages—as reliance on hydropower renders power supply prey to periodic droughts. In addition, emigration and low spending on education have limited the availability of qualified workers.

9. **In concluding the 2001 Article IV consultation, Executive Directors stressed the need to build on past achievements with further structural reforms and improvements in governance, in order to sustain rapid growth and alleviate poverty.** They also stressed the need to strengthen tax and customs administration and broaden the tax base to accommodate the required expansion in social expenditures, while keeping the public debt within prudent limits.

10. **Consistent with these recommendations, the authorities' economic strategy contains wide-ranging measures to improve the environment for private sector activity.** The approach, outlined in the NSSED, includes:

[5] See Selected Issues Papers.

- Legal and institutional reforms toward more transparent tax and licensing procedures, a functioning land market, and a more effective judicial system.

- Infrastructural improvements, through expanding the transportation network and reducing electricity shortages—by strengthening bill collection and aligning tariffs to costs to reduce excessive power use, while diversifying energy supply over the medium term.

- Increasing public spending on health and education by over 20 percent in real terms during 2002–04.

- Steps to strengthen the financial sector, by privatizing the large Savings Bank, facilitating the provision of credit, and introducing a new bankruptcy law.

11. **Within this framework, the PRGF arrangement supports efforts to ensure a sound macroeconomic environment—a key precondition for sustained growth.** Monetary policy aims at maintaining inflation within a 2–4 percent range, with intermediate targets for base money, and using indirect instruments within a floating exchange rate system. To promote fiscal and external sustainability, the overall deficit is to be lowered from 8½ percent of GDP in 2001 to 5¾ percent of GDP by 2005, thereby gradually reducing the public debt ratio. To reconcile increased poverty reduction and infrastructural spending with fiscal consolidation, and given the extensive fiscal evasion, ambitious goals were set for improving tax collection.

B. Recent Developments

12. **Economic growth during 2001 and 2002 appears to have fallen below the 7 percent estimated historical average, although it is hard to gauge the extent of the slowdown** (Table 1, Figures 1 and 2). Agricultural production was adversely affected by drought in 2001 and flooding in late 2002, while industrial production was hit by protracted electricity shortages. Moreover, political uncertainty and pressure on taxpayers have undermined private investment. In 2002, growth was also affected by delays in reform and privatization, and stagnant public investments. The slowdown is visible in a lower-than-expected expansion of tax revenues and, since mid-2001, patchy export performance.[6] But import growth has been strong.

13. **High foreign investments in 2001 and a surge in remittances late in that year have maintained robust import demand** (Table 2). Strong growth in capital good imports throughout the period has been accompanied by high imports of fuel and electricity

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[6] Measured exports of services (mostly tourism) also declined in the first half of 2002, following robust growth in 2001, although poor source data hamper meaningful analysis and year-to-year comparability.

generators in 2001Q4, and of consumption goods in early 2002. As a result, and notwithstanding fiscal restraint, the trade deficit widened in 2001 and the first half of 2002, while the hike in remittances at end-2001 contributed to a temporary improvement in the current account. The exchange rate has remained fairly stable, with a gradual depreciation during the first half of 2002 following the euro conversion-related appreciation in late 2001. Sustained inflows of official financing (and the depreciation of the dollar) contributed to a further increase in official reserves to about 5 months of imports of goods and services in December 2002.

14. **Tax collection shortfalls since end-2001 have likely reflected lower-than-expected GDP growth, delays in reform, and managerial changes, in the context of ambitious targets.** The overall shortfall is estimated at about ¾ percent of GDP in 2002—about half of the budgeted rise in the tax to GDP ratio. An October 2002 FAD tax and customs administration mission found that as the targets appeared unfeasible, attention had shifted from reform efforts toward excessive pressure on the relatively small base of regular taxpayers. A new "road tax", introduced in August 2002 to help finance additional road construction, provided only a small offset during its initial phase.

15. **The fiscal deficit has nevertheless remained well within the budgetary limits** (Tables 3 and 4). The overall deficit (excluding grants) declined to 8½ percent of GDP in 2001 and is estimated at 7½ percent in 2002. In both years, below-target receipts were more than offset by ad hoc spending cuts on operations and maintenance, and public investment. Combined with external debt forgiveness (Table 2), this has reduced total public debt to about 64 percent of GDP from about 72 percent at end-2000. The 2002 budget was amended in May to accommodate shortfalls in privatization receipts.

16. **Concerns about rising inflation prompted some tightening of monetary policy.** Supply constraints have triggered upward price pressures since mid-2001, with inflation peaking at 7 percent in early 2002. Fruit and vegetable prices, which accounted for most of the increase, have come down during 2002, and inflation—corrected for statistical changes—has fluctuated around 4 percent since May.[7] Core inflation has remained more subdued, at about 3 percent. The increase in the repo rate since mid-2001—from 6.5 percent to 8 percent—was also motivated by two upward jumps in currency in circulation (Table 5). First, at end-2001, euro area currency cash was converted into foreign currency deposits and domestic currency cash. Second, in March and April 2002, the BoA injected liquidity as about 8 percent of total bank deposits was withdrawn from the largest two banks, based on unfounded rumors of solvency problems.[8] Stability has since returned and deposits have

[7] The official figure, which includes a temporary upward bias during 2002 due to the gradual introduction of updated commodity weights, amounted to 4 percent in November.

[8] The rumors were triggered by political uncertainty and a misinterpretation of the debate in parliament on the deposit insurance law, against the background of the privatization of the Savings Bank and the 1997 pyramid scheme collapse.

been recovering gradually. Lek lending remains very limited, as banks mainly intermediate between lek deposits and treasury bills—with large spreads reflecting limited interbank competition in the depositor market. In addition, dollarization is still increasing, with foreign currency deposits rising to about 33 percent of total deposits, matched largely by banks' liquid foreign assets, notwithstanding rapid foreign currency credit growth (from a low base).

17. **While drought has been the main cause of the severe electricity shortages in recent years, slippage in sectoral reform since mid-2002 could prolong the crisis.** In consultation with the World Bank, the authorities have made significant progress in reforming the ailing energy sector, but a prolonged drought caused disruptive outages during the past two winters. Higher-than-planned electricity imports have put additional pressure on the budget and the electricity company's (KESH) limited financial resources. In recent months, inflows into the hydropower lake have picked up, but slippages since May 2002 in meeting targets for bill collection and losses have further worsened KESH's financial position, and pose a serious risk to continued donor support. The crucial process of installing meters—scheduled to be finalized by mid-2004—was also delayed over the summer as a consequence of KESH's liquidity problems.

18. **More generally, structural reforms have slowed since mid-2001, reflecting mainly repeated political changes.** These changes, together with the weakened global market, hindered the planned mid-2002 sale of the Savings Bank and Albtelekom. However, in the latter case, outstanding legal and financial disputes also played an important part. Structural reforms were accelerated ahead of the Bank and Fund Board meetings in June 2002, with the adoption of a new bankruptcy law, a deposit insurance scheme, and the privatization law for INSIG, the state-owned insurance company.

C. PRGF Arrangement Conditionality

19. **The overall weakening of policy implementation and coordination has also affected performance under the program.**

- **All end-September 2002 and continuous quantitative performance criteria were met,** but the indicative revenue targets were missed, as was the end-June indicative target for net credit to the government (MEFP, Table 1).

- **Several structural targets were missed, including the end-September 2002 performance criterion on parliamentary approval for the closure of duty-free shops** (Table 6). Of the structural benchmarks, selecting a buyer for the Savings Bank was not possible; the introduction of longer-term government securities was postponed to October due to legal problems; the recording of inter-enterprise arrears and preparations for a settlement were delayed from end-October to end-December 2002, as further technical assistance was needed; a World Bank-sponsored study of electricity tariffs was delayed to January 2003; and—some progress notwithstanding—the resolution of Albtelekom's legal and financial claims was not completed by end-September. On the positive side, the BoA successfully expanded its role in marketing treasury bills, after

Albapost proved unable to perform the task as required by a structural benchmark; the tax and customs departments continue to produce reports on the use of cash registers and the functioning of customs; and the Ministry of Finance (MoF) completed the second and third quarter reports on external arrears.

III. Report on the Discussions

A. The Authorities' Overall Policy Strategy

20. **The authorities and the mission concurred that recent experience with the reform strategy had not been fully satisfactory.** Reform has been seriously disrupted by: a) political and administrative changes during the past 18 months, which strained the—already limited—administrative capacity, and compounded coordination and communication problems across agencies; and b) reduced budgetary resources—delaying infrastructural improvements needed for sustained, private sector-led growth. This suggests that the strategy may require re-examination in some areas—in particular concerning fiscal policy. On the other hand, prudent budgetary management has preserved the overall deficit targets. Monetary and financial sector management has also responded well to price pressures and sectoral instability.

21. **Recent problems raise some questions concerning the strategy:**

- What is the extent of the recent slowdown and how reliable are estimates of GDP growth?
- Is the fiscal strategy well-founded? Initial revenue projections appear to have been overly optimistic; lower revenue projections could jeopardize poverty reduction goals and essential investment, thus requiring greater prioritization.
- Is the growth strategy supported by well-specified policies—in particular, to improve the business environment and promote higher growth in industry and mining? And is there a competitiveness problem, undermining longer-term external sustainability?

B. Real GDP Growth

22. **The absence of comprehensive activity indicators is a serious impediment to assessing trends in the Albanian economy and the authorities' strategy.** Staff emphasized that the database on economic activity—while comparable to many other PRGF countries—was in urgent need of further improvements, including through publishing the National Accounts.

23. **The authorities concurred with staff's assessment of slower growth in 2002.** The authorities and staff discussed extensively the available evidence to gauge recent trends. The authorities estimated a modest 2 percent expansion of agricultural production in 2002. Growth in other sectors was assessed on the basis of the new sales index (which excludes agriculture) for the first half of the year, supplemented by several sector-specified indicators

(including for electricity shortages). On that basis, real GDP growth was estimated to have eased to about 4¾ percent in 2002, from 6½ percent in 2001. Staff noted that using the new sales index based on tax records—although an advancement over previous methods—could introduce an upward bias reflecting more intensive collection efforts. On the other hand, the BoA's business confidence survey suggested more buoyancy, and the authorities felt growth could be somewhat higher than the agreed estimate.

C. Fiscal Policy

24. **The authorities' revenue strategy was revised to bolster the reform effort, while assuming smaller gains from collection improvements.** Staff argued that, in light of disappointing recent collection experience and evidence of increased harassment of taxpayers, more modest gains should be attributed to strengthening tax administration, and that supporting measures should be specified more clearly, based on the recommendations of the recent FAD mission. In particular, the collection of social security premiums—which had so far been underperforming—should be improved through strengthened coordination and—in consultation with Bank and Fund staff—gradual integration with the tax department. Collection improvements would complement the authorities' adjustments to the tax system—in particular the gradual introduction of more local taxes to promote decentralization, one of the authorities' policy priorities. Staff proposed lowering projected tax and customs revenues (including social insurance) from 24 percent of GDP in 2005 in the original strategy to 23 percent of GDP. The authorities fully endorsed the need for strengthened tax administration reform, which remains at the core of the fiscal strategy, as extensive evasion provides ample scope for raising collection over time (MEFP; ¶9–10). Indeed, they considered the revised revenue path to be unambitious and difficult to pass through parliament because of the implications for spending. They also expected that further modifications may well be warranted, as collection improves. Staff acknowledged this possibility, but, noting evidence of increased tax harassment, emphasized that collection efforts should be based on a fair application of the law. The authorities confirmed that—contrary to press reports—they were not considering a tax amnesty, in line with staff advice to avoid undermining tax compliance.

25. **Combining effective poverty alleviation with safeguarding fiscal sustainability will require improved expenditure prioritization and management.** The revenue path and the need for ongoing fiscal consolidation (see Section F) yield a relatively stable envelope for expenditure as a share of GDP—about 31 percent in 2003, rising to nearly 32 percent in 2005. Staff noted that medium-term budgetary planning had improved with the introduction of the NSSED and the medium-term expenditure framework (MTEF), but further improvements were needed, especially in relation to promoting policy coherence and coordination, and identifying policy priorities. The authorities' medium-term strategy aims to raise priority spending, while gradually eliminating subsidies for electricity imports.

- The authorities confirmed their key priorities, relating to health care, education, and infrastructure, while social protection transfers are to be rationalized. In this context, they were strengthening monitoring functions in line ministries to improve policy evaluation.

- They considered that further salary increases in the public sector are a key component of efforts to improve governance—for example, in the health and education sectors, to attract qualified staff. However, against the background of escalating wage demands following sizable increases in 2002 for top civil servants, staff underscored the need for wage control to preserve other priorities.

- The scope for local government spending will increase over time with the expansion of local taxes and transfers from the central level, although local governments will not be granted access to deficit financing. Staff emphasized combining this process with improved tracking and expenditure management capacity.

- The authorities also noted that, to qualify for NATO membership, defense spending should rise by about 1 percent of GDP by 2010 compressing the room for other items.

26. **In line with revisions to the overall fiscal strategy, the 2003 budget assumes lower tax and privatization receipts than projected in June 2002, and aims to reduce the overall deficit to 6½ percent of GDP.** Budgeted tax and customs receipts (including social security contributions) in 2003 are estimated at 21.4 percent of GDP, compared with 22.2 percent in June. Although the currently projected increase in the revenue ratio (relative to the estimated outcome in 2002) is unchanged from the June 2002 projected increase (relative to the 2002 budget), it is now underpinned by concrete measures. The budget also includes only very small privatization receipts (MEFP, ¶8). To cushion the impact on spending, domestic borrowing declines only slightly to 2¾ percent of GDP, and priority spending can increase if privatization receipts are higher (MEFP, ¶8). In this regard, the authorities are preparing contingency scenarios with unchanged deficit ceilings in the event of deviations from budgeted receipts. Staff would have preferred these contingency plans to be incorporated fully into the budget, but the authorities did not consider this feasible.

- Tax revenues are projected to rise about 0.9 percentage points of GDP relative to the estimated 2002 outcome, of which about 0.6 percentage points is based on tax policy measures, including the "road taxes", revisions to excise taxes, and new local and environmental taxes. Staff stressed that stepped-up improvements in tax and customs administration should substitute for untenable collection methods, in particular the excessive blocking of bank accounts (MEFP, ¶11).

- Spending will be reoriented further toward NSSED priorities. New salary increases will increase the wage bill by less than 2 percent in real terms—implying an increase in the wage bill in line with nominal GDP, given the raises granted in mid-2002 (MEFP, ¶12). Budgeted subsidies for electricity imports have been reduced. However, if water inflows, again, turn out much lower than expected, this scenario may have to be revisited.

- A comprehensive settlement of inter-enterprise arrears within the public sector is planned for 2003, coupled with new strategies for ensuring payments discipline in the future—developed with FAD assistance (MEFP, ¶14).

D. Monetary and Exchange Rate Policy

27. **Discussions on monetary policy focused on three issues:**

- The authorities continue to improve the operation of monetary policy. Since the switch to indirect tools of monetary management in 2000, interest-based policy instruments have been refined and the BoA has started research into the determinants of inflation—with MAE assistance. However, policy transmission is complicated by instability in money demand, dollarization, a monopolistic banking sector, and a very small credit channel. Accordingly, efforts to manage inflation directly are still supported by intermediate targets for NDA and NIR. The staff also recommended close monitoring of the ongoing dollarization.

- The authorities will continue to focus on keeping inflation within its 2–4 percent target range. Notwithstanding their relative success in maintaining price stability, however, the BoA expressed concern about the feasibility and desirability of controlling headline inflation, especially in the context of recurrent supply shocks and liberalizing administered prices. Staff concerned that, although simple targets could foster credibility monetary policy should, in principle, not respond to such temporary shocks, unless these trigger wider inflationary pressures.

- The authorities confirmed that their planned move to formal inflation targeting would not be feasible within the next few years. They also affirmed the continued suitability of the flexible exchange rate regime, with allowance for smoothing excessive fluctuations.

28. **The authorities stressed the need to tighten monetary policy further in case inflationary pressures resurface.** While staff attributed most price hikes since mid-2001 to temporary factors, it fully supported the current policy stance as well as the need for continued vigilance. It also praised the authorities' handling of the bank run in early 2002—through the immediate provision of liquidity and efforts to reassure deposit holders—and welcomed the improved monitoring system of deposits. Further strong efforts to educate the public will be essential for preventing a recurrence of such crises as steps are taken toward privatizing the Savings Bank and introducing the deposit insurance scheme.

29. **The 2003 monetary targets are predicated on the gradual but full reversal of the early 2002 deposit withdrawals.** Both base money and M2 are projected to grow slowly, with the continued return of depositors to banks, and consistent with unchanged credit to the government and little credit to the private sector in domestic currency. Dollarization would continue as the private banks—which focus on foreign currency services—expand their networks further. With smaller privatization inflows than foreseen in mid-2002, the target for growth in reserves is more modest, while still maintaining an import coverage of more than

4½ months. Staff underscored that, with further evidence on the composition of money demand, this scenario might have to be revisited during the course of the year.

E. Structural Reform to Promote Medium-Term Growth

30. **Comprehensive reforms are needed to promote private sector growth and exports,** and to provide rewarding employment for those currently working abroad or in the informal (including illegal) sector. Sustainable growth in the formal economy also requires building up the productive capacity in the tradables sector, in particular industry.

31. **Expanding the production of tradables is constrained more by a range of nonprice factors than by overvaluation of the exchange rate.** Discussions with business representatives pointed to factors such as inadequate infrastructure—especially severe electricity shortages—weaknesses in governance, improper tax collection, and inadequate consultation with business. Nonetheless, some of the causes of the real appreciation of the exchange rate (including large external inflows) may also have squeezed the tradable sector (Box 2 and Selected Issues Papers).

32. **In this context, staff stressed the need to address impediments to growth and private sector activity directly, rather than focus on establishing new agencies.** The authorities expressed confidence in the benefits from three planned agencies for promoting investment, exports, and small- and medium-sized firms (MEFP, ¶22). On the other hand, staff, in line with Bank advice, put more emphasis on basic deficiencies in the institutional environment. While new agencies could provide useful guidance to firms and feedback to policy makers, more direct efforts were needed for tackling these root problems. Staff supported the authorities' general inclination against introducing financial incentives that would undermine the tax system, invite rent seeking, and distort investment patterns. Accordingly, staff deplored the recent exemption for certain fuel imports from regular duties.

33. **Albania's trade regime remains relatively open with a rating of one out of ten on the IMF's trade restrictiveness index,** notwithstanding the imposition of a temporary 1 percentage point surcharge on all imports.[9] The authorities are moving quickly to finalize free trade agreements with seven (non-EU) Balkan countries under a June 2001 Memorandum of Understanding. They do not expect this to have a large net impact on the trade balance.

34. **The authorities are preparing revised strategies for the restructuring and marketing of Albtelekom and the Savings Bank.** The privatization of these dominant firms will be key to improving their services. In view of current market conditions, the authorities and foreign advisors have agreed to improve the functioning of the two firms and to settle

[9] The surcharge, introduced as part of the "road tax", adds to administrative complexity, but is intended to be temporary. Albania's combined average tariff is 8.7 percent.

Box 2: External Competitiveness

Albania has experienced a large REER appreciation since the onset of transition (Figure 1). The pace of appreciation has slowed in recent years, and a depreciation in 2002 has returned the REER to its January 2000 level. Nevertheless, the persistent trade deficit and weak export performance (Figure 2) (and the increasing contribution of private sector dissaving to the current account deficit) raise the question of whether Albania faces a competitiveness problem. Four likely causes of the appreciation can be identified:

Initial price liberalization: The CPI-based REER appreciated rapidly between mid-1992 and 1995, as the number of price-controlled items in the CPI basket decreased, reducing price distortions.

Balassa-Samuelson effect: The literature on REER movements in transition economies has generally upheld the relevance of this effect, which does not have adverse implications for the traded goods sector. Although private sector wage and productivity data for Albania are limited, the available evidence appears comparable to other transition economies.

Transfer effect: The spending of large financial inflows (including official assistance and private remittances), averaging about 20 percent of GDP over 1995–2001, has likely put upward pressure on the exchange rate, while also directly affecting the tradable sector. The impact on external sustainability depends on the degree to which the inflows are used to build up productive capacity for tradables. In Albania, official inflows have predominantly been used to build up productive capacity.

Fiscal and monetary policy mix: Stabilization policies following the pyramid scheme crisis boosted confidence in the currency and contributed to the nominal appreciation since 1997. Moreover, arguably, monetary policy was relatively more restrictive than fiscal policy during 1997–99, putting additional upward pressure on the exchange rate through currency substitution.

Given data limitations, it is difficult to disentangle these effects. In addition, and given these factors, the appreciation could be considered an equilibrium response to, in principle, beneficial developments, which nevertheless could have an impact the tradable sector. The relative importance for the tradable sector of the appreciation vis-à-vis non-price factors such as the political climate and business environment was assessed using econometric analysis. The results—although tentative, given data limitations—suggest that while the appreciation may have positively impacted imports, its effect on exports has likely been limited. This supports the assessment that export performance has likely been impaired by nonprice factors.

Figure 1: Albania: CPI-based REER

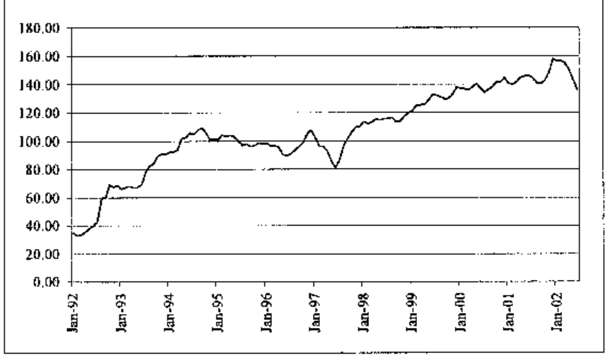
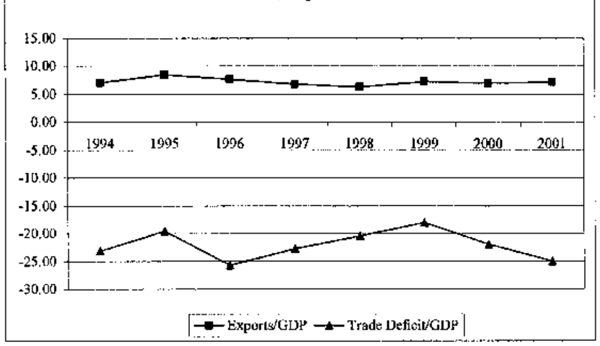


Figure 2: Albania, Trade Deficit and Exports, as a share of GDP, in percent



Albtelekom's legal and financial claims, before resuming privatization attempts. Given past abuse, the Savings Bank will not be allowed to extend credit to private borrowers before its privatization, except with the prior approval of the BoA and Bank and Fund staff (MEFP, ¶19).

