

Albania: Fourth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, Request for a Waiver of Nonobservance of Performance Criterion, and Financing Assurances Review—Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Albania

In the context of the fourth review under the three-year arrangement under the Poverty Reduction and Growth Facility, request for a waiver of nonobservance of a performance criterion, and financing assurances review with Albania, the following documents have been released and are included in this package:

- the staff report for the fourth review under the three-year arrangement under the Poverty Reduction and Growth Facility, request for a waiver of nonobservance of a performance criterion, and financing assurances review, prepared by a staff team of the IMF, following discussions that ended on **April 28, 2004**, 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 June 21, 2004.** 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 Press Release summarizing the **views of the Executive Board as expressed during its July 14, 2004 discussion** of the staff report that completed the request and review.
- a statement by the Executive Director for Albania.

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

Joint Staff Assessment of the Poverty Reduction Strategy Paper Progress Report
Letter of Intent sent to the IMF by the authorities of Albania*
Memorandum of Economic and Financial Policies by the authorities of Albania*
Poverty Reduction Strategy Paper—Progress Report
Technical Memorandum of Understanding*

*May also be included in 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

Fourth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, Request for a Waiver of Nonobservance of Performance Criterion, and Financing Assurances Review

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

Approved by Carlo Cottarelli and Martin J. Fetherston

June 21, 2004

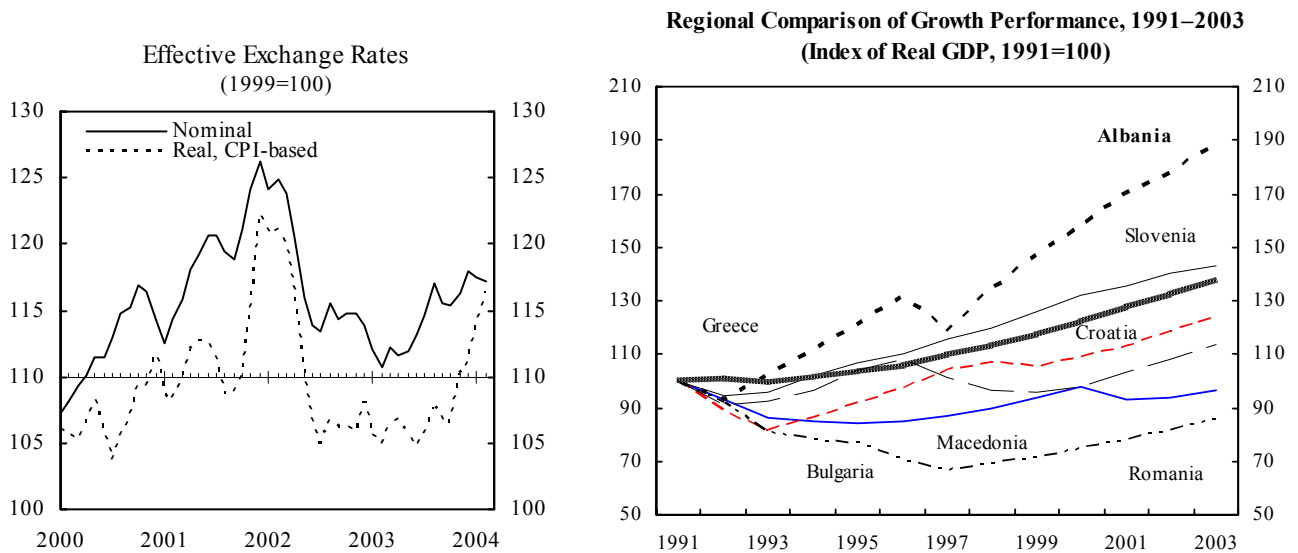
- Discussions for the fourth review under the PRGF—approved on June 21, 2002—and financing assurances review were held in Tirana during April 14–28, 2004. The mission met with Prime Minister Nano; Ministers Malaj (Finance), Angjeli (Economy), Doda (Industry and Energy), Meksi (EU integration), and Poçi (Transport and Communications); Bank of Albania (BoA) Governor Cani; parliamentarians; senior officials; academics; and representatives from the banking and business sectors, and the international donor community. The staff team comprised Messrs. Escolano (head), Lazar and Oestreicher, Ms. Ruiz-Arranz (all EUR), Ms. Simard (FAD), Ms. Tumbarello (PDR), Mr. Olters (resident representative), and Ms. Spahia (resident representative’s office). Mr. Vittas (alternate Executive Director) assisted in the discussions.
- The third review was concluded on January 23, 2004. At that time, Executive Directors commended Albania’s macroeconomic performance, but noted delays in structural reforms. Directors emphasized that efforts to improve governance and the business climate were crucial to elicit private investment and enhance growth prospects. Directors also indicated that budget revenue mobilization remained critical to the success of the authorities’ poverty reduction strategy.
- In the attached Letter of Intent and Supplementary Memorandum of Economic and Financial Policies (MEFP) the authorities request a waiver for the nonobservance of an end-March performance criterion—which was subsequently carried out as prior action—and completion of the review and financing assurances review.
- Albania participates in the GDDS, and a ROSC on data dissemination was prepared in June 2000. A safeguards assessment of the BoA was finalized in June 2002, and a fiscal ROSC in June 2003. Albania’s economic program is supported by the World Bank through several sectoral lending programs and a second Poverty Reduction Support Credit (PRSC) approved in July 2003. The authorities have requested a FSAP.

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I. INTRODUCTION

1. **Albeit from a precarious starting point, Albania's macroeconomic performance over the last few years has been remarkable, as epitomized by average output growth above 7 percent in 1999–2003.** After a slowdown in 2002 caused by electricity shortages and floods, growth recovered to an estimated 6 percent in 2003 (Table 1). The 12-month inflation rate was brought down from its peak during the 1997–98 crisis and has not exceeded the Bank of Albania's (BoA) 2–4 percent target range since 2002 (except for one month). Following the 2002 depreciation, the lek has steadily appreciated on a trade-weighted basis since early 2003, helped by a recovery in confidence and external current account gains.



2. **The authorities' macroeconomic policies, supported by the program, have been key to regaining stability.** A firm monetary policy stance and continued strengthening of the prudential framework after a 2002 financial stress episode were instrumental in restoring confidence. There has also been substantial progress towards a sustainable public finance position. The overall fiscal deficit declined from 10¼ percent of GDP in 1998 to 4½ percent of GDP in 2003—almost entirely due to current savings—while the public debt-to-GDP ratio fell from 76 percent to 57 percent over the same period.

3. **However, a sustained private sector broad-based and export-driven expansion has proven elusive so far—owing primarily to deficient infrastructure and a weak institutional environment.** Growth has been focused on services and other nontradables, while industry and export sectors have not yet taken off—underlying a persistent external deficit. Poor transportation, telecommunications, and utilities infrastructure are key impediments to expanding economic activity. But also a pervasive informal sector, weak

administrative capacity, and governance issues stymie private sector development and hamper export-generating FDI.

4. **Poverty remains a key challenge despite significant income growth and improvements in some development indicators (Table 2).** With per capita income of US\$1,740 in 2003 and about ¼ of the population with consumption below basic poverty levels, Albania remains among the poorest countries in Europe. While some indicators do suggest progress over time in key areas such as absolute poverty, child mortality, maternal health, and youth and young female literacy, data paucity still hinders a comprehensive assessment. While tax revenue increased by 2 percentage points of GDP in 1998–2003, its level of about 20 percent of GDP remains low relative to the social demand for poverty-alleviating public expenditure.

Albania: Poverty indicators 1/

	LCS 1998	LSMS 2002
Percentage of population with consumption below basic requirements	...	25.4
Percentage of population with consumption below minimum calorie requirements	...	4.7
Percentage of population with consumption below 60 percent of median	29.6	13.5
Percentage of population with income below 2 USD a day	46.6	10.8
Gini Coefficient	0.43	0.28

1/ The Living Condition Survey (LCS) was carried out in 1998 by INSTAT. The Living Standards Measurement Survey (LSMS) was carried out in 2002 by the World Bank. Due to different methodologies, data are not necessarily comparable.

II. RECENT DEVELOPMENTS

5. **Performance since the third review has been satisfactory overall, although 2003 fiscal revenue fell short of the ambitious budget targets.** All quantitative performance criteria for end-March 2004 were met. The end-December 2003 indicative target for net credit to government was also met despite revenue and external assistance substantially

Albania: 2003 Budget Outturn
(In percent of GDP)

	Program	Outturn	Difference w/r Program
Total revenue and grants	23.6	22.4	-1.2
Tax revenue	20.1	19.5	-0.6
Nontax revenue	2.8	2.6	-0.2
Grants	0.7	0.4	-0.3
Total expenditure	28.5	26.5	-2.0
Current expenditure 1/	23.1	22.3	-0.7
Capital expenditure	5.5	4.2	-1.3
Overall balance	-5.0	-4.1	0.8
Domestic financing	2.9	2.8	-0.1
Foreign financing	2.1	1.3	-0.7

Sources: Albanian authorities; and staff estimates.

1/ Program includes contingency reserves and outturn includes net lending.

below budget. The authorities offset these shortfalls by cutting spending, resulting in expenditure 2 percentage points of GDP below program and a fiscal balance over $\frac{3}{4}$ percentage point of GDP stronger than program. BoA's net international reserves and domestic assets also overperformed as a result of the tight monetary policy stance and sterilized purchases of foreign currency, partly prompted by the strength of the lek.

6. **While an action covered by a structural performance criterion was implemented with delay, most structural reforms (privatization, fiscal institutions administration, and removal of administrative barriers to business creation) have regained momentum (Table 3).** Notably, in April 2004, the Savings Bank (representing about 60 percent of banking system deposits) was sold to an international strategic investor. The end-March structural PC concerning the implementation of the ASYCUDA customs data management system in the Durrës port and initiation of a system integrity audit was not met. Implementation of the system in Durrës was carried out as prior action. The integrity audit was postponed at the recommendation of the EU Customs Assistance Mission in Albania (EU CAM-A). EU CAM-A, which is the lead donor and technical adviser in the customs area, now believes partly as a result of ongoing progress, that it would be preferable to postpone the audit until the customs administration has gained experience with the system. In view of this argument and the close surveillance that the EU maintains on the operation of the system, staff considers conditionality on implementation of the integrity audit as no longer appropriate.

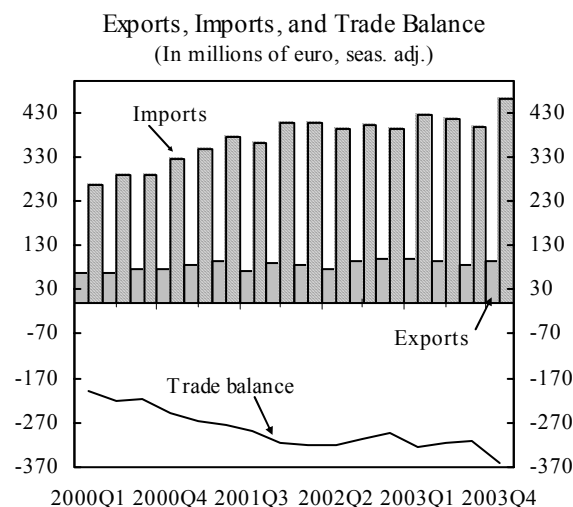
7. **Progress on a wider front of institution-building reforms, mostly beyond the scope of the program—including judiciary reform, enforcement of the rule of law, and property rights protection—has been slow.** In the March 2004 annual report, the EU criticized the pace of political and institutional reform, questioning the feasibility of reaching a Stabilization and Association Agreement in the short term. More recently, Albania was excluded from participating in the US Millennium Challenge Account owing, inter alia, to insufficient progress in curbing corruption.

8. **Brisk output growth in 2003 was sustained by buoyant domestic demand and still low but rapidly increasing export volumes.** While publication of national accounts continues to be delayed, available indicators suggest that GDP rose by 6 percent in 2003, with pronounced increases in construction, and transportation and telecommunications. Merchandise export volume growth—notably textile and footwear exports—accelerated from 6 percent in 2002 to 19 percent in 2003, albeit from low levels. The output recovery has been buttressed by improvements in power supply resulting from favorable weather conditions and sectoral restructuring in collaboration with the World Bank.

9. **Inflation has remained muted, with broad money paralleling nominal GDP in line with program projections.** Broad money composition, however, shifted towards bank deposits away from cash holdings, and the proportion of lek deposits in total deposits increased—both trends reflecting rising confidence (Table 4). Private sector credit grew by 30 percent but the stock still represents only about 7 percent of GDP. The 12-month inflation

rate exceeded slightly the BoA's target range in February for the first time since 2002—owing to administered price increases partly related to rationalization of the utilities sector. However, it later abated quickly.

10. **The external position strengthened during 2003, exceeding program levels, partly owing to a better-than-expected trade balance (Table 5).** The 2003 current account deficit is estimated at 7½ percent of GDP—one percentage point of GDP below program and 1½ percentage points down from the 2002 outturn. The lek has appreciated slightly relative to the euro, notwithstanding central bank interventions that raised reserve cover to 4⅓ months of imports.



11. **After the December 2003 cabinet reshuffle, which included the economic policy portfolios, the political environment is increasingly dominated by the approaching mid-2005 general elections.** In early-2004 the opposition led several well attended demonstrations (opposing inter alia utilities tariff hikes). Although tensions abated subsequently, political uncertainties remain high.

III. REPORT ON THE DISCUSSIONS

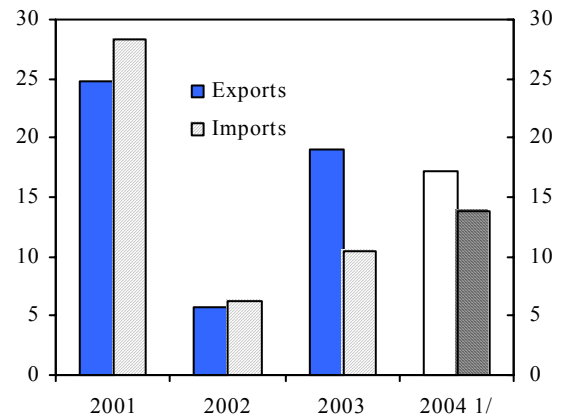
12. **Discussions focused on (i) reassessing revenue projections in view of the 2003–2004Q1 outturns and associated fiscal adjustments; (ii) allocating receipts from the Savings Bank sale (1.6 percent of GDP); and (iii) updating the structural reform and poverty-reduction agenda.** Understandings included substantial fiscal revenue and expenditure adjustment amounting to 0.7 percent of GDP to meet program targets and structural measures to improve the management of fiscal institutions, governance, and transparency. Understandings were also reached to consolidate central bank independence and foster bank intermediation.

A. Macroeconomic Outlook

13. **The macroeconomic outlook envisaged during the third review remains appropriate.** Growth is forecast to stay close to its 6 percent trend during 2004–07, and inflation to remain within the BoA's target range. The volume growth of merchandise exports is expected to moderate, while merchandise import growth continues to pick up. Downside

risks relate mainly to increased political uncertainty surrounding the forthcoming election, which may test investors' confidence and negatively influence economic policy formulation. Over the medium term, growth would be underpinned by rising investment and exports, aided by comparative cost advantages. As the fiscal position consolidates, and the corporate sector and financial intermediation expand, national savings will continue to increase as a share of GDP—allowing for a gradual shift away from external savings. This scenario is postulated on a continued improvement in the business climate and increased investment and trade links with international partners.

Goods Trade Volume, 2000–04
(Percentage change)



Source: IMF staff estimates.
1/ Projection.

14. **The current account deficit in 2004 is expected to remain unchanged from the previous year, 0.6 percentage point of GDP better than previously programmed, due to strong exports and private remittances.** The authorities and private sector representatives expressed the view that the moderate appreciation of the lek had not undermined competitiveness—as evidenced by the ongoing export expansion—since the cost differential remains wide. Rather, export potential is more closely linked to the level of foreign direct investment. External debt is projected to remain at sustainable levels in the medium-term baseline scenario due to improvements in the country's export capacity (Appendix IV). Under the program, external borrowing by the government will continue to be primarily on concessional terms, with non-concessional borrowing subject to program limits. External debt service indicators are expected to worsen moderately in the medium term as non-concessional borrowing grows after the expiration of the PRGF program. Stress tests show that the external debt position is particularly sensitive to current account shocks, notably those concerning export performance, underscoring the importance of raising export capacity. Also, a stronger-than-envisaged pickup in consumer credit could pose risks to the trade balance.

B. Fiscal Policy

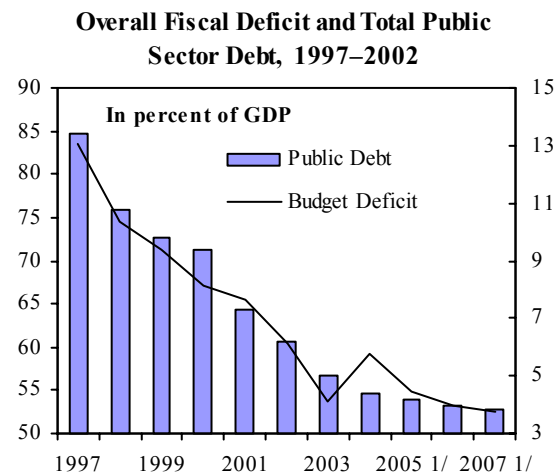
15. **In light of the disappointing 2003 revenue outturn, the authorities saw a need to reassess 2004 revenue projections and implement commensurate adjustment measures to meet program targets (Tables 6a and 6b).** For several years now, optimistic budget projections have been met with disappointing revenue outturns. In the authorities' view, ongoing administration reforms could yield significant revenue gains, including in the short term. But they agreed that, given the inherent uncertainty, prudent budgeting required that these gains be allocated to spending only after they materialize. Staff also argued that budget revenue projections should not fall hostage to political expedience in an attempt to accommodate conflicting expenditure demands. Instead, transparency and accountability would be better served by a realistic revenue projection and associated expenditure

prioritization. For 2004, to offset the revenue shortfall, the authorities will adopt additional measures equivalent to 0.7 percent of GDP. This adjustment is required to meet program targets, after allocating the expenditure from privatization proceeds (discussed below). It also provides room for a 0.2 percent of GDP contingency reserve. While these measures fall mainly on the expenditure side, the authorities are also introducing revenue enhancing tax policy legislation (MEFP ¶5) that will add 0.1 percent of GDP to revenue this year, and will have a full impact in 2005. Spending will be curtailed by strengthening discipline in current outlays and postponing lower priority investment projects—cabinet decisions to this effect have already been issued. To forestall haphazard spending cuts, budget plans contain a 0.2 percent of GDP contingency reserve that will only be released in the last quarter of 2004 under stringent conditions (MEFP, ¶5).

16. **The authorities have appropriated half of the privatization proceeds from the Savings Bank for debt reduction (MEFP, ¶5).** The remainder will be devoted to key projects in transportation infrastructure, education, health, other investment, and judiciary in collaboration with the World Bank—thus, increasing capital spending with respect to the original 2004 budget (Table 7). Staff argued the benefits of spreading this expenditure over two years, but the authorities maintained that it could all be spent efficiently in 2004, as agreed at the time of the third review.

17. **These adjustments will allow the program targets to be met while reducing the public debt-to-GDP ratio by over 2 percentage points of GDP in 2004.** The 2004 budget deficit is projected at $5\frac{3}{4}$ percent of GDP—slightly below the program deficit adjusted for half of the privatization receipts. The domestic borrowing requirement is projected at slightly below 2 percent of GDP—in keeping with the program target adjusted for privatization—while external borrowing will be mainly project-related and on concessional terms. The corresponding reduction in outstanding T-bills relative to GDP will support the ongoing expansion of private sector credit in domestic currency and the declining trend in interest rates.

18. **Regarding 2005 and the medium term, the authorities envisage increasing budgetary self-sufficiency to offset declining concessional assistance, while safeguarding priority spending (MEFP, ¶7).** The fiscal deficit is projected to decline to below 4 percent of GDP by 2007 with the debt-to-GDP ratio falling from 57 percent at end-2003 to 53 percent by 2007. In addition, at least half of the proceeds of all future large privatizations will be used for debt reduction (these proceeds have not been included in the projections since their timing and amounts are uncertain). Staff’s sustainability analysis



Source: IMF staff estimates.
1/ Projection.

(Appendix IV) indicates that public debt remains stable in most plausible adverse scenarios—but the sustainability of debt and spending plans is critically dependent on the envisaged output growth and fiscal consolidation path.

Albania: Medium-Term Fiscal Path

(In percent of GDP)

	2004	2005	2006	2007
Overall balance	-5.8	-4.5	-4.0	-3.7
Domestic financing	4.2	2.9	2.6	2.4
Privatization receipts	2.3	0.3	0.3	0.1
Domestic net borrowing 1/ 2/	1.9	2.5	2.3	2.3
Foreign financing	1.6	1.6	1.3	1.4
Public debt	54.6	54.0	53.3	52.8
Domestic	35.7	35.0	34.3	33.7
External	18.9	18.9	19.0	19.1

1/ Quantitative performance criterion.

2/ In 2004, target adjusted for 1.6 percent of GDP in privatization proceeds, half of which are used to retire domestic debt.

C. Fiscal Policy Framework

19. **Since late-2003, there has been progress on institutional and administrative reforms aiming at increasing efficiency in mobilizing budgetary resources and improving fiscal governance.** While broader-based institutional reforms continue to be protracted and implementation capacity remains weak, there are signs of stronger focus and stability of purpose since late-2003. In particular, the pace of tax and customs administration reforms to improve the professionalism of officials and fight tax noncompliance accelerated in 2004. The recent extension of civil service status to tax and customs officials, and application of the code of ethics and asset declaration requirements are intended to limit political interference and curb corruption. Ongoing programs to increase the use of IT—such as the ASYCUDA system—will facilitate tax enforcement while reducing officials’ room for discretion. A variety of tax policy and administration reforms, including most FAD TA recommendations, are being introduced to strengthen revenue and streamline the tax system (MEFP, ¶7). In terms of outcomes, the mission found that, since late-2003, instances of taxpayer harassment have declined and procedural irregularities, such as pre-declaration of imports, have been discontinued. The transfer of social contributions collection to the tax administration, however, has proceeded slowly, partly owing to resource constraints.

