

**Albania: 2004 Article IV Consultation, Fifth Review Under the Poverty Reduction and Growth Facility, Request for Extension of the Arrangement, and Financing Assurances Review—Staff Report; Public Information Notice and Press Release on the Executive Board Discussion; and Statement by the Executive Director for Albania**

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2004 Article IV consultation with Albania, fifth review under the Poverty Reduction and Growth Facility, request for extension of the arrangement, and financing assurances review, the following documents have been released and are included in this package:

- the staff report for the combined 2004 Article IV consultation, fifth review under the Poverty Reduction and Growth Facility, request for extension of the arrangement, and financing assurances review, prepared by a staff team of the IMF, following discussions that ended on December 16, 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 February 8, 2005. 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 Public Notice Information and Press Release, summarizing the views of the Executive Board as expressed during its February 28, 2005, discussion of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.
- a statement by the Executive Director for Albania.

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

Letter of Intent sent to the IMF by the authorities of Albania\*  
Memorandum of Economic and Financial Policies by the authorities of Albania\*  
Selected Issues Paper and Statistical Appendix  
Technical Memorandum of Understanding\*  
Ex Post Assessment of Longer-Term Program Engagement  
\*May also be included in Staff Report

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INTERNATIONAL MONETARY FUND

ALBANIA

**Staff Report for the 2004 Article IV Consultation, Fifth Review Under the Poverty Reduction and Growth Facility, Request for Extension of the Arrangement, and Financing Assurances Review**

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

Approved by Ajai Chopra and Donal Donovan

February 8, 2005

- Discussions for the 2004 Article IV consultation, fifth review under the PRGF and financing assurances review were held in Tirana during December 1–16, 2004. The Ex Post Assessment (EPA) report was also discussed with the authorities. The mission met with Prime Minister Nano; Ministers Malaj (Finance), Angjeli (Economy), Doda (Industry and Energy), and Poçi (Transport and Communications); Bank of Albania (BoA) Governor Fullani; parliamentarians; senior officials; academics; and representatives from business sectors, civil society, and the international donor community. The staff team comprised Messrs. Escolano (head), Lazar, Oestreicher (EUR), Dalgic (FAD), Mansilla (PDR), Olters (resident representative), and Ms. Spahia (resident representative's office). Mr. Gola (Executive Director's office) assisted in the discussions.
- The 2002 Article IV consultation was concluded on February 26, 2003. The current arrangement, in an amount equivalent to SDR 28 million (57 percent of quota), was approved on June 21, 2002 (IMF Country Report No. 02/135) and the fourth review was completed on July 14, 2004 (IMF Country Report No. 04/206). An FSAP is planned for early-2005. 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.
- In the attached Letter of Intent and Supplementary Memorandum of Economic and Financial Policies (MEFP) the authorities request completion of the program and financing assurances reviews; and a five-month extension of the program to November 2005 to allow for the sixth review and associated disbursement to take place within the program period.

	Page
Executive Summary .....	4
I. Introduction.....	5
II. Recent Developments .....	7
III. Report on the Discussions.....	10
A. Macroeconomic Outlook.....	11
B. Monetary and Financial Sector Policies.....	12
C. Fiscal Policy .....	15
D. Poverty Alleviation and Other Structural Reforms.....	19
E. External Policies.....	23
F. Program Issues.....	24
IV. Staff Appraisal .....	25
 Text Boxes	
1. National Accounts Revisions.....	10
2. Dollarization and the Financial System.....	13
3. 2005 Fiscal Package.....	17
4. Poverty Issues .....	20
5. Structural Conditionality.....	23
 Figures	
1. Economic Developments and Prospects, 1994–2004 .....	28
2. Monthly Economic Indicators, 2000–04 .....	29
3. Monetary Developments.....	30
 Tables	
1. Basic Indicators and Macroeconomic Framework, 2000–09 .....	31
2. Millennium Development Goals.....	32
3. Balance of Payments, 2001–09.....	34
4. Performance Criteria and Structural Benchmarks under the PRGF Arrangement .....	35
5a. General Government Operations (In percent of GDP) .....	36
5b. General Government Operations (In billions of Lek).....	37
6. Priority Expenditure.....	38
7. Monetary Aggregates, 2002–09.....	39
8. External Public and Publicly Guaranteed Debt Stock by Creditors, 1997–2004.....	40
9. External Financing Requirement and Sources, 2001–07.....	41
10. Indicators of External and Financial Vulnerability, 1997–2004 .....	42
11. Projected Payments to the Fund as of December, 2004 (In millions of SDRs).....	43

12. Indicators of Fund Credit, 1998–2004.....	44
13. Schedule of Disbursement Under PRGF Arrangement.....	45

Appendices

I. Fund Relations.....	46
II. IMF-World Bank Relations.....	48
III. Statistical Issues.....	54
IV. Debt Sustainability Analysis.....	59
V. Letter of Intent and Supplementary Memorandum on Economic and Financial Policies Attachment I: Technical Memorandum of Understanding.....	64

## EXECUTIVE SUMMARY

After a slowdown in 2002, Albania's macroeconomic performance has been commendable: growth has been 6 percent in 2003–04 with low inflation, and the lek has appreciated reflecting increasing confidence. The public debt-to-GDP ratio has fallen from nearly 67 percent at end-2001 to about 55 percent at end-2004, and external liabilities, at 17 percent of GDP, are limited. However, despite a narrowing of the external deficit, the trade deficit remains wide and the economy is dependent on transfers from abroad—as a broad-based export-driven expansion has not yet taken root. Thus, improving competitiveness and attracting investment are key priorities. Performance under the program since the fourth review has been good and program conditionality was observed, some with significant margins. The political environment is dominated by the upcoming mid-2005 elections.

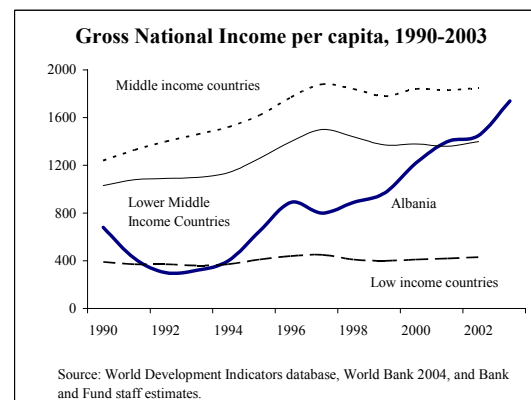
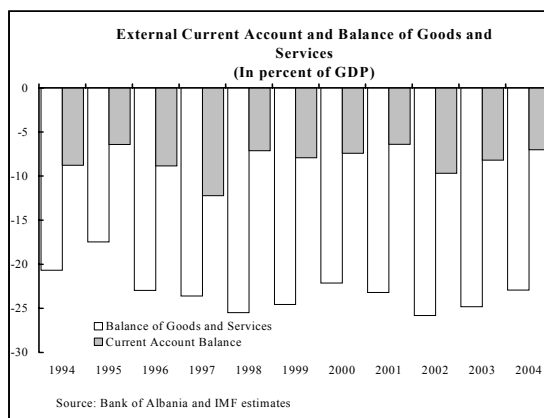
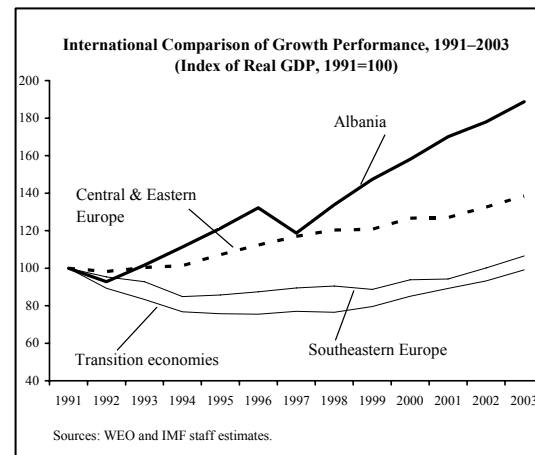
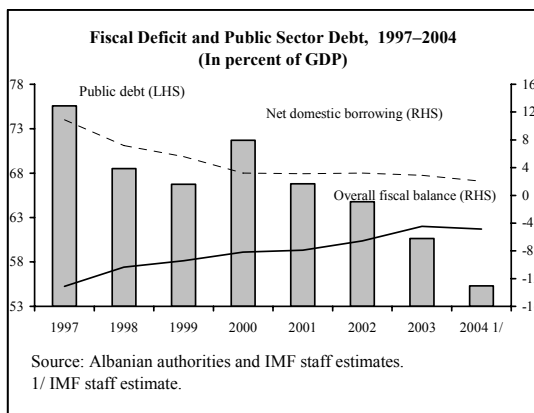
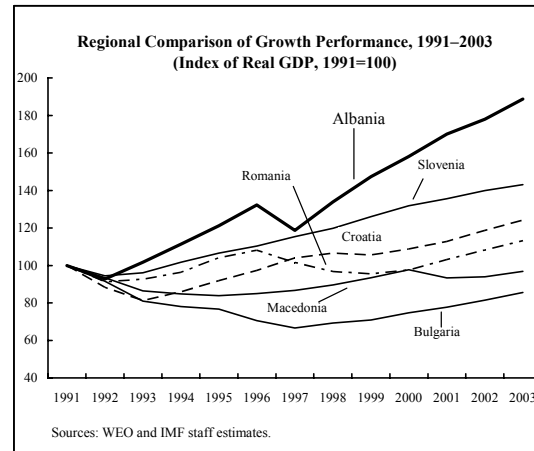
**Policy discussions** focused on maintaining macroeconomic stability, strengthening the monetary, financial, and budget policy frameworks, and improving the investment climate. The accompanying Ex Post Assessment was also discussed with the authorities.

- The outlook is for growth to remain close to its 6 percent trend supported by domestic demand in the near term, and then increasingly by productivity and external trade gains in the medium term. However, maintaining this growth pace will require significant improvements in infrastructure and the business climate, including governance, property rights protection, and the rule of law.
- The newly appointed management of the Bank of Albania (BoA) reiterated the commitment to a strong monetary policy framework based on BoA independence, price and financial stability, and a flexible exchange rate. The monetary stance remains tight, but the current neutral bias is appropriate. In the wake of the large Savings Bank privatization, the financial sector is showing welcome dynamism and the BoA is stepping up prudential vigilance. The upcoming FSAP will contribute to these efforts. Financial intermediation is expanding, helped by the authorities' initiatives to build market infrastructure and curtail the use of cash—including by paying public wages through the banking system. Dollarization hinders the monetary policy transmission mechanism, but does not pose an immediate financial stability threat.
- Staff supported the 2005 budget, which embodies further fiscal and public debt retrenchment. It envisages current spending restraint leading, for the first time, to a current surplus—thus, providing for increased public investment. The budget is premised on a realistic projection of revenue, which should help planning and implementation. Discussions covered policies to improve tax compliance, taxpayer rights, budget process, expenditure management and civil service reform. In this context, the authorities agreed to refrain from across-the-board wage increases in 2005 and will formally eliminate inflation indexation of wages before the 2006 budget.
- Other structural reforms have experienced increased momentum, notably privatization, electricity sector restructuring, and national accounts statistics. But further progress in infrastructure provision, economic statistics, and investment climate is needed. Indicators of absolute poverty have improved reflecting increasing incomes, but targeted social programs need strengthening.

The accompanying supplementary Memorandum of Economic and Financial policies constitutes a strong policy program and staff supports completion of the 2004 Article IV consultation, fifth review of the program, and financing assurances review.

## I. INTRODUCTION

1. **The overall macroeconomic performance of the Albanian economy has been remarkable (Table 1).** After a slowdown in 2002, growth has recovered to about 6 percent; inflation has declined, with the 12-month rate generally remaining within the 2–4 percent target of the Bank of Albania (BoA); the lek has shown an appreciating trend reflecting increased confidence; and the external current account and trade deficits, although still high, have improved. This performance has been supported by sound monetary and financial sector policies, fiscal consolidation, privatization, and structural reforms in selected areas. Public indebtedness has declined steeply, by 9½ percentage points of GDP since end-2002, to 55¼ percent of GDP at end-2004. More broadly, since 1998, output has increased at an average annual rate over 6½ percent and per capita income has



doubled (Figure 1). This has resulted in reductions in absolute poverty (Table 2), although one fourth of the population is still below the poverty line and poverty alleviation remains a key challenge.