35. **Staff underscored the urgency of well-coordinated efforts to get the electricity reforms back on track.** The authorities emphasized that on a cumulative basis over the first eight months of 2002, the targets for reducing losses and improving bill collection had been met. However, staff noted the unsatisfactory deterioration in performance during the third quarter. Although recent rainfall has expanded the scope for domestic production, the outlook for the 2003 winter is uncertain as the electricity company's liquidity problems limit the scope for imports. The authorities agreed to step up reforms in consultation with the World Bank, and the MoF agreed to monitor closely the company's financial performance (MEFP, ¶20). However, the authorities did not accept suggestions to accelerate planned price increases, to limit the subsidy need and create a cushion in case of further setbacks. They argued that further reform combined with scheduled price increases would allow meeting their commitment to phase out the subsidy for electricity imports by 2005.

36. **The authorities recognized the risks arising from financial fragility, but noted that, despite the rapid expansion of credit to the private sector, the overall soundness of banks had been maintained,** as the share of bad loans was low, profitability remained strong. Nonetheless, they recognized that one individual bank needed to strengthen its capitalization and that supervision needed further strengthening (MEFP, ¶17). In the context of the high degree of dollarization, an MAE mission has recommended additional scrutiny of foreign currency loans. While appreciating that the legal framework for fighting money laundering was being upgraded, staff emphasized the need for better implementation, which was hampered by a lack of skilled personnel. Staff strongly supported efforts to enhance competition as a means to improving service, monetary transmission, and reducing interest rate spreads—and thereby the government's borrowing costs (MEFP, ¶21).

F. Medium-Term Economic Outlook

37. **Assuming renewed reform efforts along the above lines, a modest recovery should be feasible, to 6 percent real growth during 2003–05**—compared with 7 percent in earlier projections. Staff underscored that such growth, in particular for tradables, hinged on the steadfast implementation of the authorities' program, as well as macroeconomic and political stability. The authorities insisted that reforms would indeed be accelerated with the recent improvement in the political climate.

38. **On that basis, programmed fiscal consolidation is consistent with fiscal and external sustainability.** Albania's public debt ratio is projected to decline marginally from 64 percent of GDP in 2002 to 63 percent by 2005, with the external component stabilizing at around 25–26 percent of GDP. Compared with the baseline presented in June 2002

(EBS/02/94), the debt ratio is somewhat higher at end-2002 and the path is flatter, largely as a result of the less optimistic growth outlook. Nevertheless, the broad findings of the sensitivity analysis undertaken in June remains valid, in particular, that, depending on the shock, the public debt ratio could be higher by 9–14 percentage points of GDP through 2005 before reverting to a declining path. The high grant element of Albania's foreign financing—projected to remain well above 50 percent, compared with more than 75 percent historically—will help contain debt service. Nonetheless, the outlook leaves no room for fiscal slippage. In this context, staff stressed the need to strengthen debt management, especially the capacity for evaluating foreign-financed infrastructure projects, and the domestic marketing of government debt instruments—in view of the considerable interest rate premium on treasury bills over bank deposits.

39. **External sustainability is also predicated on the planned actions to improve the climate for foreign investment and exports.** On this basis, the current account deficit should improve gradually to below 7 percent by 2005 and further through 2010. Import growth is expected to moderate with the more cautious fiscal path, while allowing for essential infrastructure investments. Following the weak performance in early 2002, the projections assume a modest recovery in tourism, exports, and nonprivatization related foreign investment. Net private sector savings are projected to remain stable, with a small increase over time in gross savings and investments, as the investment climate improves.

G. Data Issues

40. **The authorities will intensify their efforts to improve the statistical database.** Staff argued that the lack of activity indicators seriously hampered the assessment of tax collection, monetary policy, and the overall effectiveness of economic policies. Judging external sustainability is hindered by the lack of reliable balance of payments data. The authorities have made efforts to improve cooperation among agencies and increase available resources (MEFP, ¶6 and 23). Staff welcomed the planned publication of the first national accounts, but stressed the importance of improving data quality. The mission also encouraged the authorities to improve the monitoring of external public and publicly guaranteed debt through a consolidated reporting of external arrears, and further efforts to improve the timeliness and quality of recording of official transfers. It also urged the authorities to start collecting data on private external debt and foreign direct investment.

H. External Financing

41. **The 2003 program period is fully financed, but additional donor support will be needed in 2004–05** (Table 7). While donor support is expected to continue in 2003 and beyond, the financing situation has become more difficult due to weaker exports and delayed privatization receipts. The financing gap for 2003 will be met through Fund and World Bank support. Reserves are projected to remain at a comfortable level of around 4½ months of imports through the program period.

42. **Albania should be able to service its obligations to the Fund and other creditors** (Tables 8, 9 and 10). Albania has met its obligations to the Fund on time. External debt remains manageable, with debt service expected to rise moderately to 9 percent of exports by 2010. The current projections, and nonconcessional debt ceilings, allow for some decrease in the overall concessionality of donor flows, reflecting Stability Pact-related infrastructure investments. The debt ceilings increase modestly next year despite the underutilization to date, because sizable loans remain in the pipeline.

43. **The authorities have made good progress in regularizing arrears with official external creditors.** During 2001–02, rescheduling agreements were finalized with the remaining Paris Club creditors (Germany and Russia) and progress was made with non-Paris Club creditors (including Turkey and China (post-1978 arrears)). Other negotiations have been delayed while the government develops comprehensive criteria for future negotiations. The authorities plan to submit to parliament by mid-2003 rescheduling agreements relating to arrears already reconciled (MEFP, ¶25), covering the majority of outstanding debit balances under inoperative bilateral payments agreements.

44. **Efforts to regularize external arrears with private creditors need to be accelerated.** Albania's arrears to private creditors consist largely of pre-1991 trade credits to state-owned entities. Despite the authorities' good faith efforts to address these arrears, progress has been limited. The arrears to Greek companies were resolved in mid-2002 and the arrears to private creditors in FRYM and Hungary have been reconciled. Staff urged a more aggressive approach to regularizing these arrears. As all current and projected financing sources are official, and no new private financing is anticipated in the foreseeable future, these arrears should not undermine Albania's adjustment efforts.

I. Program Issues

45. **The authorities acknowledged the urgent need to improve performance in meeting program targets.** They explained that securing parliamentary approval for closing the duty-free shops required more time than anticipated. To limit the impact of the delay, they had taken measures in July to prevent the smuggling of alcohol and tobacco through these shops. In order to improve program implementation, consultations among ministries concerning the MEFP were more extensive than during previous missions. In addition, staff discussed program conditions directly with the line ministries involved, rather than through the MoF. Conditionality under the program has been prepared for the period up to June 2003. The third disbursement under the program is scheduled to take place upon observance of the end-March 2003 performance criteria and completion of the second review scheduled for July 2003 (Table 11 and MEFP, ¶27). Quantitative performance criteria are specified in Table 1 of the MEFP. The proposed structural conditionality focuses on measures critical to macroeconomic performance (Box 3 and MEFP, Table 2). All conditions have been set in close collaboration with the World Bank.

Box 3. Structural Conditionality

Coverage of Structural Conditionality in the Current Program
Structural conditionality for the second review under Albania's PRGF arrangement (MEFP, Table 2) has been streamlined further since the request for the arrangement (from 15 measures to 6), focusing on measures critical to the goals of the program, namely fiscal sustainability and private sector-led growth. Conditionality includes:

- A number of **tax and customs administration** measures that are collectively necessary to underpin the revenue projections, while reversing the rise in taxpayer harassment.

- Efforts to regularize **domestic inter-enterprise and external arrears,** essential to manage contingent fiscal liabilities, which could jeopardize fiscal sustainability and limit the scope for infrastructure investment.

- Actions to bring the **privatization** process back on track will help improve crucial business services and provide resources for future budgets. The World Bank and the IFC are providing technical support.

Status of Previous Structural Conditionality and Relevant Measures Not Included in the Current Program

Performance against structural conditionality for the first review of the PRGF arrangement has been mixed (see Sections C and I). The revenue administration benchmarks are complemented by a range of measures in the MEFP, that were excluded from conditionality in the interest of parsimony, although delays in implementing this wider reform program could undermine the fiscal strategy. Measures for addressing the ongoing energy crisis—a major impediment to growth—are now addressed fully through World Bank conditionality.

Structural Areas Covered by World Bank Lending and Conditionality

The Bank's relations are described in Appendix II. The Bank's Country Assistance Strategy for Albania for 2002-05 focuses on three priority areas: (i) governance and institution building; (ii) sustainable private sector development; and (iii) human development. For 2003, the Bank is planning a second PRSC, and several sectoral lending projects are ongoing. In consultation with the Bank, the authorities [recently adopted] a new two-year action plan for the electricity sector.

IV. Staff Appraisal

46. **Recent economic developments and the immediate growth outlook are less upbeat than in previous assessments,** reflecting political developments, unfavorable weather conditions, limited foreign interest in privatization projects, and uncertain prospects for foreign and domestic investment. The slowdown in growth poses risks to poverty reduction and the sustainability of the agreed fiscal strategy. Accordingly, swift policy responses are needed to improve the investment climate and safeguard the success of the authorities' policy strategy.

47. **The authorities are committed to speeding up reforms, improve coordination, and strengthen the strategy itself.** They have signaled their commitment directly and through the implementation of several prior actions. Furthermore, the strategy itself is being strengthened, to be presented in their revised strategy in the NSSED update in April. In this context, over the coming years, the PRSP process should be utilized to deepen political

consensus, improve prioritization, enhance policies on the basis of past experience, and to strengthen cooperation across departments and agencies.

48. **The authorities have revised their revenue strategy, in light of recent revenue performance and unsustainable collection methods.** The strategy remains focused on improving collection and increasing the tax base over the medium term. However, it is now based on more specific measures and projects a less ambitious path for collections, with increased reliance on tax policy measures. Nonetheless, the pace at which enhancements will be implemented and the resulting revenue gains remain hard to predict. In the staff's view, lower than projected receipts should not result in a relaxed fiscal stance, given the need to safeguard sustainability. Combined with the need to protect pro-poor spending, this consideration highlights the importance of improved prioritization of spending plans and of developing operational budgetary contingency plans. It also underscores the need for moderate average salary increases within the public sector.

49. **The planned fiscal consolidation should contribute to a sound macroeconomic environment.** However, domestic and overall public debt ratios decline only marginally between 2002 and 2005. Combined with the results of stress testing, this calls for strict fiscal discipline.

50. **The gradual strengthening of the monetary policy framework and continued prudent policies should also support stability.** The monetary authorities' strong commitment to maintaining price stability combined with an eclectic approach to monetary management, within the floating exchange rate regime, has served the country well. Low inflation and central bank independence and credibility should also foster both financial sector and exchange rate stability.

51. **Staff remains concerned about the adequacy of the authorities' efforts for reducing electricity shortages that undermine growth prospects.** Appropriate reforms have been formulated in consultation with foreign donors, including the World Bank, and it is essential that reform targets under the action plan be met. In this context, the recent improvement in hydrological conditions should not be allowed to slow reforms. Rather, efforts should be accelerated, including through swift installation of meters, disconnection of nonpayers, organizational improvements of the electricity company, and improved policy coordination—including with the MoF.

52. **More concerted efforts are needed to establish a business-friendly environment and a supportive financial system.** Efforts should focus on the removal of key obstacles to foreign and domestic investments, utilizing the feedback provided by the business community. In particular, relations with taxpayers should be improved without delay. On the other hand, demands for protection or special financial incentives should be resisted.

53. **Staff strongly supports efforts to strengthen domestic and foreign debt management.** Better marketing of domestic public debt instruments can help lower interest costs. In addition, the ex ante evaluation and coordination of foreign-financed infrastructural

projects should be improved with the aim of limiting and phasing overall debt service in line with payment capacity. Staff welcomes the more strategic approach to regularizing external arrears, but urges faster progress to possibly allow a move to Article VIII status by the time of the next Article IV consultation.

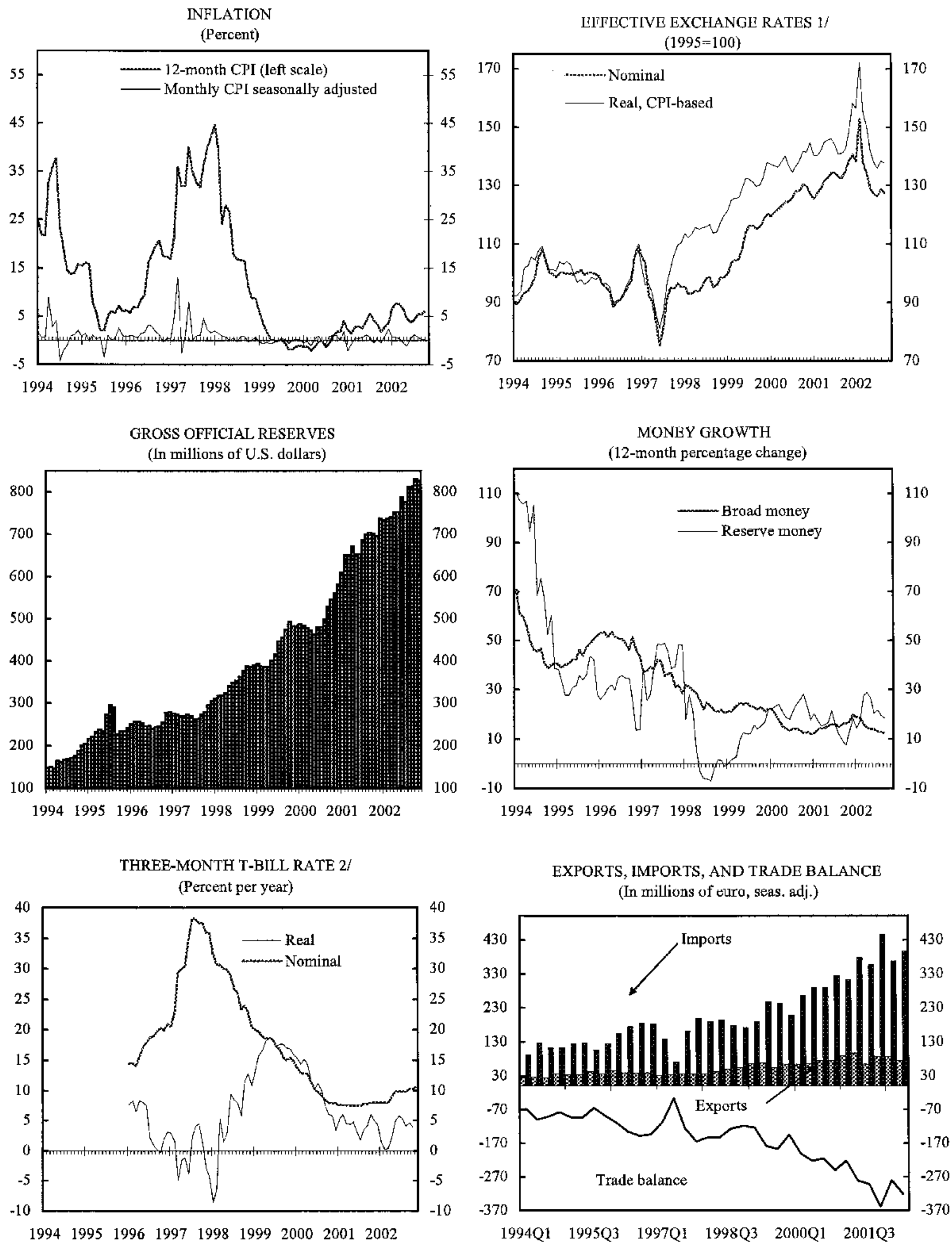
54. **The authorities urgently need to speed up progress in data gathering and compilation, as lack of economic data is a serious impediment to proper policy design.** The main challenge is to collect reliable source data on current activity. As data series are being improved and revised, it is all the more important to document and promptly disseminate any change in methodology or source data to all users.

55. **The execution of the authorities' strategy, and prospects for growth and poverty reduction remain subject to several risks,** in particular stemming from the prospects for political stability and the provision of electricity. Further uncertainty emanates from potential regional instability, and unpredictable financial sector and investor confidence. In addition, policy implementation is subject to severe limitations to institutional capacity. On the other hand, the strategy includes several features to limit vulnerabilities, including the provision of targeted assistance by foreign donors, efforts to strengthen governance, and increased emphasis on contingency plans and consensus-based policy formation. Generally, the authorities' ownership of the agreed policy program is strong, and its main goals are shared across the political spectrum. Regarding the 2003 budget, however, the government has faced difficulties in obtaining parliamentary support for the reduced revenue projections and the implied spending path.

56. **Staff supports the authorities' request for completing the first program review and the request for a waiver.** The supplementary MEFP provides a solid basis for economic policies, with emphasis on restoring growth and strengthening revenue performance. A waiver for the nonobservance of the structural performance criterion on parliamentary approval for the closure of duty-free shops is supported based on the authorities' actions in July to limit the impact of the delay and by their planned closure of these shops as a prior action for the completion of this review.

57. It is recommended that the next Article IV consultation with Albania be held on the 24-month cycle, subject to the provisions of the decision on consultation cycles approved on July 15, 2002.

Figure 1. Albania: Monthly Economic Indicators, 1994-2002

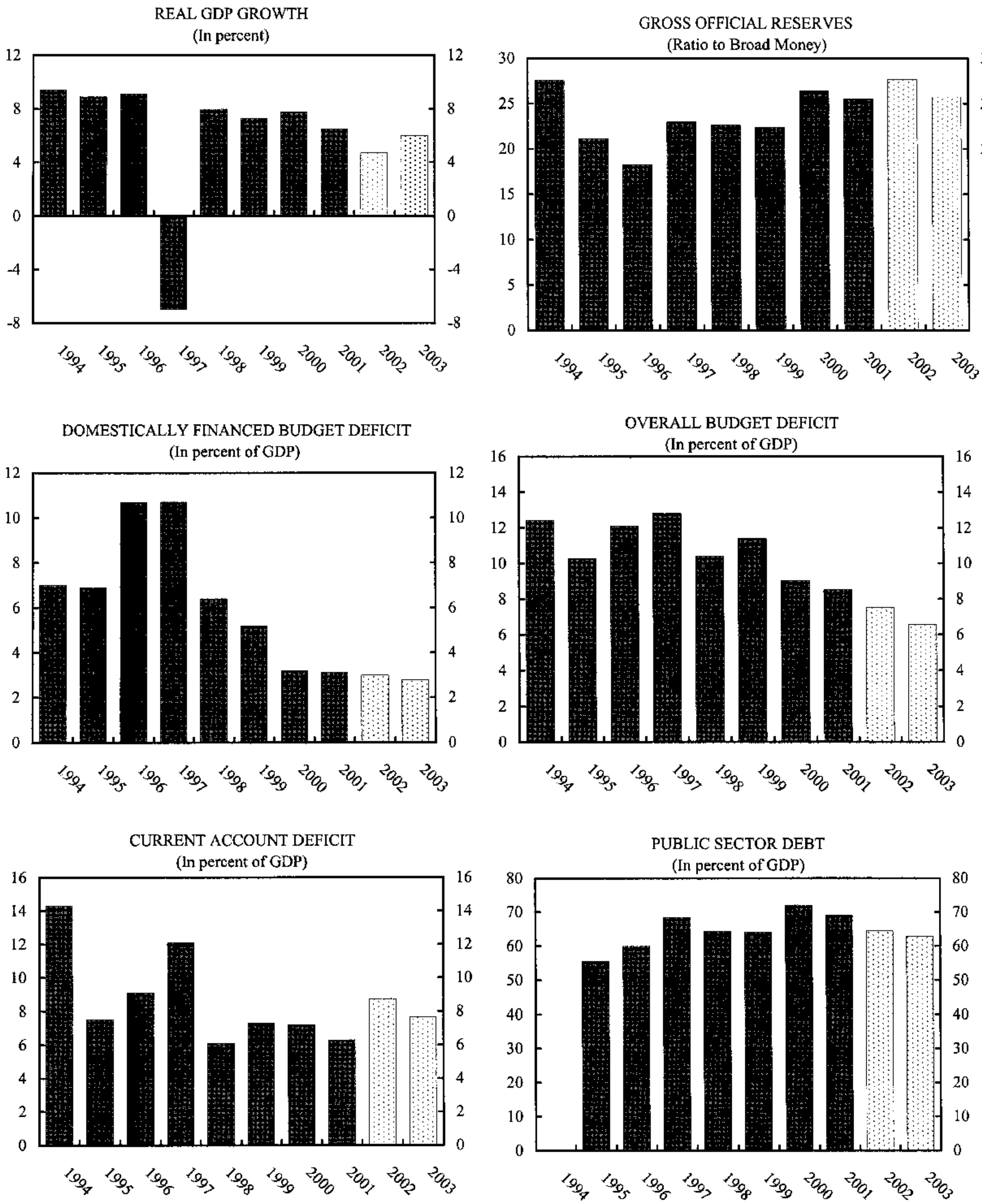


Sources: Bank of Albania, Ministry of Finance, INSTAT, and Fund staff estimates.

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

2/ The real rate using annualized seasonally adjusted CPI inflation.

Figure 2. Albania: Economic Developments and Prospects, 1994-2003 1/



Source: Albanian authorities and Fund staff estimates.