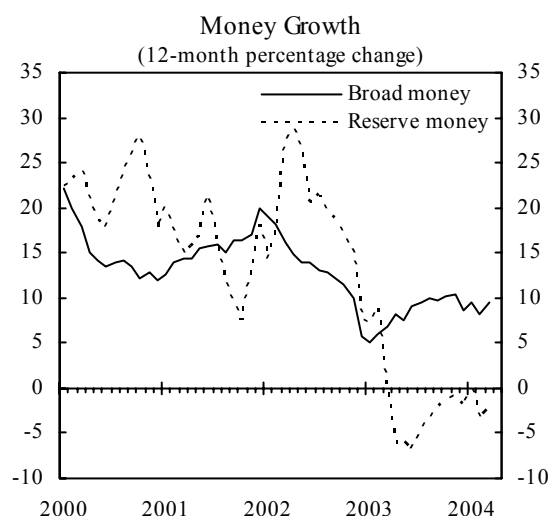
20. **The expenditure management system is also undergoing modernization.** With World Bank and bilateral donor assistance, the authorities are seeking to computerize treasury operations and debt management, which are still performed manually for the most part. Procurement payments above a threshold are already paid through the banking system and public wages will soon follow (see below). Also with World Bank assistance, the authorities are undertaking a civil service reform to increase its professionalism, independence from political pressure, and efficiency in the delivery of public services (MEFP, ¶15).

21. **In this connection, staff regretted the automatic indexation of government wages to inflation, introduced in early-2004.** The authorities argued that this measure would not affect the budget wage bill in the foreseeable future and, in fact, could result in some savings, as past increases had often exceeded the inflation rate. In staff's view, however, wage indexation undermines performance-based pay and incentives for professionally qualified public employees. Moreover, the indexation had been introduced as a pay increase floor, and thus could eventually result in spending overruns. Finally, it could have a deleterious demonstration effect on the private sector, hindering monetary stability. Therefore, staff urged the repeal of this measure and the authorities agreed to reconsider it on during the next review discussions (MEFP, ¶15).

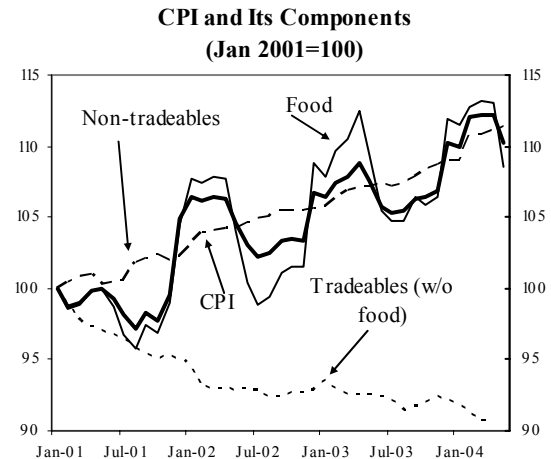
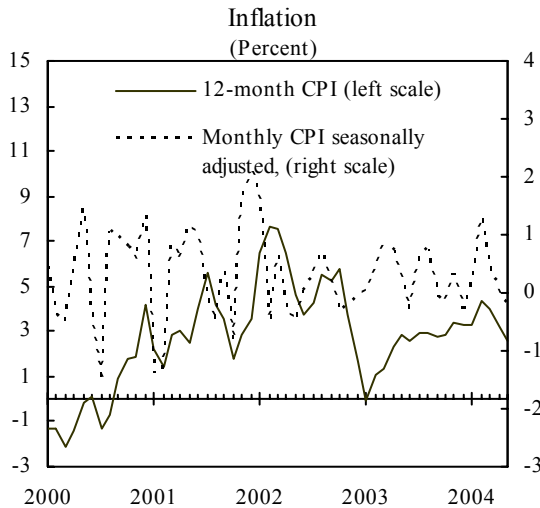
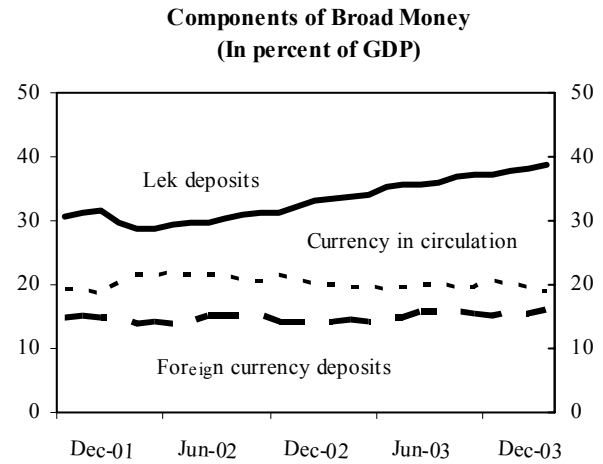
22. **The authorities are introducing changes in the budget process to enhance transparency, accountability, and the quality of policy formulation.** Starting with the 2005 budget, the authorities intend to lower further the maximum allowable transfer between appropriations, from 7 to 5 percent of total spending (MEFP, ¶15). They are also considering means to integrate the annual budget with the Medium-Term Budget Framework.

D. Monetary and Financial Policies

23. **In light of the steady appreciation of the lek, rising reserve cover, and prospects for subdued inflationary pressure, the authorities continued the gradual monetary easing begun in 2003.** In 2004, three 25 basis-point cuts brought the policy rate to 5¾ percent—a historical low and 2¾ percentage points below its 2002 peak. The authorities expected underlying inflation to remain low in 2004 since prospects for this year's agricultural output were good (the weight of foodstuffs in the basket is 41 percent). Regarding the lek appreciation, the authorities considered that it had played a positive role in



supporting confidence, but its direct effect in the CPI had been limited. First, tradables (excluding foodstuffs) constitute only a small part of the basket. And second, tradable prices do not respond symmetrically to exchange rate changes: while a depreciation is typically passed through quickly, a moderate appreciation has only a long-term effect owing to market imperfections. In sum, a broadly stable trade-weighted exchange rate, as projected in the program, would be consistent with the inflation target. Staff indicated that, although there may be room for further easing, the BoA should continue to exert caution and watch carefully international interest rates and energy prices. Regarding the latter, the direct impact of fuel prices is relatively low on the current account (0.1 percent of GDP per US\$1/bbl) and the CPI (the energy weight is 4.6 percent), but they could have substantial second-round effects.



24. **There was agreement on measures to bolster the monetary policy framework.** Staff commended steps to strengthen the BoA’s data base and economic monitoring capabilities with TA from MFD and the World Bank—consistent with the BoA’s intention to advance towards a formal inflation targeting framework. Also, the authorities agreed to phase out gradually, starting in 2005, the Treasury’s overdraft facility with the BoA; and to transfer government securities to the BoA to offset the 2004 exchange rate losses on foreign reserves due to lek appreciation—in accordance with the central bank Law (MEFP, ¶6).

25. **Reforms of the financial framework continue in anticipation of a take-off in credit and banking intermediation (MEFP, ¶11).** The privatization of the Savings Bank is expected to boost the dynamism of the domestic banking system. The authorities are aware of

the attendant challenges. Significant progress has been made in implementing the Supervisory Development Plan with World Bank assistance, and the BoA is adopting an increasingly proactive approach to supervision. The BoA is receiving MFD and World Bank TA on several areas including prudential policies, anti-money laundering, and combating the financing of terrorism. The recently introduced real-time gross settlement system is operating well and the BoA plans to implement by mid-2005 an automated clearing house (MEFP, ¶10). The authorities have requested an FSAP, currently scheduled for 2005, to chart future efforts.

26. **The Ministry of Finance and the BoA are leading a campaign to reduce the use of cash and the informal economy, while fostering banking intermediation.** With the size of the informal economy estimated at about 30 percent of GDP, channeling transactions through banks is a key element in improving business practices as well as law and tax enforcement. In this context staff urged the authorities to expedite the payment of government wages (about 6 percent of GDP, covering 110,000 employees) through the banking system. Discussions with the BoA and banks indicated that this could be instrumental in achieving the critical mass of banking transactions and individual bank accounts necessary to change business and household practices. Staff also argued that it would improve treasury management while eliminating opportunities for misgovernance. The authorities concurred, but were concerned that banks might not yet be ready to provide the quality of service that would elicit the necessary support among public employees. Thus, they intend to move gradually in this direction, aiming to eliminate cash payments by end-2005 (MEFP, ¶10).

E. Other Structural Reforms

27. **The authorities intend to press ahead with privatization (MEFP, ¶14).** The intended privatization of Albtelekom in the short term, however, will require the settlement of outstanding commercial disputes with other private telephone operators.

28. **There has been progress in restructuring the critical electricity sector.** Electricity production has increased by 50 percent since 2002. Collection targets under the action plan have been met, and a significant rationalization of tariffs took place at end-2003. A planned subsidy scheme to shield low-income consumers from tariff increases—which had suffered delays, contributing to popular protests—will be introduced by end-September 2004 (SB). (MEFP, ¶17). The authorities continue to monitor closely progress in clearing inter-enterprise arrears, which have not re-emerged. However, water supply company weaknesses warrant intense vigilance.

29. **A property restitution law, based on a draft prepared by OSCE, is being discussed by Parliament since November 2003 (Box 1).** While supporting settlement of land property rights as central to the efficient mobilization of resources and small business credit, staff advised caution and realism regarding budgetary implications. In this regard, staff welcomed assurances that compensation would be transparent and rules-based, consistent with budget plans, and exclude tax privileges (MEFP, ¶18).

Box 1. Property Restitution Law

Large amounts of agricultural and tourism land, expropriated during the mid-1940s, have been resold during the last 10–12 years without clear property titles. The frequent absence of secure tenure or clear property titles has hampered development of the land market and impeded investment in agriculture and tourism. The European Union has included resolution of disputed land claims in negotiations of the Stability and Association Agreement.

The version of the law passed by Parliament—but returned to it by the President—provided for compensation of former landowners with land or money. Compensation in kind was to be concluded by end-2006; while payment of cash compensation was to take place over 2006-16 from a dedicated fund to be created for this purpose. The law so far excludes compensation in the form of tax credits or exemptions, but leaves a number of important aspects undefined, including: (i) budgetary implications; (ii) land valuation methods; (iii) claim eligibility and decision process; and (iv) the public assets available for use as compensation.

30. **The authorities are committed to reduce administrative barriers to investment and business creation, which are high, including relative to neighboring countries (MEFP, ¶13).** The authorities will update the action plan in collaboration with FIAS.

31. **The authorities are making progress in implementing their poverty-reduction strategy paper—the National Strategy for Socio-Economic development (NSSED).** As indicated in the companion Joint Staff Assessment (JSA) there were many areas of improvements in 2003, including a better definition of the policies the authorities intend to pursue through 2007; and improved coordination between the government institutions involved in the NSSED. However, the link between the NSSED, the medium-term budget plan (MTBP) and the annual budget cycle are still weak.

32. **Severe data deficiencies continue to hinder assessment of economic developments and policy formulation.** With assistance from STA and the Italian National Statistical Institute, INSTAT is conducting a project to improve national accounts methodology and coverage of the informal economy. Outcomes, however, have not improved since the mid-2003 publication of the 1998–2001 national accounts, and the 2002 figures have not been produced yet. Staff acknowledged that methodological improvements may carry an initial cost, but emphasized the need for radical progress in this area (MEFP, ¶22).

Business Climate Indicators (2003)

	Albania	Regional Average	OECD Average
Starting a Business			
Number of procedures	11	10	7
Duration (days)	47	48	30
Cost (% GNI per capita)	65	21.7	10.2
Hiring & Firing Costs			
Flexibility of hiring 1/	33	51	49
Flexibility of firing 1/	15	39	28
Enforcing Contracts			
Number of procedures	37	25	17
Duration (days)	220	344	233
Cost (% GNI per capita)	72.6	27.9	7.1
Procedural Complexity Index (Max=100)	76	56	49
Getting Credit			
Public credit registry index 2/	0	49	58
Private bureau coverage (borrowers per 1000 capita)	0	38.6	443.5
Closing a Business			
Goals of insolvency index 3/	42	51	77
Court powers index 4/	67	57	36

Source: Doing Business, 2003.

1/ Each index assigns values between 0 and 100, with higher values representing more rigid regulations.

2/ The index ranges from 0 to 100, with higher values indicating that the rules are better designed to support credit transactions.

3/ The index ranges from 0 to 100. A higher value indicates a more efficient insolvency system.

4/ Higher values indicate a more court involvement in the process, usually an impediment to resolutions.

F. External Financing and Trade Policy

33. **The program is fully financed.** Projected debt flows, given the external outlook, indicate that Albania should not have difficulty in meeting its current and future external debt service obligations to the Fund (Tables 8, 9, 10 and 11).

34. **The authorities remain committed to reschedule the remaining external arrears within the program period and maintain good faith negotiations on arrears on former nonconvertible currencies (MEFP, ¶20).** Agreements with Hungary and with FYR Macedonia private creditors were ratified by the Albanian parliament in March 2004.

35. **The authorities reaffirmed their commitment to a liberal multilateral trade regime and to further regional and European integration (MEFP, ¶19).** To this end, parliament ratified free trade agreements with Serbia and Montenegro, and Moldova in February 2004.

G. Program Monitoring

36. It is proposed: (i) that the sixth disbursement under the arrangement be conditional upon observance of end-September 2004 quantitative and structural performance criteria, the end-December 2004 structural performance criterion, and completion of the fifth review (Table 12); and (ii) that the seventh disbursement under the arrangement be conditional upon observance of end-March 2005 quantitative performance criteria, and completion of the sixth review. The proposed structural conditionality is consistent with the priorities identified in the PRSP and the second progress report, and has been set in collaboration with the World Bank (Box 2).

Box 2. Structural Conditionality

In addition to implementing 2004 budget measures (¶15, ¶16, MEFP ¶5), structural conditionality focuses on improving governance, the business climate, and fiscal institutions (MEFP, Table 2)—areas deemed critical to achieving program objectives.

- Measures to **strengthen governance and improve the business climate**, include promoting financial deepening through the use of the banking system for economic transactions (¶26, MEFP ¶10) and the action plan to remove administrative barriers to investment (¶30, MEFP ¶13; NSSD Chapter 7, Section on Ministry of Economy).
- Measures to improve **governance of fiscal institutions and strengthen revenue collection**, include: (i) introducing ASYCUDA in the Durrës customs office (¶6, ¶19; NSSD Chapter 7, Section on Customs); (ii) improving VAT legal and regulatory features and its monitoring; (iii) following transparent procedures for the efficient use of nonconcessional foreign loans (MEFP ¶20, TMU¶18); and (iv) reporting quarterly on the stock of external arrears (¶33), also related to external sustainability.

Structural conditionality performance has improved since the third review (Table 1, MEFP ¶2).

World Bank Structural Conditionality

Bank's conditionality focuses on governance and institution building; sustainable private sector development; human development, and restructuring of key sectors (Appendix II).

IV. STAFF APPRAISAL

37. **The economy has recovered from the 2002 slowdown and macroeconomic performance has been good.** Growth is primarily driven by domestic demand, although exports are picking up from low levels. The supply recovery has been underpinned by improved energy production owing to favorable weather and restructuring efforts. The current account strengthened in 2003 due to trade gains and increased private remittances.

38. **The outlook is for output growth to remain close to its trend at about 6 percent and inflation within the 2–4 percent target range—contingent on progress in structural reforms.** The external position is sustainable but dependent on maintaining the export expansion. Thus, improving the business climate and attracting export-generating FDI remains the cornerstone of a successful growth strategy. To this end, it will be essential to improve the efficiency of the public sector, governance, and the rule of law.

39. **The ongoing budget retrenchment is appropriate to stay the course of fiscal consolidation in the face of budget resource shortfalls.** The decline in the public debt ratio and the authorities' decision to devote at least half of all future large privatization proceeds to further debt reduction are welcome. For 2004, it will be important to ensure that capital spending financed by proceeds from the privatization of the Savings Bank is undertaken effectively and in consultation with the World Bank. The 2005 budget should be based on a sound and credible revenue forecast, forestalling haphazard spending cuts. In 2005 and over the medium term, additional fiscal consolidation will be necessary to accommodate growing private sector credit and the envisaged decline in external concessional assistance.

40. **Therefore, the emphasis should be placed on accelerating tax revenue mobilization efforts, and improving the effectiveness and accountability of budgetary institutions.** Although the tax-to-GDP ratio has increased somewhat over time and tax and customs administration reform has progressed since late-2003, much remains to be done to ensure the medium-term sustainability of key growth-enhancing and poverty alleviation programs. A broad-based improvement in outcomes will require sustained commitment to a multipronged reform agenda—including treasury and expenditure management enhancements, civil service reform, and anti-corruption measures. Public wage indexation should be discontinued, as it undermines public administration reform, weakens budget discipline, and could prompt inflationary pressures. Steps towards more transparency in the budget process are encouraging, but should involve better integration of the annual budget with the medium-term strategy, realistic revenue projections, and effective expenditure prioritization.

41. **The BoA has managed liquidity skillfully and the prudent easing of monetary policy has been appropriate.** While there may be still further room for rate cuts, the BoA should continue its gradualist approach, carefully monitoring domestic supply conditions, and international energy prices and interest rate differentials.

42. **Ongoing efforts to strengthen financial supervision and market infrastructure are well placed.** The envisaged expansion in banking intermediation will require enhanced vigilance. The planned FSAP will be instrumental in this regard. The decision to channel payment of public wages through banks will boost financial intermediation, help to curb informality, and strengthen treasury management and governance.

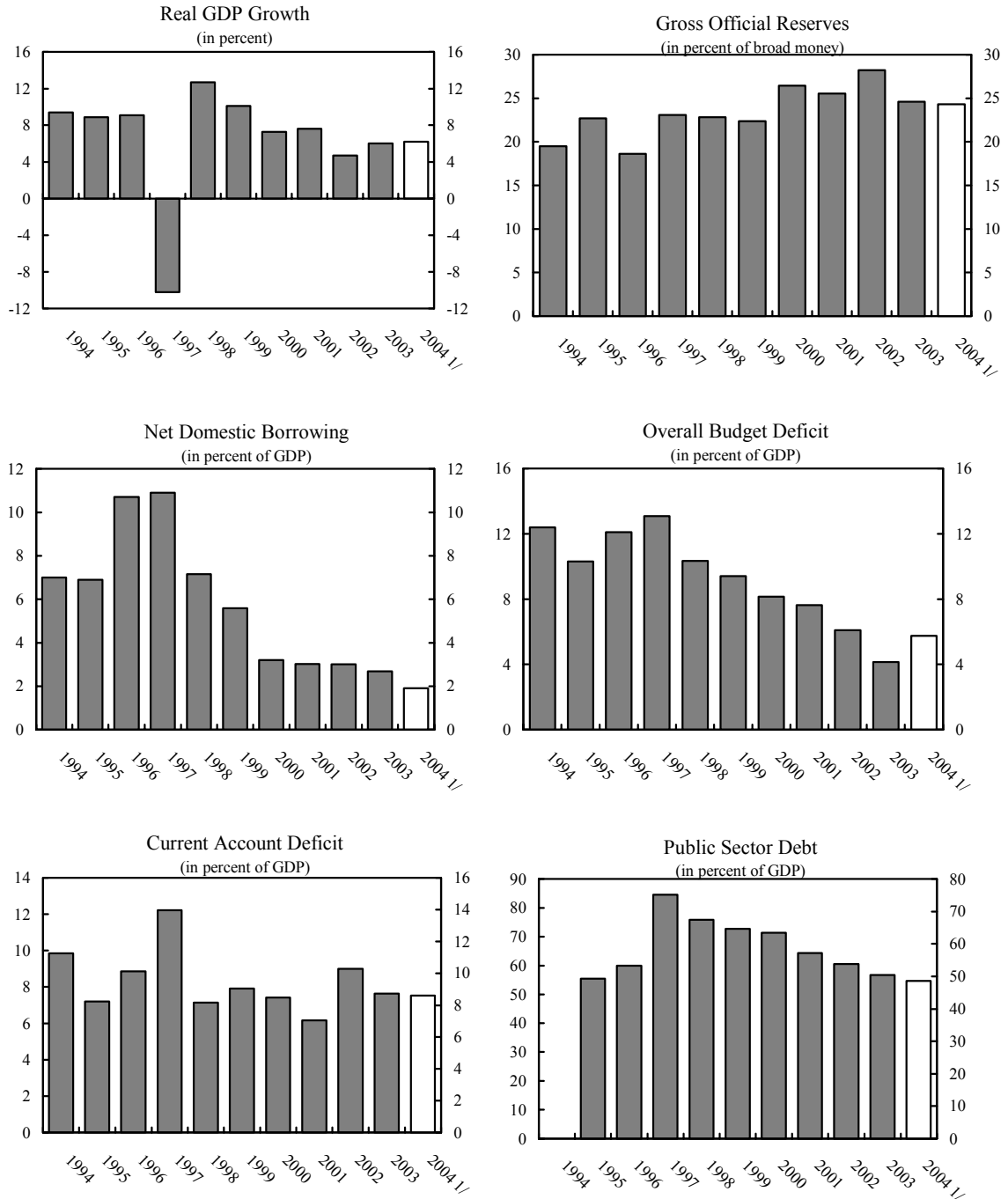
43. **The renewed privatization momentum should be maintained.** The aim should be to sell in the short term the public stakes in the financial and oil sectors. The authorities are also encouraged to prepare Albtelekom for early privatization.

44. **The authorities are pursuing good faith efforts to reach agreements with official and private creditors on remaining arrears.**

45. Fund and World Bank staffs consider that progress made towards the implementation of the NSSD has been sufficient through 2003, and is demonstrative of Albania's continued commitment to poverty reduction.

46. The supplementary MEFP contains a strong policy program to preserve macroeconomic stability and growth, consistent with the PRSP progress report. Program implementation has been overall satisfactory, despite persistent difficulties in expanding budget revenue and delay in implementing structural conditionality related to the ASYCUDA system. Staff considers that this delay did not compromise program objectives. Furthermore, in light of progress made and expert advice received in this area, staff takes the view that conditionality on initiating an integrity audit is no longer appropriate. Staff therefore supports the authorities request for completion of the fourth review and financing assurances review, as well as for a waiver for the non-observance of a structural performance criterion.