**2. The continuation of high growth, however, cannot be taken for granted as a self-sustained, broad-based expansion of tradeable output has not yet taken root.**

Expansion of the market economy and an open trade regime have generated large increases in productivity through reallocation of resources since the start of the transition (the private sector now accounts for about ¾ of GDP). However, analyses by Fund and World Bank (WB) staff indicate that this source of total factor productivity (TFP) growth may be waning.<sup>1</sup> In particular, nontradeable sectors have contributed most of the growth. In contrast, the contribution from industry has been modest.

Although in 2002–04 the current account deficit narrowed from 10 to 7 percent of GDP reflecting trade gains, it remains high—as does the goods and services trade deficit, which was 23 percent of GDP in

Contributions to economic growth 2003-04 (in percent)		
	2003	2004
Agriculture, Hunting and Forestry	0.8	1.0
Industry	0.3	0.3
Construction	0.9	0.5
Trade and services	3.2	3.2
Transport	0.9	0.9
GDP at factor cost	6.0	5.9

Sources: Albanian authorities and IMF staff estimates.

2004 (Table 3). This trade deficit has largely been covered by migrant remittances and other private and official transfers from abroad, buttressing incomes and domestic demand. But remittances and transfers cannot be relied upon to sustain the current fast growth pace for much longer. Indeed, these sources can be expected to decline over time as a share of GDP.

**3. Therefore, looking towards the future, the challenge will be to foster significant increases in competitiveness and high quality investment.**

The recent prosperity of tourism-related activity and selected exports—textile, footwear, and vegetables—may

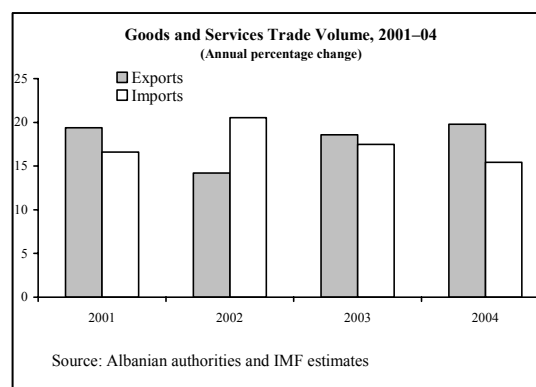
harbinger a new export-based growth phase, but it is still in an early stage. Albania’s growth track record and the macroeconomic stability gained in

	SE Europe: Foreign Direct Investment	
	Average 1997-2003	
	In US \$ millions	In percent of GDP
Albania	114	2.7
o/w related to privatizations	23	0.6
Bosnia and Herzegovina	147	2.8
Croatia	1,129	5.6
Macedonia	137	3.6
Serbia and Montenegro	405	2.6

<sup>1</sup> See associated EPA (www.imf.org). Also, a WB growth accounting exercise indicates that whereas TFP growth explains most of the 1993–2003 increase in productivity, it has decelerated in recent years (“Albania: Sustaining Growth Beyond the Transition,” World Bank Country Economic Memorandum, December 2004).



recent years should provide an excellent starting point to attract the strategic domestic and foreign direct investment with the scale, technology and know-how needed to spark a new growth phase based on external competitiveness. But progress in this direction will require substantial improvements in infrastructure, as well as in governance and the institutional investment environment—including in areas beyond traditional economic policies, such as strengthening the rule of law, defining and enforcing property rights, and reforming the court system.



4. **This analysis and policy perspective has been at the core of earlier IMF Board discussions and has been incorporated in the authorities' Poverty Reduction Strategy Papers (PRSPs).**<sup>2</sup> On occasion of the 2002 Article IV consultation, and more recently, at the conclusion of the fourth review, Directors praised the good macroeconomic performance of Albania, fiscal consolidation, adept monetary and prudential policies, and selected structural reforms. Nevertheless, Directors also pointed out that a broad-based export-driven expansion had not yet taken hold and stressed the need to accelerate structural reforms, improve physical and financial infrastructure, and strengthen governance and the rule of law.

## II. RECENT DEVELOPMENTS

5. **Since the fourth review, performance under the program has been good and all program conditionality has been observed.** Quantitative and structural performance criteria for end-September 2004 and the structural performance criterion for end-2004 were all met, some with significant margins (Table 4). Tax collections have met program projections although foreign project-related disbursements and grants continued to underperform. In response, fiscal spending was contained to meet program targets on domestic borrowing—resulting in an overall deficit lower than programmed by

	2004		
	Budget 1/	Program	Estimate
Total Revenue and Grants	25.4	24.8	23.7
Tax Revenue	21.9	21.6	21.3
Non-tax Revenue	2.7	2.3	2.0
Grants	0.8	0.8	0.4
Total Expenditure	31.7	30.9	28.5
Current Expenditure	24.0	23.8	23.4
Capital Expenditure	7.1	6.6	5.2
Overall Balance	-6.3	-6.2	-4.9
Domestic Financing	4.5	4.5	4.1
of which: Domestic Borrowing	2.0	2.0	2.0
Foreign Financing	1.8	1.7	0.8
Current Balance	0.5	0.1	-0.1
Public debt	61.5	58.6	55.3

Sources: Ministry of Finance; and staff estimates.  
1/ Incorporates the Supplementary Budget.

<sup>2</sup> The PRSP is known in Albania as the *National Strategy for Socio-Economic Development* (NSSED). See IMF Country Report No. 04/2004.

1¼ percentage point of GDP (Tables 5a, 5b, and 6). Monetary conditions have stayed tight and both BoA's net domestic assets and international reserves also overperformed, resulting in a comfortable 4-month reserve import cover (Table 7).

6. **Some structural reforms gained momentum in 2004—notably privatization, financial framework development, electricity sector restructuring, customs modernization, and budget process.** The successful privatization of the large Savings Bank (more than half of banking sector deposits) has revamped banking activity. In addition, notable progress has been made on the privatization of other large public enterprises—i.e., INSIG (insurance), Albtelecom (fixed-line telecom) and ARMO (refinery)—and on implementation of the Power Sector Action Plan (PSAP), allowing the elimination of electricity import subsidies in the 2005 budget. Customs modernization with EU assistance—e.g., deploying the ASYCUDA system in the main custom houses (a program performance criterion)—has tangibly improved efficiency and revenue. The average custom clearing time has been reduced from more than five days in 2003 to below two days, and seizures and cases submitted for prosecution have increased steeply—the latter more than fivefold. Nevertheless, much remains to be done on tax administration, and taxpayer harassment and poor professionalism of some public servants are consistently singled out by private sector bodies as key investment deterrents. The 2005 budget discussion process incorporated substantial advances in transparency, civil society participation, and supporting analyses and information—including much improved revenue forecasts and the simultaneous presentation for parliamentary discussion of the Medium-Term Expenditure Framework (MTEF).<sup>3</sup>

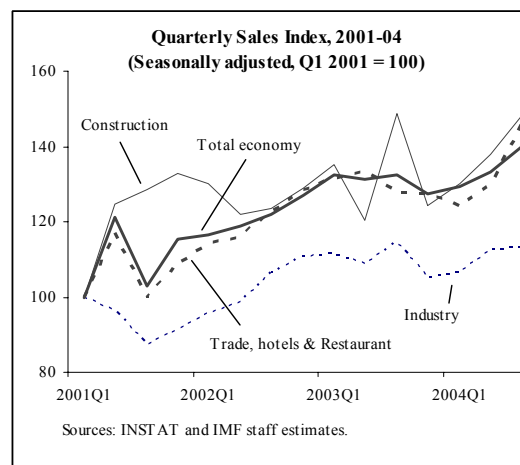
7. **However, progress on wider institutional reforms, mostly beyond the scope of the program, has been protracted and suffered from increasing polarization in the run-up to the mid-2005 general elections.** Multilateral and bilateral donors are providing assistance on a broad range of political and institutional reforms, but progress has been slow. Partly as a result, ongoing negotiations on a Stabilization and Association agreement with the EU have not yet been concluded. In its early-2004 Stabilisation and Association Process report, the European Commission called for greater authorities' commitment in fighting organized crime, human trafficking, money laundering and corruption. Some significant steps, however, have been taken in 2004, including the implementation of asset disclosure requirements for public officials, passage of the property restitution law, and active anti-money laundering collaboration.

8. **Turning to economic activity, output accelerated during the second half of 2004, after a weak start at the turn of the year, to an annual rate of about 6 percent.** While statistical evidence is scant, it seems that output decelerated substantially by end-2003, partly due to stricter enforcement of urbanistic regulations that dampened construction activity, and to restrained public spending. However, activity picked up in

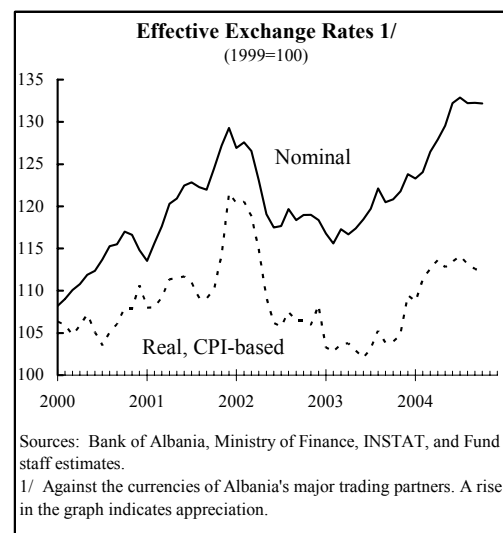
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<sup>3</sup> Known in Albania as the Medium-Term Budget Plan (MTBP).

2004Q2 underpinned by favorable weather conditions that boosted agricultural and agro-processing production, and electricity supply aided by sectoral performance improvements. Output accelerated further in the summer supported by a strong tourism season, increased remittances, and public investment. Based on partial indicators of turnover, annual GDP growth in 2004 is estimated at about 6 percent—subject, however, to a wide uncertainty margin.



9. **In 2004, the external position strengthened further, exceeding programmed levels, reflecting trade gains and the accounting effect of the lek appreciation.** Indications of strong migrant remittances and tourism earnings; growth in re-export processing activities; and subdued imports due to increased domestic supply of strategic products (electricity, foodstuffs) point to a decline of the current account deficit to 7 percent of GDP in 2004—compared to 8 percent of GDP envisaged in program and to 8¼ percent of GDP in 2003. Reflecting an improved external outturn and firming confidence, the lek has appreciated about 6 percent with respect to the euro during 2004 despite easing domestic interest rates and occasional BoA interventions. In this regard, while Albania’s cost advantage remains wide, competitiveness may be starting to erode.



10. **In collaboration with staff, INSTAT published recently 2001–02 national accounts—incorporated in this paper—resulting in a 7 percent lower nominal GDP level (Box 1).** Beyond this level effect, the revisions do not alter the assessment of the recent past (for which national accounts are not yet available).<sup>4</sup>

<sup>4</sup> To facilitate comparisons, all GDP-share figures (including the program), are presented as ratios to the new GDP in this report.

### Box 1. National Accounts Revisions

The first national accounts for Albania, published in 2003, covered the period 1996-2001. In September 2004, INSTAT issued 2002 national accounts and revised 2001 estimates. Figures for periods after 2002 are preliminary estimates or projections agreed with the authorities, but have no national accounts support. The main revisions introduced by the new national accounts estimates are as follows.

- Real GDP growth in 2002 has been corrected downwards reflecting a sharper drop in electricity output and lower growth in industry and services.
- Both 2001 and 2002 GDP deflators are now lower.
- As a result, 2002 nominal GDP is now 7 percent lower than in previous staff reports—a difference carried forward.

Other revisions for years after 2002 reflect estimates of activity in 2004, lek appreciation, and WEO projections, including oil prices.

	2000	2001	2002	2003	2004	2005	2006
Nominal GDP (lek billion)							
Current estimate	531	589	630	695	780	857	939
Previous estimate 1/	531	610	678	746	837	920	1007
Difference (in percent)	0	-3.6	-7.0	-6.9	-6.8	-6.8	-6.8
Real GDP growth (in percent)							
Current estimate	7.3	7.2	3.4	6.0	5.9	6.0	6.0
Previous estimate 1/	7.3	7.6	4.7	6.0	6.2	6.0	6.0
Difference (in percent)	0.0	-0.4	-1.3	0.0	-0.3	0.0	0.0

Sources: INSTAT for 2000-02; staff estimates and projections thereafter.

1/ IMF County Report No. 04/206.