1/ Program projections for 2002 and 2003.

Table 1. Albania: Basic Indicators and Macroeconomic Framework, 1997-2005

	1997	1998	1999	2000	2001	2002		2003		2004	2005
						SR06/02	Proj.	SR06/02	Proj.	Proj.	Proj.
						(Percent change)					
Real GDP	-7.0	8.0	7.3	7.8	6.5	6.0	4.7	7.0	6.0	6.0	6.0
Retail prices (avg.)	32.1	20.9	0.4	0.0	3.1	5.3	5.6	3.0	3.0	3.0	3.0
Retail prices (end-period)	42.1	8.7	-1.0	4.2	3.5	3.9	3.0	3.0	3.0	3.0	3.0
						(In percent of GDP)					
Saving-investment balance 1/											
Foreign saving 2/	12.1	6.1	7.3	7.2	6.3	8.1	8.9	7.1	7.7	7.5	6.9
Domestic saving	3.9	9.9	9.5	11.4	13.1	12.7	10.1	15.4	11.8	14.0	14.6
Public 3/	-8.8	-5.2	-4.0	-2.6	-1.2	-0.4	-1.0	1.0	0.1	2.3	2.5
Private	12.7	15.1	13.5	14.2	14.3	13.0	11.1	14.4	11.7	11.7	12.1
Investment	16.0	16.0	16.8	18.6	19.4	20.8	19.0	22.5	19.5	21.5	21.5
Public	4.0	5.2	7.4	6.5	7.3	7.6	6.5	8.2	6.7	8.3	8.3
Private	12.0	10.8	9.4	12.1	12.1	13.2	12.5	14.3	12.8	13.2	13.2
Fiscal sector											
Revenues	16.7	20.3	21.3	22.4	23.0	24.2	23.5	25.0	24.4	25.3	26.0
Tax revenue	13.4	15.6	16.5	19.1	19.7	21.1	20.4	22.2	21.4	22.2	22.9
Of which: social security contributions	3.8	3.4	3.6	3.7	3.8	4.0	4.0	4.2	4.3	4.6	4.9
Expenditures	29.4	30.7	32.7	31.4	31.5	32.2	31.0	32.2	31.0	31.3	31.8
Primary	24.0	22.9	25.7	25.7	27.1	28.4	27.2	28.4	27.2	27.3	28.2
Interest 4/	5.5	7.8	7.0	5.7	4.3	3.8	3.7	3.8	3.8	4.0	3.6
Overall balance (excluding grants)	-12.8	-10.4	-11.4	-9.1	-8.5	-8.0	-7.5	-7.2	-6.6	-6.0	-5.8
Primary balance	-7.3	-2.6	-4.4	-3.4	-4.2	-4.2	-3.8	-3.4	-2.8	-2.0	-2.2
Primary balance (excl. foreign financed projects)	...	0.3	-1.0	-0.4	-1.0	0.2	-0.3	0.4	1.0	2.0	1.9
Domestic borrowing	10.7	6.4	5.2	3.2	3.1	3.0	3.0	-2.2	2.8	2.1	1.8
Privatization receipts	0.3	0.0	0.2	1.7	2.1	0.2	0.2	1.3	0.1	0.4	0.6
Foreign finance	1.8	4.0	6.1	4.3	3.3	4.9	4.4	-3.7	3.6	3.5	3.4
Public Debt	69.0	64.3	64.1	72.1	69.6	62.9	64.4	61.6	64.6	63.7	62.6
Domestic 5/	35.8	32.4	35.1	41.9	40.9	39.6	39.6	38.0	39.1	37.8	36.4
External (including publicly guaranteed) 6/	33.2	31.8	29.1	30.2	28.7	23.3	24.7	23.6	25.5	25.9	26.3
Monetary indicators											
Broad money growth (in percent)	28.5	20.7	22.3	12.0	19.9	6.0	7.6	9.3	8.9	8.9	8.9
Private credit growth (in percent)	19.0	14.7	29.4	26.9	43.1	28.8	33.0	29.3	26.5	...	...
Velocity	1.7	1.9	1.7	1.6	1.5	1.6	1.6	1.6	1.6	1.6	1.6
Interest rate (3-mth T-bills, end-period)	26.0	20.4	14.8	7.8	8.0	...	...	...	...	...	
						(In millions of U.S. dollars)					
External sector											
Trade balance 7/	-519	-621	-663	-821	-1027	-1072	-1096	-1116	-1129	-1208	-1276
(in percent of GDP)	-22.7	-20.4	-18.0	-21.9	-25.0	-23.4	-23.7	-22.3	-22.8	-22.3	-21.5
Current account balance	-276	-187	-270	-271	-260	-372	-410	-357	-381	-405	-409
(in percent of GDP)	-12.1	-6.1	-7.3	-7.2	-6.3	-8.1	-8.9	-7.1	-7.7	-7.5	-6.9
(in percent of GDP; incl. official transfers)	-8.7	-3.2	-3.4	-4.3	-3.3	-5.9	-6.4	-4.9	-5.3	-5.3	-5.0
Official transfers	77	89	139	111	125	104	115	109	119	117	114
(in percent of GDP)	3.4	2.9	3.8	3.0	3.0	2.3	2.5	2.2	2.4	2.2	1.9
Gross international reserves	306	384	485	608	737	750	809	828	819	839	889
(in months of imports of goods and services)	3.8	3.7	3.8	4.1	4.6	4.5	4.9	4.6	4.6	4.4	4.4
(relative to external debt service)	14.0	21.8	29.3	23.7	22.7	11.9	12.6	14.6	12.9	11.1	10.6
(in percent of broad money)	23.0	22.6	22.4	26.4	25.6	26.1	27.7	26.3	25.7	24.1	23.3
Change in real effective exchange rate	0.5	18.3	12.5	7.0	4.3	...	...	...	...	...	...
Memorandum item:											
Nominal GDP (in millions of lek)	341,716	460,631	506,205	539,210	590,237	658,753	658,062	727,218	718,574	786,007	860,746

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

1/ Estimated based on indirect information in the absence of national accounts.

2/ Current account excluding official transfers.

3/ Revenue minus current expenditure.

4/ Including interest payments for bank restructuring.

5/ Including bonds for bank restructuring (lek 24.6 bn for 2000).

6/ Includes arrears, with the exception of those transferable ruble arrears for which the value is subject to reconciliation and rescheduling agreements have yet to be reached with creditors.

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

Table 2. Albania: Balance of Payments, 2000-2010
(In millions of US dollars)

	2000	2001	2002 SR 06_02	q1	q2 Est.	q3 Proj	q4 Proj	2002 Proj.	2003 SR 06_02	q1 Proj.	q2 Proj.	q3 Proj.	q4 Proj.	2003 Proj.	2004 Proj.	2005 Proj.	2006 Proj.	2007 Proj.	2008 Proj.	2009 Proj.	2010 Proj.
I. Current account	-271	-260	-372	-66	-169	-55	-120	-410	-357	-88	-114	-90	-89	-381	-405	-409	-395	-377	-360	-343	-324
Trade balance	-821	-1,027	-1,072	-240	-288	-268	-301	-1,096	-1,116	-256	-279	-297	-297	-1,129	-1,208	-1,276	-1,333	-1,390	-1,446	-1,501	-1,554
Exports	255	305	342	76	72	83	77	309	391	83	87	79	92	341	387	439	497	564	640	725	823
Imports	1,076	1,332	1,414	316	360	351	378	1,405	1,507	339	366	376	389	1,470	1,595	1,715	1,830	1,954	2,086	2,227	2,377
Services and income	111	225	190	18	-5	57	68	137	206	40	31	50	44	166	181	201	226	253	283	315	351
o/w: Interest due	10	12	24	7	9	3	7	26	25	4	8	4	8	24	30	36	43	49	53	58	61
Private transfers	439	543	510	156	124	156	112	549	554	128	134	157	163	582	622	666	713	759	803	843	878
II. Capital account	319	279	331	71	125	38	102	335	414	84	117	78	92	371	388	401	376	354	343	339	339
Official transfers	111	125	104	23	35	29	28	115	109	24	36	24	36	119	117	114	104	91	80	75	72
Direct investment	143	204	153	22	59	30	46	156	215	38	42	32	45	156	165	180	173	164	177	191	206
Other capital including short-term flows	-6	-131	2	10	15	-39	10	-5	-17	-2	11	1	-17	-7	0	0	0	0	0	0	0
Short-term capital	25	-3	0	-7	9	-2	-2	-1	0	2	2	2	2	8	0	0	0	0	0	0	0
Other financial flows (increase = -)	-30	-128	2	16	6	-38	11	-4	-17	-4	9	-1	-19	-15	0	0	0	0	0	0	0
o/w Change in NFA of commercial banks (incr. -)	-30	-128	57	65	13	-42	8	45	-17	-17	-5	-15	-19	-57	0	0	0	0	0	0	0
Official medium- and long-term loans (net) 1/	71	81	72	17	16	19	18	69	108	23	29	22	29	103	106	108	100	99	87	73	60
New borrowing	79	89	97	20	23	23	28	94	132	27	40	27	40	134	143	148	152	146	149	149	148
Multilateral loans 1/	60	54	73	15	20	16	21	72	87	18	28	18	28	92	99	88	88	87	82	81	80
World Bank	40	34	41	8	12	15	3	38	42	8	13	8	13	42	44	40	40	40	35	35	35
EBRD	2	2	10	2	0	0	7	10	14	3	4	3	4	14	14	14	14	12	10	10	8
Other	18	18	22	4	8	1	11	24	31	7	11	7	11	36	41	34	34	35	37	36	37
Bilateral loans	19	34	24	5	3	7	7	23	45	8	13	8	13	42	45	59	63	60	67	68	68
Other loans	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Amortization 1/	-9	-7	-26	-3	-7	-4	-10	-25	-24	-3	-11	-5	-11	-31	-37	-40	-51	-47	-63	-76	-88
III. Errors and omissions 2/	33	106	0	-6	96	16	-12	94	0	0	0	0	0	0	0	0	0	0	0	0	0
IV. Net balance = I+II+III	80	125	-42	-1	51	-1	-30	19	57	-4	4	-12	3	-10	-17	-7	-18	-23	-17	-4	14
V. Financing requirement = - IV	-80	-125	42	1	-51	1	30	-19	-57	4	-4	12	-3	10	17	7	18	23	17	4	-14
Available financing	-80	-125	-27	1	-51	1	0	-49	-87	-1	-4	-11	-3	-19	-28	-58	-60	-62	-63	-62	-61
Change in net reserves (increase = -)	-111	-131	-26	-4	-47	-28	0	-80	-87	-1	-4	-11	-3	-19	-28	-58	-60	-62	-63	-62	-61
Change in gross reserves, (increase = -)	-123	-129	-13	-2	-48	-26	4	-72	-78	0	0	-10	0	-10	-20	-50	-50	-50	-50	-50	-50
Use of Fund Resources (net)	12	-1	-13	-2	1	-3	-4	-9	-9	-1	-4	-1	-3	-9	-8	-8	-10	-12	-13	-12	-11
Fund (PRGF)	19	12	0	0	5	0	0	5	0	0	0	0	0	0	0	0	0	0	0	0	0
Repayments to Fund	-7	-14	-13	-2	-4	-3	-4	-14	-9	-1	-4	-1	-3	-9	-8	-8	-10	-12	-13	-12	-11
BOP support	29	4	0	0	2	29	0	31	0	0	0	0	0	0	0	0	0	0	0	0	0
Bilateral (grants+loans)	5	4	0	0	2	0	0	2	0	0	0	0	0	0	0	0	0	0	0	0	0
Multilateral	24	0	0	0	0	29	0	29	0	0	0	0	0	0	0	0	0	0	0	0	0
Changes in arrears (increase = +) 3/ 4/	2	-32	-282	6	-250	0	-39	-283	0	0	0	0	0	0	0	0	0	0	0	0	0
Overdue debt forgiveness 3/ 4/	0	10	207	0	207	0	0	207	0	0	0	0	0	0	0	0	0	0	0	0	0
Debt service relief (rescheduling) 3/ 4/	0	23	75	0	37	0	39	76	0	0	0	0	0	0	0	0	0	0	0	0	0
Financing gap	0	0	68	0	0	0	31	31	29	6	0	23	0	29	45	65	78	86	80	66	46
Identified financing (provisional)	0	0	68	0	0	0	31	31	10	5	0	23	0	28	11	11	0	0	0	0	0
o/w: IMF PRGF	0	0	5	0	0	0	0	0	10	5	0	5	0	11	11	11	0	0	0	0	0
EU Budgetary Support	0	0	4	0	0	0	2	2	0	0	0	0	0	0	0	0	0	0	0	0	0
WB SAC/PRSC	0	0	28	0	0	0	0	0	0	0	0	18	0	18	0	0	0	0	0	0	0
Greece	0	0	5	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Italy	0	0	26	0	0	0	28	28	0	0	0	0	0	0	0	0	0	0	0	0	0
Remaining gap	0	0	0	0	0	0	0	0	19	0	0	0	0	0	35	55	78	86	80	66	46
Memorandum items:																					
Gross usable reserves	608	737	750	739.1	787.3	812.8	808.8	808.8	828.1	808.8	808.8	818.8	818.8	819	839	889	939	989	1,039	1,089	1,139
(months of imports of goods and services)	4.1	4.6	4.5	...	...	...	...	4.9	4.6	...	...	...	...	4.6	4.4	4.4	4.3	4.3	4.2	4.1	...
(relative to external debt service)	23.6	22.7	11.9	...	...	...	...	12.6	14.6	...	...	...	...	12.9	11.1	10.6	9.0	9.1	8.1	7.5	7.1
Total Debt service (including IMF)	25.7	32.5	62.8	13.0	19.6	10.2	21.5	64.2	56.9	8.3	23.2	9.8	22.3	63.6	75.3	84.0	104.6	108.8	128.7	145.7	159.9
Trade balance (percent of GDP)	-21.9	-25.0	-23.4	...	...	...	...	-23.7	-22.1	...	...	...	...	-22.8	-22.3	-21.5	-20.5	-19.5	-18.6	-17.8	-17.0
Current account (percent of GDP) (excluding official transfers)	-7.2	-6.3	-8.1	...	...	...	...	-8.9	-7.1	...	...	...	...	-7.7	-7.5	-6.9	-6.1	-5.3	-4.6	-4.1	-3.5
Total debt service (percent of GDP)	0.7	0.8	1.4	...	...	...	...	1.4	1.1	...	...	...	...	1.3	1.4	1.4	1.6	1.5	1.7	1.7	1.7
Debt service (percent of exports of goods and services)	3.6	3.9	7.0	...	...	...	...	7.8	5.8	...	...	...	...	7.1	7.7	7.8	8.9	8.4	8.9	9.1	9.0
External debt (percent of GDP) 5/	30.9	28.7	23.3	...	...	...	...	24.7	23.6	...	...	...	...	25.5	25.9	26.3	26.4	26.3	25.8	25.1	24.1
Debt service (percent of fiscal revenues)	3.1	3.4	...	...	...	...	...	5.9	...	...	...	...	...	5.3	5.5	5.4	...	...	...	...	...
Merchandise exports (percent growth)	-7	19	12	...	...	...	...	1	14	...	...	...	...	10	13	13	13	13	13	13	13
Merchandise imports (percent growth	15	24	6	...	...	...	...	6	7	...	...	...	...	5	9	8	7	7	7	7	7
Exports (GNFS) (percent growth)	18.8	19.0	6.2	...	...	...	...	-1.7	10.0	...	...	...	...	8.1	9.5	9.6	9.7	10.8	10.8	10.9	10.9
Imports (GNFS) (percent growth)	21.3	17.6	5.8	...	...	...	...	6.3	6.1	...	...	...	...	4.1	7.8	7.1	6.4	6.7	6.7	6.7	6.7

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

1/ Excluding IMF.

2/ The errors and omissions in 2002Q2 largely reflect preliminary estimates of the currency valuation effect on gross reserves, subject to further discussions with the authorities.

3/ The figure for 2001 corresponds principally to the clearance of arrears to the Turkish Export-Import Bank in May 2001 (USD9.4 million in overdue interest forgiven; USD17.6 million rescheduled at 6M Libor+0.5%, 15 years maturity, 5 years grace) and the Turkish Central bank in December 2001 (USD0.5 million in penalty interest forgiven; USD5.1 million rescheduled at 6M Libor−0.5%, 15 years maturity, 5 years grace; 20 equal semi-annual instalments).

4/ The figure for 2002 corresponds principally to the clearance of arrears to Russia (Rbl 142.8 million converted at official rate of USD1=Rbl0.6 to USD 238.0 million; after an up-front discount of 70%, 50% debt reduction was applied under the 1998 Paris Club agreement; the remaining USD 35.7 million will be rescheduled at Libor+2%, 6 years grace, 23 years maturity) and China (USD38.9 million rescheduled at 3.5%, from 2004 to 2015). The agreement with Russia was finalized in May 2002 and the agreement with China was finalized in 2002Q4.

5/ Includes arrears, with the exception of those transferable ruble arrears for which the value is subject to reconciliation and rescheduling agreements have yet to be reached with creditors.

Table 3 . Albania: Government Revenues and Expenditures
(In percent of GDP)

			1999 Outturn	2000 Outturn	2001 Outturn	2002 Original Budget	2002 Revised Budget	2002 Jan-Sep Prelim.	2002 Revised Proj.	2003 Draft budget
Total Revenue			**21.3**	**22.4**	**23.0**	**24.0**	**24.2**	**16.3**	**23.5**	**24.4**
II.	**Tax Revenue:**		**16.5**	**19.3**	**19.7**	**21.1**	**21.1**	**14.1**	**20.4**	**21.4**
II.1	**Tax revenues from Tax directorate and Customs**		12.7	15.3	15.5	16.7	16.7	11.0	16.0	16.4
	1.	Turnover tax / VAT	5.9	7.1	7.0	7.8	7.8	5.0	7.2	7.6
	2.	Profit tax	1.2	1.5	1.7	1.7	1.7	1.4	1.8	1.8
	3.	Excise tax	1.4	1.7	1.6	2.1	2.1	1.0	1.5	1.6
	4.	Small business tax	0.2	0.3	0.3	0.4	0.4	0.3	0.4	0.4
	5.	Personal income tax	0.6	0.9	1.1	1.0	1.0	0.6	0.9	1.0
	6.	National taxes 1/	1.2	1.4	1.6	1.5	1.5	1.2	1.8	1.5
	7.	Customs duties	2.3	2.5	2.2	2.3	2.3	1.4	2.1	2.0
	8	Road tax	0.0	0.0	0.0	0.0	0.0	0.0	0.2	0.4
II.2	**Property and local taxes**		0.2	0.2	0.3	0.5	0.5	0.3	0.5	0.7
II.3	**Social insurance contributions**		3.6	3.7	3.8	4.0	4.0	2.8	4.0	4.3
	1.	Social insurance	3.3	3.4	3.5	3.7	3.7	2.6	3.7	3.9
	2.	Health insurance	0.3	0.3	0.3	0.3	0.3	0.2	0.3	0.3
III	**Non-tax revenue:**		**4.8**	**3.1**	**3.3**	**2.9**	**3.1**	**2.1**	**3.1**	**3.0**
	1.	Profit transfer from BOA	3.5	1.9	1.8	1.4	1.4	1.0	1.4	1.4
	2.	Income of budgetary institutions	1.1	0.9	0.7	1.0	1.0	0.8	1.0	1.1
	3.	Other	0.2	0.3	0.7	0.5 0.0	0.7	0.4	0.7	0.5
Total Expenditure			**32.7**	**31.4**	**31.5**	**32.5**	**32.3**	**19.6**	**31.0**	**31.0**
I.	**Current Expenditure**		**25.4**	**24.9**	**24.2**	**24.5**	**24.6**	**16.4**	**24.5**	**24.3**
	1.	**Personnel cost**	**6.1**	**6.5**	**7.0**	**6.9**	**6.4**	**4.4**	**6.4**	**6.4**
		Wages and other personnel expenditures	4.7	5.1	5.6	5.2	5.2	3.5	5.2	5.0
		Social insurance contributions	1.4	1.4	1.4	1.2	1.2	0.9	1.2	1.4
		Wage increase								0.1
	2.	**Interest**	**7.0**	**5.7**	**4.3**	**3.7**	**3.8**	**2.7**	**3.7**	**3.8**
	a.	Domestic	6.9	5.2	4.1	3.2	3.3	2.5	3.3	3.3
	b.	Foreign	0.1	0.4	0.2	0.5	0.5	0.3	0.4	0.4
	3.	**Operations & maintenance**	**4.7**	**4.3**	**3.9**	**4.6**	**3.0**	**2.1**	**3.5**	**2.8**
	4.	**Subsidies 2/**	**0.5**	**1.0**	**1.3**	**1.0**	**1.5**	**0.8**	**1.5**	**0.9**
	a.	Electricity	0.0	0.6	1.0	0.6	1.1	...	1.1	0.5
		KESH (public electricity company)	0.0	0.6	1.0	0.6	0.6	...	0.6	0.5
		DARFO (Mining company)						...		0.1
		additional for KESH (conditional on performance)					0.6	...	0.6	0.0
	b.	Water companies	0.1	0.0	0.0	0.1	0.1	...	0.1	0.1
	c.	others	0.0	0.3	0.3	0.3	0.3	...	0.3	0.2
	5.	**Social insurance outlays**	**5.4**	**5.8**	**6.1**	**6.1**	**6.1**	4.4	**6.1**	**6.3**
	a.	Social insurance	4.9	5.4	5.6	5.5	5.5	4.1	5.5	5.6
	c.	Health insurance	0.5	0.5	0.5	0.6	0.6	0.4	0.6	0.6
	6	**Local government expenditure**	**1.1**	**0.9**	**0.8**	**1.4**	**1.9**	1.0	**1.9**	**2.0**
	a	Local budget (grant) 3/	1.1	0.9	0.8	1.0	1.0	0.5	1.0	1.0
	b	Local budget (local revenues)				0.5	0.5	0.2	0.5	0.6
	c	Small business tax					0.4	0.3	0.4	0.4
	7	**Social protection transfers**	**1.6**	**1.6**	**1.5**	**2.3**	**1.4**	0.9	**1.4**	**1.4**
	a.	Unemployment insurance benefits	0.3	0.4	0.3	0.3	0.3	0.1	0.2	0.2
	b.	Social assistance 2/	1.3	1.2	1.2	1.3	1.2	0.8	1.2	1.2
II.	**Other expenditures**						**0.5**	...	...	**0.8**
	a.	Reserve Fund					0.3	...	...	0.6
		of which: Intenterprise arrears					0.0	...	...	0.3
	b.	Contingency					0.2	...	...	0.1
	c.	Deposit insurance agency						...	...	0.1
	d.	Local elections						...	...	0.1
III.	**Capital Expenditure**		7.3	6.5	7.3	7.9	7.6	3.2	6.5	6.7
	1.	**Domestically financed**	2.3	2.9	4.1	3.9	3.6	1.6	3.0	2.8
	a.	from the budget	2.1	2.9	3.3	3.6	3.3	...	...	2.6
	b.	from own revenues	0.2	0.1	0.8	0.3	0.3	...	...	0.2
	2.	**Foreign financed projects**	3.4	3.0	3.2	4.0	4.0	1.6	3.5	3.8
Overall Balance			**-11.4**	**-9.1**	**-8.5**	**-8.5**	**-8.0**	**-3.4**	**-7.5**	**-6.6**
Financing			**11.5**	**9.1**	**8.5**	**8.5**	**8.0**	**3.4**	**7.5**	**6.6**
Sources of financing										
		Domestic Financing	**5.4**	**4.8**	**5.3**	**4.1**	**3.1**	**1.3**	**3.2**	**2.9**
		Privatization receipts	0.2	1.7	2.1	1.7	0.2	0.1	0.2	0.1
		Bank and non-banks	5.2	3.2	3.1	2.4	3.0	1.3	3.0	2.8
		Foreign Financing	**6.1**	**4.3**	**3.3**	**4.3**	**4.9**	**2.1**	**4.4**	**3.6**
		Budget support	2.9	1.5	0.2	0.8	1.4	0.7	1.3	0.4
		Development (gross)	3.4	3.0	3.2	4.0	4.0	1.6	3.5	3.8
		minus: principal repayment	0.2	0.2	0.1	0.5	0.5	0.2	0.4	0.6

1/ Includes solidarity tax (discontinued in 2003) 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/ Includes 1 billion Lek of tax on vehilces in 2003, also included under local and property taxes.