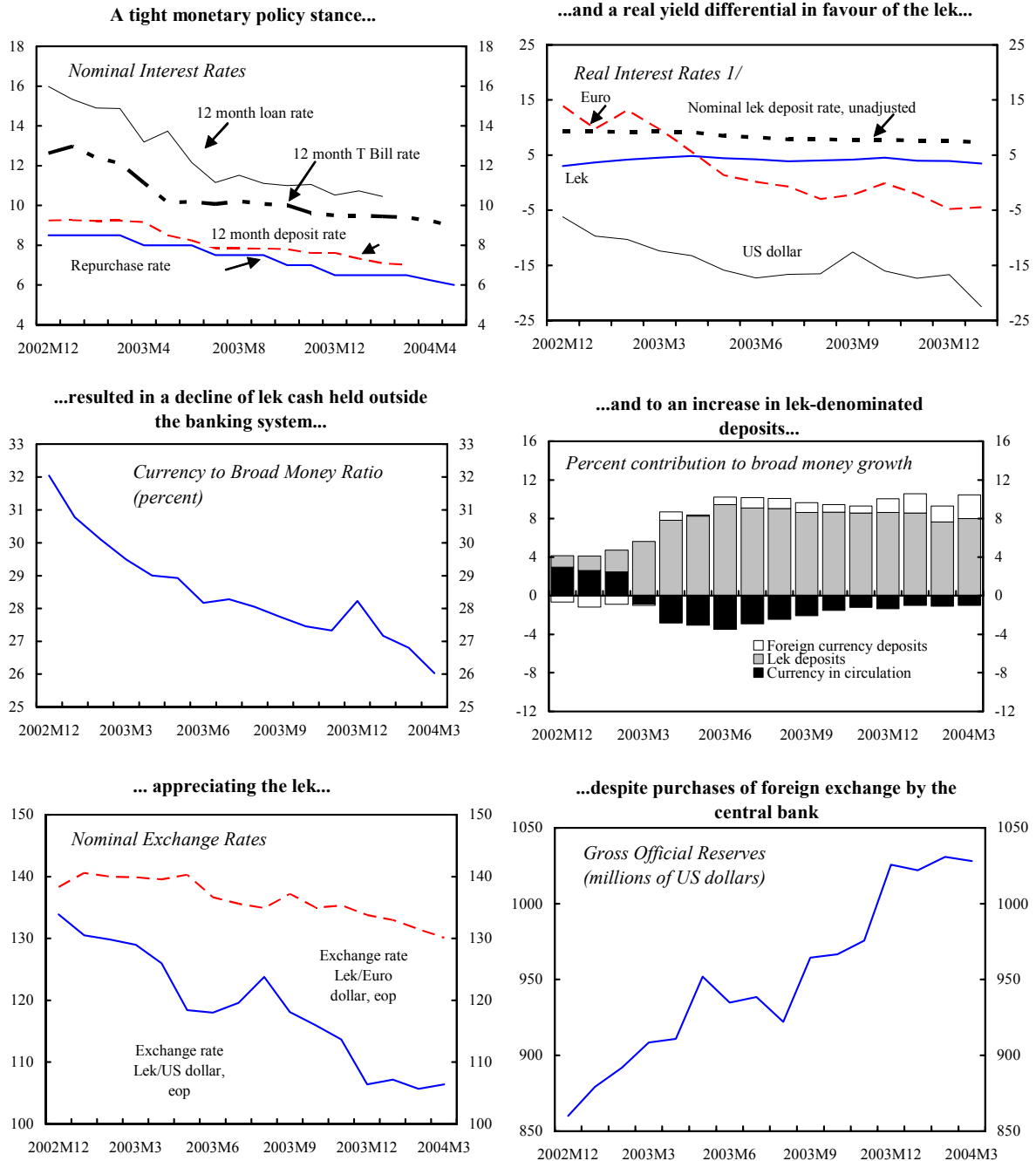
Figure 1. Albania: Economic Developments and Prospects, 1994–2004 1/



Sources: Albanian authorities; and Fund staff estimates.

1/ White bars indicate staff estimates.

Figure 2. Albania: Monetary Sector Developments, December 2002–May 2004



Sources: Data provided by Bank of Albania; and IMF staff estimates.

1/ Adjusted for backward looking exchange rate movements, except where noted.

Table 1. Albania: Basic Indicators and Macroeconomic Framework, 1998–2007

	1998	1999	2000	2001	2002	2003		2004		2005	2006	2007
						Staff Report /1	Est.	Staff Report /1	Proj.	Proj.	Proj.	Proj.
(Growth rate in percent)												
Real GDP 2/	12.7	10.1	7.3	7.6	4.7	6.0	6.0	6.0	6.2	6.0	6.0	6.0
Retail prices (avg.)	20.9	0.4	0.0	3.1	5.2	2.3	2.4	3.0	3.4	3.0	3.0	3.0
Retail prices (end-period)	8.7	-1.0	4.2	3.5	1.7	2.8	3.3	3.0	3.4	3.0	3.0	3.0
(In percent of GDP)												
Saving-investment balance 3/												
Foreign saving 4/	3.9	3.9	4.4	3.2	6.5	6.3	5.1	6.1	5.5	5.2	4.8	4.5
Domestic saving	12.0	16.3	19.4	26.3	19.7	20.2	20.2	20.6	21.4	20.8	21.9	23.3
Public 5/	-4.6	-1.6	-1.6	-0.6	0.1	0.5	0.1	0.8	0.4	0.3	1.1	1.8
Private	16.6	17.9	20.9	26.9	19.7	19.7	20.1	19.8	21.0	20.5	20.9	21.5
Investment	15.9	20.2	23.8	29.5	26.2	26.5	25.3	26.6	26.9	26.1	26.8	27.8
Public	5.8	7.8	6.6	7.1	6.2	5.5	4.2	5.9	6.2	4.8	5.0	5.5
Private	10.1	12.3	17.2	22.4	20.0	21.0	21.0	20.7	20.7	21.2	21.7	22.2
Fiscal sector												
Revenues and grants 6/	24.2	25.5	23.8	22.8	22.8	23.6	22.4	24.1	23.1	22.7	22.8	22.9
Tax revenue	17.5	17.6	19.6	19.0	19.0	20.1	19.5	20.8	20.2	20.1	20.3	20.4
Of which: social security contributions	3.8	3.8	3.8	3.7	3.8	4.0	3.8	4.1	4.0	4.0	4.1	4.2
Expenditures	34.5	34.9	31.9	30.4	28.9	28.5	26.5	29.3	28.8	27.2	26.8	26.6
Primary	25.8	27.5	26.1	26.3	25.3	24.5	22.5	25.5	25.1	23.7	23.7	23.8
Interest 7/	8.8	7.5	5.8	4.2	3.7	4.1	4.0	3.8	3.7	3.4	3.1	2.8
Overall balance (excluding grants)	-12.0	-12.2	-9.2	-8.2	-6.7	-5.6	-4.5	-6.0	-6.5	-5.0	-4.5	-4.3
Overall balance (including grants)	-10.3	-9.4	-8.2	-7.6	-6.1	-5.0	-4.1	-5.1	-5.8	-4.5	-4.0	-3.7
Primary balance (excluding grants)	-3.2	-4.8	-3.4	-4.1	-3.1	-1.6	-0.5	-2.2	-2.8	-1.6	-1.4	-1.4
Net domestic borrowing	7.2	5.6	3.2	3.0	3.0	2.7	2.7	2.8	1.9	2.5	2.3	2.3
Privatization receipts	0.0	0.2	1.7	2.1	0.1	0.2	0.1	0.7	2.3	0.3	0.3	0.1
Foreign finance	3.2	3.6	3.3	2.5	3.0	2.1	1.3	1.7	1.6	1.6	1.3	1.4
Public Debt	75.9	72.7	71.3	64.4	60.6	59.3	56.8	58.4	54.6	54.0	53.3	52.8
Domestic 8/	43.5	43.4	41.9	39.5	38.8	38.0	37.9	37.2	35.7	35.0	34.3	33.7
External (including publicly guaranteed) 9/10/	32.4	29.3	29.4	24.9	21.8	21.3	18.9	21.2	18.9	18.9	19.0	19.1
Monetary indicators												
(Growth rate in percent unless otherwise indicated)												
Broad money growth (in percent)	20.6	22.3	12.0	20.2	5.7	9.0	8.7	10.6	11.8	9.9	10.3	11.8
Private credit growth (in percent)	14.7	13.3	31.8	23.4	41.0	28.0	31.1	27.4	31.3	35.5	38.6	34.7
Velocity	1.7	1.6	1.6	1.5	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.6
Interest rate (3-mth T-bills, end-period)	20.4	14.8	7.8	8.0	11.2	...	7.3	...	...	...	...	...
(In millions of U.S. dollars)												
External sector												
Trade balance (goods only) 11/	-621	-846	-821	-1027	-1155	-1371	-1336	-1469	-1602	-1746	-1870	-2018
(in percent of GDP)	-22.8	-24.6	-22.3	-24.2	-23.9	-22.8	-21.8	-21.5	-20.4	-20.2	-19.7	-19.4
Current account balance (excluding official transfers)	-195	-272	-274	-263	-435	-509	-469	-555	-592	-635	-672	-685
(in percent of GDP)	-7.1	-7.9	-7.4	-6.2	-9.0	-8.5	-7.6	-8.1	-7.5	-7.3	-7.1	-6.6
(in percent of GDP; incl. official transfers)	-3.9	-3.9	-4.4	-3.2	-6.5	-6.3	-5.1	-6.1	-5.5	-5.2	-4.8	-4.5
Official transfers	89	139	111	126	121	128	157	138	162	184	213	221
(in percent of GDP)	3.3	4.1	3.0	3.0	2.5	2.1	2.6	2.0	2.1	2.1	2.2	2.1
Gross international reserves	388	485	608	737	860	974	1026	1019	1132	1227	1296	1384
(in months of imports of goods and services)	3.7	3.8	4.1	4.3	4.0	4.4	4.0	4.4	4.0	4.0	3.9	3.8
(relative to external debt service)	16.4	21.6	23.6	21.2	13.8	17.7	17.5	13.8	13.1	9.4	7.6	8.3
(in percent of broad money)	22.8	22.4	26.4	25.5	28.2	26.3	24.6	24.8	24.3	23.9	22.9	21.8
Change in real effective exchange rate	8.5	15.2	4.9	9.4	-11.6	...	2.9	...	...	...	...	...
Memorandum items												
Nominal GDP (in millions of lek)	412,326	474,291	530,906	610,417	677,674	744,585	746,318	821,620	836,937	919,731	1,006,989	1,101,032

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

- 1/ As reported in IMF Country Report 04/22, except the savings-investment balance and the external debt to GDP ratios which have been adjusted for compatibility purposes.
- 2/ Data for 1998-2001 is the first public official national accounts and includes estimates of the non-observed economy. Reported growth is also based on the non-observed economy.
- 3/ The statistical discrepancy contained in the national accounts (31 percent of GDP in 2001), corresponding to the informal economy, was allocated to private consumption and investment according to the ratio observed in the national accounts excluding the discrepancy. Unexplained oscillations in this discrepancy introduced additional statistical uncertainty into the historical data.
- 4/ Negative of current account including official transfers.
- 5/ Revenue and grants less current expenditure and net lending.
- 6/ Grants for 1998-2001 are estimated.
- 7/ Includes interest payments for bank restructuring.
- 8/ Includes bonds issued for bank restructuring (lek 24.6 bn in 2000).
- 9/ Includes arrears, with the exception of the exception of pre-1978 arrears to China which are still under negotiation.
- 10/ Excludes IMF repurchase obligations.
- 11/ For 1999, excludes imports of direct humanitarian aid related to the Kosovo crisis.

Table 2: Albania: Millennium Development Goals , 1999–2002 and 2015

	1990	1995	2001	2002	2015 Target
General Indicators					
Population (million)	3.3	3.2	3.1	3.2	
GNI per capita (\$)	680	650	1400	1450	
Adult literacy rate (% people ages 15 and over)	77	81.2	98.7	...	
Total fertility rate (births per woman)	3	2.6	2.1	2.2	
Life expectancy at birth (years)	72.3	71.3	74	74	
Aid (% of GNI)	0.5	7.3	6.1	6.4	
Goal 1. Eradicate extreme poverty and hunger					
Target 1. Halve, between 1990 and 2015, the proportion of people whose income is less than one dollar a day					
1. Population below 1 US\$ a day (percent)	...	...	...	2	1.4
2. Poverty gap ratio at US\$ a day (percent)	...	...	...	0.5	...
3. Share of income consumption held by poorest 20 percent (percent)	...	...	...	9.1	...
Target 2: Halve, between 1990 and 2015, the proportion of people suffering hunger					
4. Prevalence of child malnutrition (percent of children under 5)	...	...	14	...	5.4
5. Population below minimum level of dietary energy consumption (percent)	...	...	...	...	...
Goal 2. Achieve universal primary education					
Target 3: Ensure that, by 2015, children will be able to complete a full course of primary schooling					
6. Net primary enrollment ratio (percent of relevant age group)	...	98.7	97.2	...	100
7. Percentage of cohort reaching grade 5	...	...	82	...	100
8. Youth literacy rate (percent ages 15-24)	94.8	96.6	98	98.2	100
Goal 3. Promote gender equality and empower women					
Target 4: Eliminate gender disparity in primary and secondary education preferably by 2005 and to all levels of education in 215					
9. Ratio of girls to boys in primary and secondary education (percent)	96.1	101.3	102	...	100
10. Ratio of young literate females to males (percent ages 15-24)	94.4	96.2	100.1	...	100
11. Share of women employed in the nonagricultural sector (percent)	39.6	...	41.1	...	...
12. Proportion of seats held by women in the national parliament (percent)	...	6	...	...	30
Goal 4. Reduce child mortality					
Target 5: Reduce by two-thirds, between 1990 and 2015, the under-five mortality rate					
13. Under-five mortality rate (per 1,000)	42	33	26	24	13.7
14. Infant mortality rate (per 1,000 live births)	36	29	24	22	...
15. Immunization against measles (percent of children under 12-months)	88	91	95	96	97.3
Goal 5. Improve maternal health					
Target 6: Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio					
16. Maternal mortality ratio (modeled estimate, per 100,000 live births)	...	31	55	...	9.5
17. Proportion of births attended by skilled health personnel	...	...	99.1	...	...
Goal 6. Combat HIV/AIDS, malaria and other diseases					
Target 7: Halt by 2015, and begin to reverse, the spread of HIV/AIDS					
18. HIV prevalence among females (percent ages 15-24)	...	...	...	...	0
19. Contraceptive prevalence rate (percent of women ages 15-49)	...	...	...	...	...
20. Number of children orphaned by HIV/AIDS	...	...	...	...	0

Table 2: Albania: Millennium Development Goals , 1999–2002 and 2015 (continued)

	1990	1995	2001	2002	2015 Target
Target 8: Halt by 2015, and begin to reverse, the incidence of malaria and other major diseases					
21. Prevalence of death associated with malaria	...	...	...	...	0
22. Share of population in malaria risk areas using effective prevention treatment	...	...	...	...	...
23. Incidence of tuberculosis (per 100,000 people)	...	...	29	27.5	<20
24. Tuberculosis cases detected under DOTS (percent)	...	...	20	24	...
Goal 7. Ensure environmental sustainability					
Target 9: Integrate the principles of sustainable development into policies and programs. Reverse the loss of environmental resources.					
25. Forest area (percent of total land area)	39	...	36.2	...	...
26. Nationally protected areas (percent of total land area)	...	2.9	3.1	3.8	...
27. GDP per unit of energy use (PPP \$ per kg oil equivalent)	3.1	7.6	8.3	...	...
28. CO2 emissions (metric tons per capita)	2.2	0.6	0.9	...	...
29. Proportion of population using solid fuels	...	...	...	...	...
Target 10: Halve by 2015 the proportion of people without access to safe drinking water					
30. Access to improved water source (percent of population)	...	...	97	...	86.1
Target 11: Achieve by 2020 significant improvement for at least 100 million slum dwellers					
31. Access to improved sanitation (percent of population)	...	...	91	...	94.7
32. Access to secure tenure (percent of population)	...	...	...	...	...
Goal 8. Develop a Global Partnership for Development 1/					
Target 16. Develop and implement strategies for productive work for youth					
45. Unemployment rate	9	13	16.8	...	...
Female	8	12	14.8	...	...
Male	11	15	19.3	...	...
Target 17: Provide access to affordable essential drugs					
46. Proportion of population with access to affordable drugs	...	...	...	...	...
Target 18: Make available new technologies especially information and communications					
47. Fixed line and mobile telephones (per 1,000 people)	12.6	13.4	191.2	347.7	...
48. Personal computers (per 1,000 people)	...	1.6	9.7	11.7	...

Source: World Bank and Fund staff estimates

1/ Targets 12-15 and indicators 33-44 are excluded because they cannot be measured on a country-specific basis. These are related to official development assistance, market access, and the HIPC initiative.

Table 3. Albania: Performance Criteria and Structural Benchmarks under the PRGF Arrangement

Measures	Test-date	Status
A. Prior Actions for the Third Review		
1. Parliament to approve the 2004 budget consistent with the Supplementary Memorandum of Economic and Financial Policies.		Completed
2. Execute the government-assisted netting and final settlement of public sector inter-enterprise arrears as of end-2001.		Completed
B. Performance Criteria for the Fourth Review		
1. Make ASYCUDA computer administration system operational in the Tirana custom house.	End-January 2004	Completed
2. Make ASYCUDA computer administration system operational in the Durres port; and initiate and integrity audit of the ASYCUDA system in both the Tirana customs house and the Durrës port.	End-March 2004	Waiver requested. ASYCUDA system implemented in Durrës as a prior action.
C. Structural Benchmarks under the Fourth Review		
1. Extend the Civil Service Law or its equivalent to selected central government organizational units, with priority given to INSTAT, GDT and GDC, and adopt all supporting instructions and decisions to that effect.	End-June 2004	Completed
2. Adopt a government decision not to release up to Lek 1 billion from each of the reserve fund and contingency fund by the amount that final tax revenue collected in 2003 by the GDT, GDC and SSU (including taxes collected on behalf of local government) falls short of Lek 144.5 million.	End-June 2004	Completed
3. Strengthen tax and customs administration through:		
(i) Improving the VAT refunds process by reporting on the stock of VAT refunds claimed and refunds paid out every month;	End-March 2004 and ongoing	Completed
(ii) Implementing the recommendations of the integrity audit of the ASYCUDA computer administration system in the Tirana customs office and in the Durrës port.	End-June 2004	...
4. Ensure implementation of the Action Plan for removing administrative barriers to investment.	End-June 2004	Completed
5. Prepare quarterly reports (within one month of the end of each quarter) on the stock of external arrears.	Throughout	Completed
6. Safeguard the efficient use of nonconcessional foreign project loans through:		
(i) Conducting an independent feasibility study for any large project (as defined in the TMU) financed through non-concessional borrowing.	Throughout	Completed
(ii) Provide a quarterly listing and status report on all projects being considered for nonconcessional foreign financing.	Throughout	Completed

Table 4. Albania: Monetary Aggregates, 2001–07 1/
(In billions of leks unless otherwise indicated; end-period)

	Actuals								IMF Projection						
	2001 1/	2002		2003			2004		2005		2006	2007			
	Dec.	Dec.	March	June	Sep.	Dec.	Dec.	Mar	June	Sep.	Dec.	March	Dec.	Dec.	
Monetary survey															
Broad money	394.3	408.1	411.3	422.0	437.1	445.0	443.5	450.2	470.3	484.2	495.8	511.0	544.9	601.2	672.4
Currency outside banks	119.1	130.8	121.3	118.9	121.3	126.8	125.2	117.2	127.1	130.8	135.0	138.1	147.8	162.5	181.0
Deposits	275.2	277.4	290.0	303.1	315.8	318.2	318.3	333.0	343.2	353.4	360.8	372.9	397.1	438.7	491.3
Domestic currency deposits	186.2	190.8	203.7	216.2	220.3	221.7	226.1	236.6	239.8	242.7	247.8	257.8	276.1	307.7	354.4
Foreign currency deposits	89.0	86.5	86.3	86.9	95.5	96.5	92.2	96.4	103.3	110.7	113.0	115.1	121.0	131.1	136.9
M1	142.9	145.9	137.1	135.7	138.5	144.8	142.0	137.5	144.1	148.3	153.1	156.6	167.6	186.8	208.1
M2	305.3	321.6	325.0	335.1	341.6	348.5	351.3	353.8	366.9	373.4	382.8	395.9	423.9	470.1	535.4
Net foreign assets	158.6	164.4	165.0	156.5	166.4	164.4	161.8	165.8	181.7	184.8	185.2	184.3	189.7	189.9	194.3
Bank of Albania 2/	86.0	96.9	99.0	93.7	96.5	99.6	99.8	99.1	113.8	109.4	111.3	113.5	120.9	128.2	137.5
Commercial Banks	72.7	67.5	66.0	62.7	69.9	64.8	62.0	66.7	67.8	75.4	73.9	70.8	68.9	61.7	56.8
Net domestic assets	235.7	243.8	246.4	265.5	270.7	280.6	281.7	284.4	288.6	299.3	310.6	326.7	355.1	411.3	478.1
Claims on government (net of deposits)	231.0	245.3	245.8	249.3	255.7	261.8	260.1	264.4	260.1	266.9	273.8	282.6	294.2	314.4	336.5
BOA financing	67.6	71.0	69.1	65.3	65.0	67.7	64.6	60.5	53.7	62.7	67.2	65.4	70.5	70.5	70.5
Other (including T-bills)	163.4	174.3	176.8	184.0	190.7	194.2	195.5	203.9	206.4	204.3	206.5	217.2	223.7	243.9	266.0
Claims on state enterprises and farms	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Claims on the private sector (excluding BART)	27.4	39.9	41.7	46.1	49.6	53.1	52.3	54.9	59.8	64.0	68.7	76.0	93.1	129.1	173.8
of which in leks	4.8	9.2	9.4	10.3	9.9	10.7	10.6	11.1	12.5	13.6	14.8	17.1	27.0	43.4	85.4
in foreign currency	22.6	30.7	32.3	35.8	39.8	42.4	41.7	43.8	47.3	50.4	53.9	58.9	66.1	85.7	88.5
Other items, net	-23.2	-41.5	-41.2	-29.9	-34.6	-34.3	-30.8	-34.9	-31.3	-31.6	-31.9	-31.9	-32.2	-32.2	-32.2
OIN of BOA	-8.1	-14.9	-14.6	-7.9	-9.2	-9.2	-3.1	-1.8	-3.7	-3.9	-4.2	-4.3	-4.5	-4.5	-4.5
Monetary authorities															
Reserve money	152.1	163.9	157.9	151.7	157.2	162.9	160.6	154.4	165.8	170.1	176.2	176.6	188.8	194.8	204.6
Net foreign assets	86.0	96.9	99.0	93.7	96.5	...	99.8	99.1	113.8	109.4	111.3	113.5	120.9	128.2	137.5
Net domestic assets	66.2	67.0	58.9	58.0	60.7	...	60.7	55.3	52.0	60.7	65.0	63.1	67.9	66.0	66.0
Net credit to government	67.6	71.0	69.1	65.3	65.0	...	64.6	60.5	53.7	62.7	67.2	65.4	70.5	70.5	70.5
Memorandum items:															
Broad money growth during the year	20.2	5.7	0.8	3.4	7.1	9.0	8.7	1.5	6.0	9.2	11.8	3.1	9.9	10.3	11.8
Of which:															
Net foreign assets	8.5	0.9	0.1	-1.9	0.5	0.0	-0.6	0.9	4.5	5.2	5.3	-0.2	0.9	0.0	0.7
Net domestic assets	11.7	4.8	0.6	5.3	6.6	9.0	9.3	0.6	1.6	4.0	6.5	3.2	9.0	10.3	11.1
Claims on government	4.8	3.5	0.1	1.0	2.5	4.0	3.6	1.0	0.0	1.5	3.1	1.8	4.1	3.7	3.7
Deficit financing through banking system	15.6	14.4	0.5	4.0	10.4	16.1	14.8	4.2	0.0	6.8	13.6	8.8	20.4	20.2	22.0
in percent of GDP	2.6	2.1	0.1	0.6	1.4	2.2	2.0	0.6	0.0	0.8	1.6	1.0	2.2	2.0	2.0
Annual broad money growth (y-o-y; in percent)	20.2	5.7	6.8	9.0	9.8	9.0	8.7	9.5	11.4	10.8	11.8	13.4	9.9	10.3	11.8
Annual reserve money growth	18.1	0.0	-1.1	-6.8	-2.3	-0.6	-2.0	-2.2	9.3	8.2	9.8	10.5	7.1	3.2	5.0
Annual growth in private sector credit (y-o-y; in percent) 3/	23.4	41.0	39.3	34.5	35.2	33.2	31.1	31.6	29.8	28.9	31.3	36.1	35.5	38.6	34.7
Annual growth in private sector credit (y-o-y; in percent) 4/	43.1	32.1	31.1	28.1	29.2	28.0	26.3	...	25.8	25.3	27.6	32.1	32.2	...	...
Annual M1 growth	15.2	6.9	-3.3	-9.2	-5.4	-0.8	-2.7	-3.1	6.2	7.1	7.8	13.0	9.5	11.4	11.4
Annual M2 growth	15.4	6.4	7.2	8.6	9.5	8.4	9.2	0.7	9.5	9.3	9.0	12.2	10.7	10.9	13.9
Velocity (annual GDP/BM)	1.5	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.6
Money multiplier (absolute values)	2.59	2.49	2.61	2.78	2.78	2.73	2.76	2.92	2.84	2.85	2.81	2.89	2.89	3.09	3.29
Currency/Broad Money ratio	30.2	32.0	29.5	28.2	27.8	28.5	28.2	26.0	27.0	27.0	27.2	27.0	27.1	27.0	26.9
Currency/deposit ratio	43.3	47.1	41.8	39.2	38.4	39.8	39.3	35.2	37.0	37.0	37.4	37.0	37.2	37.0	36.8
Currency/lek deposit ratio	64.0	68.5	59.5	55.0	55.1	57.2	55.4	49.5	53.0	53.9	54.5	53.6	53.5	52.8	51.1
Deposits/broad money	69.8	68.0	70.5	71.8	72.2	71.5	71.8	74.0	73.0	73.0	72.8	73.0	72.9	73.0	73.1
Foreign currency deposits/total deposits	32.3	31.2	29.8	28.7	30.2	30.3	29.0	28.9	30.1	31.3	31.3	30.9	30.5	29.9	27.9
Lek deposits/total deposits (percent)	67.7	68.8	70.2	71.3	69.8	69.7	71.0	71.1	69.9	68.7	68.7	69.1	69.5	70.1	72.1
FX deposits/broad money (percent)	22.6	21.2	21.0	20.6	21.9	21.7	20.8	21.4	22.0	22.9	22.8	22.5	22.2	21.8	20.4
Gross reserves (millions of U.S. dollars)	737	860	908	935	964	974	1025.55	1028.08	1154	1117	1132	1158	1227	1296	1384
in percent of broad money	25.5	28.2	28.5	26.1	26.3	24.6	24.3	26.2	24.6	24.3	24.1	23.9	22.9	21.8	21.8
US Dollar Exchange Rate (end of period)	136.6	133.9	129.0	118.0	118.1	...	106.4	106.4	...	...	...	...	...	...	...
Euro Exchange Rate (end of period)	120.3	138.3	139.9	136.7	137.2	...	133.8	130.1	...	...	...	...	...	...	...
3-month T-bill rate (in percent)	8.0	11.2	10.5	8.2	7.3	...	7.3	7.0	...	...	...	...	...	...	...
BoA repo rate (in percent)	7.0	8.5	8.5	8.0	7.5	...	6.5	6.5	...	...	...	...	...	...	...