### III. REPORT ON THE DISCUSSIONS

11. **Discussions centered on the program objectives of cementing macroeconomic stability, building up solid institutional frameworks for macroeconomic policy implementation, and improving the investment climate.** The authorities see the ongoing expansion in financial intermediation as the cornerstone for expanding private investment and moving economic activity into the formal sector. Thus, nurturing confidence in the monetary policy framework and promoting financial development are key priorities. Given the low level of external debt (17¼ percent of GDP, mainly official assistance), the sustainability of public finances hinges on reducing the domestic borrowing requirement and domestic debt, while the overall deficit is capped by the availability of donors' assistance. Structural reforms on the fiscal area focus on channeling increasing resources to investment in priority areas and improving the quality of fiscal institutions—including by strengthening governance and implementation capacity. Other structural reforms

encompass privatization, sectoral restructuring, and removing barriers to investment—aiming at promoting private sector development and completing the transition to a modern rules-based market economy.

12. **The authorities agreed with the thrust of the staff's analysis and recommendations.** In particular, there was agreement on the importance of medium term-oriented structural reforms within the policy agenda. While there has been progress in this area, stability of purpose and consistent implementation will be essential.

#### A. Macroeconomic Outlook

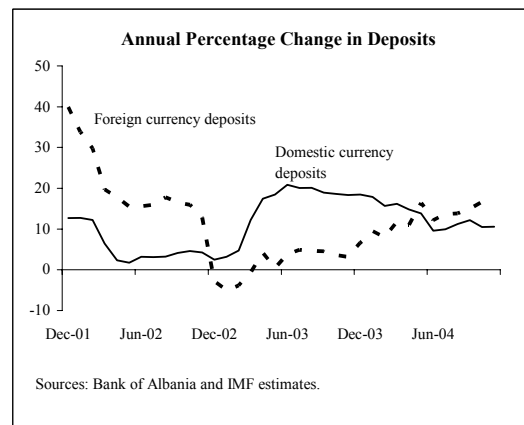
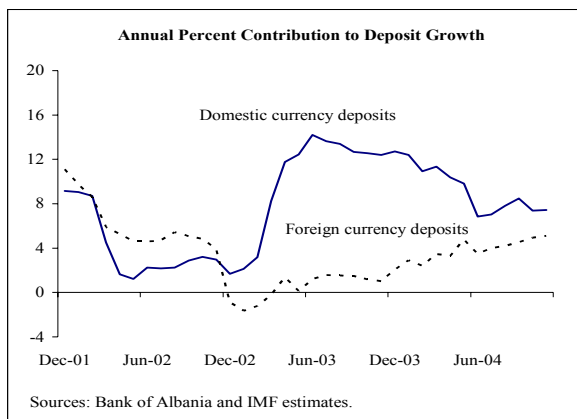
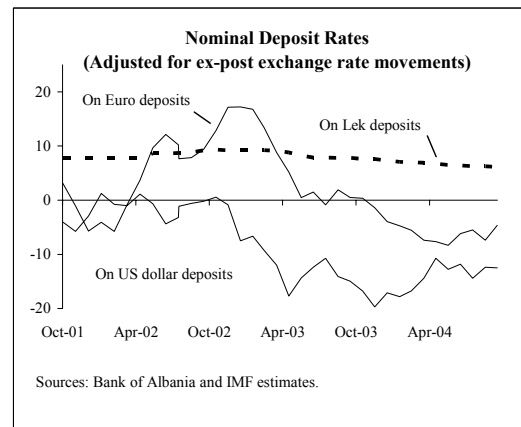
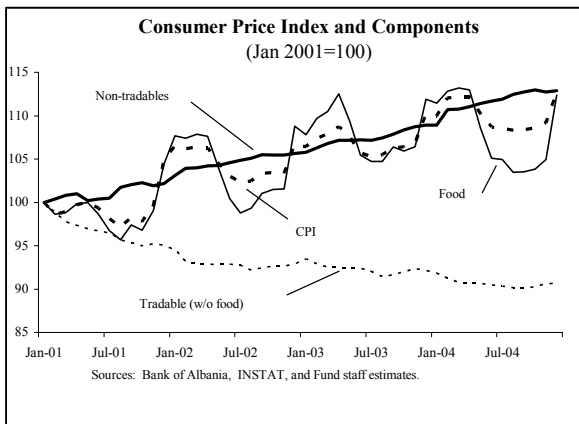
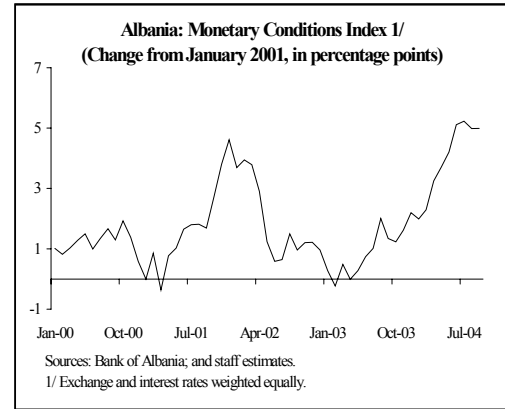
13. **The authorities envisaged 6 percent growth in 2005, which underlies budget projections, or possibly even somewhat higher.** Staff concurred that a number of arguments supported this scenario, but with some downward risk. Domestic demand appeared robust and activity was accelerating, further buttressed since the summer by increased public investment and planned privatizations that would attract FDI and support investors' confidence. Banking intermediation and domestic lending was also growing and several banks had started to tap the consumer credit market. The external current account deficit (before official transfers) is projected to remain broadly unchanged as a share of GDP, as export growth is offset by the negative impact of oil price increases and a deceleration of external transfers. On the downside, however, the external environment will probably be less expansionary than in 2004, particularly with a stronger lek, and investment could slow down owing to electoral uncertainties.

14. **Over the medium term, under the assumption of an improved investment climate, growth can remain close to its historical 6 percent trend.** This expansion, however, is predicated on rising exports and productivity, as structural reforms, improvements in the business climate, financial intermediation, and credit facilitate investment. Reforms to improve the efficiency of tax administration and budget expenditure are envisaged to protect fiscal consolidation gains, while gradually permitting greater expenditure on infrastructure and poverty alleviation. As export earnings and domestic savings expand, the external deficit is projected to resume a downward trend, although possibly remaining around 5–5½ percent of GDP in the medium term owing to capital inflows and associated imports.

15. **The main risks to this scenario stem from possible floundering on structural and institutional reforms.** With low external liabilities, debt sustainability analyses (DSAs) reveal limited vulnerability (Appendix IV). Under the central projection, DSAs point to a steady improvement of the external and public finance positions—a robust outcome under most stress tests. Nevertheless, the DSAs also show that curtailing the trade deficit and sustaining high growth are essential to debt sustainability. Should investment and exports disappoint, output growth could be significantly lower: while imports would also undershoot projections to some extent, the bulk of adjustment would need to fall on domestic absorption.

## B. Monetary and Financial Sector Policies

16. **Despite interest rate cuts, the monetary policy stance has remained tight and inflation subdued—against the backdrop of a strengthening banking sector.** The BoA’s independence and determination in pursuing its price and financial stability mandates has built credibility on the monetary and financial frameworks, and anchored inflation expectations after the 2002 depreciation and banking stress episode. Although the BoA’s policy rate has gradually eased since 2002 by 325 basis points to 5¼ percent, it has remained high—which jointly with the lek appreciation resulted in tight monetary conditions. Price pressures were further muted in 2004 by abundant agricultural supply, with the 12-month rate of inflation closing 2004 at 2.2 percent. Responding to lower perceived risk and interest rate differentials, the composition of broad money has started to shift away from cash towards bank deposits—with the bulk of their growth contributed by lek deposits (Figures 2, 3, Box 2). In the wake of the Savings Bank privatization, the

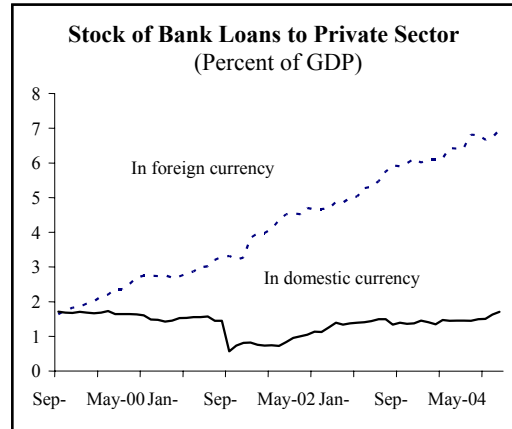
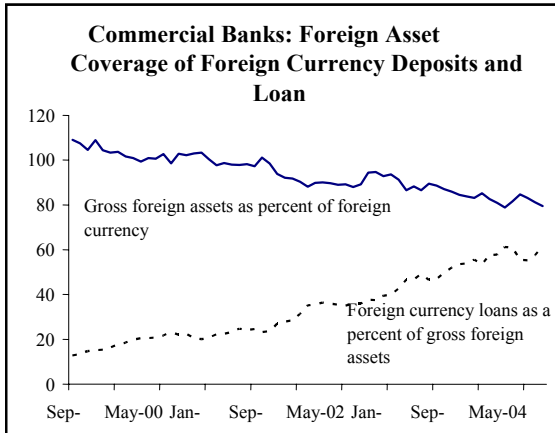
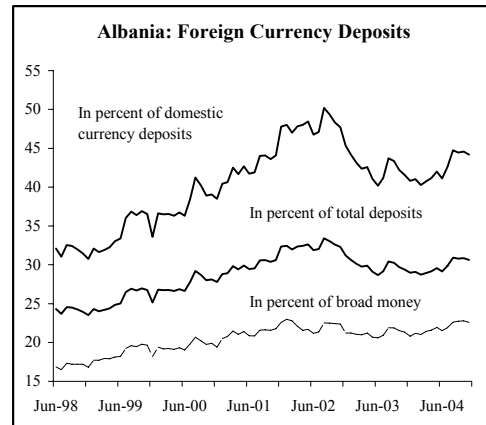


banking sector is now fully under private management, and the BoA is reinforcing the prudential and payment system frameworks with MFD and WB TA, in anticipation of growing credit activity.

### Box 2. Dollarization and the Financial System<sup>1</sup>

**Following the collapse of the pyramid schemes, dollarization increased.**

However, even at its peak in late 2002, it remained at relatively moderate levels—below the average for transition countries. Dollarization of deposits has since declined in response to tighter monetary policy. Lending to the private sector, however, still takes place mostly in foreign currency. Potential risks to financial stability are mitigated by limits on banks’ open foreign currency positions, strict lending criteria, and large asset positions abroad. Looking forward, banks are expected to continue substituting domestic for foreign assets, and to increase lek-denominated lending.



Sources: Bank of Albania; and IMF staff estimates.

<sup>1</sup> An accompanying Selected Issues paper analyzes dollarization in Albania.

17. **The newly appointed management of the BoA reaffirmed its commitment to price stability, a flexible exchange rate regime, and central bank independence.** Although parliamentary appointment of the new BoA Board and Governor had suffered delays and at times become politicized, the authorities provided assurances of their commitment to BoA independence and a strong monetary policy framework. In this regard, the Treasury’s overdraft facility with the BoA (which is seldom used, and always for

liquidity management and not for budget financing) is to be phased out, starting 2005; and government securities have been issued to the BoA to cover the reserve valuation losses stemming from the lek appreciation in accordance with the Central Bank Law (MEFP ¶18). Staff supported BoA's plans to reinforce its analytical and forecasting capabilities. In order to raise the understanding of policy actions by financial market participants and enhance the leading role of the BoA in setting expectations, staff recommended that Board meetings be followed by public statements explaining the Board's policy stance.

18. **There was also agreement that foreign exchange interventions should keep aiming at smoothing out fluctuations, maintaining reserve cover, and facilitating the shift towards lek assets of private sector balance sheets—without any exchange rate target.** There had recently been public calls for the BoA to counteract actively the strength of the lek. However, the authorities consider that, while the lek appreciation has resulted in some temporary loss of competitiveness, monetary policy should stay focused on the inflation target. Moreover, the appreciation with respect to the US dollar is largely explained by the evolution of the euro—which the lek broadly tracked during the second half of 2004.

19. **With inflation subdued and the lek appreciating, the BoA's gradual easing of its policy stance had been appropriate, but there was agreement that a pause was now warranted.** Over 2004, increased lek demand, appreciation, and favorable domestic supply conditions had allowed the interest rate to reach record lows without triggering inflation. At the time of the discussions, however, expectations of price increases around the holidays, agricultural output seasonality, and the possible lagged effect of higher international oil prices argued for a waiting period with neutral bias before any further repo rate move.