Table 4. Albania: Government Revenues and Expenditures
(In millions of Lek)

	1999 Outturn	2000 Outturn	2001 Outturn	2002 Original Budget	2002 Revised Budget	2002 Jan-Sep Prelim.	2002 Revised Proj.	2003 Draft Budget
Total Revenue	**107,809**	**120,588**	**135,481**	**158,025**	**159,525**	**106,947**	**154,475**	**175,257**
II. Tax Revenue:	**83,530**	**104,098**	**116,171**	**138,887**	**138,987**	**92,814**	**134,137**	**153,697**
II.1 Tax revenues from Tax directorate and Customs	64,488	82,730	91,629	109,800	109,900	72,166	105,050	**118,038**
1. Turnover tax / VAT	29,794	38,107	41,148	51,076	51,076	32,660	47,104	54,584
2. Profit tax	6,033	8,115	10,248	11,000	11,000	9,200	12,051	12,811
3. Excise tax	6,961	9,153	9,544	13,600	13,600	6,560	9,600	11,599
4. Small business tax	1,188	1,641	1,974	2,800	2,900	2,186	2,697	3,054
5. Personal income tax	3,110	4,590	6,300	6,600	6,600	4,207	6,179	7,435
6. National taxes 1/	5,952	7,576	9,621	9,800	9,800	7,992	12,154	10,882
7. Customs duties	11,450	13,548	12,794	14,924	14,924	9,361	13,965	14,673
8 Road tax	0	0	0.0	0.0	0.0	0.0	1,300	3,000
II.2 Property and local taxes	885	1,315	2,036	3,000	3,000	1,953	3,000	**5,000**
II.3 Social insurance contributions	**18,157**	**20,053**	**22,506**	**26,087**	**26,087**	**18,695**	**26,087**	**30,659**
1. Social insurance	16,783	18,523	20,710	24,051	24,051	17,178	24,051	28,200
2. Health insurance	1,374	1,530	1,796	2,036	2,036	1,517	2,036	2,459
III Non-tax revenue:	**24,124**	**16,490**	**19,310**	**19,138**	**20,538**	**14,133**	**20,338**	**21,560**
1. Profit transfer from BOA	17,591	10,225	10,912	8,900	9,300	6,287	9300	10,000
2. Income of budgetary institutions	5,352	4,841	4,383	6,738	6,738	5,268	6638	7,700
3. Other	1,181	1,424	4,015	3,500	4,500	2,578	4400	3,860
Total Expenditure	**165,616**	**169,424**	**185,751**	**213,653**	**212,341**	**129,178**	**203,999**	**222,432**
I. Current Expenditure	**128,411**	**134,361**	**142,656**	**161,402**	**162,024**	**108,067**	**161,047**	**174,601**
1. Personnel cost	**30,737**	**35,140**	**41,210**	**45,227**	**42,275**	**28,910**	**42,275**	**46,300**
Wages and other personnel expenditures	23,800	27,720	32,942	34,155	34,185	22,719	34,185	35,611
Social insurance contributions	6,937	7,420	8,268	8,090	8,090	6,191	8,090	9,954
Wage increase								735
2. Interest	**35,399**	**30,597**	**25,505**	**24,115**	**25,085**	**18,011**	**24,626**	**27,050**
a. Domestic	34,814	28,272	24,429	21,015	21,985	16,193	22,015	23,997
b. Foreign	585	2,325	1,076	3,100	3,100	1,818	2,611	3,053
3. Operations & maintenance	**23,785**	**23,422**	**23,237**	**30,488**	**19,887**	**13,976**	**22,709**	**19,888**
4. Subsidies 2/	**2,583**	**5,247**	**7,811**	**6,386**	**10,033**	**5,243**	**10,033**	**6,300**
a. Electricity	-	**3,295**	**5,840**	**3,780**	**7,480**	...	**7,480**	**3,800**
KESH (public electricity company)		3,295	5,840	3,780	3,780	...	3,780	3,400
DARFO (Mining company)						...		400
additional for KESH (conditional on performance)					3,700	...	3,700	
b. Water companies	506	70		865	865	...	865	745
c. Others		1,882	1,971	1,741	1,688	...	1,688	1,755
5. Social insurance outlays	**27,587**	**31,375**	**36,073**	**39,936**	**39,836**	**29,151**	**39,836**	**45,032**
a. Social insurance	24,981	28,948	33,104	36,100	36,050	26,659	36,050	40,473
c. Health insurance	2,606	2,427	2,969	3,836	3,786	2,492	3,786	4,559
6 Local government expenditure	**5,699**	**4,595**	**4,981**	**9,518**	**12,418**	**6,753**	**12,418**	**14,354**
a Local budget (grant) 3/	5,699	4,595	4,981	6,518	6,518	3,571	6,518	7,300
b Local budget (local revenues)				3,000	3,000	996	3,000	4,000
c Small business tax					2,900	2,186	2,900	3,054
7 Social protection transfers	**8,320**	**8,580**	**8,820**	**15,250**	**9,350**	**6,023**	**9,150**	**9,877**
a. Unemployment insurance benefits	1,450	1,919	1,881	1,700	1,700	820	1,500	1,477
b. Social assistance 2/	6,360	6,661	6,939	8,250	7,650	5,203	7,650	8,400
II. Other expenditures					**3,140**	...	...	**5,800**
a. Reserve Fund					2,140	...	...	4,000
of which: Intenterprise arrears						...	...	2,000
b. Contingency					1,000	...	...	1,000
c. Deposit insurance agency						...	...	400
d. Local elections						...	...	400
III. Capital Expenditure	**37,204**	**35,062**	**43,095**	**52,251**	**50,317**	**21,111**	**42,952**	**47,831**
1. Domestically financed	**11,880**	**15,663**	**23,955**	**25,751**	**23,817**	**10,532**	**20,014**	**20,350**
a. From the budget	10,807	15,375	19,505	23,562	21,628	...	...	19,005
b. From own revenues	1,073	288	4,450	2,189	2,189	...	...	1,345
2. Foreign financed projects	**17,158**	**16,327**	**19,140**	**26,500**	**26,500**	**10,579**	**22,938**	**27,481**
Overall Balance	**-57,807**	**-48,836**	**-50,270**	**-55,628**	**-52,816**	**-22,231**	**-49,524**	**-47,175**
Financing	58,185	49,181	50,435	55,628	52,816	22,231	49,524	47,175
Sources of financing								
Domestic financing	**27,389**	**25,986**	**31,102**	**27,217**	**20,569**	**8,737**	**20,895**	**21,144**
Privatization receipts	906	8,975	12,683	11,153	1,127	341	1,153	1,077
Bank and non-banks	26,483	17,012	18,419	16,064	19,442	8,396	19,742	20,067
Foreign financing	**30,797**	**23,195**	**19,333**	**28,411**	**32,247**	**13,496**	**28,629**	**26,032**
Budget support	14,639	7,867	1,011	5,211	9,047	4,361	8,410	2,596
Development (gross)	17,158	16,327	19,140	26,500	26,500	10,579	22,938	27,481
minus: principal repayment	1,000	999	818	3,300	3,300	1,444	2,719	4,045

1/ Includes solidarity tax (discontinued in 2003) 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/ Includes 1 billion Lek of tax on vehicles in 2003, also included under local and property taxes.

Table 5. Albania: Monetary Aggregates 1/

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

	2000 Dec.	2001 Dec.	2002 March	2002 June	2002 Sep.	2002 Dec. Proj.	2002 Dec. SR0602	2003 March Proj.	2003 June Proj.	2003 Sep. Proj.	2003 Dec. Proj.	2003 Dec. SR0602
Monetary survey												
Broad money	328.1	393.6	392.4	395.4	407.4	423.5	417.3	432.7	440.8	449.8	461.3	456.1
Currency outside banks	99.2	119.1	124.7	132.7	130.7	136.2	138.0	136.2	136.1	136.2	138.5	149.0
Deposits	228.9	274.5	267.8	262.7	276.6	287.2	279.3	296.5	304.7	313.6	322.8	307.1
Domestic currency deposits	165.3	186.2	181.6	178.9	185.2	191.0	187.5	195.7	199.6	203.9	208.1	203.7
Foreign currency deposits	63.6	88.2	86.2	83.7	91.4	96.2	91.8	100.8	105.1	109.7	114.7	103.4
M1	124.0	143.1	148.5	156.5	153.2	160.0	164.3	159.9	159.8	159.9	162.5	177.4
M2	264.5	305.3	306.2	311.7	316.0	327.3	325.5	331.9	335.8	340.1	346.6	352.7
Net foreign assets	130.8	158.7	159.2	157.8	165.6	171.3	161.3	172.5	174.4	177.5	180.7	174.8
Bank of Albania	71.8	86.0	92.1	94.5	96.8	100.6	94.9	100.1	100.5	101.4	101.9	106.0
Commercial Banks	58.9	72.7	67.1	63.4	68.8	70.7	66.4	72.4	73.9	76.1	78.9	68.8
Net domestic assets	197.3	234.9	233.2	237.5	241.8	252.2	256.0	260.2	266.4	272.3	280.5	281.3
Claims on government (net of deposits)	215.3	231.0	233.5	235.2	236.7	248.8	248.0	254.0	256.7	259.5	264.8	260.0
Claims on state enterprises and farms	1.1	0.5	0.6	0.1	0.1	0.1	0.6	0.1	0.1	0.1	0.1	0.6
Claims on the private sector	22.2	27.4	29.0	33.2	35.5	38.9	37.4	41.8	45.3	48.4	51.3	50.6
of which in leks	7.5	4.8	4.4	5.7	6.9	7.4	6.5	8.1	9.3	10.4	11.5	10.5
in foreign currency	14.6	22.6	24.6	27.4	28.6	31.6	30.9	33.7	36.0	38.0	39.8	40.1
Other items, net	-41.3	-24.0	-29.9	-30.9	-30.5	-35.7	-29.9	-35.7	-35.7	-35.7	-35.7	-29.9
Monetary authorities												
Reserve money	128.8	152.1	159.6	162.8	161.0	169.1	171.0	171.9	172.8	173.9	177.3	185.2
Program NIR (millions of U.S. dollars) 2/	...	542.6	547.4	545.4	570.7	569.9	560.6	561.1	560.9	...	...	...
Program NDA 2/	...	78.1	84.8	88.3	83.0	91.3	94.4	95.3	96.2	...	...	...
Memorandum items:												
Broad money growth during the year	12.0	19.9	-0.3	0.5	3.5	7.6	6.0	2.2	4.1	6.2	8.9	9.3
Of which:												
Net foreign assets	10.4	8.5	0.1	-0.2	1.8	3.2	0.7	0.3	0.7	1.5	2.2	3.2
Net domestic assets	1.7	11.4	-0.4	0.7	1.8	4.4	5.4	1.9	3.4	4.8	6.7	6.0
Claims on government	4.8	4.8	0.6	1.1	1.5	4.5	4.3	1.2	1.9	2.5	3.8	2.9
Domestically bank-financed deficit	14.1	15.6	2.6	4.3	0.0	17.8	17.0	5.2	7.9	10.6	16.0	12.0
in percent of GDP	2.6	2.6	0.4	0.6	2.7	2.7	2.6	0.7	1.1	1.5	2.2	1.3
Cumulative change in banks' NFA during the year	5.5	13.8	-5.6	-9.4	-3.9	-2.1	-6.4	1.8	3.3	5.5	8.2	2.5
Annual broad money growth (y-o-y; in percent)	12.0	19.9	16.1	14.0	12.4	7.6	6.0	10.3	11.5	10.3	8.9	9.3
Annual reserve money growth (y-o-y; in percent)	17.8	18.1	27.4	20.5	18.6	11.1	12.4	7.8	6.2	8.0	4.9	8.3
Annual growth in private sector credit (y-o-y; in percent) 3	26.9	43.1	43.5	48.2	46.3	33.0	28.8	35.1	36.5	29.7	26.5	29.3
Annual M1 growth (y-o-y; in percent)	20.4	15.3	27.3	25.5	18.6	11.8	14.9	7.7	2.1	3.8	1.6	8.0
Annual M2 growth (y-o-y; in percent)	10.4	15.4	15.4	13.5	11.2	7.2	6.6	8.4	7.7	7.5	5.9	8.4
Velocity (Quarterly GDP/BM)	42.6	38.7	41.1	40.8	0.0	40.4	41.1	40.4	40.3	40.2	40.2	40.9
Money multiplier (absolute values)	2.55	2.59	2.46	2.43	2.53	2.50	2.4	2.52	2.55	2.59	2.60	2.46
Currency/Broad Money ratio	30.2	30.3	31.8	33.6	32.1	32.2	33.1	31.5	30.9	30.3	30.0	32.7
Currency/deposit ratio	43.4	43.4	46.6	50.5	47.3	47.4	49.4	45.9	44.7	43.4	42.9	48.5
Deposits/broad money	69.8	69.7	68.2	66.4	67.9	67.8	66.9	68.5	69.1	69.7	70.0	67.3
Foreign currency deposits/total deposits	27.8	32.1	32.2	31.9	33.0	33.5	32.9	34.0	34.5	35.0	35.5	33.7
Lek deposits/total deposits (percent)	72.2	67.9	67.8	68.1	67.0	66.5	67.1	66.0	65.5	65.0	64.5	66.3
FX deposits/broad money (percent)	19.4	22.4	22.0	21.2	22.4	22.7	22.0	23.3	23.8	24.4	24.9	22.7
Gross reserves (millions of U.S. dollars)	607.8	737.1	739.1	787.3	812.8	808.8	750.1	808.8	808.8	818.8	818.8	828.1
in percent of broad money	26.4	25.6	27.1	27.8	27.7	27.7	26.1	27.1	26.6	26.4	25.7	26.3
US Dollar Exchange Rate (end of period)	142.6	136.6	143.8	139.8	138.9	145.0	145.0	...	...	...	...	...
3-month T-bill rate (in percent)	7.8	8.0	8.7	9.8	10.3	...	...	...	...	...	...	...
BoA repo rate (in percent)	...	7.0	7.5	8.5	8.5	...	...	...	...	...	...	...

Sources: Bank of Albania; and Fund staff estimates.

1/ Data exclude the balance sheet of the Bank Asset Resolution Trust (BART). In particular, private sector credit of lek 6.1 billion is excluded as of September 2001, when it was transferred to the BART from the Savings Bank.

2/ Derived using end-December 2001 exchange rates.

3/ Including credit transferred to the BART.

Table 6. Albania: Prior Actions, Structural Performance Criteria, and Structural Benchmarks Under the First Annual PRGF Arrangement

Measures	Deadline	Status as of November 2002
A. Prior Actions under Initial Program		
1. Meet the targets to end-April 2002, on a cumulative basis, consistent with the two-year action plan for the electricity sector reform (MEFP, ¶27; and GPRS, Section IV.F.3).		Completed
2. Prepare the first comprehensive quarterly report updating the stock of external arrears as of end-March 2002, and identifying progress in, and plans for the clearance of external arrears (MEFP, ¶32).		Completed
3. Finalize domestic process for the external arrears rescheduling agreement with Russia and pay the already scheduled amounts (interest and principle) (MEFP, ¶32).		Completed
4. Parliament to approve amendments to the 2002 budget consistent with the revised Memorandum of Economic and Financial Policies (MEFP, ¶13).		Completed
B. Performance Criteria under Initial Program		
1. Parliament to pass legislation to close down duty-free shops at all land crossing points in border areas to reduce scope for smuggling and fiscal evasion (MEFP, ¶16).	End-September 2002	Delayed
C. Structural Benchmarks under Initial Program		
1. Resolve all of Albtelekom's financial and legal disputes in preparing it for privatization (MEFP, ¶26; and GPRS, Section IV.F.4).	End-September 2002	Delayed
2. Internal Audit Unit to produce quarterly reports on the functioning of customs system, including specific recommendations for the remedy of identified shortcomings, and Director-General to send reports on corrective measures taken by the Customs Department	Throughout	In observance
3. The Tax Department to prepare quarterly reports on the controls of the use of cash registers and penalties imposed on misusers(MEFP, ¶16; and GPRS, Section IV.C).	Throughout	In observance
4. Draft and implement an action plan jointly prepared by Tax and Customs Departments to reduce fiscal evasion through underinvoicing (MEFP, ¶16; and GPRS, Section IV.C).	End-June 2002	In observance
5. Extend the tax base through (MEFP, ¶16):		
a) introducing environmental taxes (by September 1, 2002) and a tax on the ownership of agricultural land (by October 1, 2002); and		Delayed until January 2003
b) increasing the number of registered taxpayers from 47,000 at end-2001 to 57,000 at end-2002 (GPRS, Section IV.C).	End-December 2002	
6. With regard to arrears within the public sector (MEFP, ¶19):		
a) finalize the recording of inter-enterprise arrears and tax arrears, complete the reconciliation process, and sign bilateral memoranda of understanding indicating the amount of net overdue payables/receivables as of December 31, 2001; and		
b) determine the amount of inter-enterprise arrears that can be cancelled through multilateral nettings.	End-October 2002	Delayed
7. Select a buyer for the Saving Bank and initiate negotiations (MEFP, ¶26; and GPRS, Section IV.D.2).	End-June 2002	Not met due to lack of interested buyers
8. Finalize a major study of the energy sector with the aim of determining electricity tariffs based on long-run marginal costs and phasing out subsidies by end-2004 (MEFP, ¶27; and GPRS, Section IV.F.3).	End-September 2002	Delayed
9. Prepare quarterly reports (within one month of the end of each quarter), identifying progress in and plans for the clearance of external arrears, and updating the stock of external arrears (MEFP, ¶32).	Throughout	In observance
10. In relation to monetary policy and the financial sector (MEFP, ¶28; and GPRS, Section IV.D.2):		
a) introduce government securities with a maturity of at least two years;	End-June 2002	Delayed until end-October
b) promote the sale of T-bills to the public through Albapost and further improve the accessibility of the BoA's window for selling T-bills.	Throughout	Dropped; BoA provided substitute venue for sale of T-bills

Table 7. Albania: External Financing Requirement and Sources, 2000-2005
(In millions of U.S. dollars)

	2000	2001	*2002*	2002	2003	2004	2005
			SR01/02		*Projections*		
Current account	271	260	*384*	410	381	405	409
Amortization	16	21	*39*	38	40	45	48
o/w: IMF	7	14	*14*	14	9	8	8
Change in reserves (increase = +)	123	129	*62*	72	10	20	50
Reduction in arrears 1/	-2	32	*281*	283	0	0	0
Total financing requirement	409	441	*767*	803	431	470	506
Available financing	380	404	*442*	459	402	425	441
Official grants	111	125	*106*	115	119	117	114
Foreign direct investment	143	204	*264*	156	156	165	180
Short-term private financing flows	-6	-131	*-39*	-5	-7	0	0
Official medium- and long-term loans	79	89	*111*	94	134	143	148
Multilateral	60	54	*72*	72	92	99	88
Bilateral	19	34	*39*	23	42	45	59
Other loans	0	0	*0*	0	0	0	0
IMF disbursements	19	12	*0*	5	0	0	0
Other	33	106	*0*	94	0	0	0
Financing gap = I-II	29	37	*324*	345	29	45	65
Debt relief 1/	0	33	*281*	283	0	0	0
Balance of payments support	29	4	*0*	31	0	0	0
Multilateral	24	0	*0*	29	0	0	0
Bilateral	5	4	*0*	2	0	0	0
Remaining gap	0	0	*43*	31	29	45	65
Identified financing (provisional)	*0*	*0*	*43*	*31*	*28*	*11*	*11*
o/w: IMF PRGF	0	0	*10*	0	11	11	11
o/w: EU Budgetary Support	0	0	*5*	2	0	0	0
o/w: WB SAC/PRSC	0	0	*28*	0	18	0	0
o/w: Greece	0	0	*0*	0	0	0	0
o/w: Italy	0	0	*0*	28	0	0	0
Unfinanced gap	0	0	*0*	0	0	35	55

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

1/ The figure for 2001 corresponds principally to the clearance of arrears to the Turkish Export-Import Bank and the Turkish Central Bank finalized in May and December 2001, respectively. The figure for 2002 includes estimates for the clearance of arrears to Russia (finalized in 2002Q2) and China (finalized in 2002Q4).