Sources: Bank of Albania; and staff estimates.

1/ Data up to and including 2001 are based on the previous reporting standard. As of December 2002, data are based on a new reporting standard, in accordance with the 2000 Monetary and Financial Statistics Manual. The main changes are the exclusion of blocked deposits from broad money (Lek 10.7 billion at end-2002) and the inclusion of accrued interest in assets and liabilities. 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/ The series (on the old reporting standard) includes a break at end-2002, as a change in definitions lowered NFA by Lek 1.4 billion, raising other items net by the same amount.

3/ Excluding credit transferred to the Bank Asset Resolution Trust (BART).

4/ Including credit transferred to the BART.

Table 6a. Albania: Government Revenues and Expenditures 1/
(in percent of GDP)

	2001	2002	2003			2004			2005		2006	2007
	Outturn	Outturn	Budget	Staff Report	Outturn	Budget Staff Report	Q1 outturn	Staff projections 2/	Staff Projections		Staff Projections	
									Q1	year		
Total Revenue and Grants	22.8	22.8	25.2	23.6	22.4	24.1	19.8	23.1	20.1	22.7	22.8	22.9
Tax Revenue	19.0	19.0	21.4	20.1	19.5	20.8	18.0	20.2	18.1	20.1	20.3	20.4
Tax revenues from Tax directorate and Customs	15.0	14.9	16.5	15.4	15.0	15.8	13.5	15.3	13.4	15.2	15.4	15.4
Turnover tax / VAT	6.7	6.8	7.6	6.8	6.8	7.0	6.0	6.8	5.8	6.8	7.0	7.0
Profit tax	1.7	1.8	1.8	1.8	1.8	1.9	1.7	1.8	1.8	1.8	1.8	1.8
Excise tax	1.6	1.4	1.6	1.7	1.6	2.0	1.4	2.0	1.4	2.0	2.0	2.0
Small business tax	0.3	0.4	0.4	0.5	0.4	0.5	0.8	0.5	0.7	0.5	0.5	0.5
Personal income tax	1.0	0.9	1.0	0.9	0.9	1.0	0.8	0.9	0.8	0.9	0.9	0.9
National taxes 3/	1.6	1.4	1.5	1.3	1.2	1.5	1.3	1.4	1.3	1.4	1.4	1.4
Customs duties	2.1	2.0	2.0	2.0	1.9	1.8	1.4	1.7	1.4	1.6	1.6	1.5
Road tax	...	0.2	0.4	0.4	0.5	...	...	...	...	...	...	...
Tax on vehicles	...	...	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Automobile circulation tax	...	...	...	...	...	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Property and local taxes	0.3	0.4	0.6	0.6	0.6	0.8	0.8	0.8	0.7	0.8	0.8	0.8
Social insurance contributions	3.7	3.8	4.3	4.0	3.8	4.1	3.6	4.0	3.9	4.0	4.1	4.2
Social insurance	3.4	3.5	3.9	3.7	3.5	3.8	3.3	3.6	3.5	3.7	3.8	3.9
Health insurance	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Non-tax revenue:	3.2	3.2	3.0	2.8	2.6	2.5	1.6	2.1	1.0	2.1	2.0	1.9
Profit transfer from BOA	1.8	1.5	1.4	1.3	1.2	0.9	0.5	0.6	0.0	0.7	0.6	0.5
Income of budgetary institutions	0.7	0.9	1.1	0.9	0.8	1.1	1.0	1.0	0.8	0.9	0.9	0.9
Other	0.7	0.7	0.6	0.5	0.6	0.5	0.2	0.5	0.2	0.5	0.5	0.5
Grants 4/	0.6	0.6	0.7	0.7	0.4	0.8	0.1	0.8	1.0	0.6	0.5	0.5
Budgetary	...	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.5	0.2	0.0	0.0
Project	...	0.6	0.6	0.6	0.3	0.8	0.1	0.8	0.5	0.3	0.5	0.5
Total Expenditure	30.4	28.9	31.1	28.5	26.5	29.3	23.4	28.8	26.3	27.2	26.8	26.6
Current Expenditure	23.4	22.8	23.4	22.5	22.5	22.6	21.1	22.0	18.9	21.6	21.2	20.6
Personnel cost	6.8	6.2	6.4	6.1	6.0	6.2	5.2	6.1	5.2	5.9	5.9	5.9
Wages and other personnel expenditures	5.4	4.9	5.0	4.7	4.8	4.9	4.1	4.8	4.1	4.6	4.7	4.6
Social insurance contributions	1.4	1.3	1.4	1.3	1.2	1.3	1.1	1.3	1.2	1.3	1.3	1.3
Interest	4.2	3.7	3.8	4.1	4.0	3.8	3.6	3.7	3.3	3.4	3.1	2.9
Foreign	4.0	3.3	3.3	3.8	3.8	3.5	3.5	3.4	3.1	3.1	2.9	2.6
Domestic	0.2	0.3	0.4	0.3	0.2	0.3	0.1	0.3	0.2	0.3	0.2	0.2
Operations & maintenance	3.8	3.0	2.8	2.6	3.0	2.7	1.9	2.5	2.1	2.6	2.4	2.3
Subsidies 5/	1.3	0.9	0.9	0.6	0.7	0.5	0.4	0.5	0.2	0.3	0.2	0.2
Social insurance outlays	5.9	5.9	6.3	6.0	6.0	6.0	5.4	5.9	5.4	6.0	6.1	6.1
Social insurance	5.4	5.4	5.6	5.4	5.4	5.4	4.8	5.3	4.8	5.3	5.4	5.4
Health insurance	0.5	0.5	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.7	0.7	0.7
Local government expenditure	1.5	1.8	2.0	1.9	1.9	2.1	1.1	2.1	1.8	2.4	2.4	2.2
Local budget (grant)	0.8	1.3	0.9	0.8	0.9	0.8	0.6	0.7	0.7	0.8	0.8	0.8
Local budget (local revenues)	0.4	0.5	0.6	0.5	1.0	0.8	0.4	0.8	0.2	0.8	0.8	0.8
Small business tax	0.3	0.0	0.4	0.5	0.0	0.5	...	0.5	0.7	0.5	0.5	0.5
Tax on vehicles	...	0.0	0.1	0.1	0.0	0.1	...	0.1	0.2	0.1	0.1	0.1
Social protection transfers	1.4	1.3	1.3	1.2	1.2	1.2	0.9	1.2	0.8	1.1	1.0	1.0
Unemployment insurance benefits	0.3	0.2	0.2	0.2	0.1	0.2	0.1	0.2	0.1	0.2	0.2	0.2
Social assistance 5/	1.1	1.1	1.1	1.1	1.0	1.1	0.8	1.0	0.7	0.9	0.9	0.8
Other 6/	0.0	0.0	...	...	-0.3	...	2.7	...	...	...	...	...
Capital Expenditure	7.1	6.2	6.8	5.5	4.2	5.9	2.2	6.2	6.7	4.8	5.0	5.5
Domestically financed	3.9	2.8	3.0	2.8	2.5	3.0	1.2	3.5	4.3	2.6	2.7	3.2
Foreign financed projects	3.1	3.4	3.9	2.7	1.8	2.9	1.0	2.7	2.4	2.2	2.4	2.3
Net lending	...	-0.1	...	...	-0.2	...	...	...	...	...	...	...
Reserve and contingency funds	...	0.0	0.8	0.5	0.0	0.7	0.2	0.6	0.7	0.7	0.5	0.5
Cash Balance	-7.6	-6.1	-5.9	-5.0	-4.1	-5.1	-3.6	-5.8	-6.2	-4.5	-4.0	-3.7
Cash Balance (excluding grants)	-8.2	-6.7	-6.6	-5.6	-4.5	-6.0	-3.7	-6.5	-7.2	-5.0	-4.5	-4.3
Sources of Financing	7.6	6.1	5.9	5.0	4.1	5.1	3.6	5.8	6.2	4.5	4.0	3.7
Domestic	5.1	3.1	2.9	2.9	2.8	3.4	2.9	4.2	4.5	2.9	2.6	2.4
Privatization receipts	2.1	0.1	0.1	0.2	0.1	0.7	0.0	2.3	0.3	0.3	0.3	0.1
Net borrowing	3.0	3.0	2.8	2.7	2.7	2.8	2.9	1.9	4.1	2.5	2.3	2.3
Foreign	2.5	3.0	3.0	2.1	1.3	1.7	0.7	1.6	1.7	1.6	1.3	1.4
Budget support	0.1	0.6	0.3	0.3	0.3	0.3	0.0	0.2	0.3	0.1	0.0	0.0
Development (gross)	2.5	2.8	3.3	2.1	1.4	2.1	0.9	1.9	1.9	1.9	1.9	1.8
minus: principal repayment	0.1	0.4	5.6	0.4	0.3	0.7	0.2	0.6	0.5	0.5	0.5	0.4
Memorandum items:												
Public Debt	64.4	60.6	64.9	59.3	56.8	58.4	...	54.6	...	54.0	53.3	52.8
General government domestic debt	39.5	38.8	39.4	38.0	37.9	37.2	...	35.7	...	35.0	34.3	33.7
External 7/	24.9	21.8	27.5	21.3	18.9	21.2	...	18.9	...	18.9	19.0	19.1
Direct government external debt 7/	22.6	19.4	...	...	16.4	...	...	16.4	...	16.2	16.2	16.2
Government guaranteed external debt 7/	2.3	2.4	...	...	2.5	...	...	2.5	...	2.7	2.8	2.9
GDP (in billions of leks) 8/	610.4	677.7	718.6	744.6	746.3	821.6	209.2	836.9	229.9	919.7	1,007.0	1,101.0
Dutiable imports (in billions of leks)	...	163.2	...	186.6	174.1	193.1	...	195.6	...	215.7	235.1	258.5

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

1/ The presentation of the fiscal data has been revised since the January 2003 staff report, to include grants as revenue rather than financing.

2/ Includes US\$ 126 million from privatizing the Savings Bank, 50 percent of which is used to retire domestic debt.

3/ Includes solidarity tax (discontinued in 2003) and non tax revenue collected by Customs Department.

4/ Information on grants are estimates, except for the 2002 outturn.

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

6/ Includes statistical discrepancy

7/ Evaluated at end-period exchange rate and expressed in percent of GDP in dollars evaluated at end-of-period exchange rate.

8/ The entry for the 2003 budget reflects projections at the time of budget formulation.

Table 6b. Albania: Government Revenues and Expenditures 1/
(In millions of Lek)

	1997	1998	1999	2000	2001	2002	2003		2004		2005		2006	2007		
	Outturn	Outturn	Outturn	Outturn	Outturn	Outturn	Budget	Staff Report	Outturn	Budget Staff Report	Outturn (prel.)	Staff Projections 2/	Staff projections	Staff projections		
Total Revenue and Grants	58,838	99,650	121,028	126,101	139,151	154,595	180,775	175,574	167,150	198,052	41,356	193,093	46,239	208,770	229,726	251,635
Tax Revenue	45,670	72,160	83,530	104,098	116,171	128,948	153,887	149,687	145,314	170,624	37,714	168,793	41,630	184,806	204,594	224,695
Tax revenues from Tax Directorate and Customs	32,527	56,028	64,488	82,730	91,629	100,635	118,228	114,518	111,721	129,636	28,262	128,244	30,856	139,873	154,649	169,179
Profit tax / VAT	15,655	28,771	29,794	38,107	41,148	46,113	54,584	50,760	50,625	57,148	12,466	57,307	13,387	62,889	69,986	77,072
Excise tax	2,393	4,323	6,033	8,115	10,248	12,198	13,001	13,200	13,147	15,200	3,604	15,139	4,107	16,687	18,270	19,977
Small business tax	2,168	4,910	6,961	9,153	9,544	9,324	11,599	12,830	12,258	16,232	2,852	16,636	3,196	18,531	19,894	21,761
Personal income tax	385	910	1,188	1,641	1,974	2,548	3,054	3,354	2,944	4,044	1,635	4,044	1,643	4,284	4,691	5,129
National taxes 3/	814	1,167	3,110	4,590	6,300	6,149	7,435	6,600	6,414	8,162	1,597	7,917	1,765	8,691	9,516	10,405
Customs duties	8,960	12,615	11,450	13,548	12,794	13,387	14,673	15,041	13,854	14,700	2,962	13,882	3,195	14,542	15,868	16,878
Road tax	...	...	...	...	...	1,281	3,000	3,200	3,359	...	...	...	...	...	...	...
Tax on vehicles	...	...	...	...	...	0	1,000	600	525	800	195	800	247	878	962	1,051
Automobile circulation tax	...	...	...	...	...	...	...	...	...	1,600	394	1,600	493	1,757	1,923	2,103
Property and local taxes	...	304	885	1,315	2,036	2,677	4,000	4,620	4,455	6,500	1,635	6,650	1,634	7,136	7,813	8,543
Social insurance contributions	13,143	15,828	18,157	20,635	22,506	25,237	30,659	29,949	28,613	33,688	7,622	33,100	8,893	36,918	41,770	45,922
Health insurance	12,212	14,566	16,783	18,523	20,710	23,548	28,200	27,490	26,059	30,888	6,971	30,300	8,159	33,950	38,024	42,587
Other	930	1,262	1,374	1,530	1,796	2,088	2,459	2,459	2,554	2,800	651	2,800	734	2,968	3,146	3,335
Non-tax revenue:	11,040	20,806	24,124	16,490	19,310	21,528	21,879	20,879	19,219	20,806	3,416	17,678	2,393	18,876	20,098	21,414
Profit transfer from BOA	8,067	16,400	17,591	10,225	10,912	10,291	10,000	10,000	8,852	7,500	1,045	5,000	0	6,000	6,000	6,000
Income of budgetary institutions	1,834	3,326	5,352	4,841	4,383	6,302	7,800	6,800	6,095	9,006	2,041	8,378	1,915	8,278	9,063	9,909
Other	1,139	1,080	1,181	1,424	4,015	4,934	4,079	4,079	4,272	4,300	329	4,300	478	4,599	5,035	5,505
Grants 4/	2,128	6,683	13,374	5,513	3,670	4,119	5,009	5,009	2,617	6,622	226	6,622	2,217	5,088	5,035	5,525
Budgetary	...	...	...	...	...	...	325	365	365	163	0	0	0	1,063	2,135	0
Project	...	...	...	...	...	...	3,794	4,644	4,644	2,455	6,622	226	6,622	1,154	2,953	5,035
Total Expenditure	101,006	142,304	165,616	169,424	185,751	195,993	223,420	212,432	198,054	240,360	48,926	241,220	60,508	249,836	269,771	292,907
Current Expenditure	87,255	118,515	128,411	134,361	142,656	154,582	168,453	167,721	167,730	185,744	44,077	184,441	43,418	198,780	213,972	226,969
Personnel cost	25,544	28,336	30,737	35,140	41,210	41,942	46,340	45,340	44,737	51,925	10,777	51,052	12,017	54,310	59,542	65,200
Wages and other personnel expenditures	20,377	22,048	23,800	27,720	32,942	33,438	35,659	34,938	35,741	40,414	8,537	40,414	9,362	42,736	46,853	50,834
Social insurance contributions	5,167	6,288	6,937	7,420	8,268	8,504	9,966	9,966	8,997	10,638	2,240	10,638	2,655	11,574	12,689	14,366
Interest	18,779	36,086	35,399	30,597	25,505	24,762	27,050	30,318	29,824	31,082	7,562	31,079	7,703	31,599	31,273	31,456
Domestic	18,073	35,195	34,814	28,272	24,429	22,468	23,997	28,200	28,174	28,650	7,260	28,640	7,228	28,609	28,809	29,009
Foreign	706	891	585	2,325	1,076	2,294	3,053	2,118	1,649	2,432	302	2,439	2,990	2,464	2,447	
Operations & maintenance	13,565	18,537	23,785	23,422	23,237	20,524	19,770	19,270	22,156	22,286	3,953	20,986	4,744	23,489	24,359	25,260
Subsidies 5/	1,551	2,308	2,583	5,247	7,811	6,243	6,250	4,550	5,112	4,165	739	4,165	535	2,386	2,431	2,479
Social insurance outlays	20,123	24,329	27,587	31,375	36,073	40,168	45,032	45,032	44,785	49,503	11,295	49,503	12,319	55,201	61,531	67,410
Social insurance	18,533	21,934	24,981	28,948	33,104	36,564	40,473	40,419	44,353	49,946	14,433	49,946	13,951	54,662	59,674	
Health insurance	1,600	2,395	2,606	2,427	2,969	3,604	4,559	4,559	4,366	5,150	1,349	5,150	1,363	6,232	6,869	7,736
Local government expenditure	385	910	8,038	7,669	9,404	12,230	14,354	14,154	14,244	17,621	2,197	17,621	4,215	21,636	24,273	25,861
Local budget (grant)	0	0	5,699	4,595	4,981	9,014	6,300	6,300	6,605	6,277	1,343	6,277	1,588	8,496	9,310	8,841
Local budget (local revenues)	0	0	1,151	1,433	2,449	3,216	4,000	3,900	7,638	6,500	854	6,500	492	7,977	9,310	8,841
Small business tax	385	910	1,188	1,641	1,974	...	3,054	3,354	...	4,044	4,044	1,643	4,284	4,691	5,129	
Tax on vehicles	...	...	...	...	...	...	1,000	600	...	800	800	493	878	962	1,051	
Social protection transfers	7,298	8,009	8,320	8,580	8,820	8,713	9,657	9,657	8,823	10,035	1,844	10,035	1,891	10,158	10,564	11,304
Unemployment insurance benefits	2,204	1,621	1,450	1,919	1,881	1,115	1,477	1,127	999	1,300	240	1,300	325	1,600	1,700	2,210
Social assistance 5/	4,274	6,168	6,360	6,661	6,939	7,598	8,180	7,930	7,824	8,735	1,604	8,735	1,566	8,558	8,864	9,094
Other 6/	...	...	...	...	0	0	...	...	...	5,710	...	...	...	...	...
Capital Expenditure	13,751	23,789	37,204	35,062	43,095	41,967	49,167	40,711	31,472	48,516	4,608	51,679	15,498	44,257	50,799	60,938
Domestically financed	6,520	10,590	11,880	15,663	23,955	19,013	21,206	20,481	18,305	24,925	2,450	29,295	9,954	22,621	36,857	55,519
Foreign financed projects	7,231	13,199	17,158	16,327	19,140	22,954	27,961	20,229	13,167	23,591	2,158	22,384	5,544	20,636	23,942	25,419
Net lending	...	...	...	...	...	-556	...	...	-1,148	...	-159	...	...	...	...
Reserve and contingency funds	...	...	...	...	...	...	5,800	4,000	...	6,100	400	5,100	1,591	6,800	5,000	5,000
Contingency fund	...	...	...	...	...	...	...	...	...	2,000	...	2,000	595	3,000	...	
Reserve fund	...	...	...	...	...	...	...	...	...	2,500	...	1,500	397	2,000	...	
Arrears settlement 7/	...	...	...	...	...	...	...	...	...	1,600	400	1,600	600	1,800	...	
Cash Balance	-42,169	-42,654	-44,588	-43,323	-46,600	-41,398	-42,646	-36,857	-30,904	-42,308	-7,570	-48,127	-14,269	-41,067	-40,044	-41,272
Cash Balance (excluding grants)	-44,297	-49,337	-57,962	-48,836	-50,270	-45,517	-47,654	-41,866	-33,521	-48,930	-7,796	-54,749	-16,485	-46,155	-45,079	-46,798
Sources of Financing	42,169	42,654	44,587	43,322	46,600	41,398	42,645	36,857	30,904	42,308	7,569	48,127	14,269	41,067	40,044	41,272
Domestic	36,026	29,666	27,389	25,966	31,102	20,838	21,143	21,342	20,899	28,300	6,102	34,978	10,338	26,598	26,480	26,316
Privatization receipts	910	133	906	8,975	12,683	485	1,077	1,277	899	5,680	102	19,036	797	2,186	3,233	899
Net borrowing	35,116	29,533	26,483	17,012	18,419	20,353	20,066	20,065	20,000	22,620	6,000	15,942	9,541	23,412	23,247	25,417
Foreign	6,143	12,988	17,199	17,336	15,498	20,560	21,502	15,515	10,005	14,008	1,467	13,149	3,931	14,469	13,564	14,956
Budget support	-	6,424	3,973	5,316	846	4,032	1,897	2,596	2,096	2,500	0	2,024	595	1,189	0	0
Development (gross)	7,231	7,975	14,226	13,019	15,470	19,160	23,650	15,585	10,309	16,969	1,931	15,762	4,390	17,682	18,907	19,894
minus: principal repayment	1,088	1,411	1,000													