20. **The authorities are undertaking reforms to foster financial intermediation, curtail the use of cash in the economy, and strengthen prudential supervision.** Credit to the private sector is still low (8½ percent of GDP in 2004), but it is growing fast at 30 percent annually and the banking sector is showing welcome dynamism and expanding the range of its products. Supporting this process, the BoA successfully introduced a real-time gross settlement system and plans to launch in 2005 a bulk clearing system for small transactions that will facilitate the payment of bills, credit card use, and other services through the banking system. The government is channeling the payment of salaries through banks, rather than using cash—which will improve governance and expenditure management as well as household access to financial services (MEFP ¶16). The authorities are also considering the development of an inter-bank collateralized money market and foreign exchange swaps to foster better liquidity management and mitigate spot market shocks. In staff's view, measures to deepen the T-bill market also warrant consideration—including extending participation to large enterprises and introducing market-making arrangements. With MFD and WB assistance, the authorities are upgrading their prudential monitoring capacity and taking an increasingly proactive approach to supervision. In this vein, the authorities see the 2005 FSAP as an opportunity to assess financial stability issues



and chart future improvements in the monetary framework and supervisory capacity, including in the incipient insurance sector.

Albania: Banking Sector Indicators			
	2002	2003	2004 1/
Outstanding Bank Loans by Economic Sector in percent of total			
Trading and maintenance of durables	40.4	34.0	21.9
Processing industry	17.0	17.0	18.2
Real estate	9.1	13.0	15.6
Construction	8.6	10.0	10.2
Hotels and restaurants	6.0	6.0	8.3
Agriculture, hunting and fruit production	0.8	1.0	1.6
Other	18.1	19.0	24.2
Indicators of Banking Sector Soundness			
Regulatory capital as a percent of risk weighted assets	31.6	28.5	25.1
Non performing loans as a percent of total loans	5.6	4.6	4.7
Non performing loans net of provisions as a percent of capital	4.8	3.9	3.4
Non performing loans as a percent of total assets	0.3	0.2	0.2
Return on assets (on an annual basis)	1.2	1.2	1.4
Return on equity (on an annual basis)	19.1	19.5	23.7
Liquid assets to total assets (liquid asset ratio)	77.8	73.6	73.5

Source: Data provided by Bank of Albania.  
1/ As at September 2004.

### C. Fiscal Policy

21. **The public finances have strengthened substantially over the past few years, but progress on budget process and administration has lagged behind.** The overall deficit improved by about 3 percentage points of GDP in 2002-2004, reflecting expenditure retrenchment. But, although tax collections have increased somewhat, primarily as a result of tax policy measures, tax and customs administrations' capacity remains low. Progress in budget implementation, expenditure planning and control, and investment in priority areas

Albania: Budget Performance  
(In percent of GDP)

	2002		2003		2004		2005
	Budget	Actual	Budget	Actual	Budget 1/	Est.	Budget
Total Revenue and Grants	25.7	24.5	26.0	24.0	25.4	23.7	24.1
<i>of which:</i> Tax Revenue	22.0	20.5	22.1	20.9	21.9	21.3	21.3
Total Expenditure	34.6	31.1	32.1	28.5	31.7	28.5	29.0
<i>of which:</i> Current Expenditure	26.3	24.5	24.2	24.1	24.0	23.4	22.7
Overall Balance	-8.8	-6.6	-6.1	-4.4	-6.3	-4.9	-4.9
Domestic Financing	4.3	3.3	3.0	3.0	4.5	4.1	3.3
<i>of which:</i> Domestic Borrowing	2.5	3.2	2.9	2.9	2.0	2.0	2.7
Foreign Financing	4.5	3.3	3.1	1.4	1.8	0.8	1.6
Current Balance	-1.2	-0.7	1.1	-0.5	0.5	-0.1	0.5
Public debt	69.5	64.8	67.1	60.7	61.5	55.3	54.5

Sources: Ministry of Finance; and staff estimates.

1/ Incorporates the Supplementary Budget.

have been undermined by repeated over-optimistic budget revenue projections—resulting in haphazard spending cuts when expected resources failed to materialize.

22. **In 2004, the authorities stayed the course of fiscal consolidation and, after downward adjustments to revenue and expenditure projections during the fourth review, budget implementation has improved.** Through a supplementary budget, the authorities allocated the Savings Bank privatization proceeds to investment and debt reduction in equal parts, which jointly with a limited deficit, lek appreciation, and GDP growth, resulted in a decline of 5½ percentage points in the debt-to-GDP ratio. In 2004, the current budget is estimated to have been in broad balance, for the first time since transition. Thus, budget financing—including borrowing and privatization receipts—funded only investment.

23. **The 2005 budget embodies further reduction of the underlying domestic borrowing and debt, improvements in spending composition, and a realistic revenue projection.** Staff supported the budget submitted to Parliament—including through meetings with legislators. The 2005 budget envisages a reduction in underlying domestic borrowing (i.e., excluding the effects of the Savings Bank privatization) by 0.2 percentage points of GDP to 2.7 percent of GDP. This will help to accommodate the expected expansion of private sector credit without triggering inflation and to maintain the public debt-to-GDP ratio on a downward trend. While increasing somewhat total spending as a share of GDP, it plans a reduction in current outlays—thus, redirecting resources to investment in priority areas and further improving the current balance. Crucially, the expenditure plans are based on a credible revenue forecast, based on past realizations and not on previous over-optimistic budgets that remained under-realized. The budget also envisages the divestment of the remaining minority stakes in banking and other companies. The ongoing privatization of Albtelecom has not been budgeted given uncertainties as to its timing and amount. The authorities, however, reiterated their commitment to continue devoting half of the proceeds of all large privatizations to debt redemption.

24. **While the 2005 fiscal package is a significant first step, substantial additional efforts are needed to modernize and enhance the efficiency of revenue administration (MEFP ¶12).** The authorities plan to expand ASYCUDA to the remaining custom houses and apply risk assessment methods for inspections. Staff argued that, likewise, tax administration reforms should emphasize the implementation of standardized procedures and risk assessment methods, strict application of existing regulations (reforming them if necessary), training and professional qualification of tax officials, fair and professional taxpayer relations, and extensive use of information technology. Staff supported the thrust of the 2005 fiscal package along these lines, including the implementation of many FAD TA recommendations (Box 3). But it argued against some of the measures included in the package: The introduction of a VAT exemption of providers to exporters and filing requirements beyond the monitoring capabilities of the tax administration risk adding opportunities for noncompliance. The authorities agreed to discuss these issues with upcoming FAD TA, supplementing the enacted package as necessary. Also, the authorities

have adopted a plan to clear VAT refund arrears to exporters (0.1 percent of GDP) and implement a quick refund system in 2005.

### **Box 3. 2005 Fiscal Package**

**The 2005 fiscal package aims at improving revenue administration.** The cost of the package is about 0.3 percent of GDP in 2005. Its main measures are the following.

#### **Reducing administrative complexity and tax evasion:**

- subjecting the first sale of residential units to VAT, while exempting rental payments starting in 2006;
- eliminating the requirement for small businesses to renew their registration every year;
- reducing the number of personal income tax brackets to 5 from 7;
- including social security contributions in the base of the personal income tax;
- introducing personal income tax returns.

#### **Bringing tax obligations on businesses closer to the regional average:**

- reducing the corporate income tax rate from 25 percent to 23 percent in 2005, and to 20 percent in 2006;
- reducing the small business tax rate on turnover from 4 percent to 3 percent;
- exempting from VAT sub-contractors of re-export companies;
- shortening from 6 to 3 months the obligatory carry-forward period before reimbursement of VAT credit.

#### **Strengthening taxpayers' rights:**

- strengthening appeal procedures with clear steps for appeal escalation and time limits for issuing decisions;
- limiting the response period for VAT refund requests (before interest charges apply) to 30 days;
- introducing accrual of interest on overdue tax refunds.

25. **Other structural reforms in the fiscal area also need to be accelerated with a focus on improving the budget process, expenditure management, and civil service and public pay reform (MEFP ¶13).** The mission discussed means to enhance the medium-term orientation of the budget, including by casting it on a rolling multi-year projection. The authorities plan to build up capacity to manage expenditure and monitor investment projects that extend over the medium term, including by introducing information technology and strengthening public procurement and tendering procedures. In this regard, staff expressed concern about the Tirana-Rinas-Durrës railway project which, after receiving the results of the independent feasibility study, the authorities were

considering to undertake. In the authorities' view, the project would have significant spill-over effects on growth. In contrast, WB staff has argued that an alternative focus on improving the road network, including secondary and local roads, would be more consistent with the authorities' NSSED and would represent a better use of limited public funds—EU recommendations on transportation sector strategy also support these relative priorities. The mission stressed that, in any case, the associated budgetary and financial impact would need to be accommodated within the medium-term expenditure envelope and without undermining the declining path of public debt. Regarding wage policy, the authorities intend to refrain from granting automatic across-the-board public pay increases in 2005. Instead, they will use the wage bill expansion appropriated in the budget to implement targeted wage increments in priority sectors and performance incentives associated with the civil service reform. The authorities also intend to formally repeal the automatic indexation of wages prior to the formulation of the 2006 budget.

26. **The mission discussed medium-term plans to maintain the downward course of public debt while making preparations to tap international financial markets as concessional assistance declines (Table 8).** While aiming for a full mobilization and effective use of domestic budget resources, the authorities are considering how to replace concessional foreign assistance over time in a cost-effective manner and without crowding out domestic investment. In this regard, staff welcomed plans to improve debt management and recommended considering steps to obtain a sovereign credit rating—which would introduce an additional source of policy discipline and facilitate market access for the larger domestic firms. While the authorities agreed on this recommendation, they argued for pacing the access to international capital markets with improvements in the budget framework to ensure the efficient use of the additional resources.

Albania: Medium-Term Fiscal Path  
(In percent of GDP)

	2004	2005	2006	2007	2008	2009
Overall balance	-4.9	-4.9	-4.2	-3.9	-3.6	-3.3
Domestic financing	4.1	3.3	3.0	2.7	2.7	2.7
Privatization receipts	2.0	0.6	0.4	0.2	0.2	0.2
Domestic net borrowing	2.0	2.7	2.6	2.5	2.5	2.5
Foreign financing	0.8	1.6	1.1	1.1	0.9	0.6
Public debt	55.3	54.5	54.0	54.0	53.1	52.0
Domestic	38.0	37.3	36.7	36.5	35.9	35.3
External	17.3	17.1	17.2	17.5	17.3	16.8
Debt service to revenue 1/	17.6	17.6	16.7	15.6	16.0	15.9

1/ Revenue excludes grants. Almost none of the domestic debt has a maturity of more than one year.

#### D. Poverty Alleviation and Other Structural Reforms

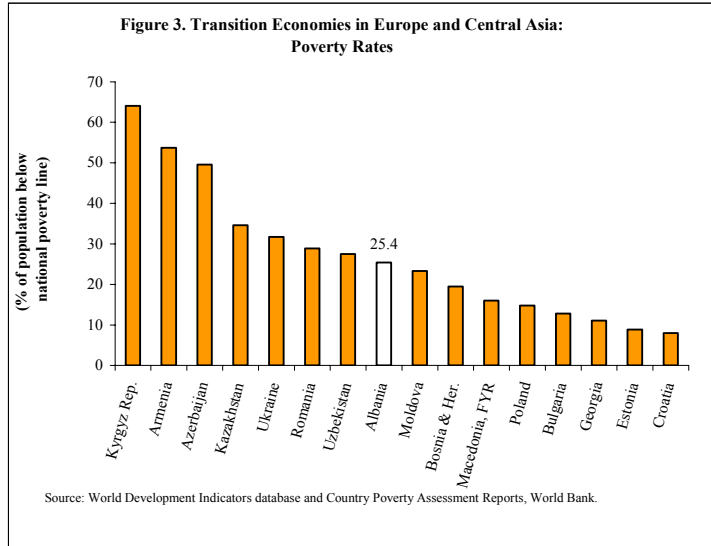
27. **Rising incomes have underpinned progress along some basic dimensions of poverty—although poverty remains a key policy priority (Box 4).** Consistent time series data are still wanting but indicators of absolute poverty, such as population with daily expenditure below US\$2, and child and maternal mortality appear to have improved (Table 2). Analyses point to the key positive role played by sustained high growth, selected social assistance programs, and non-official safety net arrangements—including migrant remittances and micro-credit networks. The evidence, however, is not all positive, as some social indicators (e.g., educational enrollment) have deteriorated. The authorities are improving social assistance targeting in collaboration with municipal governments and are

<b>Albania: Poverty Indicators 1/</b>		
	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 per capita income below US\$2 a day	46.6	10.8
Gini coefficient 2/	0.43	0.28
Percentage of population without running water	...	34
Percentage of population without sanitation in dwelling	...	39
Percentage of population without electricity for over 6 hours/day	...	61
Infant mortality rate (per 1,000 live births) 3/	27.6	22
1/ The 1998 Living Condition Survey (LCS) was carried out by INSTAT. The 2002 Living Standards Measurement Survey (LSMS) was carried out by the World Bank. Due to different methodologies, data are not necessarily comparable. 2/ Higher value indicates more inequality. 3/ The source is the World Development Indicators database.		

testing a system which requires participation in labor market programs for unemployment benefit eligibility. The authorities have implemented a subsidy to shield low-income households from electricity tariff hikes through direct reduction in their bill. This delivery vehicle has prompted better targeting and budget savings, while helping to forestall opposition to sectoral restructuring plans.