Table 8. Albania: Projected Payments to the Fund as of November 30, 2002
(In millions of SDRs)

	2002 1/	2003	2004	2005	2006	2007	2008	2009	2010	2011	Beyond	Total
Obligations from existing drawings												
1. Principal												
GRA Repurchases	1.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.1
PRGF Repayments	0.7	6.8	6.4	6.2	7.6	9.4	9.2	7.1	4.3	2.2	0.4	60.3
2. Charges and Interest 2/												
Periodic Charges	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
PRGF Interest	0.2	0.3	0.3	0.2	0.2	0.1	0.1	0.0	0.0	0.0	0.0	1.4
SDR Net Charges	-0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.4
Total Obligations	1.6	7.1	6.6	6.4	7.8	9.5	9.3	7.1	4.4	2.2	0.4	62.5
(percent of quota)	3	15	14	13	16	20	19	15	9	5	1	128
Obligations from prospective drawings												
1. Principal												
PRGF Repayments	0.0	0.0	0.0	0.0	0.0	0.0	0.4	2.0	3.6	4.8	13.2	24.0
2. Charges and Interest 2/												
PRGF Interest	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.9
Total Obligations	0.0	0.0	0.1	0.1	0.1	0.1	0.5	2.1	3.7	4.9	13.3	24.9
(percent of quota)	0	0	0	0	0	0	1	4	8	10	27	51
Cumulative obligations (existing and prospective)												
1. Principal												
GRA Repurchases	1.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.1
PRGF Repayments	0.7	6.8	6.4	6.2	7.6	9.4	9.6	9.1	7.9	7.0	13.6	84.3
2. Charges and Interest 2/												
PRGF Interest	0.2	0.3	0.4	0.3	0.3	0.2	0.2	0.1	0.1	0.1	0.1	2.3
SDR Net Charges	-0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.4
Total Obligations	1.6	7.1	6.8	6.5	7.9	9.6	9.8	9.2	8.0	7.1	13.7	87.4
(percent of quota)	3	15	14	13	16	20	20	19	16	15	28	179
Outstanding Fund credit	59.6	60.8	62.4	64.3	56.7	47.3	37.6	28.6	20.6	13.6	...	...
Memorandum items:												
Outstanding Fund credit												
In percent of:												
Exports of goods & services	9	9	8	8	6	5	3	2	2	...	...	...
External public debt	7	6	6	5	4	3	2	2	1	...	...	...
Gross official reserves	10	10	10	10	8	6	5	3	2	...	...	...
GDP	2	2	2	1	1	1	1	0	0	...	...	...
Quota	122	125	128	132	116	97	77	59	42	28	...	...
Total Obligations												
In percent of:												
Exports of goods & services	0.3	1.1	0.9	0.8	0.9	1.0	0.9	0.8	0.6	...	...	...
External public debt	0.2	0.7	0.6	0.6	0.6	0.7	0.6	0.6	0.5	...	...	...
Gross official reserves	0.3	1.1	1.1	1.0	1.1	1.3	1.3	1.1	0.9	...	...	...
GDP	0.0	0.2	0.2	0.1	0.2	0.2	0.2	0.1	0.1	...	...	...
Quota	3	15	14	13	16	20	20	19	16	15	28	179

1/ November 1, 2002 to December 31, 2002.
2/ Projections are based on current interest rates for PRGF. The current SDR interest rate is assumed for net use of SDRs.

Table 9. Albania: Indicators of External and Financial Vulnerability, 1995-2003
(In percent of GDP, unless otherwise indicated)

	1995	1996	1997	1998	1999	2000	2001	*2002 SR06/02*	2002 Proj.	2003 Proj.
Financial Indicators										
Public sector debt	57.4	61.8	73.3	65.2	64.8	72.8	69.6	*62.8*	64.4	64.6
Broad money (percent change, end of period)	51.8	43.8	28.5	20.6	22.3	12.0	19.9	*7.1*	7.6	8.9
Private Sector credit (percent change, end of period)	15.9	30.5	19.0	14.7	29.4	26.9	43.1	*28.5*	33.0	26.5
Interest rate (3-mth T-bills, end period)	...	21.1	35.9	20.4	14.8	7.8	8.0	...	...	...
Foreign currency deposits (share of total deposits)	30.6	31.8	28.9	23.5	25.2	27.8	32.1	*30.7*	33.5	35.5
External indicators										
Exports (annual percent change, in US dollars)	44.9	11.8	-27.1	22.9	34.2	-7.1	19.3	*12.2*	1.5	10.4
Imports (annual percent change, in US dollars) 1/	13.0	35.6	-25.6	20.6	13.5	14.8	23.7	*6.2*	5.6	4.6
Current account balance										
(excluding official transfers) 1/	-7.3	-9.2	-12.3	-6.3	-7.3	-7.2	-6.3	*-8.1*	-8.9	-7.7
(including official transfers)	-2.4	-6.4	-8.9	-3.4	-3.6	-4.3	-3.3	*-5.9*	-6.4	-5.3
Capital and financial account balance	8.3	6.2	3.7	3.2	6.0	8.5	6.8	*7.2*	7.2	7.5
of which: Foreign direct investment	3.7	3.6	1.8	1.5	1.4	3.8	5.0	*3.3*	3.4	3.2
Gross official reserves (in US dollars, millions)	240.3	275.3	306.2	384.0	484.6	607.8	737.1	*750.1*	808.8	818.8
Official reserves in months of imports (goods and services)	2.7	4.0	3.8	3.7	3.8	4.1	4.6	*4.5*	4.9	4.6
Official reserves to broad money (ratio)	0.2	0.2	0.2	0.2	0.2	0.3	0.3	*0.3*	0.3	0.3
Official reserves to reserve money (ratio)	0.4	0.5	0.5	0.6	0.6	0.7	0.7	*0.6*	0.7	0.7
Central bank foreign liabilities (in US dollars, millions)	357.1	357.1	361.1	392.0	178.8	143.6	138.7	...	...	...
Foreign assets of the banking sector (in US dollars, millions)	249.0	343.8	261.2	355.5	429.0	456.1	611.4	...	...	...
Foreign liabilities of the banking sector (in US dollars, millions)	12.1	11.8	13.5	20.4	35.8	47.9	88.2	...	...	...
Total external debt (in US dollars, millions) 2/	782.7	838.4	868.4	996.4	1095.8	1157.8	1181.3	*1066.8*	1144.9	1265.7
Total external debt 2/	32.3	31.2	38.0	32.7	29.8	30.9	28.7	*23.3*	24.7	25.5
Total external debt to exports (percent)	259.1	240.3	357.4	353.9	184.6	164.1	140.7	*119.7*	138.8	141.9
Total short term external debt to reserves (percent) 3/	2.7	5.8	5.9	5.8	3.9	3.0	2.6	*6.6*	6.2	6.7
External amortization payments to exports (in percent)	0.2	1.5	3.1	3.4	1.3	1.2	0.9	*2.9*	3.0	3.4
External interest payments to exports (in percent)	2.0	3.0	4.4	4.6	1.9	1.4	1.4	*2.7*	3.1	2.7
External debt service to exports (excluding IMF, in percent)	2.1	4.5	7.5	8.0	3.2	2.6	2.3	*5.6*	6.1	6.1
External debt service to exports (including IMF, in percent)	2.5	6.9	10.8	8.4	3.8	3.6	3.9	*7.0*	7.8	7.1
External debt service (excluding IMF)	0.3	0.6	0.8	0.7	0.5	0.5	0.5	*1.1*	1.1	1.1
External debt service (including IMF)	0.3	0.9	1.1	0.8	0.6	0.7	0.8	*1.4*	1.4	1.3
Change in REER (+ appreciation)	-1.5	-3.2	0.0	0.0	0.0	7.0	4.3	...	...	...
Exchange rate (period average)										
(lek per US dollar)	93.0	104.8	149.6	151.2	138.1	144.0	143.6	...	...	...
(lek per euro)	127.0	136.1	168.6	168.4	147.4	132.8	128.9	...	...	...

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

1/ Excludes imports (official transfers) related to the Kosovo crisis.
2/ Includes arrears, with the exception of those transferable ruble arrears for which the value is subject to reconciliation and rescheduling agreements have yet to be reached with creditors.
3/ Residual maturity basis; Albania has no short-term original maturity external debt.

Table 10. Albania: Stock of Public Sector External Debt, 1994-2002 1/

	1994	1995	1996	1997	1998	1999	2000	2001	2002 1/
	(In millions of U.S. dollars; end of period)								
Total External Debt	1101	783	838	868	996	1096	1158	1181	1105
Multilateral	119	182	208	221	304	419	492	523	625
EBRD	0	5	10	9	9	8	8	9	10
EIB	0	0	0	0	1	15	27	35	46
World Bank	65	109	137	148	220	296	345	366	452
Islamic Development Bank	0	0	0	0	1	1	2	5	6
IFAD	1	2	5	5	8	12	13	15	18
IMF 2/	53	66	54	56	62	80	89	84	83
OPEC	0	0	1	2	4	6	7	8	9
Bilateral	113	145	170	183	218	211	214	259	368
Austria	10	13	13	11	10	7	6	5	6
Germany	33	46	53	57	68	58	56	59	69
Greece	0	0	0	0	11	11	11	12	13
Italy	41	48	58	63	75	72	75	81	95
Japan	8	11	9	17	21	31	29	26	28
China 3/	0	0	0	2	2	2	2	2	41
Kuwait	1	7	12	13	15	16	15	16	20
Norway	0	0	3	3	3	3	11	26	26
Sweden	0	0	4	4	4	4	4	4	4
Turkey	0	0	0	0	0	0	0	23	23
United Kingdom	0	0	0	0	0	0	0	0	0
Denmark	0	0	0	0	0	0	0	0	0
France	19	20	17	13	10	8	5	4	4
Netherlands	1	1	1	1	1	0	0	0	0
Russia 3/	0	0	0	0	0	0	0	0	40
Arrears	869	455	461	465	474	465	452	399	112
Convertible currency	130	133	134	134	134	134	131	91	56
Budgetary	56	59	60	60	60	60	57	21	17
Bilateral clearing account (U.S. $)	74	74	74	74	74	74	74	71	39
Non-convertible currency 4/	168	168	168	168	171	171	160	161	23
Commercial	473	52	52	52	52	39	37	34	33
Cumulative Overdue Interest 5/	98	102	106	111	117	121	124	113	0
	(In percent of GDP)								
Total External Debt	56	32	31	38	33	30	31	29	...
Of which:									
Multilateral	6	8	8	10	10	11	13	13	...
Bilateral	6	6	6	8	7	6	6	6	...
Arrears	44	19	17	20	16	13	12	10	...
	(In percent of exports of goods and services)								
Total External Debt	489	259	240	242	354	185	164	141	...
Of which:									
Multilateral	53	60	60	61	108	71	70	62	...
Bilateral	50	48	49	51	78	36	30	31	...
Arrears	386	151	132	129	168	78	64	48	...
Memorandum items:									
GDP (in USD millions)	1984	2422	2689	2284	3046	3676	3745	4109	4628
Exports (GNFS; in USD millions)	225	302	349	360	282	594	705	839	825

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

1/ As at end-September 2002.

2/ PRGF (formerly ESAF) and ordinary resources.

3/ End-September 2002 stock reflects amounts rescheduled during 2002. (Agreement was ratified in 2002Q3, but domestic legislative processes completed

4/ Excludes transferable ruble arrears the value of which is subject to reconciliation and rescheduling agreements yet to be agreed with creditors.

5/ Overdue and penalty interest calculated as part of 2001 and 2002 rescheduling agreements with Turkey, Russia, Greece (private creditors) and China.

Table 11. Albania: Schedule of Purchases Under PRGF Arrangement

Date	Amounts in millions of SDRs	In percent of quota 1/	Conditions
June 2002	4.0	8.21	Board approval of PRGF arrangement
January 2003	4.0	8.21	Observance of end-September 2002 performance criteria and completion of first review.
July 2003	4.0	8.21	Observance of end-March 2003 performance criteria and completion of second review.
January 2004	4.0	8.21	Observance of end-September 2003 performance criteria and completion of third review.
July 2004	4.0	8.21	Observance of end-March 2004 performance criteria and completion of fourth review.
January 2005	4.0	8.21	Observance of end-September 2004 performance criteria and completion of fifth review.
July 2005	4.0	8.21	Observance of end-March 2005 performance criteria and completion of sixth review.
Total	28.0	57.49	

1/ Albania's quota is SDR 48.7 million.

Albania: Fund Relations
As of November 30, 2002

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

II. **General Resources Account**:	SDR Million	%Quota
Quota	48.70	100.00
Fund Holdings of Currency	46.35	93.12
Reserve position in Fund	3.36	6.89

III. **SDR Department**:	SDR Million	%Allocation
Holdings	60.88	N/A

IV. **Outstanding Purchases and Loans**:	SDR Million	%Quota
ESAF/PRGF arrangements	60.34	123.89

V. **Financial Arrangements**:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
PRGF	06/21/2002	06/20/2005	28.00	4.00
ESAF/PRGF	05/13/1998	07/31/2001	45.04	45.04
ESAF	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):

	Forthcoming				
	2002	2003	2004	2005	2006
Principal	0.71	6.80	6.39	6.17	7.60
Charges/Interest	0.15	0.28	0.25	0.22	0.18
Total	1.97	7.08	6.65	6.39	7.78

VII. **Safeguards Assessments**:

Under the Fund's safeguards assessment policy, the Bank of Albania is subject to a full safeguards assessment with respect to the PRGF arrangement, which was finalized in July 2002, and has taken into account prior safeguards work, including an assessment report issued in May 2001 and a monitoring mission conducted in March 2002. The assessment noted that the bank has made significant progress in implementing the recommendations of the first safeguards assessment, and that, in general, the bank has adequate safeguards in place to reduce the risk of misuse and misreporting of Fund resources. Nevertheless, the assessment noted minor weaknesses in the bank's internal auditing, financial reporting, and internal control systems, all of which BoA management agreed to address.

VIII. **Exchange Rate Arrangement**:

On July 1, 1992 the Albanian authorities adopted a floating exchange rate system (an independent float) Under the Fund's de facto exchange rate regime classification, Albania follows an independently floating exchange rate regime—although the monetary authorities occasionally intervene in the forteign exchange market with the objective of smoothening temporary fluctuations. Albania's exchange rate arrangement is free from exchange restrictions and multiple currency practices subject to Fund jurisdiction under Article VIII. However, the country still avails itself of the transitional arrangements under Article XIV and maintains exchange restrictions in the form of outstanding debit balances on inoperative bilateral payment agreements, which were in place before Albania became a Fund member. Since the last Article IV consultation in July 2001, Albania has not imposed new restrictions under Article VIII. The unified exchange rate stood at 137.9 lek per U.S. dollar on November 30, 2002.

IX. **Article IV Consultation**:

The conclusion of the last Article IV consultation and the final review under the third annual PRGF arrangement took place in July 2001 (Report number 01/117). Albania has moved from a 12-month cycle to a 24-month cycle, in line with the decision on consultation cycles approved on July 15, 2002

X. **FSAP Participation and ROSCs**:

An FSAP is being planned, but no date has been set yet. A ROSC on data dissemination was published in the Fund's website in May 2000. A fiscal ROSC is scheduled for February or March 2003. 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 is posted on the Fund's Dissemination Standards Bulletin Board (http://dsbb.imf.org).

XI. **Technical Assistance**:

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

IX. **Resident Representative**:

A Fund resident representative has been posted in Tirana since April 1993; Mr. Jan-Peter Olters has held this position since March 2002.

Albania: World Bank Relations

Partnership in Albania's Development Strategy

The Government's development objectives place increased emphasis on poverty reduction. This shift in emphasis is reflected in the Growth and Poverty Reduction Strategy (GPRS), prepared by Albania from about June 2000 to July 2001, and launched in November 2001 as the National Strategy for Socio-Economic Development (NSSED). The GPRS/NSSED process enabled the country to articulate, for the first time, a medium- and long-term development vision that identifies Albania's main development challenges and explicitly addresses poverty.

The IMF will continue to take the lead in assisting Albania to maintain macroeconomic stability and financial sustainability through setting quantitative targets within the framework of the Poverty Reduction Growth Facility (PRGF). In addition, the IMF's structural conditionality focuses on three main categories: fiscal management and control; payments discipline; and privatization.

The Bank leads the policy dialogue in financial sector reforms, power sector reforms, pension reforms and social services, as well as public expenditure management and public administration reform, and collaborates closely with the IMF on implementation.

Bank Group Strategy

The Bank's operations have been designed to support Albania's implementation of its NSSED. Therefore, in line with the objectives of the NSSED, the Bank focuses on three priorities:

- *Improve governance and strengthen institutions*, by strengthening transparency and accountability at all levels, increasing the contestability of the policy formulation process, and improving policy monitoring and evaluation.

- *Promote sustainable private sector growth*, through improving the environment for private sector development, continuing financial sector reforms, sustaining agricultural growth, improving infrastructure and promoting environmentally sustainable use of natural resources.

- *Foster human development*, by improving access to and quality of education and healthcare, strengthening the sustainability and equity of the social insurance system, and improving targeting and efficacy of social assistance and community social services.

Overall, the Bank's lending operations reflect a cross-sectoral emphasis on reducing poverty, strengthening institutions, and increasing transparency and accountability. To date, the Bank has approved a total of 47 operations amounting to US$657 million, of which 23 are completed. During the next three years, the Bank will use a mix of adjustment and investment lending as well as country analytic work to best support the NSSED. In line with its new Country Assistance Strategy, the Bank is planning on three successive Poverty Reduction Support Credits (PRSCs) plus 10 possible investment operations in education, health, power, transport, environment, municipal water, and community works.

The PRSCs provide a strong core for the Bank's lending program and focus on multi-sectoral and thematic policy reforms that are best addressed through a single adjustment operation. The four key areas supported under the PRSCs are: promoting sustainable growth and private sector development; strengthening capacity to monitor and evaluate the policy agenda; improving service delivery and social safety net effectiveness; and improving core public functions and institutional arrangements. The PRSCs and the investment operations are complementary and mutually reinforcing: the PRSCs support reforms crucial for investment projects, while investment projects help build the capacity needed to implement reforms.

The Bank will continue work to strengthen external partnerships, particularly with the EU, which is expected to begin negotiating a Stabilization and Association Agreement with Albania in early 2003. The Bank will continue to ensure a close collaboration with the IMF in major areas of reforms.

Bank-Fund Collaboration in Specific Areas

As part of its overall assistance to Albania—through the PRSC, investment lending, and country analytic work—the Bank supports policy reforms in the following main areas, in close collaboration with the IMF:

- *Financial sector reforms*

Following the civil crisis in 1997, triggered by the collapse of the pyramid schemes, Albania began implementing a broad-based program of reforms in the public administration and financial sectors. The Government's reform program has been formulated as part of its NSSED and aims at divesting the State from the banking and insurance sector and at the establishment of sound governance structures in the financial institutions. Its priority has been the revival of banking sector reforms, which are now well underway. All state-owned banks, with the exception of the Savings Bank have been privatized.

The Financial Sector Adjustment Credit, approved by the Board in June 2002, will help to advance reforms in the banking sector. Measures supported by the Bank include the privatization of the Savings Bank, the development of a deposit insurance system, improvement of the bankruptcy framework and collateral enforcement, and strengthening of bank regulation and supervision, which will also assist the Government's anti-money laundering efforts. The IMF has provided technical assistance to the Bank of Albania. The IMF is also funding a resident adviser to support the implementation of the institutional development program for banking supervision developed by the Bank of Albania.

The Government's program of reforms in the sector has been agreed in consultation with the Bank and the IMF, and the two institutions support the Government's strategy. The restructuring of the financial sector is progressing well. Privatization of the Savings Bank is critical to the reform of the system. As such, it is given high priority by the Government and it is also emphasized in the PRGF program.

- *Power sector*

Since mid-2000, Albania has experienced a severe electricity shortage, necessitating extensive power outages despite large Government subsidies for imports of electricity. The crisis results from several factors: excessive demand caused by a chronic failure to curb illegal use and nonpayment; impact of a dry hydrological cycle on the largely hydropower-based system; and transmission capacity constraints limiting electricity imports. Recognizing the magnitude of the crisis and its wide-ranging macroeconomic and social implications, the Government developed, in consultation with the World Bank, a two-year energy sector action plan at the end of 2000 to curtail illegal use of electricity, improve the financial situation of KESH, reduce excessive demand and budgetary subsidies, and increase domestic generating capacity. The action plan was updated for 2002–2003, and the Government has also adopted a Policy Statement setting out the power sector reform program.

The Bank has played the lead role in coordinating a unified stance among power sector donors on major sector issues, and has assisted the Government in shaping sector policy. Conditionality related to improving sector performance, sector restructuring, and strengthening the regulatory and legislative framework is included in the Power Sector Rehabilitation and Restructuring Project, which was approved by the Board in June 2002. The Fund-supported conditionality proposed for the three-year arrangement under the PRGF focuses on the budgetary implications and the elimination of subsidies for electricity imports by the end of the program period.

The Bank and the Fund support the Government's strategy for overcoming the crisis in the electricity sector and agree with the authorities that this will be indispensable for growth and macroeconomic stability.

- *Pension reform and Social Services*

The Government's pension reform aims to reduce the reliance of the pension system on budgetary transfers, while addressing the overall, longer-term problems of coverage, affordability, equity, and adequacy. The pension system's deficit currently amounts to about one percent of GDP, and projections suggest that this deficit will worsen over time in the absence of reform. Compliance is low, and high social insurance contribution rates discourage willing participation in the pension scheme and in formal employment. At the same time, pensions play an important role in rural poverty alleviation and as a social safety net for the elderly.