Table 7. Albania: Priority Expenditure

	1997 1/	1998 1/	1999 1/	2000 1/	2001 1/	2002 1/	2003 1/	2004 2/
	11,197	13,612	16,850	17,192	19,488	19,034	21,268	28,721
Education	6,269	7,985	12,066	12,334	12,027	13,719	15,699	20,907
Health	385	910	8,038	5,843	9,404	9,014	6,605	6,277
Local government	26,611	32,118	35,397	39,955	44,893	45,277	53,608	59,538
Social security and welfare	20,133	24,329	27,587	31,375	36,073	36,564	44,785	49,503
social insurance outlays	4,274	6,168	6,360	6,661	6,939	7,598	7,824	8,735
social assistance	2,204	1,621	1,450	1,919	1,881	1,115	999	1,300
unemployment insurance	44,462	54,625	72,351	75,324	85,812	87,044	97,180	115,443
total								
				(millions of Lek)				
					(percent of GDP)			
Education	3.5	3.3	3.6	3.2	3.2	2.8	2.8	3.4
Health	1.9	1.9	2.5	2.3	2.0	2.0	2.1	2.5
Local Government	0.1	0.2	1.7	1.1	1.5	1.3	0.9	0.7
Social security and welfare	8.3	7.8	7.5	7.5	7.4	6.7	7.2	7.1
total	13.8	13.2	15.3	14.2	14.1	12.8	13.0	13.8
					(percent of total government expenditure)			
Education	11.1	9.6	10.2	10.1	10.5	9.7	10.6	11.9
Health	6.2	5.6	7.3	7.3	6.5	7.0	7.9	8.7
Local government	0.4	0.6	4.9	3.4	5.1	4.6	3.3	2.6
Social security and welfare	26.3	22.6	21.4	23.6	24.2	23.1	26.8	24.6
total	44.0	38.4	43.7	44.5	46.2	44.4	48.6	47.8
Memorandum:								
GDP	322,186	412,326	474,291	530,906	610,417	677,674	746,318	836,937
Total Government expenditure	101,006	142,304	165,616	169,424	185,751	195,993	199,931	241,596

Sources:

1/ MTEF as of June 2003 (Table 14) and data provided by the authorities in April 2004
 2/ 2004 budget document and draft supplementary budget for 2004

Table 8. Albania: External Public and Publicly Guaranteed Debt Stock by Creditors, 1997–2004 1/
(In millions of U.S. dollars)

	1997	1998	1999	2000	2001	2002	2003	2004 1/
Total public and publicly guaranteed debt	877	1007	1108	1173	1198	1178	1408	1305
Public and publicly guaranteed debt (excl. arrears)	404	523	630	706	782	1057	1285	1180
Multilateral	221	304	419	492	523	659	824	837
EBRD	9	9	8	8	9	14	28	29
EIB	0	1	15	27	35	50	72	74
IDA	148	220	296	345	366	476	583	587
IDB	0	1	1	2	5	10	14	15
IFAD	5	8	12	13	15	21	29	29
IMF	56	62	80	89	84	77	85	89
OPEC	2	4	6	7	8	12	14	13
Bilateral	183	218	211	214	259	398	461	344
Rescheduled debt	32	27	20	18	40	117	115	114
Paris club members	32	27	20	18	17	55	52	52
Austria	6	4	3	2	1	1	1	1
Britain	0	0	0	0	0	0	0	0
France	13	10	8	5	4	3	2	2
Germany	11	10	8	5	7	6	6	6
Italy	2	1	1	6	5	5	5	5
Netherlands	1	1	0	0	0	0	0	0
Russia	0	0	0	0	0	39	38	38
Japan	0	0	0	0	0	0	0	0
Non Paris Club Members	0	0	0	0	23	62	62	62
Turkey	0	0	0	0	23	23	23	23
China	0	0	0	0	0	40	40	40
Post cut-off debt	151	192	191	196	218	281	346	229
Paris Club members	129	157	156	153	158	211	270	152
Austria	5	5	5	4	4	2	2	2
Germany	46	58	50	50	53	72	96	95
Italy	61	74	71	69	76	110	134	16
Japan	17	21	31	29	25	28	37	40
Non-Paris Club	22	34	35	43	60	69	76	77
China	2	2	2	2	2	2	2	2
Greece	0	11	11	11	12	14	17	16
Kuwait	13	15	16	15	16	23	30	32
Norway	3	3	3	11	26	26	23	23
Sweden	4	4	4	4	4	4	4	4
Arrears	473	484	478	467	416	121	124	125
Convertible currency	134	134	134	131	91	56	56	56
Budgetary	60	60	60	57	21	17	17	17
China 2/	5	5	5	4	4	0	0	0
Greece	19	19	19	17	17	17	17	17
IDB	0	0	0	0	0	0	0	0
Turkey	14	14	14	14	0	0	0	0
PTT	15	15	15	15	0	0	0	0
Railway	7	7	7	7	0	0	0	0
Other	0	0	0	0	0	0	0	0
Bilateral (USD) clearing accounts	74	74	74	74	71	39	39	39
Non-convertible currency 3/	169	172	172	161	162	13	13	13
Commercial	52	52	39	37	34	33	33	33
Cumulative Overdue Interest 4/	118	126	133	137	129	19	22	23
Memorandum items:								
Total debt (percent of GDP)	40.8	34.5	31.6	31.8	26.8	23.3	20.1	16.6
Total arrears (percent of GDP)	22.0	16.6	13.6	12.7	9.3	2.4	1.8	1.6

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

1/ As of March 31, 2004.

2/ It includes only post-1978 amount.

3/ It consists of bilateral clearing accounts in rubles converted in US\$ assuming exchange rate discussed with the authorities.

4/ Amended from previously reported arrears to reflect overdue interests arising from outstanding arrears not previously included.

Table 9. Albania: External Financing Requirement and Sources, 2000–07
(In millions of U.S. dollars)

	2000	2001	2002	2003	2004	2005	2006	2007
	Projections							
Current account	274	263	435	469	592	635	672	685
Amortization	16	21	42	39	61	94	124	110
o/w: IMF	7	14	14	10	9	9	11	13
Change in reserves (increase = +)	139	146	58	78	95	95	69	88
Reduction in arrears	-4	29	280	-1	59	37	28	0
Total financing requirement	424	458	814	585	807	860	893	883
Available financing	424	458	814	585	807	792	865	883
Official grants	111	126	121	157	162	184	213	221
Foreign direct investment	143	204	135	178	377	252	281	309
Private financing flows	-6	-130	53	43	-29	90	113	86
Official medium- and long-term loans	79	90	121	114	178	207	221	233
Multilateral	60	56	84	85	120	128	138	144
Bilateral	19	34	37	30	58	78	83	88
Other loans	0	0	0	0	0	0	0	0
IMF disbursements	19	12	5	11	6	0	0	0
Other	48	119	65	64	30	47	37	35
Debt rescheduling	0	33	283	0	59	...	...	...
Balance of payments support	29	4	31	19	0	0	0	0
Identified financing (provisional)	0	0	0	0	25	11	0	0
o/w: IMF PRGF	0	0	0	0	6	11	0	0
o/w: WB SAC/PRSC	0	0	0	0	19	0	0	0
Financing gap	0	0	0	0	0	68	28	0
Expected EU macro-financial assistance	...	...	...	...	...	31	0	0
Debt rescheduling (mostly bilateral official donors)	...	...	...	...	...	37	28	0

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

Table 10. Albania: Indicators of External and Financial Vulnerability, 1997–2004
(In percent of GDP, unless otherwise indicated)

	1997	1998	1999	2000	2001	2002	2003	2004 Proj.
Public and publicly guaranteed debt sector debt 1/	87.0	77.8	75.1	74.2	66.4	62.3	58.0	55.8
Broad money (percent change, end of period)	28.5	20.6	22.3	12.0	20.2	5.7	8.7	11.8
Private Sector credit (percent change, end of period)	19.0	14.7	13.3	31.8	23.4	41.0	31.1	31.3
Interest rate (3-mth T-bills, end period)	35.9	20.4	14.8	7.8	8.0	11.2	7.3	...
Foreign currency deposits (share of total deposits)	28.9	23.5	25.2	27.8	32.3	31.2	29.0	31.3
Exports (annual percent change, in US dollars)	-27.1	22.9	34.2	-7.1	19.3	8.4	35.5	26.7
Imports (annual percent change, in US dollars)	-25.6	20.6	35.7	-4.0	23.7	11.5	20.1	21.6
Current account balance								
(excluding official transfers)	-12.2	-7.1	-7.9	-7.4	-6.2	-9.0	-7.6	-7.5
(including official transfers)	-8.7	-3.9	-3.9	-4.4	-3.2	-6.5	-5.1	-5.5
Capital and financial account balance	3.8	3.6	6.4	8.7	6.7	8.3	7.5	8.1
o/w: Foreign direct investment	1.9	1.6	1.5	3.9	4.8	2.8	2.9	4.8
Gross official reserves (in US dollars, millions)	306	384	485	608	737	860	1026	1133
Official reserves in months of imports (goods and services)	3.8	3.7	3.8	4.1	4.3	4.0	4.0	4.0
Official reserves to broad money (ratio)	0.2	0.2	0.2	0.3	0.3	0.3	0.2	0.2
Official reserves to reserve money (ratio)	0.5	0.6	0.6	0.7	0.7	0.7	0.7	0.7
Central bank foreign liabilities (in US dollars, millions)	361.1	392.0	178.8	143.6	138.7	146.9	184.3	...
Foreign assets of the banking sector (in US dollars, millions)	261.2	355.5	429.0	456.1	610.5	608.1	728.1	...
Foreign liabilities of the banking sector (in US dollars, millions)	13.5	20.4	35.8	47.9	88.2	115.8	161.5	...
Total external debt (in US dollars, millions) 2/	876.6	1006.7	1108.3	1172.6	1198.4	1178.3	1408.7	1577.7
Total external debt 2/	40.8	34.5	31.6	31.8	26.8	23.3	20.1	20.1
o/w: Public or publicly guaranteed	16.2	15.8	15.7	16.7	15.6	19.4	17.1	15.4
Total external debt to exports (percent)	360.8	357.5	186.7	166.2	142.8	128.7	120.7	115.7
Total short term external debt to reserves (percent) 3/	6.6	6.4	4.4	3.4	2.9	5.6	4.7	7.0
External amortization payments to exports (in percent)	3.1	3.4	1.3	1.2	0.9	3.0	2.5	3.9
External interest payments to exports (in percent)	5.3	5.4	2.3	1.7	1.7	2.3	1.6	1.9
External debt service to exports (excluding IMF, in percent)	8.3	8.7	3.6	2.9	2.5	5.3	4.1	5.8
External debt service to exports (including IMF, in percent)	11.6	9.1	4.1	4.0	4.2	6.8	5.0	6.4
External debt service (excluding IMF)	0.9	0.9	0.6	0.6	0.5	1.0	0.8	1.0
External debt service (including IMF)	1.3	0.9	0.7	0.8	0.8	1.3	0.9	1.1
Change in REER (+ appreciation)	0.4	18.6	12.3	7.0	4.3	-0.5	-3.8	...
Exchange rate (period average)								
(lek per US dollar)	149.6	151.2	138.1	144.0	143.6	140.2	121.5	...
(lek per euro)	168.6	168.4	147.4	132.8	128.9	132.2	138.4	...

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

1/ It includes the IMF.

2/ Includes arrears, with the exception of pre-1998 China which is still subject to reconciliation.

3/ Residual maturity basis; Albania has no short-term original maturity external debt.

Table 11. Albania: Projected Payments to the Fund as of April, 2004
(in millions of SDRs)

	2004 1/	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total
Obligations from existing drawings													
1. Principal													
PRGF Repayments	4.8	6.2	7.6	9.4	9.6	9.1	6.7	4.6	2.8	2.0	0.4	0.0	63.3
2. Charges and Interest 2/													
PRGF Interest	0.3	0.3	0.2	0.2	0.2	0.1	0.1	0.0	0.0	0.0	0.0	0.0	1.4
SDR Net 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	0.0
Total Obligations	5.2	6.4	7.8	9.6	9.8	9.2	6.8	4.6	2.8	2.0	0.4	0.0	64.7
(percent of quota)	11	13	16	20	20	19	14	10	6	4	1	0	133
Obligations from prospective drawings													
1. Principal													
PRGF Repayments	0.0	0.0	0.0	0.0	0.0	0.0	1.2	2.4	2.4	2.4	2.4	1.2	12.0
2. Charges and Interest 2/													
PRGF Interest	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.5
Total Obligations	0.0	0.0	0.1	0.1	0.1	0.1	1.3	2.5	2.4	2.4	2.4	1.2	12.5
(percent of quota)	0	0	0	0	0	0	3	5	5	5	5	2	26
Cumulative obligations (existing and prospective)													
1. Principal													
PRGF Repayments	4.8	6.2	7.6	9.4	9.6	9.1	7.9	7.0	5.2	4.4	2.8	1.2	75.3
2. Charges and Interest 2/													
PRGF Interest	0.3	0.3	0.3	0.3	0.2	0.2	0.1	0.1	0.1	0.0	0.0	0.0	1.9
SDR Net 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	0.0
Total Obligations	5.2	6.5	7.9	9.7	9.8	9.2	8.1	7.1	5.3	4.4	2.8	1.2	77.2
(percent of quota)	11	13	16	20	20	19	17	15	11	9	6	2	158
Outstanding Fund credit 3/	62.4	64.3	56.7	47.3	37.6	28.5	20.6	13.6	8.4	4.0	1.2	0.0	...

1/ As of April, 2004.

2/ Projections are based on current interest rates for PRGF. The current SDR interest rate is assumed for net use of SDRs.

3/ End of year value.

Table 12. 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
Prior to June 20, 2005	4.0	8.21	Observance of end-March 2005 performance criteria and completion of sixth review 2/
Total	28.0	57.49	

1/ Albania's quota is SDR 48.7 million.

2/ The final disbursement under the PRGF arrangement must be carried out before expiration of the arrangement on June 20, 2005.

ALBANIA: FUND RELATIONS

As of April 30, 2004

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

II. General Resources Account:	<u>SDR Million</u>	<u>Percent Quota</u>
Quota	48.70	100.00
Fund Holdings of Currency	45.35	93.12
Reserve position in Fund	3.35	6.89
III. SDR Department:	<u>SDR Million</u>	<u>Percent Allocation</u>
Holdings	63.67	N/A
IV. Outstanding Purchases and Loans:	<u>SDR Million</u>	<u>Percent Quota</u>
ESAF/PRGF arrangements	63.28	129.93

V. **Financial Arrangements:**

<u>Type</u>	<u>Approval Date</u>	<u>Expiration Date</u>	<u>Amount Approved (SDR Million)</u>	<u>Amount Drawn (SDR Million)</u>
PRGF	06/21/2002	06/20/2005	28.00	16.00
ESAF/PRGF	05/13/1998	07/31/2001	45.04	45.04
ESAF	07/14/1993	07/13/1996	42.36	31.06

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

	<u>Forthcoming</u>				
	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>
Principal	4.84	6.17	7.60	9.41	9.62
Charges/Interest	0.31	0.28	0.24	0.20	0.15
Total	5.15	6.45	7.84	9.61	9.77

VII. **Safeguards Assessments:**

Under the Fund's safeguards assessment policy, the Bank of Albania (BoA) 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 foreign exchange market with the objective of smoothing 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. Albania has not imposed new restrictions under Article VIII. The unified exchange rate stood at 106.1 lek per U.S. dollar on March 17, 2004.

IX. Article IV Consultation:

The conclusion of the 2002 Article IV consultation and the first review under the three-year PRGF arrangement took place in February 2003 (IMF Country Report No. 03/63). 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 on the Fund's website in May 2000. A fiscal ROSC was completed in June 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 National Strategy for Socio-Economic Development (NSSED), presented to the Boards of the IMF and the Bank in June 2002 and subsequently updated in May 2003 and June 2004 is a comprehensive development strategy that increases the government's emphasis on poverty reduction. The NSSED has two pillars—strengthening governance and achieving high economic growth—and gives priority to improving education, healthcare, and infrastructure.

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 its Poverty Reduction and Growth Facility (PRGF)–supported program in 2002 and the subsequent reviews of the program in February 2003, July 2003, and January 2004. In addition, the IMF's structural conditionality focuses on three main categories: fiscal management and control; payments discipline; governance, and privatization.

The Bank leads the policy dialogue in financial sector reforms, power sector reforms, social sector and pension reforms, 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 53 operations amounting to US\$743 million. During the next year, the Bank will continue to use a mix of adjustment and investment lending as well as country analytic work to support the NSSD. In line with its Country Assistance Strategy, which covers FY03-05, the Bank has initiated its Poverty Reduction Support Credit (PRSC) program, and is planning a total of 10 possible investment operations in education, health, power, transport, environment, municipal water, and community works. Five of these operations have been approved to date.

The PRSC-1 was presented to the Board in June 2002 and the PRSC-2 in July 2003. Preparations for the PRSC-3, the last planned operation in the program, are well advanced. 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 began negotiations towards 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 NSSD 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.

The Financial Sector Adjustment Credit, approved by the Board in June 2002, has helped 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, and the successful privatization of the Savings Bank in January 2004 represented a major achievement towards reform of the system.

- *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 is updated annually, 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. A new thermal generation investment is also being supported through a project approved by the Bank's Board in March of 2004. The Fund-supported conditionality proposed for the three-year arrangement under the PRGF-supported program 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.

- *Social Sectors and Pension Reform*

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. Reforms implemented under the PRSC 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 aims to address under-funding in health and education by increasing budgetary allocations to these sectors under the Medium-Term Budget Program (MTBP), 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 MTBP. 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 MTBP 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 linked the preparation of the NSSED with the preparation of the MTBP. Continuing work to improve the linkages of the MTBP with the NSSED is an important focus of both the Bank and the Fund.

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-supported program 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-supported program, will help ensure a sound macroeconomic environment for sustainable growth.

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ALBANIA: STATISTICAL ISSUES

Albania has made significant progress in improving its statistical database with extensive technical assistance, including technical assistance 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. The authorities have thus far made progress in implementing the action plan agreed with the multisector statistics 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 the Observance of Standards and Codes (ROSC), and the ROSC was published in the Funds' website in May 2000.¹ Albania participates in the General Data Dissemination System (GDDS). 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.

A. Real Sector

Price statistics

STA has provided considerable technical assistance to Albania on price statistics. Data on consumer price index (CPI) are 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 budget survey and a revised CPI was finalized in February 2002. The compilation of the CPI generally follows international standards, and the estimation of imputed rent within the CPI has recently been improved. As regards the producer price index (PPI), STA missions of May 2000 and January 2002 assisted INSTAT in finalizing the development of this index. The official monthly PPI has been published on a quarterly frequency since March 2002.

National accounts

Until recently, and in the absence of official national accounts aggregates since 1990, Fund staff relied on their own estimates prepared in consultation with the authorities. These

¹ Albania's ROSC (data module) was undertaken before the formal adoption of the Data Quality Assessment Framework.

estimates were based on very partial data on (gross) agricultural output, activity in state industrial production, and extremely limited information on private sector activity. With technical assistance from STA, consisting of a resident advisor in 1999 and follow-up missions in 2001 and 2002, INSTAT published in January 2003 the first official GDP estimates for 1996-2000. However, the estimates continue to be hampered by weaknesses in basic data sources and incomplete coverage of the private sector.

STA formulated 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 is aimed at further improving the national accounts estimates and basic source data. The project identifies the required technical assistance inputs/activities (from the authorities and the technical assistance provider) and the measurable indicators of implementation/deliverables of the project. The project was offered for competitive bid under a fixed-price contract, an innovation in the way STA contracts technical assistance, to targeted national statistical agencies in statistically advanced countries. The Italian National Institute of Statistics (Istat) and the National Statistics Office of Finland (Statistics Finland) expressed interest. Subsequently, the two agencies reached an agreement that Istat would take the lead as primary contractor and subcontract portions of the work to Statistics Finland. The terms of reference for the project were agreed with the executing agency—Istat—and the contract for professional services (Agreement/Purchase No. 4905) was signed on November 15, 2003.

In accordance with the terms of reference for the project, Istat recently submitted a draft the first interim report covering an assessment of the accuracy of data sources, the soundness of the statistical techniques, and the internal consistency of the annual national accounts estimates in constant prices. A revised interim report, which will take into account comments from STA, is expected to be submitted by Istat. before the end of March 2004.

External trade

Data collection suffered extensively during the 1997 crisis as a number of customs posts were damaged or destroyed, and there was most likely a large temporary increase in the volume of unreported transactions. After some delays due to the Kosovo crisis, the compilation and dissemination of foreign trade data have 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.

B. 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 and again for 2002 have since been reported for inclusion in the *GFS Yearbook*. Albania currently does not report data for

inclusion in the *IFS*. although data for 1999–2002 have not yet 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.

C. 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), in 2002, Parliament passed a law providing the necessary authority to the Bank of Albania (BoA) to request the required data from the SCAs. There are currently 180–200 SCAs throughout the country and they have started reporting data to the BoA using a simplified report form. However, data from SCAs are not yet included 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 were first published in the October 2002 issue of *IFS*. The authorities are also making efforts to revise the historical data.