#### Box 4. Poverty Issues <sup>1</sup>

**Despite substantial economic progress, living standards in Albania remain among the lowest in Europe.** About one quarter of the population falls below the national absolute poverty line—compared with 19 percent in Bosnia and Herzegovina, 16 percent in FYR of Macedonia and 8 percent in Croatia. Albania also ranks low in terms of the UNDP Human Development Indicator, the UNICEF’s report on the State of the World’s Children, and progress on Millennium Development Goals.

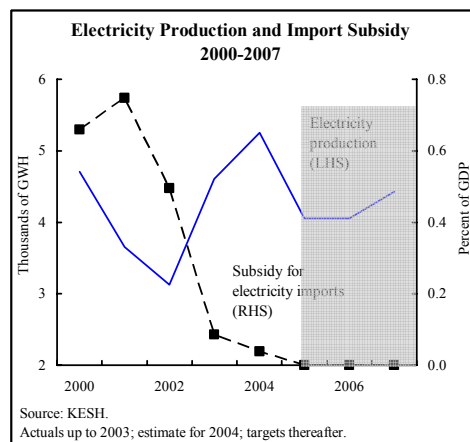


**A successful poverty reduction strategy should focus on sustaining growth and reforming basic infrastructure and service provision.** In the short-run, some mechanisms have proven particularly effective in alleviating the most severe aspects of poverty among vulnerable groups, including targeted social programs and access to micro-credit.

<sup>1/</sup> An accompanying Selected Issues paper surveys the Albanian experience on poverty alleviation.

28. **The authorities’ privatization agenda is making substantial progress (MEFP ¶ 19).** As indicated above, after privatizing the Savings Bank and completing the pre-privatization of INSIG with IFC and EBRD participation, the authorities have started the privatization of Albtelecom (abolishing also its international communications monopoly) and ARMO, and the 2005 budget envisages divestment of other public stakes. The authorities intend to follow with privatization or concession of most of the few remaining public companies.

29. **Electricity sector reform has achieved impressive success in 2003–04, but endemic problems in other infrastructure areas remain.** Decisive PSAP implementation with WB assistance and favorable rainfall resulted in a 65 percent increase in electricity production since 2002; collection targets have been met; and a stabilization fund has been set up whereby profits in good pluvial years will finance imports in less favorable times. Continued adherence to the PSAP and steady investment, however, will be needed to avoid a recurrence of energy crises. The inter-enterprise arrears clearing plan has continued on track, aiming for end-2005 completion. However, significant reforms are needed in the water supply sector—the main originator of arrears—and a pilot program has been started with WB assistance.



Albania: Basic Electricity Indicators 2000-07

	2000	2001	2002	2003	2004	2005	2006	2007
Domestic Electricity production in GWH (2000=100)	100	78	66	98	Est 1/ 112	86	Proj 2/ 86	94
Supply and use of electricity in percent of demand								
Electricity Demand	100	100	100	100	100	100	100	100
Domestic Production	76	59	50	74	83	61	60	63
Net Imports	16	28	36	15	9	34	33	32
Unsatisfied Demand	7	13	14	11	8	5	7	5
Collection rate (for electricity bills)	62	70	80	85	89	90	92	94
Subsidies for electricity imports (as percent of GDP)	0.7	0.7	0.5	0.1	0.0	0.0	0.0	0.0
Average electricity tariff (in Lek per KWh)	3.41	3.99	5.25	5.95	6.23	7.34	7.99	8.62

1/ Based on November outcomes.

2/ Action Plan for 2005-2007

30. **Reforms in other areas, however, have encountered mixed success.** Business climate indicators remain disappointing. The authorities are planning to update their action plan to remove barriers to investment (including licensing and registration procedures) based on new surveys conducted in recent months (MEFP ¶21). But faster progress will be needed in reforming the judiciary, cadastre, and property rights protection.

**Business Climate Indicators (2003)**

	Albania	Regional Average	OECD Average
<b>Starting a Business</b>			
Number of procedures	11	10	7
Duration (days)	47	48	30
Cost (% GNI per capita)	65	21.7	10.2
<b>Hiring &amp; Firing Costs</b>			
Flexibility of hiring 1/	33	51	49
Flexibility of firing 1/	15	39	28
<b>Enforcing Contracts</b>			
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
<b>Getting Credit</b>			
Public credit registry index 2/	0	49	58
Private bureau coverage (borrowers per 1000 capita)	0	38.6	443.5
<b>Closing a Business</b>			
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.

31. **Severe statistical deficiencies hamper policy formulation and the mission discussed plans to improve economic statistics (MEFP ¶24).** A statistical law was passed and 1996-2002 national accounts were published in 2004. With STA and other assistance, INSTAT plans to improve availability of economic indicators, including an experimental quarterly GDP (Box 5).



### **Box 5. Structural Conditionality**

In addition to implementing 2005 fiscal package (Box 3, MEFP ¶12), structural conditionality focuses on the following areas, deemed critical to achieving program objectives.

- **Reforms of the tax administration, and the budget and expenditure process:** (i) extend the ASYCUDA system and implement the ASYCUDA risk assessment module in 5 customs houses (¶24;MEFP¶12); (ii) implement a system of rapid VAT refunds, and clear the VAT refunds originated prior to June 2004, preparing quarterly reports (¶24;MEFP¶12); (iii) implement measures to raise efficiency and transparency of expenditure, including formally repeal price indexation of wages (MEFP¶13); (iv) carry out independent feasibility studies for large projects funded by non-concessional borrowing (MEFP¶21); (vi) continue to reschedule the arrears on inoperative payments agreements with official creditors (Article XIV) and conclude this process with official creditors by the end of the program (¶34;MEFP¶23).
- **Financial development and reduction of the use of cash, governance and business climate:** (i) increase the number of public employees paid through the banking system (¶20;MEFP¶16); and, (ii); continue to implement the action plan to remove administrative barriers to investment (¶30;MEFP¶21;NSSD Chapter 7).
- **Quality and coverage of economic statistics** (¶31; MEFP¶24): (i) present to Parliament a 5-year statistical program; (ii) publish the preliminary 2003 national accounts and introduce pilot quarterly GDP estimates; (iv) issue 2004 national accounts.

#### **World Bank Structural Conditionality**

Bank's conditionality focuses on implementing the action plan to modernize the electricity sector (¶29;MEFP¶20); governance and institution building sustainable private sector development; human development, and restructuring of key sectors (Appendix II).

### **E. External Policies**

32. **Albania has a floating exchange rate regime and there was agreement that this has served the country well.** The rapid transformation of the economy makes the underlying equilibrium exchange rate level a dynamic parameter subject to wide uncertainty. In this context, a market-determined flexible exchange rate has proven a useful means to forestall misalignments. Moreover, as a small open economy, Albania is buffeted by external, confidence, and domestic supply shocks and the flexibility of the exchange rate remains a necessary buffer to facilitate adjustment. Further, the still significant dollarization levels would undermine achieving durably any exchange rate target in the face of changing fundamentals.

33. **Albania benefits from one of the most open trade regimes among transition countries.** Import tariffs are among the lowest in the region, coupled with very limited nontariff barriers; and several regional free-trade agreements are in effect.<sup>5</sup>

Albania: Import Tariffs, 1996-2004  
(In percent)

	1996	1997	1998	1999	2000	2001	2002	2003	2004
Average tariffs									
Simple	15.0	13.8	13.6	12.7	10.5	7.9	8.1	7.9	7.3
Weighted	8.5	14.0	...	...	...	7.5	7.9	8.1	8.2
Minimum tariffs	5	5	0	0	0	0	0	0	0
Maximum tariffs	30	30	30	20	18	15	15	15	15
Number of tariff levels	4	4	5	4	4	4	4	4	5

Source: Albanian authorities.

34. **Albania maintains restrictions in accordance with Article XIV in the form of outstanding debit balances from inoperative bilateral payments agreements in former nonconvertible and convertible currencies.** These agreements were in place before Albania became a member of the Fund. As of October 2004, outstanding debit balances were maintained with Algeria, Cuba, the Czech Republic, Greece, Poland, Romania, the Slovak Republic, Vietnam, and Serbia and Montenegro. In 2004, arrears with Hungary were cleared and balances with the Czech and Slovak Republics, and Poland reconciled. An agreement with Romania is planned to be signed in early 2005.

35. **The program for 2005 is fully financed.** The 2005 financing gap (US\$ 82 million) is expected to be covered with donors assistance and bilateral arrears rescheduling (Tables 9, 10, 11, and 12).

36. **The authorities are committed to clear all remaining debit balances with official creditors by the end of the program and with private creditors by 2006.** However, incomplete documentation and counterpart delays in some cases have hindered progress. Staff urged the authorities to continue efforts to clear all outstanding arrears. Regarding the financing assurances review, in 2004 arrears with a company based in FYR Macedonia were cleared and negotiations with remaining private creditors continued. No new arrears have been incurred and the existence of the unsettled amounts does not put the recovery of the Fund's credit at risk. Fund's exposure with Albania is very limited (SDR 62 million or 128 percent of its quota) and projected to decrease after 2005. Fund's debt service represents less than 1 percent of exports.

<sup>5</sup> The free trade area comprises Bosnia-Herzegovina, Bulgaria, Croatia, Kosovo, FYR Macedonia, Moldova, Romania, and Serbia and Montenegro.

## F. Program Issues

37. **It is proposed that the last disbursement under the arrangement be conditional on the observance of end-March 2005 quantitative performance criteria, end-March and End-June 2005 structural performance criteria, and the completion of the sixth review (Table 13).**

38. **The authorities broadly agreed with the conclusions of the accompanying Ex Post Assessment, and expressed preference for a three-year successor arrangement.** In their view, the Fund had provided valuable input in the design and implementation of structural reforms through appropriately focused conditionality. They stressed the role of Fund conditionality in maintaining reform momentum, including by catalyzing political wills and shoring up consensus. They considered that a three-year successor arrangement would provide medium-term certainty to investors and donors regarding macroeconomic prospects and institutional reform continuity. In this connection, drawings (even if small) provided a significant signal. The authorities and donors envisaged that program conditionality could play a key role in the Stabilization and Association process with the EU. The authorities also indicated interest on wider room within the program to develop stronger ownership.

## IV. STAFF APPRAISAL

39. **The macroeconomic performance of the Albanian economy in recent years has been remarkable, but maintaining growth and reducing poverty will require improving external competitiveness and attracting strategic investment.** Growth has recovered to about 6 percent without rekindling inflation, and confidence in the lek and the financial sector has firmed up. This performance owes much to the authorities' perseverance on fiscal consolidation and public debt reduction, sound monetary and financial sector policies, privatization, and restructuring of the strategic energy sector. However, growth has been driven to a large extent by nontradeables, with buoyant domestic demand and incomes supported by migrant remittances and external transfers—while limited progress has been made in reducing trade imbalances. Looking ahead, growth prospects depend crucially on attracting high quality investment and fostering outward-oriented activity.

40. **The outlook is for a continuation of growth at about its 6 percent trend in 2005.** The current demand strength is set to continue into 2005 underpinned by public investment and rising credit to the private sector from its current low level, including consumer credit. However, political uncertainties and a less stimulative external environment pose downward risks—particularly since the real effective appreciation of the lek may have eroded competitiveness in some sectors.