The Fund has stressed the importance of pension reform as a key component of medium term fiscal consolidation, and has provided policy advice to the Social Insurance Institute on the reform options available to the Government. The Bank has focused intensively on pension reform under the framework of the PRSC program, and has agreed with the Government on a comprehensive program of related parametric reforms. The first round of reforms implemented under the PRSC-1 framework included, *inter alia*: (i) increasing the retirement age for men and women; (ii) reducing the contribution rates for employees' pensions and other social insurance benefits; (iii) changing the base for assessing contributions designed to increase collections for employees' pensions; (iv) improving performance in collecting pension contributions; (v) narrowing the gap in pension levels for self-employed rural and urban workers, as well as increasing their levels in real terms; and (vi) raising contribution rates for self-employed rural workers, which are currently extremely low. The Bank and the Fund both fully support the approach being adopted in this sector, with the related conditionality being fully incorporated within the Bank-supported PRSC program.

Albania's ability to ensure the health and welfare of its population has been compromised by a weak physical infrastructure, major shifts in demography including significant population movements, internal and regional instability, limited governance capacity, poor resource management and weak technical capabilities. Restructuring and reform of basic social services is therefore a priority element of poverty reduction. The Government's program addresses chronic under-funding in health and education by increasing budgetary allocations to these sectors under the MTEF, while also outlining reforms to improve the access and quality of education and health, as well as the targeting efficiency of social protection. The Fund has addressed a number of related measures during its regular review of the budget and the Medium-Term Expenditure Framework (MTEF). The Bank is supporting a comprehensive program of sector reforms through the PRSC, specific investment loans (for the human development sectors and public administration reform), and a program of economic and sector work. The Bank program focuses on strengthening sector management to improve the Government's ability to develop, monitor, and evaluate an effective policy agenda. The social sector conditionality is fully incorporated within the Bank supported PRSC program, with the Fund also monitoring the budgetary impacts of social sector reform as a part of its regular dialogue with the Government.

- *Public expenditure management*

Key challenges include: (i) ensuring that Government efforts to create a transparent budget decision making process become self-sustaining; (ii) improving the usefulness, quality, and timeliness of information upon which budget decisions are made; and (iii) enhancing budget execution transparency and accountability mechanisms, including audit mechanisms. To meet these challenges, the Government has continued to make the MTEF the centerpiece of its budget formulation process to prioritize expenditures more efficiently and to strengthen the linkages between policy objectives and budget planning. As a first step in this process, and as part of the PRSC, the Government has closely linked the preparation of the NSSED with the preparation of the MTEF.

To increase the effectiveness of the NSSED programs, the Government, as part of the PRSC, has committed to undertake a number of measures to further improve the public expenditure management process, including preparing an action plan for strengthening budget systems, procedures, and monitoring of budget outputs; training budget staff in line ministries; and preparing procedures for recording disbursement and expenditures on all externally-financed projects, including those financed by grants. To improve transparency and accountability the Government will also take steps to improve financial reporting and audit functions.

The PRGF arrangement complements the above-mentioned measures by focusing on fiscal management and control, payment discipline, and mobilizing adequate resources for expenditure priorities under the NSSED. In particular, strengthening tax and customs revenues, improving budget control of foreign-financed projects and state-owned enterprises are included in the program and deemed essential for safeguarding the programmed fiscal adjustment. Moreover, actions envisaged to regularize inter-enterprise and external arrears help address the issues of contingent budget liabilities as well as ongoing payment discipline and improved debt management. In the view of Bank staff, these measures will help maintain fiscal sustainability, and together with monetary and exchange rate policy of the PRGF program, will help ensure a sound macroeconomic environment for sustainable growth.

Prepared by World Bank staff. Questions may be addressed to Mr. Mansour Farsad at 473-2963 or Ms. Kathryn Funk at 473-5443.

Albania: Statistical Issues

Albania has made significant progress in improving its statistical database with extensive technical assistance, including TA 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. This mission was followed by several other missions in the areas identified as priority, and a resident national accounts advisor assisted the Institute of Statistics (INSTAT) during July to December 1999. In establishing a compilation system for producing GDP estimates, STA fielded short-term follow-up missions in national accounts statistics during 2001 and 2002. The authorities have thus far made progress in implementing the action plan agreed with the multisector mission as well as the recommendations of follow-up missions. The Council of Statistics has been established and its constitution and functions have been ratified. However, much still remains to be done, in particular as regards the medium-term objective of improving the compilation of the national accounts.

Albania was selected as a pilot country for the preparation of the data dissemination module of the Report on Observance of Standards and Codes (ROSC), and the ROSC was published in the Funds' website in May 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 is posted and regularly updated on the Fund's Dissemination Standards Bulletin Board (http://dsbb.imf.org). The metadata also include a comprehensive summary of plans for improving data compilation and dissemination across all statistical sectors, including socio-demographic indicators. Notwithstanding existing problems concerning the quality of Albania's database, the authorities have provided the Fund with requested information in accordance with Article VIII, Section 5.

Real Sector

A. Price Statistics

STA has provided considerable technical assistance to Albania on price statistics. The consumer price index (CPI) constructed by INSTAT meets international standards. It is reported regularly for publication in the Albania page in *International Financial Statistics (IFS)*. In 2001, a revision of CPI weights was initiated by INSTAT based on a new household budgetary survey. With assistance from STA a revised CPI was finalized in February 2002. As regards the producer price index (PPI), the technical assistance from STA on the PPI had been stalled during the civil disorder (1997), but resumed in early 2000. STA missions of May 2000 and January 2002 assisted INSTAT in finalizing the development of the PPI for Albania. The official monthly PPI has been published on a quarterly frequency since March 2002.

B. National Accounts

In the absence of official national accounts aggregates since 1990, Fund staff have relied on their own estimates prepared in consultation 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 resident advisor on national accounts assisted INSTAT to establish a compilation system for producing GDP estimates using existing and new data sources. As a result, preliminary annual GDP estimates for 1996–98 using both the production and expenditure approaches at current and constant prices were produced.. 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 STA mission of January 2001 assisted INSTAT to further improve and develop national accounts statistics in accordance with the *System of National Accounts 1993 (1993 SNA)*. The mission worked with the authorities in improving the annual GDP estimates for 1996–99 by using the results of the 1998 and 1999 Annual Structural Survey and of the recently available 1999 PPI results. However, the compilation of GDP estimates continues to be hampered by weaknesses in basic data sources and incomplete coverage of the private sector and the informal economy. A follow-up STA mission in April 2002 recommended further enhancements and agreed on an action plan aimed at dissemination of the annual GDP data for 1996–2000 by end-December 2002. The action plan also identified activities for further improving the national accounts, for which additional technical assistance is needed.

STA has recently prepared a proposal for a technical assistance project for which the Italian government has agreed to commit $500,000 from its sub account with the IMF over a period of two years. The project will be put up for competitive bid from advanced national accounts agencies and represents an innovation in the way STA contracts technical assistance by promoting a fixed-price contract approach. The proposed project is aimed at further improving the national accounts estimates and basic source data. The project identifies the required technical assistance inputs (from the authorities and the technical assistance provider) and the indicators of implementation of the project.

C. External Trade

Data collection suffered extensively during the 1997 crisis as a number of customs posts were damaged or destroyed, and most likely a large temporary increase in the volume of unreported transactions occurred. After some delays during the Kosovo crisis, the compilation and dissemination of foreign trade indices 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 1999 assisted in upgrading the quality of the data reported in this publication to *GFSM 1986* standards and developing a system for the regular and timely reporting of data to the Fund for publication. Data for 1997 and 1998 have since been reported for inclusion in the *GFS Yearbook*; although data for 1999–2002 have not been reported. Some 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. Nonetheless, further improvements are urgently required regarding the accuracy and timeliness of information on foreign financed capital expenditures.

Monetary Accounts

The existing data compilation framework conforms to the methodology recommended in the *Monetary and Financial Statistics Manual*, and data are compiled on a timely basis. Following the multisector statistics mission's recommendation to expand the coverage of monetary statistics to include the accounts of the savings and credit associations (SCAs), the legal framework has been changed to permit the authorities to require reporting by the SCAs. However, SCAs have not reported data yet, and hence, they are not covered in the monetary survey.

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 money and banking statistics mission of November 1999 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.

The authorities have revised the monetary accounts of the BoA, the commercial banks, and the monetary survey from February 2001 onward to properly record the repurchase and reverse repurchase agreements; the revised data have been published beginning with the October 2002 issue of *IFS*. The authorities are also making efforts to revise the historical data.

Balance of Payments

The data compiled by the BoA are methodologically sound, although some estimates need to be refined. The BoA has established data compilation procedures based on the classification system of the fifth edition of the *Balance of Payments Manual (BOPM5)*. The BoA reports quarterly data to STA on a regular and timely basis. In 2000, the BoA revised the methodology for measuring tourism services, principally through the introduction of surveys of travelers.

While this should improve the measurement of tourism services, further refinements are required. More generally, there are no reliable source data on most other service transactions and on remittances, financial account transactions, and foreign investment. In addition, problems remain regarding the monitoring of foreign assistance and external debt. These problems could be addressed by strengthening existing data sources and improving estimation methods. The Albanian authorities have not yet initiated compiling data on foreign currency liquidity in line with the Data Template on International Reserves and Foreign Currency Liquidity. While the definition of data on official reserve assets in principle is consistent with that of the data Template, the data may not be adequate for monitoring the economy because other foreign currency assets and currency drains are not included.

External Debt Statistics

External debt statistics for government and government-guaranteed debt are compiled by the Ministry of Finance (MoF). These data are generally sound. The MoF's external debt database, developed with technical assistance from UNCTAD, became fully operational in mid-2000. The external debt database ensures timely and accurate reporting of external government debt (including commitments of state-owned enterprises). However, the coverage of external debt data could be improved toward SDDS specifications. There have been some irregularities in the presentation and recording of old external arrears. The External Debt Committee needs to work to improve coordination to ensure the timely and accurate reporting of the stock of external arrears and changes resulting from rescheduling agreements. The authorities do not collect data on private sector external debt and should work to extend coverage to include private sector liabilities.

Albania: Core Statistical Indicators
(as of Jan. 7, 2003)

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Govern. Balance	GDP/GNP	External Public Debt/Debt Service
Date of Latest Observation	Jan 7	Jan 6	October	October	October	Dec 17	November	September	2002Q2	October	2001	September
Date Received	Jan 7	Jan 7	December	December	December	Dec 18	Dec 9	Dec 9	October	November	July	October
Frequency of Data	Daily	Daily	Monthly	Monthly	Monthly	Bi-weekly	Monthly	Monthly	Quarterly	Weekly/ Monthly	Annual	Quarterly
Frequency of Reporting	Daily	Daily	Monthly	Monthly	Monthly	Bi-weekly	Monthly	Monthly	Variable	Weekly/ Monthly	Annual	Variable
Frequency of Publication	Daily	Monthly	Monthly	Monthly	Monthly	Bi-weekly	Monthly	Monthly	Variable	Variable	Annual	--
Source of Update	BoA	BoA	BoA	BoA	BoA	BoA	INSTAT	Customs/ BoA/INSTAT	BoA	BoA/MoF	Estimated in consultation with the authorities	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 7, 2003

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

Dear Mr. Köhler,

1. Since the start of Albania's current Poverty Reduction and Growth Facility (PRGF) arrangement, macroeconomic stability has been maintained, and all quantitative performance criteria have been observed. However, we regret delays in implementing structural reforms. In particular, parliamentary approval for the closure of duty-free shops at all land crossing border areas—an end-September 2002 structural performance criterion—was delayed temporarily. The impact of this short delay has been minor, given that in July 2002, we adopted measures to prevent the sale of alcohol and tobacco in these shops. On this basis, we request a waiver for the nonobservance of this structural performance criterion.

2. The attached supplementary Memorandum of Economic and Financial Policies (MEFP) and the Technical Memorandum of Understanding describe our economic program for the period ahead. In particular, the draft 2003 budget has been prepared and submitted to parliament, and is supported by a well-specified set of measures for improving tax collection. As prior actions for the completion of this review, we will secure parliamentary approvals of closure of duty free shops and of the agreed 2003 draft budget. Based on these actions, our policy proposals, and our firm commitment to strengthen performance under the arrangement, we request completion of the first review under the PRGF arrangement.

3. The Government and the Bank of Albania believe that the policies outlined in the attached MEFP provide a sound basis for achieving our program targets. During the period of this arrangement, Albania will consult with the IMF on the adoption of any further measures that may be appropriate, at the initiative of the Government or Bank of Albania, or whenever the Managing Director of the IMF requests such a consultation. In addition, the authorities will provide the IMF with such information as the IMF may request in connection with the implementation of the program. We will continue to conduct bi-annual reviews with the Fund under the PRGF arrangement, the second before end-July 2003 and the third before end-January 2004.

4. Moreover, after the period of this arrangement and while Albania has outstanding financial obligations to the IMF arising from loan disbursements under this arrangement, Albania will consult with the IMF from time to time on economic and financial policies, at the initiative of the Government or Bank of Albania or whenever the Managing Director of

the IMF requests such consultation. These consultations may include correspondence and visits of officials of the IMF to Albania or of representatives of Albania to the IMF.

Sincerely yours,

/s/	/s/	/s/
Fatos Nano	Kastriot Islami	Shkëlqim Cani
Prime Minister	Minister of Finance	Governor, Bank of Albania

Supplementary Memorandum on Economic and Financial Policies of the Government of the Republic of Albania for 2002–03 Under a Three-Year Poverty Reduction and Growth Facility (PRGF) Arrangement

I. Background

1. **This memorandum describes our economic program for the period October 2002–June 2003.** It supplements the June 2002 memorandum, which also outlined our medium-term strategy for 2002–05, consistent with our November 2001 PRSP, entitled National Strategy for Socio-Economic Development (NSSED or GPRS).

2. **The change in government in July 2002 has not weakened our commitment to reform and the program.** While political developments during the past year, coordination problems within the successive governments, and the difficult overall environment in 2002 have had an adverse impact on policy implementation, we remain fully committed to the program. We are giving priority to reversing past slippages, improving policy coordination and accelerating reforms aimed at fostering economic growth, improving governance, reducing corruption, and promoting European integration.

3. **Macroeconomic stability has been maintained since the start of the current PRGF-supported program.** Inflation has remained under control, although—owing to statistical and supply-side factors, in the context of strong demand—it has been mostly above its 4 percent target ceiling during the past year. Monetary stability was interrupted in March and April by a bank run, but we responded appropriately and deposits have started to recover. However, as a result of electricity shortages, recent floods, and spending cuts, growth has moderated to around 4½ percent to 5 percent in 2002. The current account is now estimated to have deteriorated to 8¾ percent of GDP in 2002, due to weak export and tourism performance. The exchange rate has been stable following its effective depreciation in the second quarter.

4. **However, fiscal performance has been mixed, with shortfalls in tax and customs receipts.** Collection targets have been missed almost consistently during 2002, despite improvements in the second half of the year. Political uncertainties and other exogenous factors have caused delays in efforts to expand the tax base—in the context of ambitious targets and lower-than-projected GDP growth. The impact on the deficit, however, has been broadly offset by difficulties in implementing planned investments. Consequently, net credit to government stayed below the program ceiling at end-September (performance criterion). The duty-free shops at land border crossings have been prevented from selling cigarettes and alcoholic beverages since July 2002, but we regret that more time has been needed to secure parliamentary approval for their full closure and request a waiver for missing the related structural performance criterion. Also, new environmental and agricultural taxes, initially scheduled for September 2002, will now be introduced within the context of the 2003 budget.

5. **Following delays in a number of areas, we are strengthening our structural reform efforts.** Although we met all prior actions for the IMF's June Board meeting, and

several benchmarks under the PRGF arrangement, we encountered difficulties concerning some key structural measures. Despite our concerted efforts, no buyer could be selected for the Savings Bank, as the two interested foreign banks withdrew from the bidding process. In addition, Albtelekom's various financial and legal claims have not been settled yet, complicating its eventual privatization. Issuing government securities with a 2-year maturity was delayed from June to October due to legal complications. We have made some progress in reconciling public sector inter-enterprise arrears, but the process requires more time than expected. In the electricity sector, several monthly targets for reducing losses and improving collection have been missed since May 2002, in part owing to the accumulation of new arrears by the water companies vis-à-vis the electricity company (KESH).

II. Objectives and Policies

A. Overall Strategy

6. **In line with the NSSED, our macroeconomic and structural policies will continue to focus on promoting growth and reducing poverty.** We will aim to establish better conditions for private sector activity through: (i) ensuring macroeconomic stability; (ii) addressing infrastructural weaknesses (including electricity shortages); (iii) intensifying dialogue with the private sector to create a more business-friendly and transparent environment; (iv) improving governance; and (v) strengthening the financial system. Expenditure policies will complement efforts to promote growth by enhancing the focus on—and effectiveness of—priority spending. We plan to finalize an NSSED progress report by April 2003, which will focus on improving the costing and prioritization of spending plans. Monitoring and evaluation capacity is being strengthened in line ministries to improve the availability and analysis of policy-relevant data. We will make efforts to address the serious deficiencies in data collection, which hamper well-targeted policy design. As INSTAT bears the primary responsibility for this task, we have increased its resources in the 2002 and 2003 budgets. We will give top priority to improving communication and coordination among various ministries and agencies to enhance policy implementation and program monitoring. A fiscal Report on Observance of Standards and Codes in February 2003 will help identify further improvements in fiscal policy design, transparency, and data provision.

B. Macroeconomic Framework

7. **In light of recent developments, the macroeconomic framework for 2002–05 has been revised.** Overall, the macroeconomic outlook remains favorable. However, owing to adverse effects from the electricity situation, limited foreign investment, and the data constraints noted above, projected real GDP growth has been revised down from 7 percent to around 6 percent during 2003–05. The fiscal outlook has been adjusted to incorporate lower projections for tax and privatization receipts, with revised spending plans and lower overall fiscal deficits of 6½ percent of GDP in 2003 and 6 percent of GDP in 2004. The lower tax revenue projections are motivated by slippages during 2002, the projected growth slowdown, and the findings of a recent IMF Fiscal Affairs Department (FAD) mission. Inflation is

expected to stay within its 2–4 percent target range in 2003 and beyond, supported by cautious monetary policies, and reserve coverage is projected to remain above 4½ months of imports. Although the current account deficit is expected to narrow by 1¾ percent over the program period, the deterioration during 2002 highlights the importance of addressing weaknesses in foreign investment and the export sector. The overall outlook is subject to several risks, including uncertain electricity provision and fragile financial sector confidence. We will monitor developments closely and consult with Fund staff regarding appropriate revisions to the macroeconomic outlook if necessary.

C. Fiscal Policy

8. **The 2003 budget envisages an overall deficit of 6½ percent of GDP and domestic borrowing of 2¾ percent of GDP.** Budgeted tax and customs receipts are now targeted to increase by about 15 percent relative to the estimated 2002 outcome—to 17.1 percent of GDP, compared with 18 percent of GDP under the program. While we remain fully committed to gradually raising tax compliance, slippages in 2002 have prompted us to re-evaluate the current strategy. Against this background, the increase in budgeted revenue relative to 2002 is based on both tax policy measures in the 2003 budget and further improvements in tax and customs administration. In addition, the budget assumes no privatization receipts from the sales of Albtelekom or the Savings Bank during 2003. The ceiling on domestic borrowing has been raised by ½ percent of GDP relative to the June program to limit the impact of these changes on essential spending under our poverty reduction strategy. Nevertheless, expenditures will only increase moderately relative to 2002. Foreign financing will consist mainly of resources provided on concessional terms. As a prior action to completing this review, the 2003 budget, in line with the policies in this memorandum, will be approved by parliament. In view of the uncertain prospects for GDP growth, and tax and privatization receipts, we will ask line ministries for clear prioritization of all projects in line with the NSSED, in the event that the budget may need to be re-assessed.[1]

9. **We will improve tax and customs revenue collection on the basis of our medium-term revenue framework and the recommendations of the recent FAD mission.** Further strong reforms are needed to modernize our tax and customs administrations, and fight more effectively fiscal evasion and smuggling. As a result, we are strengthening and expanding the strategy laid out in our June 2002 memorandum. We agree with the FAD mission's argument that the focus on revenue targets should not compromise reform efforts, and that the transparency and relative simplicity of our tax system should be maintained. In this context, we will strengthen our tax and legal systems to raise tax compliance over the medium term, and will not introduce any scheme that would undermine such efforts or raise

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[1] Higher privatization receipts up to Lek 3.6 billion (0.5 percent of GDP) will be used to pay down domestic debt and receipts above that amount may be used for higher spending consistent with NSSED priorities.

the potential for money laundering and other illegal activities. Furthermore, parliament will approve the draft law on the closure of duty-free shops (prior action for the first review).

10. **We will execute the following measures for raising tax compliance and attaining the targeted revenue increase in 2003.** Regarding **tax and social insurance**, we will:

- Shift responsibilities for the collection of social insurance to the Tax Department (TD), starting with the clients of the large taxpayer unit (end-September 2003) and large nonbusiness payers of social insurance (end-December 2003). To this end, we will strengthen cooperation between the TD and Social Insurance Institute, including by undertaking complementary measures agreed with the World Bank to help resolve administrative hurdles. We will prepare monthly reports on measures taken.

- Implement fully a new function-based organization structure in the TD (end-February 2003) and recruit around 40 additional appropriately skilled staff in the TD's headquarters (structural benchmark; end-May 2003).

- Reduce the rate of interest for late payment to a more commercially realistic level (for example, 3–4 percentage points above annual average bank lending rate, with periodic re-assessments) and ensure consistency between interest rate charges for social insurance and other taxes.

- Establish formal tax policy and revenue forecasting units within the Ministry of Finance (MoF) (end-June 2003).