D. Balance of Payments

The data compiled by the BoA are methodologically sound, although some of the 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*. The BoA reports quarterly data to STA on a regular and timely basis. The BoA revised the methodology for the measurement of 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, problems remain in the areas of service transactions and remittances, and in the monitoring of financial account transactions, foreign assistance and external debt. These problems could be addressed by strengthening existing data sources and improving estimation methods. The May 2003 technical assistance mission noted that the coverage and accuracy of the data should be improved through the strengthening of the legal

framework and the use of the banks reporting system to verify data from enterprises surveys. 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.

E. External Debt Statistics

External debt statistics for government and government-guaranteed debt are compiled by the Ministry of Finance (MoF). These data are generally good. 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. 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 did make an attempt to collect data on private sector external debt albeit limited to foreign direct investment enterprises.

Albania: Core Statistical Indicators
(as of June 17, 2004)

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/GNP	External Public Debt/Debt Service
Date of Latest Observation	Jun 17	Jun 16	May	May	April	Jun 8	May	Dec	Dec	Dec	2002	Dec
Date Received	Jun 17	Jun 17	May	May	May	Jun 16	Jun	Mar	Feb	Mar	Apr 2003	Mar
Frequency of Data	Daily	Daily	Monthly	Monthly	Monthly	Weekly	Monthly	Monthly	Quarterly	Weekly/ Monthly	Annual	Quarterly
Frequency of Reporting	Daily	Daily	Monthly	Monthly	Monthly	Weekly	Monthly	Monthly	Variable	Weekly/ Monthly	Annual	Variable
Frequency of Publication	Daily	Monthly	Monthly	Monthly	Monthly	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	E-mail/ Mission	Mission	Fax/Mission	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

DEBT SUSTAINABILITY ANALYSIS

While Albania has made considerable progress reducing and restructuring its **external debt**, further efforts—including building export capacity—are needed to ensure a sustainable path over the long term. Albania's total external debt declined from 32.6 percent of GDP in 1995 to 20.2 percent of GDP at end-2003, owing primarily to significant debt relief and rapid growth. Also, non-debt creating inflows—remittances, FDI, and official transfers—have financed a large part of the trade deficit.

Albania's debt position appears sustainable over the medium term, given external debt NPV of 17.5 percent of GDP in 2003, a debt-service-to-exports ratio of about 5 percent, and benign stress tests results under most scenarios (Appendix Tables 1 and 2). Stress tests, however, highlight the risk to the debt dynamics stemming from higher-than-programmed current account deficits. This reiterates the need to raise export capacity and diversify the export base, particularly since vulnerability will increase as non-concessional financing grows.

Fiscal debt (government and government-guaranteed debt) declined from 85 percent of GDP in 1997 to 57 percent of GDP in 2003. Under the baseline scenario it will decline to 53 percent of GDP in 2007 (Appendix Table 3). About $\frac{2}{3}$ of the fiscal debt is domestic and denominated in lek.

Under most of the stress test scenarios, the fiscal debt stays on a declining or broadly stable path. Nonetheless, a shock to the primary balance could increase general government debt significantly. Also, the fiscal debt would not be sustainable in the event of a two-standard-deviation shock to growth, sustained over two years. This latter result is primarily due to the large historical standard deviation of output growth (7 percentage points of GDP). But it also reflects the public finances' primary deficit position—which demands that growth exceeds the interest rate for sustainability. Thus, growth-enhancing policies and further fiscal consolidation should remain policy priorities.

Table 1. Albania: External Debt Sustainability Framework, Baseline Scenario, 1995–2023 1/

	Actual										Projections									
	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2008	2009	2010	2011	2012	2015	2018	2023
External debt (nominal) 1/	32.6	28.1	40.8	34.5	31.6	31.8	26.8	23.3	20.2	21.0	20.9	20.4	20.6	20.4	19.6	19.1	17.9	16.2	14.4	14.4
o/w public and publicly guaranteed (PPG)	32.6	28.1	40.8	34.5	31.6	31.8	26.8	23.3	20.1	20.1	20.0	19.9	20.1	19.9	20.5	19.2	18.7	17.5	15.9	14.1
o/w private	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.2	1.0	0.9	0.6	0.5	0.4	0.4	0.4	0.4	0.4	0.3	0.3
Change in external debt	-23.6	-4.5	12.7	-6.2	-2.9	0.2	-5.0	-3.5	-3.1	0.8	-0.1	-0.4	0.4	0.2	0.6	-1.3	-0.5	-0.5	-0.5	-0.3
Identified net debt-creating flows	-11.5	-3.3	17.3	-5.7	-4.7	-1.6	-5.8	-4.0	-0.2	-1.7	2.5	2.3	2.1	1.2	1.7	-1.0	-0.3	-0.4	-0.7	-0.5
Non-interest current account deficit	6.9	8.4	11.6	6.6	7.5	7.1	5.8	8.6	7.3	7.2	6.9	6.6	5.9	5.3	5.2	4.2	3.8	3.2	2.9	2.9
Deficit in balance of goods and services	22.0	24.4	21.0	25.5	19.2	22.1	22.4	24.0	23.1	21.6	21.5	20.9	20.4	20.0	20.3	19.0	18.8	17.4	17.2	16.7
Exports	12.5	11.6	16.4	10.3	17.3	19.1	19.8	18.9	19.0	17.4	17.3	17.6	18.7	19.0	19.8	19.0	19.1	20.7	21.4	22.8
Imports	34.5	36.0	37.3	35.8	36.5	41.3	42.1	42.3	42.1	38.9	38.8	38.5	39.2	38.9	40.1	38.1	37.9	38.1	38.6	39.5
Net current transfers (negative = inflow)	-12.4	-14.1	-11.4	-16.1	-9.5	-11.9	-12.8	-12.3	-12.7	-11.9	-11.7	-11.2	-11.1	-10.9	-11.0	-10.2	-9.8	-8.9	-8.6	-7.8
Other current account flows (negative = net inflow)	-2.8	-1.8	2.1	-2.8	-2.2	-3.1	-3.8	-3.1	-3.0	-2.4	-2.9	-3.1	-3.5	-3.7	-4.1	-4.7	-5.3	-5.3	-5.6	-6.0
Net FDI (negative = inflow)	-3.7	-3.2	-1.9	-1.6	-1.1	-3.9	-4.8	-2.8	-2.9	-4.8	-2.9	-3.0	-3.1	-3.1	-3.1	-3.3	-3.1	-3.0	-3.0	-3.0
Official transfers (negative = inflow)	-4.9	-2.6	-3.5	-3.3	-4.1	-3.0	-3.0	-2.5	-2.6	-2.1	-2.4	-2.2	-2.0	-1.8	-1.7	-1.4	-1.3	-0.9	-0.8	-0.5
Endogenous debt dynamics 2/	-9.8	-6.0	11.0	-7.4	-6.7	-1.8	-3.9	-2.8	-4.7	-4.1	-1.5	-1.3	-0.7	-1.0	-0.2	-1.9	-0.9	-0.7	-0.6	-0.5
Contribution from nominal interest rate	0.3	0.4	0.6	0.6	0.4	0.3	0.3	0.4	0.3	0.3	0.4	0.5	0.6	0.6	0.7	0.7	0.7	0.6	0.6	0.6
Contribution from real GDP growth	-4.1	-2.4	4.0	-4.2	-2.8	-2.2	-2.1	-1.1	-1.1	-1.0	-1.1	-1.1	-1.1	-1.1	-0.9	-1.0	-0.9	-0.9	-0.8	-0.7
Contribution from price and exchange rate changes	-6.1	-4.0	6.5	-3.8	-4.3	0.0	-2.1	-2.1	-3.9	-3.4	-0.8	-0.7	-0.1	-0.7	0.1	-1.6	-0.6	-0.5	-0.4	-0.4
Residual 3/	-12.1	-1.2	-4.6	-0.5	1.8	1.8	0.8	-3.9	-0.3	4.6	-0.3	-0.5	0.3	0.3	0.6	1.0	1.0	0.9	0.2	0.2
o/w exceptional financing	1.2	-0.2	-0.2	-0.2	-0.3	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
NPV of external debt 4/	...	...	...	...	...	...	...	...	17.5	17.7	17.6	17.2	17.1	16.8	17.2	16.1	15.7	14.7	12.5	8.7
In percent of exports	...	...	...	...	...	...	...	...	92.2	102.1	101.4	98.2	91.3	88.8	86.6	84.3	82.0	71.2	58.5	38.1
NPV of PPG external debt	...	...	...	...	...	...	...	...	17.4	16.8	16.7	16.7	16.7	16.4	16.7	15.6	15.3	14.3	12.2	8.4
In percent of exports	...	...	...	...	...	...	...	...	91.3	96.7	96.4	95.1	88.9	86.5	84.3	82.2	79.9	69.4	56.9	36.8
Debt service-to-exports ratio (in percent)	3.2	7.5	7.9	9.1	4.1	4.0	4.1	6.8	5.0	6.3	8.7	10.2	9.1	9.1	9.4	9.5	9.2	8.4	8.0	6.5
PPG debt service-to-exports ratio (in percent)	3.2	7.5	7.9	9.1	4.1	4.0	4.1	6.4	4.7	5.8	5.9	6.8	7.4	7.6	7.9	8.0	7.8	7.2	7.0	5.7
Total gross financing need (billions of U.S. dollars)	0.0	0.1	0.2	0.2	0.2	0.2	0.1	0.3	0.3	0.2	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.5	0.7
Non-interest current account deficit that stabilizes debt ratio	30.4	12.9	-1.0	12.8	10.5	6.9	10.8	12.1	10.4	6.4	7.0	7.0	5.5	5.5	4.6	5.5	4.2	3.7	3.4	3.2
Key macroeconomic assumptions																				
Real GDP growth (in percent)	8.9	9.1	-10.3	12.7	10.1	7.3	7.6	4.7	6.0	6.2	6.0	6.0	6.0	6.0	5.0	5.0	5.0	5.0	5.0	5.0
GDP deflator in US dollar terms (change in percent)	12.1	14.0	-18.7	10.2	14.4	0.0	7.2	8.7	19.8	20.5	3.9	3.4	0.7	3.4	4.3	8.4	3.3	2.9	2.9	2.9
Effective interest rate (percent) 4/	0.7	1.6	1.5	1.7	1.3	1.1	1.2	1.7	1.6	1.8	2.3	2.6	3.2	3.2	3.5	3.6	3.6	3.9	4.1	4.6
Growth of exports of G&S (US dollar terms, in percent)	...	15.5	3.1	-21.7	110.9	18.8	19.0	9.0	27.5	16.9	10.1	10.9	11.8	9.9	9.4	9.4	9.0	11.5	9.3	9.3
Growth of imports of G&S (US dollar terms, in percent)	...	29.6	-24.3	19.1	28.4	21.3	17.7	15.9	24.6	18.3	9.8	8.6	8.9	7.8	8.0	8.0	8.1	8.2	8.4	8.5
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	...	...	...	...	26.0	21.8	21.1	18.8	18.4	18.1	17.7	17.5	17.3	16.8	16.2
Memorandum item:																				
Nominal GDP (billions of US dollars)	2.4	3.0	2.2	2.7	3.4	3.7	4.2	4.8	6.1	7.9	8.7	9.5	11.1	12.0	12.6	14.3	15.6	19.6	24.7	36.3
Averages and Standard Deviations																				
Historical Average	Standard Deviation		Average		Average		Average		Average		Average		Average		Average		Average		Average	
Real GDP growth (in percent)	6.2	6.6	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0
GDP deflator in US dollar terms (change in percent)	7.5	11.3	6.4	7.5	6.4	6.4	6.4	6.4	6.4	6.4	6.4	6.4	6.4	6.4	6.4	6.4	6.4	6.4	6.4	6.4
Effective interest rate (percent) 5/	1.4	0.3	2.6	1.4	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6
Growth of exports of G&S (US dollar terms, in percent)	22.8	38.6	12.2	22.8	12.2	12.2	12.2	12.2	12.2	12.2	12.2	12.2	12.2	12.2	12.2	12.2	12.2	12.2	12.2	12.2
Growth of imports of G&S (US dollar terms, in percent)	16.5	17.2	11.0	16.5	11.0	11.0	11.0	11.0	11.0	11.0	11.0	11.0	11.0	11.0	11.0	11.0	11.0	11.0	11.0	11.0
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Non-interest current account deficit	7.8	1.7	6.5	7.8	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5
Net current transfers (negative = inflow)	-12.6	1.8	-11.4	-12.6	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8
Net FDI (negative = inflow)	-2.9	1.1	-3.4	-2.9	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1

Source: Staff simulations.

1/ Includes both public and private sector external debt.

2/ Derived as $(r - g - \rho(1-g))/(1-g+p-g)$ times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Assumes that NPV of private sector debt is equivalent to its face value.

5/ Current-year interest payments divided by previous period debt stock.

Table 2. Albania: Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2003-23
(In percent)

	Actual		Projections																			
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	
NPV of debt-to-GDP ratio																						
Baseline	17	17	17	17	17	17	17	17	17	17	15	15	14	14	13	12	11	11	10	10	8	
A. Alternative Scenarios																						
A1. Key variables at their historical averages in 2004-23 1/	17	14	21	23	24	25	33	34	35	36	37	37	37	37	37	37	37	37	37	37	37	
A2. New public sector loans on less favorable terms in 2004-23 2/	17	15	17	19	21	22	23	23	22	22	21	21	21	21	21	21	20	19	18	18	17	
B. Bound Tests																						
B1. Real GDP growth at historical average minus one standard deviation in 2004-05	17	17	21	22	23	25	26	26	26	25	24	23	23	23	23	21	20	18	17	16		
B2. Export value growth at historical average minus one standard deviation in 2004-05 3/	17	21	29	37	38	40	37	36	36	36	35	33	30	28	26	24	23	21	21	21	21	
B3. US dollar GDP deflator at historical average minus one standard deviation in 2004-05	17	17	20	24	25	26	28	27	27	26	24	22	20	19	17	16	16	17	17	16	17	
B4. Net non-debt creating flows at historical average minus one standard deviation in 2004-05 4/	17	22	28	29	30	32	30	30	29	28	27	25	23	21	20	18	17	17	17	17	17	
B5. Combination of B1-B4 using one-half standard deviation shocks	...	17	21	25	27	29	33	33	33	33	32	30	29	28	26	25	24	24	24	24	24	
B6. One-line 30 percent nominal depreciation relative to the baseline in 2004 5/	...	17	26	28	30	33	34	34	34	33	31	29	26	24	22	20	19	19	19	19	19	
NPV of debt-to-exports ratio																						
Baseline	91	97	96	95	92	89	77	73	69	67	62	57	53	49	46	43	37	37	37	37	37	
A. Alternative Scenarios																						
A1. Key variables at their historical averages in 2004-23 1/	91	83	119	128	134	135	168	170	169	172	175	172	169	167	164	162	161	161	161	161	161	
A2. New public sector loans on less favorable terms in 2004-23 2/	91	86	98	108	115	118	117	114	108	104	101	96	92	88	83	79	76	76	76	76	76	
B. Bound Tests																						
B1. Real GDP growth at historical average minus one standard deviation in 2004-05	91	100	118	126	131	134	134	131	125	122	115	106	97	89	82	76	70	70	70	70	70	
B2. Export value growth at historical average minus one standard deviation in 2004-05 3/	91	172	329	413	416	413	372	356	338	323	301	277	254	233	213	196	181	181	181	181	181	
B3. US dollar GDP deflator at historical average minus one standard deviation in 2004-05	91	91	120	129	136	140	140	130	123	118	108	98	89	80	73	66	66	66	66	66	66	
B4. Net non-debt creating flows at historical average minus one standard deviation in 2004-05 4/	91	128	162	167	169	170	155	148	140	135	126	116	106	97	89	82	75	75	75	75	75	
B5. Combination of B1-B4 using one-half standard deviation shocks	...	95	124	152	161	167	177	174	169	166	160	150	142	134	127	120	115	115	115	115	115	
B6. One-line 30 percent nominal depreciation relative to the baseline in 2004 5/	...	95	107	115	121	125	125	121	115	112	104	95	86	78	71	64	58	58	58	58	58	
Debt service ratio																						
Baseline	5	6	6	7	7	7	8	7	7	7	7	7	7	7	6	6	6	6	6	6	6	
A. Alternative Scenarios																						
A1. Key variables at their historical averages in 2004-23 1/	5	5	4	6	6	6	6	6	6	6	6	6	6	6	6	6	6	6	6	6	6	
A2. New public sector loans on less favorable terms in 2004-23 2/	5	5	4	6	6	6	6	6	6	6	6	6	6	6	6	6	6	6	6	6	6	
B. Bound Tests																						
B1. Real GDP growth at historical average minus one standard deviation in 2004-05	4.7	4.9	5.3	6.5	6.0	6.2	9.3	9.5	9.6	9.8	10.0	10.2	9.9	9.7	9.3	8.7	8.1	8.1	8.1	8.1	8.1	
B2. Export value growth at historical average minus one standard deviation in 2004-05 3/	4.7	6.6	10.6	14.9	16.1	16.2	28.9	28.8	28.0	28.3	28.1	28.0	27.0	26.4	25.3	23.7	22.3	22.3	22.3	22.3	22.3	
B3. US dollar GDP deflator at historical average minus one standard deviation in 2004-05	4.7	4.2	5.3	6.5	6.1	6.3	9.7	10.0	10.1	10.1	10.2	10.4	10.1	9.8	9.4	8.9	8.2	8.2	8.2	8.2	8.2	
B4. Net non-debt creating flows at historical average minus one standard deviation in 2004-05 4/	4.7	4.6	5.7	7.4	6.9	7.0	11.8	11.8	11.6	11.7	11.7	11.7	11.3	11.0	10.6	9.9	9.2	9.2	9.2	9.2	9.2	
B5. Combination of B1-B4 using one-half standard deviation shocks	4.7	4.6	5.1	7.1	6.9	7.2	12.0	12.5	12.6	13.0	13.3	13.6	13.4	13.3	13.0	12.5	11.9	11.9	11.9	11.9	11.9	
B6. One-line 30 percent nominal depreciation relative to the baseline in 2004 5/	4.7	4.6	4.7	5.8	5.4	5.7	8.7	9.0	9.0	9.1	9.3	9.4	9.1	8.8	8.4	7.8	7.2	7.2	7.2	7.2	7.2	
<i>Memorandum Item:</i>																						
Grant element assumed on residual financing (i.e., financing required above baseline)	...	21	21	21	21	21	21	21	21	21	21	21	21	21	21	21	21	21	21	21	21	

Source: Staff projections and simulations.
 1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
 2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline. ... while grace and maturity periods are the same as in the baseline.
 3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).
 4/ Includes official and private transfers and FDI.
 5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

Tirana, June 24, 2004

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. de Rato:

The Poverty Reduction and Growth Facility (PRGF) arrangement, which was approved in June 2002, has been instrumental in promoting macroeconomic stability and economic growth, and improving governance in Albania.

All quantitative performance criteria (PCs) under the program have been observed. We did not meet at end-March 2004 the PC requiring the implementation of the ASYCUDA system in the Durrës customs house and the initiation of an integrity audit of the system. However, we implemented the ASYCUDA system in the Durrës customs house in June 2004 as a prior action for completion of the fourth review. Regarding the integrity audit, we have postponed it at the recommendation of the EU Customs Assistance Mission in Albania (EU CAM-A). Given the progress in implementing the ASYCUDA system and the close supervision they provide, EU CAM-A now feels that the audit would be more useful if undertaken after the customs administration has gained more experience with the system. As this delay does not compromise program objectives, we request a waiver for the non-observance of this PC. As additional prior actions for the fourth review, we have allocated the revenues from the privatization of Savings Bank as detailed in the attached memorandum and started to pay wages of the central bank of Albania through the banking system. We request completion of the fourth review as well as the financing assurances review under the arrangement.

The attached supplementary Memorandum of Economic and Financial Policies (MEFP) and the Technical Memorandum of Understanding (TMU) describe our economic program for the period ahead. These policies are consistent with our November 2001 National Strategy for Socio-Economic Development (NSSD) and the Annual Progress Reports of May 2003 and May 2004.

We believe that the policies set forth in the attached MEFP are adequate to achieve the objectives of the program, but will take any further measures that may become appropriate for this purpose. Albania will consult with the IMF prior to the adoption of any such measures, and of revisions to the policies contained in the MEFP, in accordance with the IMF's policies on such consultations.

Moreover, after the end 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. In continuing with our policy of transparency, we consent to the publication of this letter, the attached MEFP, and the accompanying Executive Board documents on the IMF's website.

Sincerely yours,

/s/
Fatos Nano
Prime Minister

/s/
Arben Malaj
Minister of Finance

/s/
Shkëlqim Cani
Governor, Bank of Albania

Supplementary Memorandum on Economic and Financial Policies (MEFP) for Albania

I. BACKGROUND

1. **This memorandum reviews the implementation of the PRGF-supported program, updates the macroeconomic framework for 2004–07, and lays out our policies for the period June 2004–March 2005.** It is consistent with the November 2001 National Strategy for Socio-Economic Development (NSSED) and the May 2003 and May 2004 Progress Reports; and supplements the June 2002, January 2003, June 2003, and January 2004 MEFPs.

II. PERFORMANCE UNDER THE PROGRAM

2. **Following the crisis of 1997-1998, our government has achieved considerable success in creating the macroeconomic and structural conditions needed for the rapid modernization and development of our country.** As an integral part of these policies we have adopted a poverty reduction strategy aiming to ensure that the benefits of economic growth are shared by the most vulnerable sectors of the population. The PRGF-supported program approved in June 2002 has been instrumental in advancing these policies.

- **Since 1999, Albania's economic growth performance has been impressive by any standard.** During this period, output growth averaged 7 percent, underpinned by a stable macroeconomic environment. We have reduced inflation, which is now within the 2-4 percent target range of the Bank of Albania (BoA). Private investment, although still low relative to our growth needs, has increased as a proportion of GDP. The current account deficit has narrowed since 2002 supported by a rapid increase in exports. Reserve cover rose substantially each year, while confidence in the lek firmed up, reflected in its steady appreciation.
- **We achieved significant fiscal consolidation, which played a key role in maintaining macroeconomic stability.** The overall fiscal deficit is now about 5 percentage points of GDP lower than it was in 1999, most of it accounted for by higher public savings. Although still below our targets, the tax revenue-to-GDP ratio has increased by 2 percentage points of GDP in 1999-2003, while our tax system has undergone significant modernization. Through lower deficits and the use of privatization receipts for debt amortization, we have reduced the public debt-to-GDP ratio from 76 percent at end-1998 to an expected 55 percent at end-2004.
- **We carried out measures to improve the transparency, accountability, and efficiency of our tax (GDT) and customs (GDC) administrations, and plan to intensify efforts in this area as much remains to be done.** These reforms included implementation of ASYCUDA within the Tirana and Durrës custom houses; extension of civil servant status or its equivalent to the staff of the GDT and GDC; hiring of additional qualified employees in the GDT and GDC; greater public dissemination of internal tax procedures and regulations; greater taxpayer protection

through a strengthened appeal process and the publication of appeals proceedings; and more use of information technology. We assigned taxpayer identification numbers to all businesses but suffered delays in completing the process for individuals. The first phase of the transfer of social security contributions collection to the GDT (large and VAT taxpayers) has been implemented and subsequent steps toward the full transfer are under way.