41. **Over the medium term, export-oriented investment and associated productivity is expected to improve gradually the trade balance and increasingly drive growth.** Although external indebtedness is limited, DSAs confirm that external

sustainability hinges on successfully improving competitiveness and maintaining growth. Therefore, it is essential that macroeconomic stability be complemented with improvements in infrastructure and the investment environment. Beyond traditional macroeconomic policy-related structural reforms, a fuller integration of Albania in the regional and world economies will require progress in institutional reforms that promote the establishment and protection of property rights, and complete the transition to a rules-based market economy.

42. **The authorities' determination in building a sound monetary policy framework has been instrumental to macroeconomic stability.** This framework is appropriately based on a clear BoA mandate on price and financial stability; central bank independence; and a flexible exchange rate regime. Its credibility will require that BoA's foreign exchange interventions continue avoiding any explicit or implicit exchange rate target. Plans to introduce a bulk clearing system and a collateralized inter-bank money market are well timed to support financial development with market infrastructure provision—and would be buttressed by measures to deepen the T-bill market and allow trading of foreign exchange swaps. The ongoing expansion of financial intermediation is welcome but will require improvements in supervisory capacity, encompassing the insurance sector. The upcoming FSAP will provide an opportunity to advance in this direction. Payment of government wages through the banking system will be an important catalyst for increased banking intermediation of transactions—reducing the use of cash and opportunities for informality and misgovernance.

43. **The gradual easing of the monetary policy stance since 2002 has been appropriate, but the current pause and neutral bias are warranted.** Whereas there may be further room for easing in 2005 if current trends continue, the policy direction should be reconsidered afresh as more evidence becomes available on seasonal price pressures, fuel price effects, and international conditions.

44. **Much progress has been made in consolidating the public finances and the 2005 budget is a further step in that direction.** The continued reduction in the underlying domestic borrowing requirement and declining profile of public debt are appropriate to crowd in private sector credit and in anticipation of a likely decline of concessional assistance. The budget emphasis in curtailing current spending to a level commensurate with a realistic projection of recurrent revenue—thus devoting borrowing and privatization resources fully to invest—is a substantial step forward in the quality of expenditure and fiscal sustainability. The decision to replace across-the-board wage increases by targeted incentives to improve performance and services in priority areas, and to formally repeal wage indexation before the 2006 budget will further enhance expenditure efficiency. In an election year, the authorities' determination to persevere at fiscal consolidation and improve the budget process is commendable and should cement credibility and investors' confidence.

45. **Progress in capacity building and fiscal institutions reform, however, has been weak and needs to be accelerated.** The 2005 fiscal package and other current initiatives

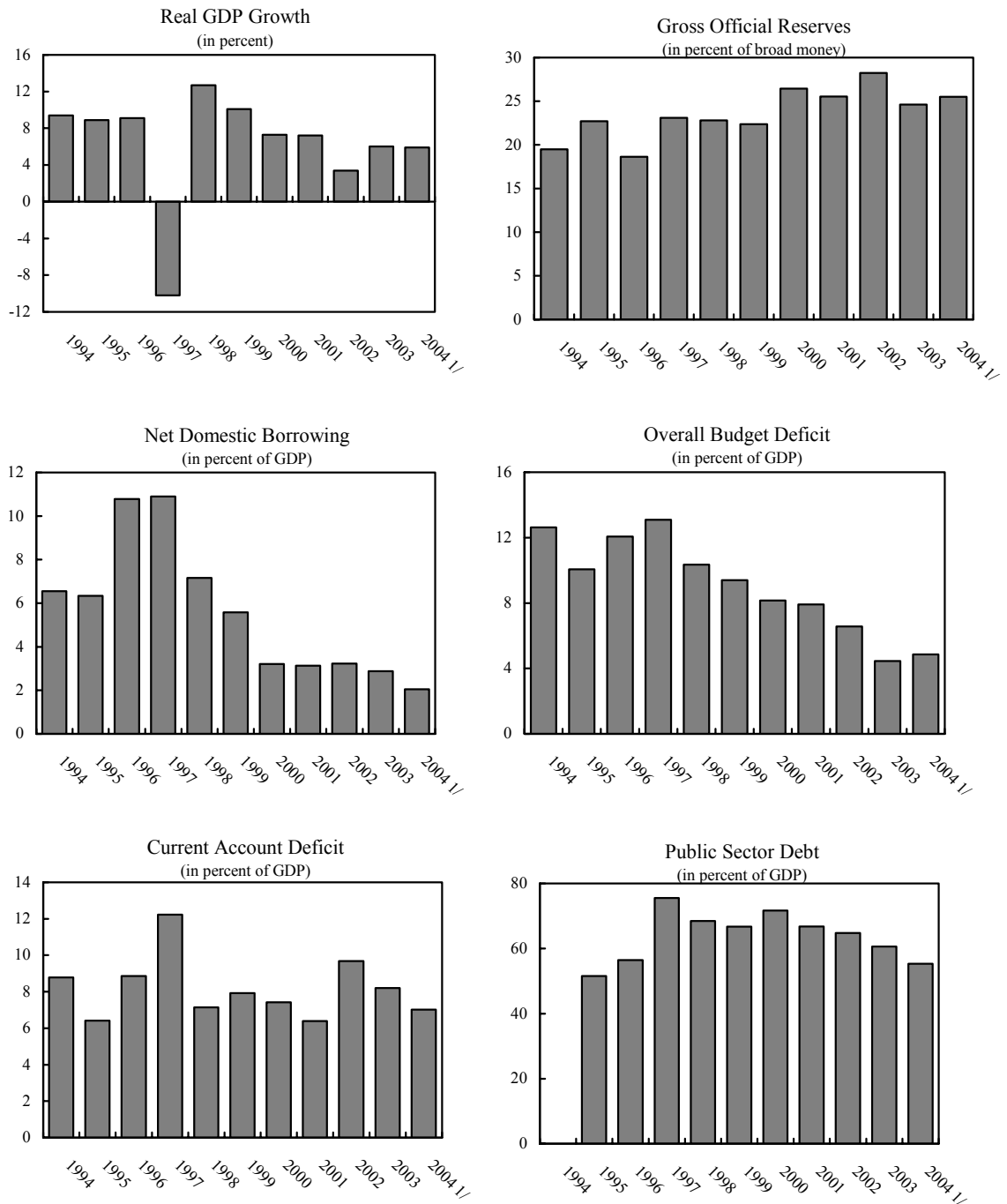
contain many positive elements that, if consistently implemented, could enhance the efficiency of the tax system. The introduction of an effective VAT refund mechanism should be a priority as it would reduce export costs and benefit the investment climate. But broader tax administration reforms are necessary to substantially boost compliance and mobilize budget resources—including standardized procedures, risk analysis-based audit methods, information technology, and human resource rationalization. Likewise, on the spending side, control and tendering procedures; payment, commitment and reporting systems; and treasury and debt management need strengthening.

46. **Privatization and electricity sector reforms have achieved substantial success, but structural and institutional reforms in other areas need to be intensified.** We welcome the start of the privatization process of Albtelcom and ARMO; the decision to sell the minority public stake in banking and telecommunications; and the end of the Albtelcom monopoly on international communications. While vigilance has prevented the emergence of new inter-enterprise arrears, eliminating pressures in this direction will require restructuring of the water provision system and other utilities to ensure their viability. While data provision to the Fund is adequate, plans to expedite and improve the production of economic statistics are welcome and should be considered a priority.

47. **Program implementation has been good and the supplementary MEFP contains a strong policy program to preserve macroeconomic stability and foster growth.** The authorities continued appropriate good-faith efforts to reach agreements with official and private external creditors on remaining arrears. Staff therefore supports the authorities' request for completion of the fifth review and financing assurances review, and for a 5-month extension of the program to allow for the sixth review and associated disbursement to take place during the program period. It is proposed that Albania be kept on a 24-month Article IV consultation cycle, subject to the provisions of Board decision number 127-94 (02/76).

48. **Given the extensive reform agenda and the authorities' preference, a successor medium-term arrangement appears appropriate, as discussed in the accompanying EPA.** The nature of the successor arrangement, would depend on Albania's PRGF eligibility following expiration of the current arrangement.

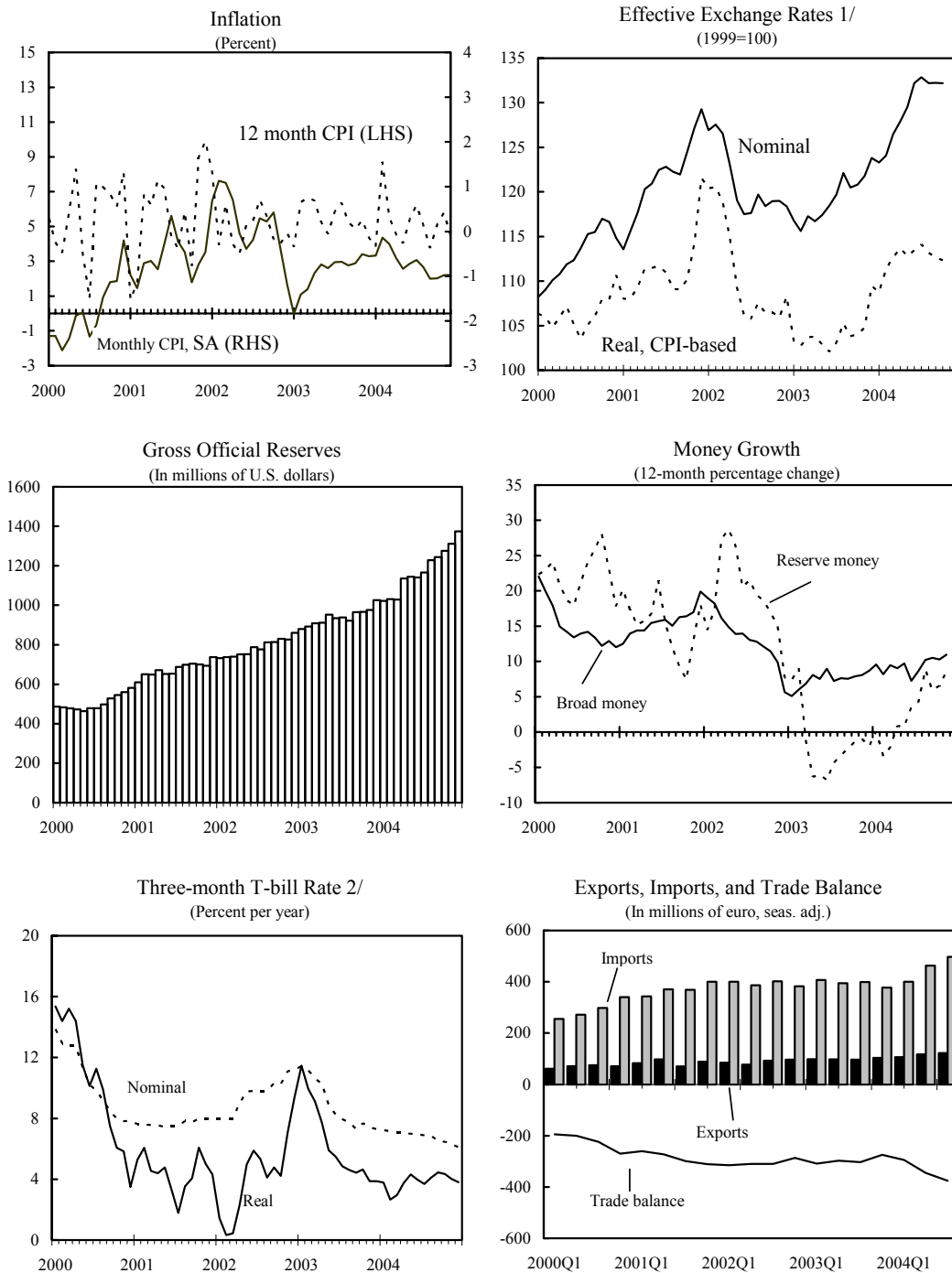
Figure 1. Albania: Economic Developments and Prospects, 1994–2004 1/



Sources: Albanian authorities; and Fund staff estimates.

1/ Data for 2004 are staff estimates.

Figure 2. Albania: Monthly Economic Indicators, 2000-04



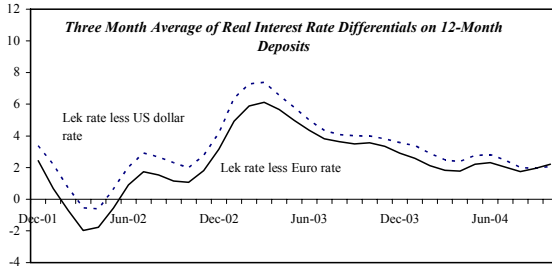
Sources: Bank of Albania, Ministry of Finance, INSTAT, and Fund staff estimates.