- Complete implementation of new computer administration systems for profit taxes (end-June 2003) and small business tax and excise (end-September 2003).

- Raise the number of registered taxpayers to 57,000 by mid-2003.

In relation to **tax policy**, we will:

- Introduce a new excise law (by end-June, 2003) aimed at (i) bringing most excise rates close to EU standards and aligning them with the existing customs code; and (ii) enhancing administrative procedures, including for tax assessment, the appeals process, the approval process of establishing bonded warehouses for excisable goods, and search and inspection of sites suspected of evading excise taxes. Introduce environmental and agricultural land ownership taxes in the 2003 budget.

In the area of **customs administration**, we will:

- Develop an overall strategy for combating customs fraud and corruption based on effective direction to field units, an enhanced role for regional offices, cooperation with the TD, and internal audits (end-March 2003). Enhance cooperation between the Customs

Department (CD) and TD to fight evasion through underinvoicing. An action plan was adopted in June 2002 and a report is being prepared.

- Establish a post-clearance control unit of up to 10 senior inspectors, concentrating on valuation, classification, origin, exemption, and suspension claims (structural benchmark; end-May 2003), while continuing to regularly update the reference prices file.

- Complete implementation of ASYCUDA computer administration system in the Tirana custom house and Durrës port (end-September 2003).

- Maintain the quarterly reporting on corrective measures being taken to deal with problems identified by internal audit function.

11. **We will enhance our efforts to improve relations with taxpayers and reform the appeals procedures.** We will extend the tax base to reduce pressure on the limited pool of existing taxpayers. To ensure the fair application of tax legislation, we will establish taxpayer service centers in the TD and CD, and each local tax branch, and create mechanisms to speed up VAT refunds. We will set up a working group, comprising representatives of the MoF, TD, and business community, to strengthen the independent appeals tribunal for resolving tax disputes. We will revise the procedures and manuals for the enforced collection of all taxes (including the freezing of bank accounts) to comply with the following principles, unless there are extraordinary circumstances pertaining to a particular taxpayer: (i) all overdue tax liabilities will be subject to initial collection action and respect for taxpayers' right of appeal before enforced collection measures are initiated; (ii) enforced collection measures will not be initiated if the liability is less than 30 days overdue or is the subject of an appeal; and (iii) taxpayers will be given 30 days from the date of notification of an appeal decision before further collection action is taken. Procedures for the initiation and conduct of enforced collection action will be disseminated publicly and their operation subject to oversight by the taxpayers' consultative forum to be established (structural benchmark, end-May 2003).

12. **In the 2003 budget, we will continue our efforts to reorient expenditures toward NSSED priorities.** In particular:

- We intend to increase expenditure allocations for health and education by about 15 percent relative to the 2002 outturn, and, in consultation with the World Bank, introduce specific measures to improve access by the poor to health care.

- The wage bill will not increase in 2003 as a share of GDP, implying a real increase of up to 6 percent. Of this, over 4 percent is already locked in by the carry-over from salary increases in 2002, limiting the room for new salary increases in 2003. Within this envelope, the sectoral allocation of the salary increases will be determined in consultation with the World Bank. To further assist efforts at building a more effective public administration, a database on all employees is becoming fully functional.

- The quality and motivation of teachers and healthcare workers will be strengthened by reducing wage differentials vis-à-vis the private sector, increasing wage differentiation within these sectors, and conducting specific training programs. To this end, the 2003 budget envisages further salary increases in health and education by around 5 percent in real terms.

- We will continue to improve the targeting of allocations for social assistance, including through completing a World Bank-supported study on social safety nets.

- Electricity import subsidies will be limited to Lek 3.4 billion in 2003. To increase transparency, we have included other subsidies as separate line items in the budget—specifically for the payment of arrears (Lek 1.6 billion) and the concession agreement with the Italian company, DARFO (Lek 0.4 billion). In addition, to ensure the full and timely payment of current obligations by the water companies to KESH, the budget includes an explicit subsidy to the water companies (including about Lek 0.6 billion for electricity) and a designated amount in the reserve fund (Lek 0.4 billion).

- We will give local communities more decision-making authority within our program of decentralization, with further increases in grants, and will ensure that the pace of decentralization is in line with progress in developing administrative capacity.

- To the extent possible, any net government obligations arising from the regularization of inter-enterprise arrears (see below) may be met from the reserve and contingency funds. We will otherwise use the reserve and contingency funds sparingly and in emergencies.

13. **We will continue our efforts to improve expenditure management.** To enhance the timeliness and quality of reporting foreign-financed capital expenditures, we will issue a new regulation (and ensure its implementation) requiring project-implementation units in line ministries to report on a monthly basis. We will continue with computerizing regional treasury offices to improve reporting—to be completed for the Tirana office in 2003 and for the entire project in 2004.

14. **We will proceed to regularize inter-enterprise arrears.** A procedure for settlement of inter-enterprise arrears has been put in place. With respect to large enterprises, we are in the process of finalizing the recording of these arrears, completing the reconciliation process, and signing bilateral Memoranda of Understanding specifying net overdue amounts as of December 31, 2001. As the next step, and in consultation with Fund staff, we will reduce the stock of these arrears through bilateral netting and determine the amount of arrears that can be cancelled through government assisted scheme for multilateral repayments of arrears. Public companies participating in this scheme will be required to enter into contractual arrangements with the government. We will design strategies for promoting the full and timely payment of all obligations contracted after December 31, 2001 (structural benchmark; end March 2003). For this purpose a special unit will monitor, and report to the Ministry of Finance and Economy, and line ministries, on a quarterly basis, the receivables and payables

position of these companies. We will also assess the inter-enterprise arrears position of the smaller public enterprises, and if required, encompass these within our scheme.

D. Monetary Policy

15. **Monetary policy will remain cautious, given the risks to inflation and with base money still elevated after the large-scale withdrawal of bank deposits.** We will ensure that the independent position of the Bank of Albania (BoA) will not be compromised. The BoA will continue to conduct its monetary operations with the aim of keeping inflation within a 2–4 percent range, in the context of a flexible exchange rate regime, while smoothing excessive exchange rate fluctuations. The repo rate will remain our key policy instrument, while we will also seek to ensure compliance with NIR and NDA targets under the program. We will proceed with plans to strengthen data collection, conduct research on the determinants of inflation, and further refine our policy instruments, with technical assistance from the IMF's Monetary and Exchange Affairs Department (MAE).

16. **The monetary program assumes continued monetary stability, inflation in line with the target, and a reserve-to-import ratio of about 4½ months.** Velocity is projected to decline slightly, in part due to the redepositing of foreign currency withdrawn in March and April 2002. Moreover, the trend shift within broad money towards foreign currency deposits is expected to persist in 2003. The gradual return of depositors to the banking system is also reflected in limited base money growth in the first half of 2003.

17. **The BoA will continue to strengthen banking supervision**, in the context of the new Supervisory Development Plan, developed in consultation with the World Bank. The MoF will reinforce its efforts to combat money laundering. In both areas, technical assistance will be provided by a new MAE resident advisor.

18. **The BoA will strengthen its control, accounting, and auditing systems**, in line with the July 2002 safeguards assessment report. It will seek to ensure the timely implementation of the recommendations to: (i) guarantee the integrity of data reporting under the program; (ii) strengthen its internal auditing on the basis of the recommendations of the Financial Services Volunteer Corps; (iii) formalize the oversight of nonexecutive members of the Supervisory Council over the bank's auditing, internal control, and financial reporting; and (iv) ensure that any remaining deviation from International Accounting Standards is stated in the audit opinion, and disclose the financial implications. The BoA will continue to cooperate with the safeguards policy and provide updated documents and data as necessary.

E. Structural Policies

19. **We will intensify efforts to improve the Savings Bank's and Albtelekom's marketability following privatization delays.** With World Bank assistance, we are preparing an action plan to restructure the Savings Bank. Specific measures include: (i) transferring all pension functions to Albapost by end-March 2003 (structural benchmark); (ii) further efforts to move the bank's fiscal functions to other banks; (iii) further consolidation of rural offices; (iv) strengthening its IT network; and (v) building the capacity

for credit provision—although no credit will be extended before privatization except on a pilot basis and with the prior approval of the BoA, and World Bank and Fund staff. In view of the partial exemption of the bank from the Competition Law, we will, by end-June 2003, prepare draft legislation to avoid abuse of market power. Regarding Albtelekom, we will submit a request for deregistration of its joint venture with New World to the Tirana court by end-January 2003. We will also settle the company's remaining unresolved financial claims by end-March 2003 (structural benchmark). In the oil sector, we will bring all parts of ARMO and SERVCOM to the point of sale by end-2003.

20. **Recent slippages in electricity sector reform will be addressed without delay.** We are making every effort to ensure that the end-December 2002 and end-March 2003 targets under the Action Plan are met. Meeting these targets is critical also for maintaining essential donor support. To this end, we have stepped-up disconnections in case of nonpayment. Also, the MoF will monitor carefully the financial situation of KESH to help ensure compliance with the collection targets and to avoid unexpected financial problems—in particular, the emergence of new arrears or slippages in counterpart financing. We remain fully committed to phasing out subsidies to KESH for electricity imports by the end of 2004. We will adopt a new Action Plan for 2003–04, with further measures and targets to improve bill collection and reduce losses. Electricity prices will be increased as of January 1, 2003, and we intend to introduce the next price increase no later than by January 1, 2004. Further price increases will be based on a World Bank-financed study and will be accompanied by measures to alleviate the impact on vulnerable households. The installation of electricity meters is key to reducing excessive electricity demand and we aim to complete the process by mid-2004. We will not grant any further concessions to investors that include reduced or fixed electricity tariffs. Regarding power generation capacity, we will only proceed with new electricity generation projects in consultation with the World Bank and will first focus our efforts on thermal power.

21. **Ongoing efforts serve to strengthen and modernize our financial system.** The deposit insurance scheme will become operational by end-January 2003. We have improved and expanded the accessibility of the BoA's windows for selling treasury bills. We will also encourage the direct sale of treasury bills by commercial banks and the MoF will actively support their marketing. With World Bank assistance, we will strengthen the supervision of the insurance market and establish a credit information bureau within the BoA. For small firms, access to credit will be facilitated by a partial guarantee scheme. Further improvements should result from the adoption of the new Bankruptcy Law in 2002.

22. **Improving the business environment, strengthening the export sector, and attracting foreign and domestic investors are crucial for sustained growth.** We will strengthen the consultation process with the private sector, including by reinforcing the role of the Business Advisory Council. We are establishing an investment promotion agency. We will consult with the World Bank before establishing export promotion and small business development agencies to ensure that these initiatives do not lead to increased bureaucracy or duplication. We will, in cooperation with the World Bank's Foreign Investment Advisory Service, conduct a study of administrative barriers by end-March 2003 and design an action

plan for implementing its recommendations. In order to create better conditions for developing the agricultural sector, we will prepare a law to regulate private land ownership, complete the registration of most lots by 2004, and establish offices for land in every district.

23. **We will give a high priority to improving the quality and coverage of economic statistics, using the GDDS as a framework.** We will ensure that the first official National Account Statistics for 1998–2000 (including full documentation of the employed methodology and data sources) are published by end-January 2003. We will improve the quality of these statistics during 2003 and 2004 (planned to be financed in part by a grant from the Italian government) including through increasing the use of surveys and recruiting two additional technical staff. We will also make concerted efforts to strengthen the provision of short-term indicators of economic activity, essential for dependable policy analysis. To support these efforts, we will strengthen statistical reporting by the line ministries and other agencies to INSTAT and vice versa. In this context, to upgrade the exchange and disclosure of information, macroeconomic analysis, and methodologies, a Macroeconomic Committee has established a quarterly framework for prompt data sharing, involving other ministries as appropriate (in particular, the Ministry of Agriculture). We will monitor the adequacy of this framework on a regular basis. The new Law on Statistics will strengthen INSTAT's access to data, and approval by Parliament is foreseen before end-March 2003. We will examine the need for a further increase in INSTAT's budget in order to ensure adequate staffing. The BoA will begin to identify possible sources of data on foreign direct investment and private sector external debt.

F. External Policies

24. **With the envisaged foreign support, we expect that the balance of payments position will remain sustainable.** Creating a more business-friendly environment will be important in improving our external position through attracting foreign investors and strengthening exports and tourism. We will ensure external debt sustainability by observing ceilings on nonconcessional borrowing (performance criterion). We will reinforce efforts to strengthen evaluation and coordination of foreign-financed projects—including through quarterly reporting by line ministries on proposed foreign borrowing over a 3-year horizon.

25. **We are committed to eliminating our external arrears to official creditors during the PRGF-supported program.** In this context, the arrears to Greek companies were repaid in June and the rescheduling agreement with China (post-1978 arrears) was finalized in November. A new comprehensive set of criteria for dealing with external arrears has been submitted to Parliament and the MoF will continue quarterly reporting on these arrears (structural benchmarks) (the BoA will complete the transfer of all related documents before end-2002). To work toward accepting our Article VIII (Sections 2, 3, and 4) obligations, we plan to submit to Parliament, by mid-2003, rescheduling agreements relating to arrears already reconciled. We will also enhance efforts to regularize arrears to private creditors.

26. **We are committed to maintaining a liberal trade regime and enhancing regional cooperation.** We are working toward concluding the scheduled regional free trade

agreements and have sought advice from the WTO regarding the consistency of the recently imposed 1 percentage point import surcharge with our WTO membership commitments.

G. Program Monitoring

27. The second review under the PRGF-supported program will be based on end-March 2003 quantitative performance criteria and end-June 2003 indicative targets (see Table 1 and the Technical Memorandum of Understanding). Prior actions and structural benchmarks are presented in Table 2. Performance criteria and indicative targets for end-September and end-December 2003 will be set at the time of the second review. During the program period, Albania will not impose or intensify restrictions on the making of payments and transfers for current international transactions, or introduce multiple currency practices, or conclude bilateral payments agreements inconsistent with Article VIII, or impose or intensify import restrictions for balance of payments reasons.

Table 1. Albania: Quantitative Performance Criteria and Indicative Targets for 2001-03 1/

	End-Dec. 2001	End-Mar. 2002	End-Jun. 2002		End-Sep. 2002 2/		End-Dec. 2002	End-Mar. 2003 2/	End-Jun 2003
	Level	Actual	Actual	Prog. (Adj)	Actual (Est.)	Prog.	Prog.	Prog.	Prog.
					(In billions of Lek)				
Ceiling on net domestic credit to the government 3/	237.5	3.5	7.8	6.7	9.2	9.5	19.5	5.0	9.0
Ceiling on net domestic assets of the BOA 4/	78.1	6.8	10.3	11.2	5.0	12	17	19	20
Indicative target for revenues collected by Tax Department 5/	91	22	47	49	35.9	39	110	13.9	28.6
Indicative target for revenues collected by Customs Department 5/					36.3	39	56	12.9	26.9
Indicative targets for Social Insurance Revenues 5/	...				18.7	...	26	7.3	14.7
					(In millions of U.S. Dollars)				
Floor for net international reserves of the BOA 4/ 6/	542.6	4.8	2.9	-12	28.1	4	16	18	18
Ceiling on contracting or guaranteeing of public and publicly-guaranteed non-concessional external debt 7/ 8/	...	26.3	56.5	100	56.2	130	160	170	180
of which: 1-5 years	...	0	0	0	0	0	0	0	0
Ceiling on public and publicly-guaranteed external debt with original maturities up to and including 1 year 9/	...	0	0	0	0	0	0	0	0
Nonaccumulation of new external payments arrears, excluding interest on pre-existing arrears 9/	...	...	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 (TMU).
2/ Performance criteria, except for revenues collected by the Tax and Customs Department, which are indicative targets.
3/ For 2002: cummulative changes as of end-December 2001. For 2003: cummulative changes as of end-December 2002. The targets of 2002 assume privatization receipts of Lek 1.1 billion and budget support of Lek 9 billion (evaluated at an exchange rate of 144 lek per dollar).
4/ Cummulative changes as of end-December 2001.
5/ The end-March and end-June 2003 targets are based on cummulative changes as of end-December 2002.
6/ Derived using the end-December 2001 exchange rates.
7/ This performance criterion applies to the contracting or guaranteeing by the central government or the Bank of Albania as specified in the TMU.
8/ The end-March and end-June 2003 ceilings for contracting nonconcessional debt are tentative, based on preliminary and partial information from the authorities. Moreover, the limits do not include borrowing for the thermopower plant project being developed in consultation with the World Bank, which is expected to be reflected in the program through either excluding it from the debt limits on the basis that the concessionality of the total financing package exceeds 35% or explicitly including the nonconcessional financing components in these borrowing limits. Further analysis of the financing terms of prospective infrastructure projects terms and their debt implications will be undertaken before finalizing the proposed limits.
9/ These performance criteria apply on a continous basis.

Table 2. Albania: Prior Actions and Structural Benchmarks under the PRGF Arrangement

Measures	Test-date
A. Prior Actions for the First Review	
1. Parliament to approve the 2003 budget consistent with this Supplementary Memorandum of Financial and Economic Policies (MEFP, ¶8).	
2. Parliament to pass legislation to close duty-free shops at all land crossings in border areas to reduce scope for smuggling and tax evasion (MEFP, ¶9).	
B. Proposed Structural Benchmarks for the Second Review	
1. To strengthen tax and customs administration: recruit around 40 additional appropriately skilled and experienced staff in the Tax Department's headquarters (MEFP, ¶10); revise procedures and manuals for the enforced collection of taxes (MEFP, ¶11); and establish a post-clearance control unit with a staff of up to 10 senior inspectors, concentrating on valuation, classification, origin, exemption, and suspension claims, while updating reference prices regularly (MEFP, ¶10).	End-May 2003
2. Determine the amount of domestic arrears within the public sector that can be cancelled through government-assisted multilateral repayments and design strategies for promoting the full and timely payment of all obligations contracted thereafter (MEFP, ¶14).	End-March 2003
3. To promote the privatization process: complete the transfer of pension functions from Savings Bank to Albapost (MEFP, ¶19); and settle the remaining financial claims of Albtelekom (MEFP, ¶19).	End-March 2003
4. Prepare quarterly reports (within one month of the end of each quarter) on the stock of external arrears and progress in clearing these arrears (MEFP, ¶25).	Throughout

ALBANIA

TECHNICAL MEMORANDUM OF UNDERSTANDING

This memorandum defines the quantitative benchmarks and performance criteria established in the Memorandum of Economic and Financial Policies for October 2002–June 2003 (MEFP).

A. Net Domestic Credit to the Central Government

1. For the purposes of the program, the **central government** covers the State Budget, 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 held by the Bank of Albania, domestic commercial banks, and other domestic lenders (including insurance companies, other firms, and households), 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.[1] Credits comprise bank loans and advances to the government (excluding advances on profit transfers by the Bank of Albania), holdings of government securities, due but unpaid interest, and negative balances in government deposits with banks.

3. 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). 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. Those components of net domestic credit to the government denominated in foreign currencies are to be valued as stipulated in the GFS. Data on other components of credit to government, if any, will be reported by the Bank of Albania.

4. According to the above definition, the level of **net domestic credit** to government was Lek 237.8 billion at end-December, 2001.[2] Gross loans were composed of (i) total outstanding T-bills at issue price in the amount of Lek 241.7 billion, of which

[1] Nonbank domestic lenders comprise both firms (including insurance companies) and households. For small lenders, a Treasury bill window is available at the central bank.

[2] This amount differs from "claims on government (net of deposits)" in the standard monetary aggregates table, as the latter excludes nonbank lending and includes foreign currency deposits.

Lek 67.8 billion was held by the Bank of Albania, Lek 164.5 billion by commercial banks, and Lek 9.5 billion by other domestic lenders; and (ii) other government lek securities, loans, and other claims on government in the amount of Lek 4.0 billion. From these gross loans, the following items were deducted: (i) central government deposits (excluding social security funds) in the amount of Lek 0.9 billion; and (ii) SSI and HII deposits and T-bill holdings in the amount of Lek 7.1 billion.

5. The limits on the change in net domestic credit to the government will be cumulative from end-December 2001.

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 at end-December 2001. Under this definition, the level of the NDA was Lek 79.4 billion as of end-December 2001. The NDA limits will be cumulative changes from end-December 2001 and will be monitored from the accounts of the Bank of Albania.

C. Net International Reserves

7. **Net international reserves (NIR)** are defined as reserve assets minus reserve liabilities of the Bank of Albania. **Reserve assets** are readily available claims of the Bank of Albania on nonresidents denominated in foreign convertible currencies, and held for the purpose of meeting balance of payments financing needs, intervention in exchange markets, and other purposes. They include Bank of Albania holdings of monetary gold, SDRs, Albania's reserve position in the IMF, foreign currency cash, and deposits abroad. Excluded from reserve assets are any assets that are pledged, collateralized, other otherwise encumbered; claims on residents; precious metals other than monetary gold; assets in nonconvertible currencies; illiquid assets; and claims on foreign exchange arising from derivatives in foreign currencies vis-à-vis domestic currency (such as futures, forwards, swaps, and options). **Reserve liabilities** shall be defined as foreign exchange liabilities to residents and nonresidents of the Bank of Albania, irrespective of their maturity. They include: foreign currency reserves of commercial banks held at the Bank of Albania; all credit outstanding from the IMF; commitments to sell foreign exchange arising from derivatives (such as futures, forwards, swaps, and options); and all arrears on principal or interest payments to commercial banks, suppliers, or official export credit agencies. Excluded from reserve liabilities are the government's foreign currency deposits at the Bank of Albania.[3] Reserve assets and reserve liabilities will both be expressed in U.S. dollars.

[3] This exclusion is justified by current procedures in Albania, whereby the government's foreign currency receipts are deposited in a blocked account at the Bank of Albania and the (continued)

8. During this program, for monitoring purposes, the exchange rates of the SDR and non-dollar currencies will be kept at their end-December 2001 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.