- **We have regularized public sector inter-enterprise arrears and set up a system to prevent the emergence of new ones.** Building on the progress achieved in 2003, memorandums of understanding rescheduling or clearing all arrears incurred up to December 2001 between public enterprises and government agencies have been signed. Provision for the full payment of these obligations, and of arrears incurred after 2001, are now appropriated in the budget on a current basis. To prevent the re-emergence of arrears, compliance with the MOUs is being closely monitored by a dedicated task force within the Ministry of the Economy, as well as by an inter-ministerial working group established by the Prime Minister. We have adopted a plan to regularize the repayment of the outstanding stock of VAT refund arrears over 2004-05.
- **We are implementing reforms in the budget process** aimed at enhancing transparency, improving parliamentary oversight, and allowing better targeting of expenditure toward meeting our poverty-reduction and growth objectives.
- **We are modernizing our financial sector and fostering banking intermediation.** We are improving our accounting standards, supervisory capacity, and enabling legislation, including on the insurance sector. The recent sale of Savings Bank places our entire banking system under private management, and we expect this to galvanize competition, improve service delivery, and increase the level of lending to the private sector. In addition, our completion of a real-time gross settlement system (AIPS) early this year, the establishment of a complementary intraday collateralized credit facility, and the forthcoming inauguration of a bulk settlement system, will establish a safe and efficient market infrastructure. With assistance from the IMF, EU, US Treasury and other donors, we are developing the technical expertise and legal framework to combat more successfully money laundering and terrorism financing. We have requested an FSAP to assess progress to date in these areas, and to help in the design of future reforms.
- **On the external front, we have regularized half of our external arrears, and expect to finalize agreement on the remainder within the program period.** We have concluded regional free trade agreements, and are negotiating a Stabilization and Association Agreement with the EU.
- **We also carried out a number of measures to improve the investment climate and governance.** These included adopting and implementing the Action Plan for reducing the administrative barriers to investment identified by FIAS; implementing

the Law on Asset Declaration of public officials; improving our system for combating money laundering; and enforcing compliance with existing conflict of interest legislation.

III. POLICIES AND MEASURES FOR JULY 2004-JUNE 2005

A. Overall Strategy

3. **As we enter the final year of our PRGF arrangement, our strategy for reducing poverty and effecting rapid economic development remains broadly unchanged.** Monetary and fiscal policies will continue to promote macroeconomic stability and growth. Essential to the successful transition to a rules-based market economy, we will pursue institution-strengthening and governance-enhancing policies and intensify our anti-corruption efforts. As the business climate improves, we expect growth to become more export driven, and increasingly sustained by rising levels of foreign and domestic investment, rather than aid flows, which are expected to decline in both volume and degree of concessionality over the longer term. At the same time, we are committed to reducing poverty; pursuing greater efficiency and equity in the mobilization and use of resources; and improving essential services such as health care, education, and social protection. Our strategy will require broad-based support and we will deepen our policy dialogue with all stakeholders.

B. Macroeconomic Outlook

4. **We expect the medium-term outlook to remain favorable.** Growth is forecast to stay close to its trend of 6 percent during 2004–07, while monetary policy and further fiscal consolidation will hold inflation within its 2-4 percent target band. The volume growth of merchandise goods exports is expected to remain strong in 2004, at about 17 percent, while import volume growth will be close to 14 percent. Over the medium term, as continued improvements in the business climate take hold, growth will be increasingly driven by rising foreign and domestic export-generating investment. Ongoing reforms to enhance the efficiency of tax administration, combined with a concerted effort to reduce the size of the informal economy, will increase tax revenue as a share of GDP and permit an expansion of priority expenditure within a framework of further fiscal consolidation. As this consolidation takes place, and the business sector takes on an increasing role, public and private consumption will decline as a share of GDP. We will gradually reduce our reliance on foreign savings, although we expect the narrowing of the current account deficit to be accompanied by a rising share of foreign trade in GDP, reflecting our increasing integration into the world economy.

C. Fiscal Policy

5. **We are taking the actions needed to adjust our 2004 fiscal program in order to meet our domestic financing targets.** This became necessary after our revised projections indicated that 2004 revenue would fall short of its budgeted level by more than the ¼ percent of GDP reserve established for this contingency, and that external disbursements would be under-realized by 0.1 percent of GDP. We intend to continue improving our revenue

forecasting capabilities as well as the practice of basing such forecasts on objective and prudent assumptions. For 2004, we see the need to take adjustment measures of 0.7 percent of GDP. In the short-term, this will mainly take the form of expenditure reductions, but we have introduced revenue-enhancing measures in parliament and plan to introduce further tax policy legislation later in the year having a full impact in 2005.

- **We allocated the proceeds from the sale of Savings Bank (1.6 percent of GDP).** We will use half to retire domestic debt and the rest will be spent on well-designed capital projects—already identified in consultation with the World Bank—in priority areas consistent with the NSSD.
- **We will reduce expenditure in 2004 by about 0.6 percent of GDP.** We will not release Lek 1 billion of spending from the Reserve Fund, as agreed during the third program review; and will reduce expenditure by about Lek 3.6 billion from administrative and non-priority operations and maintenance, other current spending, and selected capital projects in non-priority areas. As a precaution against unforeseen events, we will maintain a Contingency Fund of Lek 2 billion. We will release the latter funds at end-September 2004, only if the cumulative revenue (excluding project grants) is not less than Lek 134 billion, the net credit to government quantitative performance target is met, and prospects through the end of the year are consistent with the fiscal program.
- **We are introducing revenue-enhancing tax-policy measures equivalent to about 0.1 percent of GDP already in 2004.** We have increased rural social security contributions, and raised the minimum quality grade of imported diesel—which will result in higher indirect tax collection as well as environmental benefits. We intend to increase excise rates on cigarettes before the summer parliamentary recess, generating 0.1 percent of GDP on an annual basis. We have also increased casino registration fees. Conditional on the evolution of international energy prices, we are considering to include customs duties in the base for excise duties on diesel in the 2005 budget.

With these adjustments, we now expect an overall deficit in 2004 of 5.8 percent of GDP in 2004. Domestic borrowing is set at 1.9 percent of GDP—equivalent to the original budget value adjusted for the saving of half of the privatization receipts; and consistent with our previous program targets.

6. **We are committed to support the integrity of our monetary framework and the independence of the central bank.** Our process of fiscal consolidation will support monetary policy. As required by the central bank law, and in application of international best practice, we will issue treasury bills to the BoA by the amount required to cover the accumulated net reserve valuation losses (stemming from the appreciation of the lek) as reflected in its final balance sheet as of end-2003—currently estimated at Lek 6.4 billion. We will also reduce the maximum permissible level of direct lending from the BoA to the government—now set at 5 percent of the previous year’s budget revenue—by at least ½ percent each year.

7. **The budgets of 2005 and subsequent years will implement a strategy of further fiscal consolidation aiming at offsetting the likely decrease in external assistance and placing the public finances on a sustainable path.** In 2005, net domestic credit to the government will be set at 2½ percent of GDP—a decline of ¼ percentage point of GDP with respect to the underlying 2004 level computed before the savings from privatization proceeds. Tax measures will include price indexation of specific excises and fees—in addition to structural measures recommended by FAD aimed at further harmonizing the VAT, profit tax, personal income tax, and social insurance contributions with international best practices. Revenue will be further augmented by the full year effect of the measures enacted in 2004. We will complete the transfer of social security collection to GDT, and reform the employee compensation schemes in the GDT and GDC reinforcing performance-based incentives. Over the medium term, domestic borrowing will decline further, while total public debt is projected to decline from 55 percent of GDP in 2004 to 53 percent of GDP by 2007—before considering the additional decline that will result from the planned but still unbudgeted large privatizations. Based on conservative estimates of concessional foreign financing, this implies that the overall deficit will fall to 4½ percent of GDP in 2005, and further to 3¾ percent of GDP by 2007. Underpinning this medium-term profile, we will continue reforms to expand the tax net, improve the efficiency of expenditure, and raise the level of skill and professionalism of public servants.

8. **We will work toward instilling greater transparency, accountability, and parliamentary control into the budget process.** We have secured technical assistance from the U.K. DFID to improve our overall budget process. As agreed at the time of the third review, we will lower the maximum allowable transfer between appropriations in the 2005 budget to 5 percent. We will introduce greater detail into the appropriations of the 2005 fiscal package, particularly on current expenditure, and seek to establish a greater degree of prioritization of capital spending. We will improve compliance with procurement procedures, and ensure that all budgetary institutions develop and comply with internal rules to limit administrative and non-priority spending. We will also work toward establishing more detailed and timely reporting of fiscal developments to Parliament and to the general public.

D. Monetary and Financial Sector Policies

9. **Monetary policy will continue to aim at keeping inflation within the 2–4 percent target band of the BoA, while maintaining an adequate level of reserves.** The repo rate, supported by open market operations, will remain our main policy instrument to ensure adherence to our monetary program. Over the remainder of the program period, we expect money demand to remain broadly stable as share of GDP. From its current low base, private sector credit will grow rapidly, while the share of currency in broad money will continue to decline, reflecting rising confidence in the banking system and increased intermediation in the economy. We aim at maintaining foreign reserve coverage equivalent at least four months of imports, with the programmed 2004 increase in foreign reserves reflecting privatization receipts. We will maintain a flexible exchange rate regime with intervention used mainly for smoothing short-term shocks unrelated to fundamentals.

10. The BoA will press ahead with additional structural reforms aimed at improving banking sector intermediation and financial services provision.

- In close consultation with commercial banks, government institutions, and the private sector, the BoA developed an action plan in June 2004 for increasing the use of the banking system in the regular conduct of business. As a prior action for completion of the fourth review, and as a pilot to be extended to all public employees within one year, the BoA began paying the salaries of all its professional staff through the banking system. This practice will be extended to all remaining BoA employees and to a further 3,500 public employees by end-September 2004 (PC). By end-2004, at least 10,000 public employees will be paid through the banking system (PC; end-December 2004). In the context of discussions for the fifth review, we will consider the possibility of increasing this target in light of experience gained.
- The BoA will develop and make operational a bulk clearing system in collaboration with the World Bank, aiming at full operation in the first half of 2005. We will also take appropriate steps to support the AIPS, and ensure the proper functioning of the Intraday Collateralized Credit Facility. We will initiate the legal reforms necessary for the evidential value of electronic signatures, including preparing draft legislation in collaboration with the IMF and World Bank. Also with IMF and World Bank assistance, we will prepare draft legislation updating the Banking and the Accounting Laws.

11. The BoA will develop an action plan for implementing MFD's technical assistance recommendations in the areas of banking supervision, stress testing, inflation targeting, and accounting. With regard to banking supervision, these actions will be fully consistent with the completion of the World Bank-supported Supervisory Development Project. We will continue to strengthen our analytical capacity within BoA in preparation for an eventual adoption of inflation targeting. We will fully cooperate with the IMF safeguards policy and provide updated documents and data as necessary; and will also avail ourselves of technical assistance from the MFD resident advisor.

E. Structural Policy

12. Governance and institution-building reforms remain critical for developing a rules-based business climate and attract increasing levels of investment. Although we have achieved progress over time, with support from the World Bank, EU, OSCE, and UNDP, we believe that further progress is needed, particularly in those areas that hamper investment and capital flows, such as civil service and judiciary reform, and fighting crime and corruption.

13. We are committed to reducing administrative barriers to investment and business creation, which are still high, including relative to neighboring countries. Implementation of our Action Plan developed in conjunction with FIAS is on track (SB; ongoing). By end-December 2004, we will complete our first comprehensive self-assessment

of the reform process, and will prepare an updated set of measures. In this regard we have already initiated a second round of the Administrative and Regulatory Cost Survey and will focus on removing remaining industrial licenses, streamlining required inspections, improving the appeals system, and developing outcome-based indicators.

14. **Building on the newly gained privatization momentum, we will prepare Albtelekom for its prompt privatization.** We will fully divest our interest in INSIG, two oil-sector companies, and remaining minority positions in two commercial banks over the next 18 months. As was the case with the Savings Bank, we will use half the proceeds of the sale of Albtelekom, remaining stake in INSIG, and other future large privatizations to retire public debt; and the remaining revenue to finance priority investments.

15. **We will improve the quality and professionalism of the public sector.** Reform in this area has moved slowly, particularly with respect to training and our ability to attract and retain highly-skilled staff. We aim to relate more closely public service pay and bonuses with productivity and performance. In this context, we will implement Instruction No. 2 of Law No. 8549 assigning specialists to higher wage categories in time for inclusion in the 2005 fiscal package. We are also engaged in discussions with IMF staff as to whether our recently-introduced policy of indexing wages to changes in the CPI contradicts this aim. While we continue to see some merit in this policy, we have agreed to fully review the issue at the time of the fifth review.

16. **We have taken steps to improve the coordination of donor assistance through the creation of a secretariat under Office of the Prime Minister.** It will monitor and coordinate relations with donors in four main categories of assistance, and mirror counterpart structures set up by the donor community under the lead of the EU, World Bank, OSCE, and UNDP. We are also considering introducing a law to formalize the preparation, prioritization, execution, and evaluation of foreign-financed investments and create the necessary institutions to improve coordination with the donor community.

17. **Actions to rationalize the utilities sector will continue in consultation with the World Bank.** To cushion the social impact of the attendant tariff increases, we plan to implement a subsidy to low income electricity consumers as of September 2004 (SB).

18. **Within the constraints imposed by the sustainability of the public finances, we are progressing in the area of property recognition, restitution and compensation, necessary for solidifying the property rights needed for private sector development.** The selected form of compensation will be transparent and rules-based. The forms of compensation will exclude any tax credit or exemption and give priority to issuing equity in state-owned property, rather than generating budgetary obligations.

F. External Policy

19. **We remain committed to a liberal trade regime and will continue to work toward concluding a Stabilization and Association Agreement with the EU and**

achieving an Albania-EU free trade area. During 2003 and the first quarter of 2004 six new Free Trade Agreements were ratified by Parliament, including a free trade agreement with Kosovo. Three of them, however, have not yet taken effect as they are awaiting ratification by the trade partners.

20. **We are continuing to restructure our outstanding stock of external arrears, and aim to completing the process with official creditors by the end of the program period.** Agreements with Hungary and private creditors from FYR Macedonia were ratified by Parliament in March 2004. We have also made substantial progress with the Czech Republic, the Slovak Republic, and Poland on the terms of rescheduling and hope to complete these negotiations in 2004.

21. **We will continue to improve the management of non-concessional foreign-financed investment projects and their integration with the corresponding sectoral strategies outlined in the National Strategy for Socio-Economic Development (NSSD) and the Medium-Term Budget Program (MTBP).** We aim for further progress on establishing and following transparent, competitive procedures for negotiating and selecting favorable supply and lending agreements, pursuant to international practices and procedures and Albanian legislation. In this context, large-scale projects will be subject to international open tenders and will be executed only if independent feasibility studies by international standards are prepared (SB; ongoing). We will inform the IMF on a quarterly basis on the list and status of projects being considered for non-concessional financing (SB; ongoing). Quantitative PCs for September 2004 and March 2005, and indicative targets for June and December 2004 have been set as ceilings on the contracting or guaranteeing of public and publicly-guaranteed non-concessional borrowing.

G. Data Issues

22. We are working toward improving the quality and coverage of economic statistics, which continue to hamper monitoring of developments and economic policy making. In cooperation with our technical assistance providers, including through two major projects funded by the IMF (Italian subaccount) and the EU, we are improving the scope and collection of data on private remittances, real sector activity indicators and national accounts, with particular attention to the assessment of informal activity. We will prepare a plan to accelerate the regular preparation and improve the timeliness of the national accounts to be discussed during the fifth review. Additionally, we will employ surveys and other tools to improve our statistics on foreign direct investment through comprehensive coverage of at least the largest enterprises, and will ensure the provision of adequate resources to INSTAT.

H. Program Monitoring

23. The sixth disbursement under the PRGF-supported program will be based on the end-September 2004 quantitative PCs and end-December 2004 indicative targets (Table 1 and the TMU); the end-September and end-December 2004 structural conditionality (Table 2); and completion of the fifth review and the financing assurances review. The seventh

disbursement under the PRGF-supported program will be based on the end-March 2005 quantitative PCs; and completion of the sixth review and the financing assurances 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. We will provide a new progress report on the NSSD by April 2005, taking into account the recommendations of the joint staff assessment of the 2004 progress report.

Table 1. Albania: Quantitative Performance Criteria and Indicative Targets for 2004-05 1/

	End-Jun 2003		End-Sep. 2003 2/		End-Dec. 2003		End-Mar. 2004 2/		End-Jun. 2004		End-Sep. 2004 2/		End-Dec. 2004		End-Mar. 2005 2/	
	Actual	Prog. (Adj.)	Actual	Prog. (Adj.)	Actual	Prog. (Adj.)	Actual	Prog. (Adj.)	Actual	Prog. (Adj.)	Actual	Prog. (Adj.)	Actual	Prog. (Adj.)	Actual	Prog. (Adj.)
Ceiling on net domestic credit to the government 3/	6	9	14	16	18	20	21	21	21	6	6	12	11	16	26	
Ceiling on net domestic assets of the BOA 4/	-18	11	-14	2	4	-19	6	6	-24	-7	-5	2	7	5		
Indicative target for revenues collected by Tax Department	2.6	29	40	43	43	57	59	...	...	...	...	...	...	...	...	...
Indicative target for revenues collected by Customs Department	2.7	27	41	43	43	54	59	...	...	...	...	...	...	...	...	...
Indicative targets for Social Insurance Revenues	1.4	1.5	2.1	2.2	2.2	2.9	3.1	...	...	...	...	...	...	...	...	...
Indicative total tax revenue targets, millions of Lek 5/	...	...	...	...	...	...	...	...	36	36	76	116	161	201		
	(In billion lek)															
	(In millions of US dollars)															
Floor for net international reserves of the BOA 4/ 6/	44	20	17	52	14	-2	112	21	18	104	57	71	71	83	106	
Ceiling on contracting or guaranteeing of public and publicly-guaranteed non-concessional external debt 7/ 8/ of which: 1-5 years	21	80	80	21	100	100	20	130	130	20	150	170	190	220	240	0
Ceiling on public and publicly-guaranteed external debt with original maturities up to and including 1 year 7/ 8/ 9/	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Nonaccumulation of new external payments arrears, excluding interest on pre-existing arrears 7/ 8/ 9/	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0

1/ The performance criteria and indicative targets envisaged under the program, and their adjustments, are defined in the Technical Memorandum of Understanding (TMU). Targets for September 2004 and beyond are defined as cumulative changes from end-2003, except where noted. Targets prior to September 2003 refer to targets set during the third and previous reviews.

2/ Data in this column are performance criteria, except for revenue targets. Data in all other columns are indicative targets.

3/ For 2003 and 2004 dates, cumulative within each calendar year.

4/ For end-June 2003 to end-June 2004: cumulative changes as of end-December 2002.

5/ In 2004, the separate indicative revenue targets on tax, customs, and social security revenue used in 2002 and 2003 are replaced by a single aggregate target on all revenues collected by the GDT, GDC, and SSI. Aggregate revenue so defined includes all revenues collected on behalf of local governments, but excludes revenues collected by local governments directly.

6/ Up to end-June 2004, valued using end-December 2001 exchange rates. After end-June 2004, valued using end-2003 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/ Cumulative changes as of end-December 2002.

9/ These performance criteria apply on a continuous basis.

Table 2. Albania: Performance Criteria and Structural Benchmarks under the PRGF Arrangement

Measures	Test-date
A. Prior Actions for the Fourth Review	
1. Allocate the proceeds from the sale of the Savings Bank in accordance with the attached Memorandum of Economic and Financial Policies	Completed
2. The Bank of Albania to pay the salaries of all its professional staff through the banking system	Completed
3. The ASYCUDA computer administration system to be made operational in the Durrës port (NSSED Chapter 7, Section on Customs).	Completed
B. Proposed performance Criteria for the Fifth Review	
1. The salaries of 3,500 Government employees and of all the employees of the Bank of Albania to be paid through the banking system	End-September 2004
2. The salaries of at least 10,000 employees of budgetary institutions to be paid through the banking system	End-December 2004
C. Proposed structural Benchmarks under the Fifth Review	
1. Strengthen tax and customs administration through:	
(i) Improving the VAT refunds process by reporting on the stock of VAT refunds claimed and refunds paid out every month;	Ongoing
(ii) Redrafting the instructions, decisions and laws on tax procedure, the income tax and the VAT to make them all internally consistent, as part of the 2005 fiscal package.	End-October 2004
2. Government to implement a subsidy to low income electricity consumers	End-September 2004
3. Government of Albania to continue to implement its action plan for removing administrative barriers to investment (NSSED chapter 7, Section on Ministry of the Economy).	Ongoing
4. Prepare quarterly reports (within one month of the end of each quarter) on the stock of external arrears.	Throughout
5. Safeguard the efficient use of nonconcessional foreign project loans through:	
(i) Conducting an independent feasibility study for any large project (as defined in the TMU) financed through non-concessional borrowing.	Throughout
(ii) Provide a quarterly listing and status report on all projects being considered for nonconcessional foreign financing.	Throughout

ALBANIA

TECHNICAL MEMORANDUM OF UNDERSTANDING

This memorandum defines the quantitative benchmarks and performance criteria established in the Memorandum of Economic and Financial Policies (MEFP) for end-June 2004–end-March 2005.

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 central government** (NCG) is defined as gross domestic credit in lek and in foreign currency extended to the central government (as defined above) by the banking system, savings and loan institutions (SLIs), and other domestic lenders;² less the sum of central government financial assets held in the banking system and in the SLIs.
3. The following definitions apply to **gross domestic credit to the central government**:
 - (i) **Gross domestic credit in lek and in foreign currency extended to the central government includes:** (a) securities (including treasury bills and bonds) issued by the central government and held by the Bank of Albania (BoA), deposit money banks (DMBs), SLIs, and other domestic lenders; (b) loans and advances extended to the central government by BoA, DMBs, SLIs, and other domestic lenders; and (c) negative balances in government deposits with BoA, DMBs and SLIs.
 - (ii) **Gross domestic credit in lek and in foreign currency extended to the central government excludes** (a) the onlending of foreign project loans to all parts of central government; and (b) advances on profit transfers by the BoA. The value of the stock of gross domestic credit to government will also exclude the claims held by the units of central government as defined above (in particular, the SSI and the HII).
 - (iii) The stock of gross domestic credit extended to the central government and held by the BoA and DMBs in the form of treasury bills will be valued at issue

² Other domestic lenders comprise both firms (including insurance companies) and households. For small lenders, treasury bill windows are available at the central bank and at selected Albapost offices throughout the country.

price. The stock of gross domestic credit extended to the central government and held by the BoA in the form of other securities and direct loans to government will be valued excluding accrued interest. The stock of gross domestic credit extended to the central government and held by the DMBs in the form of fixed and variable income securities will be valued at face value. The stock of all gross domestic credit extended to the central government and held by SLIs and other domestic lenders will be valued at face value³.