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

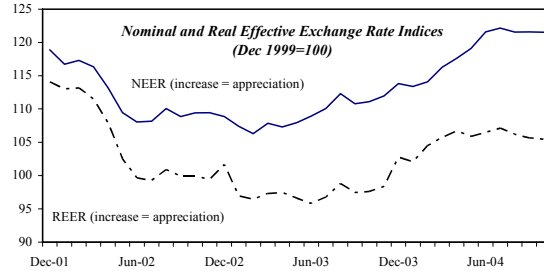
2/ The real rate is derived using annualized seasonally adjusted CPI inflation.

Figure 3. Albania: Monetary Developments

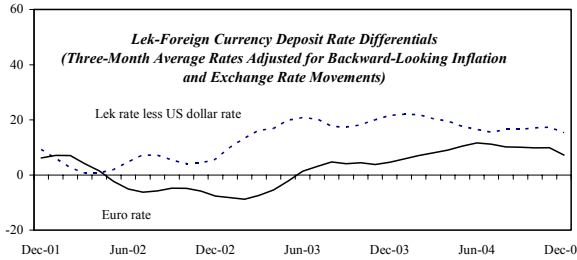
*A tight monetary policy raised real yield differentials strongly in favor of domestic assets...*



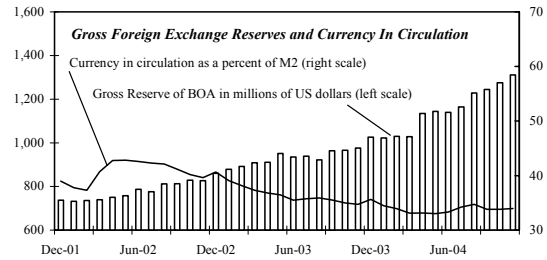
*...appreciating the lek in nominal and real terms...*



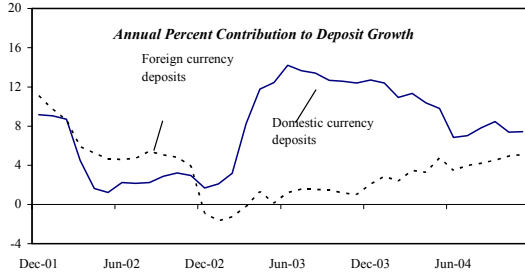
*...creating additional incentives to hold domestic rather than foreign assets...*



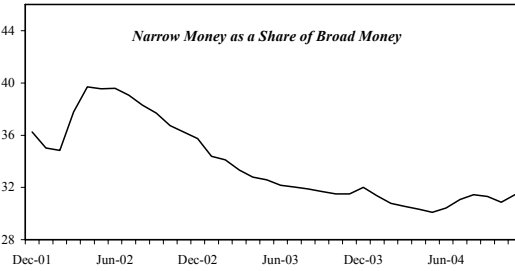
*...to which agents responded by reducing cash holdings and selling foreign currency to the central bank...*



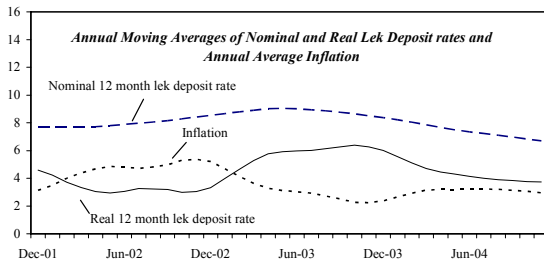
*...moving into high-earning lek deposits...*



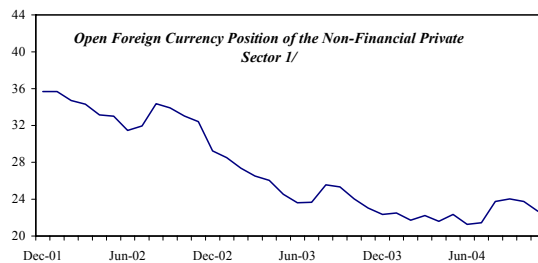
*...reducing the share of narrow money in broad money...*



*...effectively containing inflation...*



*...and reducing the net foreign asset position of the non-financial private sector.*



Sources: Data provided by Bank of Albania and Fund estimates.

1/ Foreign currency deposits less foreign currency loans as a percent of domestic deposits.



Table 1. Albania: Basic Indicators and Macroeconomic Framework, 2000–09

	2000	2001	2002	2003	2004		2005		2006	2007	2008	2009
					4th Review 1/	Est.	4th Review 1/	Proj.	Proj.	Proj.	Proj.	
	(Growth rate in percent)											
Real GDP 2/	7.3	7.2	3.4	6.0	6.2	5.9	6.0	6.0	6.0	6.0	6.0	6.0
Retail prices (avg.)	0.0	3.1	5.2	2.4	3.4	2.9	3.0	2.4	3.0	3.0	3.0	3.0
Retail prices (end-period)	4.2	3.5	1.7	3.3	3.4	2.2	3.0	2.7	3.0	3.0	3.0	3.0
	(In percent of GDP)											
Saving-investment balance 3/												
Foreign savings 4/	4.4	3.3	7.0	5.6	5.9	5.0	5.6	5.3	5.0	4.5	4.1	4.3
Domestic savings	20.3	25.9	19.2	19.4	23.0	20.4	22.5	21.3	21.8	23.1	24.1	24.4
Public 5/	-1.6	-0.6	0.0	-0.1	0.5	0.3	0.4	1.3	1.7	2.2	2.9	2.8
Private	21.9	26.5	19.2	19.5	22.5	20.1	22.1	20.1	20.1	20.8	21.3	21.6
Investment	24.7	29.2	26.2	25.0	28.9	25.4	28.1	26.6	26.7	27.5	28.3	28.6
Public	6.6	7.3	6.7	4.5	6.6	5.2	5.2	5.9	5.5	5.8	6.3	6.6
Private	18.1	21.9	19.5	20.5	22.2	20.2	22.9	20.7	21.2	21.7	22.0	22.0
Fiscal sector												
Revenues and grants	23.8	23.6	24.5	24.0	24.8	23.7	24.4	24.1	23.9	24.1	24.4	24.7
Tax revenue	19.6	19.7	20.5	20.9	21.6	21.3	21.6	21.3	21.2	21.5	21.8	22.1
Of which: social security contributions	3.8	3.8	4.1	4.1	4.2	4.2	4.3	4.3	4.3	4.3	4.3	4.3
Expenditures	31.9	31.6	31.1	28.5	30.9	28.5	29.1	29.0	28.1	27.9	28.1	28.0
Primary	26.1	27.2	27.2	24.2	26.9	24.8	25.5	25.5	24.7	24.7	24.8	24.8
Interest	5.8	4.3	3.9	4.3	4.0	3.7	3.7	3.5	3.3	3.2	3.2	3.2
Overall balance (including grants)	-8.2	-7.9	-6.6	-4.4	-6.2	-4.9	-4.8	-4.9	-4.2	-3.9	-3.6	-3.3
Primary balance (excluding grants)	-3.4	-4.2	-3.3	-0.5	-3.0	-1.5	-1.7	-2.2	-1.5	-1.3	-1.0	-0.7
Net domestic borrowing	3.2	3.1	3.2	2.9	2.0	2.0	2.7	2.7	2.6	2.5	2.5	2.5
Privatization receipts	1.7	2.2	0.1	0.1	2.4	2.0	0.4	0.6	0.4	0.2	0.2	0.2
Foreign financing	3.3	2.6	3.3	1.4	1.7	0.8	1.7	1.6	1.1	1.1	0.9	0.6
Public Debt	71.3	66.8	64.8	60.7	58.6	55.3	57.9	54.5	54.0	54.0	53.1	52.0
Domestic	41.9	41.0	41.4	40.4	38.3	38.0	37.6	37.3	36.7	36.5	35.9	35.3
External (including publicly guaranteed) 6/7/	29.4	25.8	23.4	20.3	20.3	17.3	18.7	17.1	17.2	17.5	17.3	16.8
	(Growth rate in percent unless otherwise indicated)											
Monetary indicators												
Broad money growth	12.0	20.2	5.7	8.7	11.8	12.6	9.9	9.3	11.3	12.2	13.8	13.8
Private credit growth	31.8	23.4	41.0	31.1	31.3	32.9	35.5	40.1	36.6	33.2	32.2	31.9
Velocity	1.6	1.5	1.5	1.6	1.7	1.6	1.7	1.6	1.6	1.5	1.5	1.4
Interest rate (3-mth T-bills, end-period)	7.8	8.0	11.2	7.3	...	6.1	...	...	...	...	...	...
	(In percent of GDP unless otherwise indicated)											
External sector												
Trade balance (goods and services)	-22.1	-23.2	-25.8	-24.8	-23.1	-22.9	-23.0	-22.2	-20.8	-19.9	-19.5	-19.3
Current account balance (excluding official transfers)	-7.4	-6.4	-9.7	-8.2	-8.1	-7.0	-7.9	-7.0	-6.6	-6.0	-5.6	-5.6
Current account balance (including official transfers)	-4.4	-3.3	-7.0	-5.6	-5.9	-5.0	-5.6	-5.3	-5.0	-4.5	-4.1	-4.3
Official transfers	3.0	3.1	2.7	2.6	2.2	2.0	2.3	1.8	1.6	1.5	1.5	1.3
Gross international reserves (in millions of U.S. dollars)	608	737	860	1026	1132	1374	1227	1459	1624	1830	2069	2211
(in months of imports of goods and services)	4.1	4.3	4.0	3.7	4.0	4.1	4.0	4.0	4.0	4.0	4.0	4.0
(relative to external debt service)	23.6	21.2	13.8	17.5	13.1	18.2	9.4	10.9	8.8	8.7	9.2	8.9
(in percent of broad money)	26.4	25.5	28.2	24.6	24.3	25.5	23.9	25.8	25.9	26.2	28.5	28.0
Change in real effective exchange rate (e.o.p., in percent) 8/	3.9	9.8	-10.9	4.0	...	2.7	...	...	...	...	...	...
Memorandum items												
Nominal GDP (in billions of lek) 2/	530.9	588.7	630.0	695.1	836.9	780.1	919.7	857.3	938.9	1015.4	1113.5	1220.3

**Social Indicators:** GNI per capita, Atlas Method, US\$ (2003, est.): \$1,740; **population** 3.1 million (2002); **life expectancy at birth** (2000): 74 years; **population living below the poverty line** (2002): 25.4 percent; rural households with access to running water inside dwellings (2002): 25 percent; **urban households (excluding Tirana) with water for less than 6 hrs/day (2002): 33 percent;** **households receiving continuous supply of electricity** (2002): 14.3 percent.

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

1/ The ratios to GDP have been adjusted from the ones in the IMF Country Report No. 04/206 to reflect the revisions in nominal GDP (see Box 1).

2/ GDP data through 2002 are from the official national accounts. Real GDP growth is based on the observed economy only.

3/ The statistical discrepancy contained in the national accounts (31 percent of GDP in 2001), 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 including grants less current expenditure and net lending.

6/ Includes arrears, with the exception of pre-1978 arrears to China.

7/ Excludes IMF repurchase obligations.

8/ In 2004, October 2004 to December 2003.