D. Adjusters for NCG, NDA, and NIR

9. The NCG ceiling, NDA ceiling and NIR floor are defined on the assumption that **privatization proceeds** will amount, on a cumulative basis, from January 1, 2003 to:

End-March 2003	Lek 0.660 billion
End-June 2003	Lek 0.799 billion

The NIR floor will be adjusted upward (downward) and the NDA ceiling adjusted downward (upward) by any excess (shortfall) in these receipts. The NCG ceiling will be adjusted downward by any excess in these receipts up to ½ percent of GDP (Lek 3.6 billion). It will remain unchanged for any additional excess. The NCG ceiling will be adjusted upward by any shortfall in these receipts.

10. The NCG, NDA, and NIR targets are defined based on the assumption that **foreign budgetary and/or balance of payments financing** (excluding IMF financing and project and commodity loans or grants, or other aid) will amount, on a cumulative basis, from January 1, 2003 to:

End-March 2003	US$0 million
End-June 2003	US$0 million

In cases when total foreign financing exceeds 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, and for the net international reserves upward, with the proviso that the upward adjustment to the NCG and NDA ceilings and the downward adjustment to the NIR floor should not exceed US$15 million[4].

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funds are transferred to the government's lek account before being spent. A change in this procedure, would require revisiting the NIR definition.

[4] For the NCG adjuster, the lek equivalent of deviations from the programmed amounts in terms of dollars is converted at an exchange rate of Lek 145 per dollar, in order to ensure consistency with the budget projections.

11. 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.

E. External Debt and Arrears

12. As set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-00/85) August 24, 2000), 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.

13. The limit on medium- and long-term external debt **applies to** the contracting or guaranteeing by the central government or the Bank of Albania, of new nonconcessional external debt with an original maturity of more than one year, **with sublimits** on external debt with an original maturity of more than one year and up to and including five years. It applies not only to debt as defined in paragraph 12 of this memorandum, but also to commitments contracted or guaranteed for which value has not been received. External debt will be considered to have been contracted at the point the loan agreement or guarantee is ratified by the Albanian parliament. **Excluded** from the limits are 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 at least 35 percent. The grant element is to be calculated using the OECD Commercial Interest Reference Rates (CIRRs): for maturities of less than 15 years, the grant element will be calculated based on six-month averages of CIRRs; and for maturities longer than 15 years, the grant element will be calculated based on ten-year averages. 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.

14. The limit on **short-term external debt applies** on a continuous basis to the stock of short-term external debt owed or guaranteed by the central government or the Bank of Albania, with an original maturity of up to and including one year. It applies to debt as defined in paragraph 12 of this memorandum. **Excluded** from the limit are 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.

15. A continuous performance criterion applies to the nonaccumulation of new **external payments arrears** on external debt contracted or guaranteed by the central government or the Bank of Albania. External payment arrears consist of external debt service obligations (principal and interest) falling due after March 31, 2002 and that have not been paid at the time they are due, as specified in the contractual agreements. **Excluded** from the prohibition on the accumulation of new arrears are: (i) arrears arising from interest on the stock of arrears outstanding as of March 31, 2002; and (ii) external arrears that are subject to debt rescheduling agreements or negotiations.

F. Tax Revenues

16. Collection of revenues by the Tax and Customs Departments and social insurance contributions will be monitored on the basis of quarterly indicative floors.

G. Monitoring and Reporting Requirements

17. 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 basis; their issuance of Treasury bills including gross value and cash received; and privatization receipts. The Bank of Albania will communicate monthly to the Fund: 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; and trade flows. The following information will be communicated quarterly to the Fund by the Ministry of Finance: information on the contracting and guaranteeing of new debt; information on the stock of short term, and on medium- and long-term debt; and, with assistance from the Bank of Albania, information on all overdue payments on short-term debt and on medium- and long-term debt. The Bank of Albania will also communicate to the Fund periodic updates of balance of payments estimates.

Statement by the IMF Staff Representative
February 26, 2003

The Board meeting to discuss Albania had initially been scheduled for January 29, but had to be postponed because of a delay in completing one of two prior actions. This statement describes developments since the staff report was issued on January 10. The new information does not change the thrust of the staff appraisal.

Prior Actions

1. Both prior actions have now been met:

- The 2003 budget was approved by parliament on December 19, 2002.
- The closure of duty-free shops at all land-crossing points in border areas, which had been a major source of smuggling, was approved by parliament on January 30, 2003.

The latter measure is part of the authorities' efforts to reduce smuggling and improve customs administration. It was also strongly supported by the EU Customs Assistance Mission in Albania, which argued that duty free shops represented a high revenue risk, had often been used fraudulently, and had become a source of illicit activities. It was the third time the government had put the measure to parliament since May 2002.

Recent Developments

2. On January 31, 2003 the EU officially opened negotiations with Albania on a Stabilization and Association Agreement, but only after: (i) EU Commissioner Patten, in a letter to the prime minister, directly linked the success of the SAA negotiations to a trend reversal in corruption and organized crime; and (ii) the EU troika and the U.S. Ambassador publicly reconfirmed this message.

3. In a recent letter to the Managing Director, Prime Minister Nano has confirmed his government's commitment to fighting corruption and strengthening governance. As stressed in the staff report, stronger efforts are needed in this area, and staff—in consultations with the World Bank and the EU—will work with the authorities to strengthen their anti-corruption program.

4. Preliminary estimates suggest that the end-2002 indicative quantitative targets for domestic borrowing and the Bank of Albania's NDA and NIR have been met. Tax and customs revenues in 2002, however, fell short of the budget targets by about 5 percent—in line with the projections in the staff report—necessitating delays in investment expenditures to maintain the fiscal consolidation path.

5. Activity indicators suggest a contraction in the construction and extraction industry sectors during the third quarter of 2002, but the estimated real growth rate of around 4¾ for the year as a whole still appears realistic, as other industrial sectors and services registered

higher-than-envisaged increases in sales in the same period, and export growth picked up somewhat more than expected.

6. As anticipated in the staff report, 12-month inflation has continued to decline. At end-2002 it stood at 2.1 percent, at the lower end of the Bank of Albania's 2–4 percent end-year target range, and somewhat below earlier projections. Inflation declined further in January 2003 to 0.3 percent.

7. The Albanian national statistical agency (INSTAT) published the first official National Accounts estimates for 1998–2000 on January 24, 2003, which represents an important step forward in improving data availability. The new data are consistent with staff's estimate of a trend growth rate of 7–8 percent for 1998–2000. As noted in the staff report, however, further efforts are needed to improve over time the quality of these data.

Press Release No. 03/22
FOR IMMEDIATE RELEASE
February 26, 2003

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes First Review and Approves US$5 Million Tranche under PRGF for Albania

The Executive Board of the International Monetary Fund (IMF) today completed the first review of Albania's economic performance under the Poverty Reduction and Growth Facility (PRGF)[1] arrangement. This will enable Albania to draw SDR 4 million (about US$5 million) from the IMF immediately.

The three-year PRGF arrangement was approved on June 21, 2002 (see News Brief No. 02/52) for a total of SDR 28 million (about US$38 million). So far, Albania has drawn SDR 4 million (about US$5 million) under its current PRGF arrangement from the IMF.

Following the Executive Board discussion, Shigemitsu Sugisaki, Deputy Managing Director and Acting Chair, said:

"Albania's performance during the first six months of the three-year PRGF supported program has been satisfactory, overall. Macroeconomic stability has been maintained, as highlighted by continued low inflation and gradual fiscal consolidation. However, progress in the area of structural reform has been relatively weak, reflecting political uncertainties and governance problems, which have also contributed to a slowdown in growth. Nonetheless, the authorities remain committed to speeding up reform and strengthening their economic strategy.

"The fiscal deficit targets were met in spite of weaker-than-expected revenue collection. Looking forward, restoring revenue performance will be key to combining increased expenditure on priority measures for poverty alleviation with continued fiscal consolidation. Accordingly, strong measures have been identified to broaden the tax base and improve administrative efficiency. Monetary policy has remained cautious, helping overcome a period of heightened—albeit still moderate—inflation.

[1] The PRGF is the IMF's concessional facility for low-income countries. It is 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. PRGF loans carry an annual interest rate of 0.5 percent, and are repayable over 10 years with a 5 ½-year grace period on principal payments.

"Restoring and sustaining high growth hinges on the steadfast implementation of wide ranging structural reforms to improve the business climate. In this context, combating corruption and improving governance are of utmost importance, and the authorities are urged to intensify their efforts in these areas. In addition, the authorities should continue with their efforts to eliminate the severe electricity shortages, with reforms formulated in close collaboration with the World Bank.

"The evaluation and preparation of economic policies has been complicated by weaknesses in data collection. The authorities are urged to improve data coverage and data quality--building on the recent publication of the National Accounts.

"The authorities' comprehensive National Strategy for Socio-Economic Development has provided a broad framework for the current policy program. Its recurrent updating should be used to help strengthen the fiscal strategy, deepen the participatory process, build up policy consensus, and develop an effective monitoring system as a basis for policy enhancements. Specific steps for the upcoming first-year progress report should include improvements in the costing and prioritization of planned spending.

"In view of the authorities' commitment to improving performance, combined with the strong program of measures aimed at strengthening institutions and revenue performance and restoring growth, the Executive Board completed the first review under the arrangement, and granted a waiver for the nonobservance of a performance criterion under the program," Mr. Sugisaki said.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 03/27
FOR IMMEDIATE RELEASE
March 07, 2003

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

IMF Concludes 2002 Article IV Consultation with Albania

On February 26, 2003, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Albania.[1]

Background

Sound financial policies and market reforms during most of the 1990s have fostered growth and macroeconomic stability. Nonetheless, poverty remains pervasive, and the sustainability of growth is dependent on the expansion of tradables, in particular industry and mining. However, investment in these sectors is hindered by a deficient business climate including administrative barriers and electricity shortages. The authorities' November 2001 poverty reduction and growth strategy contains wide-ranging measures for the promotion of private sector activity and poverty alleviation. Within this framework, the current Poverty Reduction and Growth Facility (PRGF) arrangement supports efforts to ensure a sound macroeconomic environment. Monetary policy aims at maintaining inflation within a 2–4 percent range, within a floating exchange rate system. To promote fiscal and external sustainability, the overall deficit is to be lowered from 8.5 percent of GDP in 2001 to 5.8 percent of GDP by 2005.

Economic growth appears to have fallen below the 7 percent estimated historical average, to 4.7 percent in 2002. High foreign investments and private remittances in 2001 have maintained robust import demand, reflected in a widening trade deficit in 2001 and the first half of 2002. The exchange rate has remained fairly stable.

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

The fiscal deficit has remained well within the budgetary limits, despite serious tax collection shortfalls since end-2001. The latter have likely reflected lower-than-expected GDP growth, delays in reform, and managerial changes, in the context of ambitious collection targets. The overall deficit (excluding grants) declined to 8.5 percent of GDP in 2001 and is estimated at 7.5 percent in 2002. Combined with external debt forgiveness, this has reduced total public debt to about 64 percent of GDP from about 72 percent at end-2000.

Concerns about rising inflation—which peaked at 7 percent in early 2002—prompted some tightening of monetary policy. The increase in the repo rate since mid-2001—from 6.5 percent to 8 percent—was also motivated by high currency in circulation—in part due to sizable deposit withdrawals from the largest two banks, in March and April 2002, based on unfounded rumors of solvency problems. Stability has since returned and deposits have been recovering.

Structural reforms have slowed since mid-2001, with delays in privatization and, since mid-2002, slippage in electricity sector reform. Political changes, together with the weakened global market, hindered the planned mid-2002 sale of the Savings Bank and Albtelekom. While the authorities have made significant progress in reforming the ailing energy sector, drought has caused severe electricity shortages in recent years. Moreover recent slippage in meeting targets for bill collection and losses could prolong the crisis.

Executive Board Assessment

Executive Directors commended the authorities' efforts to make progress toward a market economy through sound macroeconomic management as well as actions to revive the reform process since the elections in 2002. In the context of the recent slowdown in activity, Directors noted that impediments to private sector development threatened the prospects for growth and poverty alleviation. They stressed that, in order to promote a business-friendly environment, it is necessary to accelerate the implementation of structural reform, improve the physical and financial infrastructure, and strengthen the enforcement of the rule of law and governance, including by fighting corruption. Directors considered that the prospect of a Stabilization and Association Agreement with the EU provides a strong framework and a unique opportunity for pushing ahead the reform process.

Directors welcomed the observance of fiscal deficit targets in 2002 and supported the budgetary framework for 2003. In light of the weaknesses in revenue collection last year, they concurred with the more cautious approach followed by the authorities in projecting revenues in 2003. In this context, they also emphasized the continuing need to focus on sustainable improvements in revenue collection, by broadening the tax base, strengthening administration, and combating smuggling, while at the same time ensuring a fair application of the tax law. For the medium term, Directors considered that raising revenues remains key to permitting the needed expansion in social expenditures, while also keeping the fiscal balances within prudent limits and offsetting the likely decline in external concessional financing. Directors also underscored the need for careful prioritization and management of spending to avoid ad hoc cuts in public investment, should revenues fall short of targets.

Directors expressed concern that electricity shortages continue to seriously constrain growth and pose risks to private sector development, and therefore urged the authorities to bring the electricity sector reforms back on track, in close collaboration with the World Bank. They reiterated their support for the authorities' commitment to phasing out subsidies for electricity imports before 2005. Directors recommended that the authorities should continue with their efforts to put in place a price mechanism to reflect market conditions and enhance the financial viability of the electricity company. It was also suggested that the authorities should consider over time how best to diversify their energy sources. Directors also stressed the importance of a timely settlement of inter-enterprise arrears within the public sector, and of the adoption of strategies to prevent the accumulation of new arrears.

Directors commended the authorities' prudent monetary policy, which had been critical in containing inflationary pressures, and the progress to an indirect control regime. They supported the recent introduction of a deposit insurance system, with the aim of promoting financial sector confidence. Directors also encouraged the Bank of Albania to closely monitor the increasing dollarization and the rapid foreign currency growth.

Directors emphasized the importance of financial sector reform, and welcomed plans to strengthen and modernize the financial system. They encouraged the authorities to give the highest priority to the successful privatization of Savings Bank, which could be facilitated by some restructuring and improved marketing. This, and other actions, are required to help improve competition in the banking system and more generally allow a larger role for banks in private sector development. Directors encouraged further efforts to strengthen bank supervision. They commended the authorities' efforts in blocking funding for terrorists, and encouraged the authorities to improve implementation of the Money Laundering Law.

Directors urged the authorities to persevere with legal and institutional reforms to improve the climate for business and investment. In this context, they welcomed the authorities' commitment to combating corruption and the ongoing implementation of their anti-corruption program. These actions would also help reduce the size of Albania's large informal sector. Directors, however, noted that, as stressed in the staff's analysis, much remains to be done, and urged the authorities to intensify efforts in this area. They underscored, also, the importance of high-level resolve and broad political support to ensure that these efforts are successful. Directors commented on the need to modernize the operation of public enterprises, wherever necessary, and to move ahead with the privatization program.

Directors commended the authorities for maintaining a flexible exchange rate regime and an open trade system, and for making progress in negotiating several regional free trade agreements. They noted that, while a more rapid expansion of exports was primarily constrained by non-price factors, the authorities should also closely monitor price competitiveness.

Directors strongly supported the authorities' renewed focus on improving the availability of economic data through greater cooperation among agencies and the provision of adequate resources. However, noting that data deficiencies continue to seriously hamper effective policy-making, they urged further concerted efforts in this area.

Directors noted the progress Albania has made in regularizing arrears with its foreign creditors and encouraged the authorities to take the necessary steps to resolve outstanding issues as soon as possible to allow a move to Article VIII status.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board. The Staff Report for the (2002) Article IV Consultation with Albania is also available.

Albania: Selected Economic Indicators

	1999	2000	2001	2002 Est.
	(Percent Change)			
Real GDP	7.3	7.8	6.5	4.7
Retail prices (avg.)	0.4	0.0	3.1	5.6
Retail prices (end-period)	-1.0	4.2	3.5	3.0
	(In percent of GDP)			
Fiscal sector				
Revenues	21.3	22.4	23.0	23.5
Expenditures	32.7	31.4	31.5	31.0
Overall balance (excluding grants)	-11.4	-9.1	-8.5	-7.5
Domestically financed balance 1/	5.2	3.2	3.1	3.0
Public Debt	64.1	72.1	69.6	64.4
Domestic 2/	35.1	41.9	40.9	39.6
External	29.1	30.2	28.7	24.7
Monetary indicators				
Broad money growth (in percent)	22.3	12.0	19.9	7.6
Interest rate (3-mth T-bills, end-period) 3/	14.8	7.8	8.0	11.1
	(In millions of U.S. Dollars)			
External sector				
Trade balance 4/	-663	-821	-1027	-1096
(in percent of GDP)	-18.0	-21.9	-25.0	-23.7
Current account balance	-270	-271	-260	-410
Gross international reserves	485	608	737	809
(in months of imports of goods and services)	3.8	4.1	4.6	4.9
Memorandum items				
Nominal GDP (in millions of lek)	506,205	539,210	590,237	658,062
Nominal GDP (in millions of U.S. dollars)	3,676	3,745	4,109	4,628

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

1/ Excluding privatization revenues.

2/ Including bonds for bank restructuring (lek 24.6 bn for 2000).

3/ For end-November 2002.

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

Statement by Pier Carlo Padoan, Executive Director for Albania
February 26, 2003

My Albanian authorities would like to thank Staff for very fruitful discussions and consultations in completing this first review of the new PRGF program.

After a period of strong growth and macroeconomic stability Albania, with the support of a new Fund program, is tackling the deep roots of its structural problems so as to consolidate growth and stability and move forward in the fight against poverty.
The prospects of a Stabilization and Association Agreement with the EU provide a strong framework as well as a unique opportunity for pushing ahead the reform process.

My Albanian authorities are aware that the reform process has slowed down over the recent past and reiterate their commitment to maintaining macroeconomic stability, reinvigorating the pace of economic reform, and make substantial progress in improving governance and fighting corruption. The slowdown in policy action has been due to the electoral phase. Political stability now provides the basis for an acceleration of policy reform.

Macroeconomic developments

Growth over the past two years has fallen below the 7% historical average. The causes of the slowdown are due in part to natural events (draught and flooding) that have severely damaged agricultural production, and to energy shortages that have especially hit industrial production. Tackling such shortages remains one of Albania's major challenges.

Demand has remained strong, however, while price stability has been preserved through timely action by monetary authorities. The fiscal deficit has remained within budgetary limits as lower revenue and shortfalls in privatization receipts were more than offset by spending cuts.

Structural measures

Recent macroeconomic developments signal the need to speed up structural reforms to maintain the pace of growth and provide the resources for fighting poverty.
While performance under the program had been affected by political instability, related to the election period, authorities have recently stepped up their initiative including the parliamentary approval for the closure of the duty free shops, a structural performance criteria.

Progress is under way both in the privatization of Albtelekom and in the restructuring of the energy sector.

On the privatization of Albtelekom: the International Financial Corporation (IFC), and the European Bank for Reconstruction and Development (EBRD) will privatize part of the Albanian fixed phone line, following the revision of the company's privatization formula. To this purpose Albania will draft a bill to guarantee the partial purchase of the company by IFC and EBRD. The privatization procedure is to be finalized in 2003. Albtelekom plans to increase up to 500,000 fixed lines, mainly in the rural and remote areas countrywide, in 2003.

On the energy sector: following the agreement on a soft loan by the Italian government (30 million Euro) a program is under way to restructure KESH (the Albanian Energy Corporation), including its separation into production, transmission, and distribution. Under the program, which can count on the support of a large number of donors, both IFI's and bilateral, KESH seeks to significantly improve revenue collection, reduce losses, and improve financial management.

Governance issues and the fight against corruption.

Concerns have been raised recently in the press on strengthening governance and fighting corruption. Both are key priorities for Albania. As the staff report makes clear success in the improvement of governance and fight against corruption requires credible policy implementation and broad public support. Authorities are strongly committed to achieving both.

Two high-level bodies have been established with the objective of directing the Albanian National Anti-Corruption Plan, the *Governmental Commission for Fight against Corruption* at the government level and the *Anti Corruption Monitoring Group* (ACMG) at the highest civil servant level, supported by the Anti Corruption Unit (ACU) with the assistance of international organizations. The task of ACU is to coordinate the implementation of the National Anti-Corruption Plan.

The Second National Anti Corruption Conference in June 2002 adopted a new *Action Plan on the Prevention and Fight against Corruption.* ACU has completed a report on initial results in December 2002. The report identifies early results as well as specific problems to be tackled in the areas of: public administration reform, improvement of legislation and consolidation of the rule of law, public finance management and auditing, transparency and integrity in business transactions, disclosure of public information

Cooperation with international organizations is proving to be extremely helpful in strengthening institutions and governance. The Activity of ACU is supported by the PACO program, sponsored by the Council of Europe. A first project was completed in May 2002 and a second project will run through December 2003. A report, presented to the Council of Europe at the December plenary session, contains an evaluation of Albania's efforts, which can be summarized as follows:

- Albania has taken extensive action against corruption with impressive results over the past few years
- A good legal framework is in place and effective anti corruption measures have been taken
- The Anti Corruption Strategy is well designed, although implementation has to be improved
- The Government has identified priorities for future action: reform of the civil service,

including training, transparency of the privatization process, reform of the public procurement system, reform of the State Police, elimination of corruption within the judiciary, information to the public and co-operation with civil society.

Data Issues

Authorities are aware of the need to improve the quality and availability of statistical data and are preparing an action plan for improving the national account statistics. In this perspective they have requested additional long-term assistance from Eurostat to strengthen the coverage and timeliness of national accounts, under the supervision of the Fund. In January they have released GDP data from 1996 to 2000 for the first time. With Eurostat supervision they are also developing an annual business structure survey and quarterly industrial production statistics.

Conclusions

With the start of the negotiations on a Stabilization and Association Agreement with the EU Albania is enjoying a unique window of opportunity to accelerate the reform process in utilities, tax collection, and governance. The Fund supported program under the PRGF represents a key instrument in the strategy towards sustained growth, sound institutions, and successful fight against poverty.

My Albanian authorities reiterate their commitment to the reform process and would like to thank Management and Staff for their constructive support in their effort.