4. The following definitions apply to **central government financial assets held in the banking system and in the SLIs**:

(i) **Central government financial assets held at the Bank of Albania include:** (a) transferable deposits in domestic and foreign currency; (b) lek deposits held in BoA for projects; and (c) standard gold deposits of the central government. For the purposes of program monitoring, standard gold deposits will be valued at the program price of gold (SDR 280.6 per ounce)⁴.

(ii) **Central government financial assets held at the Bank of Albania exclude:** (a) foreign currency deposits related to foreign financed projects; and (b) deposits serving as the counterpart for non-standard gold and other precious metals owned by the central government.

(iii) **Central government financial assets held at the DMBs include:** (a) all deposits of central government in domestic and foreign currency; (b) all loans extended by central government to commercial banks; and (c) payable amounts owed by the DMB to central government.

(iv) **Central government financial assets held at the SLIs include** all deposits of central government held at the SLIs.

5. **For the purposes of program monitoring,** central government financial assets in foreign currency will be converted from Lek to SDRs at the end-of period Lek/SDR exchange

³ Under current reporting standards, the following data is only available at face value: (i) the stock of gross domestic credit extended to the central government and held by the DMBs in the form of fixed and variable income securities; and (ii) the stock of all gross domestic credit extended to the central government and held by the SLIs and other domestic lenders.

⁴ The lek value of standard gold deposits will be (a) converted to US dollars using the current end-of-period lek/US dollar exchange rate; (b) then converted to ounces of gold using the current US dollar market price of gold; (c) then converted to SDRs at the program price of gold (SDR 280.6 per ounce); and (d) then converted to Lek at the program Lek/SDR exchange rate of Lek 158.1104/SDR.

rate prevailing on the test date; and then converted to Lek at the end-December 2003 Lek/SDR exchange rate of Lek158.1/SDR.

6. According to the above definitions, as of end-December 2003 the level of gross domestic credit to the central government was Lek 277.9 billion; the level of central government financial assets held in the banking system and in the SLIs (excluding deposits of the SII and HII) was Lek 7.5 billion; and the level of deposits in the banking system and the SLIs of the SSI and HII was Lek 2.2 billion. The level of net domestic credit to central government was Lek 268.1 billion. The breakdown of the categories defined above is given in Attachment Table 1.

7. The limits on the change in net domestic credit to the government will be cumulative from end-December 2003.

B. Net Domestic Assets

8. The stock of **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 at the BoA—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 2003. Under this definition, the level of the NDA was Lek 72 billion as of end-December 2003. The NDA limits will be cumulative changes from end-December 2003 and will be monitored from the accounts of the Bank of Albania.

C. Net International Reserves

9. **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, or 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.⁵ Reserve assets and reserve liabilities will both be expressed in U.S. dollars.

10. During this program, for monitoring purposes, the exchange rates of the SDR and non-dollar currencies will be kept at their end-December 2003 levels and holdings of monetary gold will be valued at SDR 280.6 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

11. The NCG and NDA ceilings and the NIR floor are defined on the assumption that total privatization proceeds (privatization proceeds received in foreign currency) will amount, on a cumulative basis, from January 1, 2004, to:

End-September 2004	Lek 16,673 million, (US\$157.0 million);
End-December 2004	Lek 19,036 million, (US\$167.0 million);
End-March 2005	Lek 19,833 million, (US\$174.5 million).

The NIR floor will be adjusted upward (downward) and the NDA ceiling adjusted downward (upward) by half of any excess (shortfall) in the receipt of privatization proceeds in foreign currency from these assumed values. The NCG ceiling will be adjusted downward (upward) by half the amount of any excess (shortfall) in the receipt of total privatization proceeds from these assumed values.

12. The ceilings on NCG and NDA, and the floor on NIR are defined based on the assumption that **foreign budgetary and/or balance of payments loan financing** (excluding IMF financing, project and commodity loans, and macro-financial assistance from the EU) will amount, on a cumulative basis, from January 1, 2004, to:

End-September 2004	US\$19.0 million;
End December 2004	US\$19.0 million;
End-March 2005	US\$29.0 million.

In cases where total foreign loan financing exceeds this projection, the ceilings on NCG to the government and NDA of the Bank of Albania will be adjusted downward, and the floor on NIR will be adjusted upward by the amount of the excess⁶.

⁵ 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 funds are transferred to the government's lek account before being spent. A change in this procedure, would require revisiting the NIR definition.

13. 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

14. 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.

15. 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 sub-limits** 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 14 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

⁶ 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 106.5 per U.S. dollar.

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.

16. 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 14 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.

17. A continuous performance criterion applies to the non-accumulation 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.

18. **Large projects** (as referred to in MEFP paragraph 21 and Table 2) financed by nonconcessional foreign borrowing are defined as those projects involving total nonconcessional foreign borrowing in excess of US\$25 million.

F. Tax Revenues

19. Collection of total tax revenue by the Tax and Customs Departments and social insurance contributions will be monitored on the basis of quarterly indicative floors. These indicative floors will include all revenues collected by the GDT, GDC, and SSI (including revenues collected on behalf of local governments), but exclude revenues collected by local governments directly.

G. Monitoring and Reporting Requirements

20. Performance under the program will be monitored from information supplied monthly to the Fund by the Bank of Albania, the Ministry of Finance, the General Directorate of Taxation (GTD), the General Directorate of Customs (GDC), and the Ministry of Economy. This information will include the following, which will be supplied monthly (except where noted) and on a timely basis:

The Bank of Albania will supply to the Fund:

- (i) The balance sheets of the Bank of Albania;
- (ii) The consolidated accounts of the commercial banks and (separately) the SLIs;
- (iii) The monetary survey;
- (iv) Net domestic credit to the government (in the form outlined in Appendix Table 1);
- (v) The net foreign assets of the Bank of Albania;
- (vi) The foreign exchange cashflow of the Bank of Albania, including the level of NIR;
- (vii) Daily average exchange rates;
- (viii) Trade flows;
- (ix) Periodic updates of balance of payments estimates.

The Ministry of Finance will supply to the Fund:

- (i) The summary fiscal table, including the overall budget deficit, on a cash basis;
- (ii) Issuance of treasury bills by the MOF, including gross value and cash received;
- (iii) Privatization receipts;
- (iv) Information on the contracting and guaranteeing of new debt;
- (v) Information on the stock of short-, medium- and long-term debt;
- (vi) Information on all overdue payments on short-, medium- and long-term debt (with assistance from the Bank of Albania).
- (vii) Information on the stock of VAT refunds claimed and refunds paid out every month.

The General Directorate of Customs will supply to the Fund:

- (i) Detailed monthly data on customs revenues collected; and
- (ii) Quarterly reports on corrective measures taken to deal with problems identified by the internal audit function.

The General Directorate of Taxation will supply to the Fund:

- (i) Detailed monthly data on tax revenues collected.

The Ministry of Economy will either report quarterly to the Fund or publish quarterly:

- (i) All instances of nonpayment on the agreed memorandums of understanding for the repayment of the stock of end-December 2001 inter-enterprise arrears.
- (ii) A description of remedial actions undertaken by the ministry in the event of non-payment on the agreed MOUs for the repayment of the stock of end-December 2001 inter-enterprise arrears.

Table 1. Albania: Calculation of Net Domestic Credit to Central Government for Program Monitoring Purposes
December 2003–March 2005
(In millions of lek)

	Dec-03	Mar-04	Jun-04	Sep-04	Dec-04	Mar-05
1. Treasury bills held outside central government	271,417	277,129				
Of which:						
1. (i) Held by Bank of Albania 1/	70,372	66,169				
1. (ii) Held by deposit money banks 1/	184,203	192,425				
1. (iii) Held by savings and loan institutions 2/	0	1				
1. (iv) Held by other domestic lenders (excluding holdings of HHI and SSI) 2/	16,842	18,534				
Of which:						
1. (iv) (i) INSIG	1,548	1,488				
1. (iv) (ii) Individuals and firms	15,294	17,046				
1. (iv) (ii) (i) Of which: BoA window	9,528	10,413				
Plus:						
2. Other central government debt held outside central government (millions of lek)	6,449	6,774				
Of which:						
2. (i) Held by Bank of Albania 3/	1,449	964				
2. (i) (i) Other securities 3/	1,449	964				
2. (i) (ii) Short-term direct loans to government 3/	0	0				
2. (ii) Held by deposit money banks 4/	5,000	5,810				
2. (ii) (i) Fixed income securities 4/	5,000	5,810				
2. (ii) (ii) Variable income securities 4/	0	0				
2. (iii) Held by savings and loan institutions 5/	0	0				
2. (iv) Held by other domestic lenders 5/	0	0				
Equals gross domestic credit to government:	277,866	283,903				
Less:						
3. Assets of central government (excluding HHI and SSI)	7,534	7,203				
3. (i) Deposits held at Bank of Albania 6/	4,914	4,503				
3. (i) (i) In domestic currency	3,295	2,886				
3. (i) (i) (i) Transferable deposits in lek	2,902	2,494				
3. (i) (i) (ii) Deposits in lek for projects	393	393				
3. (i) (ii) In foreign currency evaluated at program exchange rates and program price of gold 7/ 8/	1,619	1,617				
3. (i) (ii) (i) In foreign currency evaluated at current exchange rates	1,619	1,640				
3. (i) (ii) (i) (i) Transferable deposits in foreign currency evaluated at program exchange rate 7/	0	0				
3. (i) (ii) (i) (i) (i) Transferable deposits in foreign currency evaluated at current exchange rate	0	0				
3. (i) (ii) (i) (i) (ii) Standard gold deposits of government evaluated at fixed exchange rate and gold price (Lek mms.) 8/	1,619	1,617				
3. (i) (ii) (i) (i) (ii) Standard gold deposits of government at current exchange rate and gold price (Lek mms.) 8/	1,619	1,640				
3. (i) (ii) (i) (i) (ii) (i) Number of ounces of gold equivalent	36,484	36,438				
3. (ii) Assets held at deposit money banks	2,621	2,700				
3. (ii) (i) Deposits 9/	1,757	1,624				
3. (ii) (i) (i) Deposits in domestic currency	91	270				
3. (ii) (i) (i) (i) Transferable deposits in domestic currency	91	270				
3. (ii) (i) (i) (ii) Other deposits in domestic currency	0	0				
3. (ii) (i) (ii) Deposits in foreign currency evaluated at program exchange rates	1,666	1,354				
3. (ii) (i) (ii) (i) In foreign currency evaluated at current exchange rates 7/	1,666	1,349				
3. (ii) (i) (ii) (i) (i) Transferable deposits in foreign currency evaluated at current exchange rates	1,666	1,349				
3. (ii) (i) (ii) (i) (ii) Other deposits in foreign currency evaluated at current exchange rates	0	0				
3. (ii) (ii) Loans from government to DMBs	500	493				
3. (ii) (iii) DMB payables to government	364	583				
3. (iii) Held at savings and loan institutions 9/	0	0				
Less:						
4. Deposits of HHI and SSI	2,230	2,833				
Equals:						
5. Stock of Net domestic credit to central government (1+2-3-4)	268,102	273,867				
5. (i) Change since December 2003	...	5,765				
6. Memorandum items:						
6. (i) Current exchange rate (Lek/SDR, cop)	158.1104	157.5252				
6. (ii) Current exchange rate (Lek/US dollar, cop)	106.4	106.4				
6. (iii) Program exchange rate (Lek/SDR, cop) 10/	158.1104	158.1104				
6. (iv) Program price of gold (price in SDRs dollars per ounce as at end-December 2003)	280.6	280.6				
6. (v) Market price of gold (price in US dollars per ounce)	417.0	423.0				
6. (vi) Current exchange rate (US dollar per SDR, cop)	1.4860	1.4805				

1/ Evaluated at issue price.

2/ Evaluated at face value (data on treasury bill holdings of SLAs and other domestic lenders are currently available only at face value).

3/ Excludes accrued interest.

4/ Valued at face value (data on fixed and variable income securities held by DMBs are currently available only at face value).

5/ Includes accrued interest.

6/ Includes transferable deposits of government in domestic and foreign currency, lek deposits of central government for projects; and standard gold deposits of government (footnote # 6). Excludes all non-standard gold deposits; and excludes all nongold precious metal deposits of government; and excludes government deposits in foreign currency for projects.

7/ The reported lek value of foreign currency denominated assets of government will be converted to SDRs using the current end-of-period lek/SDR exchange rate, and then converted back to lek using the program Lek/SDR exchange rate of Lek 158.1104/SDR.

8/ Standard gold deposits are usable by government and therefore included in the definition of government assets. The lek value of standard gold deposits will be (a) converted to US dollars using the current end-of-period lek/US dollar exchange rate; (b) then converted to ounces of gold using the current market price of gold; then (c) converted to SDRs at the program price of gold of SDR280.6 per ounce; and then (d) converted to lek at the program Lek/SDR exchange rate of Lek 158.1104/SDR.

9/ Includes all deposits of central government.

10/ The program Lek/SDR exchange rate is the value of this rate at end-December 2003 (Lek 158.1104/SDR).



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July 14, 2004

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes Fourth Review Under PRGF Arrangement with Albania and Approves US\$6 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the fourth review of Albania's economic performance under the Poverty Reduction and Growth Facility Arrangement. The decision will enable the release of an amount equivalent to SDR 4 million (about US\$6 million), bringing total disbursements under its current PRGF arrangement to SDR 20 million (about US\$30 million).

The Executive Board also completed the financing assurances review and granted the authorities' request to waive the nonobservance of an end-March structural performance criterion, regarding the implementation of the ASYCUDA customs data management system and the initiation of an integrity audit. The system implementation was subsequently carried out.

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\$42 million).

Following the Executive Board discussion, Anne Krueger, First Deputy Managing Director and Acting Chair, said:

“Albania's performance during the second year of the PRGF-supported program has been satisfactory overall, with growth remaining strong, the external current account improving, and reserves accumulating in excess of program targets. Skillful management of liquidity by the Bank of Albania, and ongoing fiscal consolidation and debt reduction, contributed to a recovery in confidence, a strengthening of the currency, and the maintenance of low inflation. However, fiscal revenue shortfalls relative to the budget persisted, requiring significant expenditure reductions in 2003 to meet program targets. Implementation of structural reforms improved since the last review, and include the finalization of the sale of Savings Bank, administrative reforms of fiscal institutions, and actions to remove investment barriers.

“The proposed program includes fiscal adjustment measures in response to a reassessment of the revenue forecast for 2004; and the authorities' decision on the use of the Savings Bank privatization revenues—half of which will be spent on investment projects in priority areas, while the remainder will be used for debt reduction. The program also includes revenue-enhancing tax policy measures; and further structural reforms to improve the

management of fiscal institutions, governance, and transparency, and to support central bank independence and foster greater financial intermediation.

“Over the medium term, maintaining growth and external sustainability will require continuing on the path of fiscal consolidation, as well as further structural reforms to improve the business climate and attract export-generating foreign investment. Therefore, the structural reform agenda appropriately focuses on improving budget revenue mobilization and the efficiency of the public sector—including in the delivery of poverty-alleviating programs—as well as on strengthening governance and the rule of law, and removing administrative barriers to investment,”

Ms. Krueger said.

The PRGF is the IMF's most concessional facility for low-income countries. PRGF-supported programs are 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 5½-year grace period on principal payments.

**Statement by Pier Carlo Padoan, Executive Director for Albania
and Hari Vitas, Alternate Executive Director
July 14, 2004**

On behalf of the Albanian authorities, we would like to start by expressing our appreciation to the staff for the very productive consultations in Tirana and for preparing a comprehensive report, which provides a candid assessment of the program. We are also thankful to Fund management and the Executive Board for their continued support of Albania's economic reform and transition efforts.

In spite of the approaching mid-2005 general elections, the macroeconomic situation remains healthy and the country is demonstrating its continued strong commitment to the implementation of key structural reforms. All quantitative performance criteria for end-March have been met. The authorities are firmly confident that political considerations will not affect economic policy design nor the respect of obligations under the program, as there is wide consensus among different political parties on the positive role played by the agreement with the Fund.

Macroeconomic performance

From a macroeconomic standpoint, the country has made remarkable progress. Although starting from an uncertain situation, the authorities have set the stage for average output **growth** exceeding 7 percent in the period 1999-2003. In 2003, GDP growth recovered from the previous year's slowdown, reaching 6 percent, and it is forecast to maintain this trend over the coming years. Output growth has been mostly sustained by strong domestic demand but also by rapidly increasing exports. Merchandise export growth accelerated from 6 percent in 2002 to 19 percent in 2003.

The external position has been strengthened during 2003, reflecting positive developments in the trade balance and increased private remittances: the **current account** deficit is estimated to have fallen to 7.5 percent of GDP, overperforming the program target by one percentage point. The current account balance in 2004 is expected to remain unchanged with respect to 2003, thus surpassing the targeted goal by 0.6 percentage points of GDP.

Inflation has remained in the BoA target range of 2-4 percent, thanks to a firm monetary policy. As a symptom of increasing confidence, broad money composition is progressively shifting from cash holdings towards bank deposits (with an increase in the proportion of lek-denominated deposits). In 2004, subdued inflation pressures, improvement of the external position, and rising international reserves have allowed the central bank to gradually ease the monetary stance through three successive policy rate cuts.

Fiscal policy and debt position

Albania has made substantial progress towards achieving a sustainable public finance position over the recent years, reducing the overall fiscal deficit from more than 10 percent of

GDP in 1998 to 4.5 percent in 2003. The ambitious target for 2003 fiscal revenue was not met but authorities promptly intervened to offset the revenue shortfall (1.2 percentage points of GDP) by cutting expenditures, allowing the fiscal balance to surpass the target value by 0.8 percent of GDP. The fiscal deficit is expected to decline further in the coming years, with a view to reaching 4 percent of GDP by 2007, and this will gradually increase national savings and facilitate the expansion of credit to the private sector. Authorities are confident that the ongoing reform in tax administration will produce substantial revenue gains. Nonetheless, they agree to allocate these gains to spending only after they materialize.

The debt to GDP ratio has been put on a declining path, decreasing from 76 percent in 1998 to 57 percent in 2003, and the authorities aim at further reducing the debt burden to 53 percent of GDP by 2007. Moreover, the authorities decided to devote at least half of all future large privatization proceeds to additional debt reduction. About 2/3 of the overall public debt is denominated in local currency. The staff sustainability analysis points to a stable public debt in most adverse scenarios, contingent on unvarying output growth and continued fiscal consolidation.

Structural reforms

The authorities' main policy priority is to advance steadily with the structural reform agenda. Most structural reforms have recently regained momentum and it is acknowledged that it is appropriate to take advantage of the favorable macroeconomic situation to further speed up the reform drive and complete important restructurings that are still hindering the country's performance.

The authorities are demonstrating their intention to push ahead with the **privatization** process. The recent sale of the Savings Bank to a private international investor was a major achievement and provided new impetus to the dynamic development of the banking sector. The proceeds from the sale have been allocated to the reduction of the debt and to capital spending. The government has recently approved modifications to the legal package for the sell-off of the state-controlled companies of fixed telephony and oil services, Albtelecom and AMRO. These modifications seek to enhance the transparency of the privatization process as well as to enable foreign strategic investors to buy the entire 76 percent stake of Albtelecom and at least 51 percent of AMRO shares. The improved legal framework provides for an open international tender and sets clear criteria for the evaluation process.

Progress continues to be made in the implementation of the energy sector reform. During the first six months of 2004, KESH has significantly expanded its electricity distribution network and expects to complete the installation of the remainder of the network by the end of the year, with financial assistance from Italy. Importantly, for more than 21 months, KESH has been able to meet all the economic and financial objectives agreed with the donor community.

Good progress also continues to be made in the implementation of financial sector reforms. In addition to the successful privatization of the Savings Bank, and the speedy implementation of the Supervisory Development Plan for improving banking supervision, a

Deposit Insurance Agency has been set up and satisfactory progress is being achieved in implementing the Institutional Development Program, which aims to improve bankruptcy procedures and arrangements for secured financing.

Increased **financial intermediation** and the emergence of an efficient **payments system** are key for the development of a favorable economic environment, where savings are efficiently channeled to the corporate sector. Channeling transactions through the banking system is also instrumental for the reduction of the size of the informal economy and to improve law and tax enforcement. The authorities, the central bank and the banking and private business communities in Albania have recently agreed to work together with the World Bank Group in the framework of the so-called “Convergence” program to address these issues through a comprehensive set of initiatives. Moreover, it was recently decided to initiate arrangements for the payment of government wages through the banking system in order to facilitate financial intermediation and reduce the importance of cash transactions.

The authorities are aware that the improvement of the **business climate** is central to boost private-sector activity. They are therefore placing great importance on the reduction of administrative barriers to investment and business creation.

Since late-2003, a gradual modernization of the **tax and customs administration** as well as the **expenditure management system** has been initiated. The authorities are pushing ahead with a comprehensive reform agenda for the improvement of the fiscal policy framework, which includes tax revenue mobilization efforts, expenditure management enhancements and anti-corruption measures. The ongoing program to increase the use of information technology in this field aims at facilitating tax enforcement and reducing the scope for discretion. Cooperation with Italian statistics experts is already in place to improve national accounts methodology.

Significant other steps have also been taken to improve both the legal framework and its enforcement in the fight against organized crime and **corruption**. One of the main steps taken is the new anti-Mafia legal package, consisting of improvements in the current Criminal Code and amendments to the Code of Penal Procedures. A special draft law on measures against organized crime, trafficking, terrorism and corruption has also been prepared with foreign assistance. These measures are aimed at enhancing the efficiency of judicial bodies and other law enforcement agencies. Among the fundamental innovations of the new legislation is the provision for the imposition of sanctions in the form of the blocking and seizure of assets deriving from illegal activities. [Notable, too, is the progress made in eradicating human trafficking, no single instance having been identified or reported since 2003 by either the country’s police or by neighboring countries.]

The recent decision to introduce public-employee wage indexation has been made with the major aim of maintaining incentives to work in the public sector, in order to avoid quality employees fleeing to the private sector. The measure has been introduced against the backdrop of a low and declining inflation rate and a robust expansion in economic activity. It is therefore unlikely to have a significant adverse impact on the economy or the budget. The authorities are nevertheless aware of the possible longer-term negative effects of automatic wage indexation and for this reason they consider it a temporary measure.