Table 2: Albania: Millennium Development Goals

	1990	1995	2001	2002	2003	2015 Target
<b>General Indicators</b>						
Population (million)	3.3	3.2	3.1	3.1	3.2	
GNI per capita (\$)	680	650	1400	1450	1740	
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	...	
<b>Goal 1. Eradicate extreme poverty and hunger</b>						
<b>Target 1:</b> 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)	...	...	...	2.0	...	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	...	...
<b>Target 2:</b> Halve, between 1990 and 2015, the proportion of people suffering from hunger						
4. Prevalence of child malnutrition (percent of children under 5)	...	...	14	...	...	5.4
5. Population below minimum level of dietary energy consumption (percent)	...	...	...	...	...	...
<b>Goal 2. Achieve universal primary education</b>						
<b>Target 3:</b> 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
<b>Goal 3. Promote gender equality and empower women</b>						
<b>Target 4:</b> Eliminate gender disparity in primary and secondary education preferably by 2005 and to all levels of education in 2015						
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
<b>Goal 4. Reduce child mortality</b>						
<b>Target 5:</b> 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
<b>Goal 5. Improve maternal health</b>						
<b>Target 6:</b> 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	...	...	...
<b>Goal 6. Combat HIV/AIDS, malaria and other diseases</b>						
<b>Target 7:</b> 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 (continued)

	1990	1995	2001	2002	2003	2015 Target
<b>Target 8:</b> 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	...	...
<b>Goal 7. Ensure environmental sustainability</b>						
<b>Target 9:</b> 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	...	...	...	...	...	...
<b>Target 10:</b> 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
<b>Target 11:</b> Achieve by 2020 a 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)	...	...	...	...	...	...
<b>Goal 8. Develop a Global Partnership for Development 1/</b>						
<b>Target 16:</b> 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	...	...	...
<b>Target 17:</b> Provide access to affordable essential drugs						
46. Proportion of population with access to affordable drugs	...	...	...	...	...	...
<b>Target 18:</b> 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: Balance of Payments, 2001–09  
(In millions of US dollars)

	2001	2002	2003	2004					2005			2006	2007	2008	2009	
				Q1	Q2	Q3	Q4	2004	2004	2005	2005					Projections
				Est.	Est.	Est.	Est.	Prog.1/	Est.	Prog.1/	Proj.					
Current account	-262	-435	-469	-97	-146	-105	-179	-592	-528	-635	-625	-638	-623	-638	-695	
Balance of goods and services	-950	-1,160	-1,419	-320	-370	-467	-566	-1,695	-1,723	-1,859	-1,974	-2,018	-2,077	-2,223	-2,393	
Exports	839	915	1,167	333	391	472	433	1,364	1,629	1,501	2,040	2,408	2,845	3,325	3,883	
Goods	305	330	447	137	153	158	160	567	608	750	761	925	1,117	1,318	1,537	
Services	535	585	720	197	238	314	272	797	1,021	751	1,280	1,483	1,728	2,007	2,346	
Imports	1,790	2,075	2,586	653	761	939	999	3,059	3,352	3,360	4,014	4,426	4,922	5,548	6,277	
Goods	1,332	1,485	1,783	450	523	628	682	2,168	2,283	2,398	2,700	2,999	3,373	3,822	4,292	
Services	458	590	802	203	238	311	317	891	1,069	962	1,314	1,428	1,548	1,726	1,984	
Income balance	146	128	167	29	23	58	37	164	147	210	154	155	167	209	226	
<i>of which</i> : Interest due	14	21	19	4	7	5	12	25	27	38	44	56	68	81	87	
Private transfers	543	597	782	194	201	304	350	939	1,048	1,014	1,195	1,225	1,286	1,376	1,473	
Capital account	280	406	451	53	269	19	63	636	404	649	778	800	887	973	1,007	
Official transfers	123	125	146	36	40	39	35	162	149	184	157	156	160	167	166	
Direct investment	204	135	178	35	177	64	50	377	326	252	308	339	407	487	565	
Other capital	-130	53	43	-36	40	-100	-38	-29	-134	90	216	220	237	226	216	
Private loans (incl.net trade credits, net)	-1	11	24	8	35	42	23	83	108	44	72	74	77	83	89	
Other financial flows	-129	42	18	-44	5	-142	-61	-112	-242	46	144	146	160	143	126	
<i>of which</i> : Change in NFA of commercial banks (incr = -)	-129	42	28	-44	5	-142	-61	-112	-242	46	144	146	160	143	126	
Official medium- and long-term loans (net)	83	93	85	18	12	17	16	126	63	122	96	85	84	93	60	
New borrowing	90	121	114	25	25	24	29	178	102	207	177	202	212	223	208	
Multilateral loans	56	84	85	21	20	18	17	120	76	128	139	144	138	138	121	
World Bank	34	50	42	9	10	10	5	50	33	58	65	40	40	40	40	
EBRD	4	11	15	3	3	4	5	25	15	25	27	47	40	34	27	
Other	18	22	27	8	8	5	8	45	28	45	47	57	58	64	54	
Bilateral loans	34	37	30	4	4	5	12	58	26	78	38	59	74	85	87	
Amortization (official and private loans)	-7	-28	-30	-6	-13	-7	-14	-52	-40	-85	-81	-117	-128	-130	-147	
Errors and omissions	109	47	116	54	-1	175	161	30	390	47	-101	1	-48	-86	-161	
Net balance	127	18	98	10	123	89	45	73	266	61	52	163	216	249	151	
Financing requirement	-127	-18	-98	-10	-123	-89	-45	-73	-266	-61	-52	-163	-216	-249	-151	
Available financing	-127	-18	-98	-10	-123	-90	-43	-73	-266	-61	-52	-163	-216	-249	-151	
Change in net reserves (increase = -) 2/	-135	-50	-118	-10	-123	-90	-61	-98	-285	-103	-94	-177	-221	-254	-156	
<i>Of which</i> : Change in gross reserves, (increase = -) 2/	-146	-58	-78	-15	-117	-95	-61	-107	-288	-95	-85	-165	-206	-239	-142	
Use of Fund Resources (net)	-1	-9	2	4	-2	4	-4	-3	2	-9	-10	-12	-14	-15	-14	
Budget support	4	29	19	0	0	0	0	0	0	0	0	0	0	0	0	
Changes in arrears (increase = +) 3/	-29	-280	1	0	-17	0	0	-59	-17	-37	-62	-44	0	0	0	
Overdue debt forgiveness	10	207	0	0	0	0	0	0	0	0	0	0	0	0	0	
Rescheduling 3/	23	76	0	0	17	0	0	59	17	0	0	0	0	0	0	
Identified Financing	0	0	0	0	0	0	18	25	18	11	22	0	0	0	0	
<i>Of which</i> : IMF PRGF	0	0	0	0	0	0	0	6	0	11	12	0	0	0	0	
WB FSAC/PRSC	0	0	0	0	0	0	18	19	18	0	10	0	0	0	0	
Financing gap	0	0	0	0	0	1	-2	0	0	68	82	58	5	5	5	
Expected EU Macro-Financial Assistance	...	...	...	...	...	...	...	...	...	31	20	13	0	0	0	
Arrears Rescheduling	...	...	...	...	...	...	...	...	...	37	62	44	0	0	0	
Other	...	...	...	...	...	...	...	...	...	0	0	0	5	5	5	
<i>Memorandum items:</i>																
Gross usable reserves	737	860	1,026	1,028	1,140	1,244	1,374	1,133	1,374	1,227	1,459	1,624	1,830	2,069	2,211	
(months of imports of goods and services)	4.3	4.0	3.7	...	...	...	...	4.0	4.1	4.0	4.0	4.0	4.0	4.0	4.0	
Balance of goods and services (percent of GDP)	-23.2	-25.8	-24.8	...	...	...	...	-23.1	-22.9	-23.0	-22.2	-20.8	-19.9	-19.5	-19.3	
Current account (percent of GDP)	-6.4	-9.7	-8.2	...	...	...	...	-8.1	-7.0	-7.9	-7.0	-6.6	-6.0	-5.6	-5.6	
Debt service (percent of exports of goods and services) 4/	4.2	6.4	4.7	...	...	...	...	5.8	4.1	5.9	4.6	5.3	5.0	5.1	4.9	
Debt service (percent of central government revenues) 4/	3.8	5.6	4.2	...	...	...	...	4.3	4.0	4.3	4.8	5.9	6.0	6.5	6.6	
Total external debt stock (percent of GDP) 5, 6/	27.8	25.1	21.7	...	...	...	...	22.5	19.5	22.4	19.5	19.3	19.1	18.7	18.0	
Export volumes (percent change)	23.4	6.4	19.9	...	...	...	...	17.2	25.3	14.7	24.5	22.2	21.0	17.1	15.7	
Import volumes (percent change)	25.9	8.1	7.5	...	...	...	...	13.8	13.9	10.1	17.7	12.3	12.9	12.9	11.4	

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

1/ Consistent with IMF Country Report No. 04/2006. For comparability purposes, indicators measured as percentage of the GDP have been adjusted to the new GDP.

2/ Net of valuation changes.

3/ In 2004-2006 assumes rescheduling of stock of outstanding arrears, both with official and private creditors.

4/ Public and publicly guaranteed debt only.

5/ Public and private. It includes arrears with the exception of China pre-1978 arrears.

6/ Debt stock converted into Lek at the e-o-p exchange rate.

Table 4: Albania: Performance Criteria and Structural Benchmarks under the PRGF Arrangement

Measures	Test-date	Status
<b>A. Performance Criteria for the Fifth Review</b>		
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	<b>Met</b>
2. The salaries of at least 10,000 employees of budgetary institutions to be paid through the banking system	End-December 2004	<b>Met</b>
<b>B. Structural Benchmarks under the Fifth Review</b>		
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	<b>Met in part 1/</b>
(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	<b>Met</b>
2. Government to implement a subsidy to low income electricity consumers	End-September 2004	<b>Met</b>
3. Government of Albania's to continue to implement its action plan for removing administrative barriers to investment (NSSD chapter 7, Section on Ministry of the Economy).	Ongoing	<b>Met</b>
4. Prepare quarterly reports (within one month of the end of each quarter) on the stock of external arrears.	Throughout	<b>Met</b>
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	<b>Met</b>
(ii) Provide a quarterly listing and status report on all projects being considered for nonconcessional foreign financing.	Throughout	<b>Met</b>

1/ Data on VAT refunds were only available for the total since the beginning of the year and not with a monthly breakdown. The other required information was available.

Table 5a. Albania: General Government Operations 1/  
(In percent of GDP)

	2002	2003	2004		2005	2006	2007	2008	2009
			Program 4th Review	Estimate					
Total Revenue and Grants	24.5	24.0	24.8	23.7	24.1	23.9	24.1	24.4	24.7
Tax Revenue	20.5	20.9	21.6	21.3	21.3	21.2	21.5	21.8	22.1
Tax revenues from Tax and Customs Directorates	16.0	16.1	16.4	16.3	16.2	16.1	16.4	16.7	17.0
Turnover tax /VAT	7.3	7.3	7.3	7.5	7.4	7.5	7.5	7.6	7.7
Profit tax	1.9	1.9	1.9	2.0	1.9	1.7	1.7	1.8	1.8
Excise tax	1.5	1.8	2.1	2.1	2.1	2.2	2.2	2.3	2.3
Small business tax	0.4	0.4	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Personal income tax	1.0	0.9	1.0	0.9	0.9	0.9	1.0	1.0	1.0
National taxes	1.5	1.3	1.5	1.3	1.4	1.4	1.5	1.5	1.5
Customs duties	2.1	2.0	1.8	1.7	1.8	1.7	1.8	1.8	1.8
Other taxes	0.2	0.5	0.2	0.2	0.3	0.3	0.3	0.3	0.3
Property and local taxes	0.4	0.6	0.9	0.7	0.7	0.7	0.7	0.7	0.7
Social insurance contributions	4.1	4.1	4.2	4.2	4.3	4.3	4.3	4.3	4.3
Non-tax revenue:	3.4	2.8	2.3	2.0	2.0	2.0	2.0	2.0	2.0
Grants 2/	0.7	0.4	0.8	0.4	0.8	0.7	0.6	0.6	0.5
Total Expenditure	31.1	28.5	30.9	28.5	29.0	28.1	28.0	28.1	28.0
Current Expenditure	24.5	24.1	23.8	23.4	22.7	22.1	21.7	21.4	21.1
Personnel cost	6.7	6.4	6.5	6.5	6.4	6.1	5.9	5.7	5.4
Wages and other personnel expenditures	5.3	5.1	5.2	5.2	5.1	4.8	4.7	4.5	4.3
Social insurance contributions	1.3	1.3	1.4	1.4	1.4	1.3	1.3	1.2	1.2
Interest	3.9	4.3	4.0	3.7	3.5	3.3	3.2	3.2	3.2
Domestic	3.6	4.1	3.7	3.4	3.2	2.9	2.7	2.7	2.7
Foreign	0.4	0.2	0.3	0.3	0.3	0.4	0.5	0.5	0.5
Operations & maintenance	3.3	3.2	2.7	2.8	2.6	2.7	2.6	2.5	2.5
Subsidies	1.0	0.7	0.5	0.5	0.3	0.3	0.2	0.2	0.2
Social insurance outlays	6.4	6.4	6.3	6.3	6.4	6.4	6.4	6.4	6.4
Local government expenditure	1.9	2.0	2.3	2.1	2.1	2.1	2.1	2.1	2.1
Social protection transfers	1.4	1.3	1.3	1.3	1.2	1.2	1.2	1.2	1.2
Arrears settlement	...	...	1.6	1.6	1.5	0.0	0.0	0.0	0.0
Other 3/	0.0	-2.0	...	0.0	...	...	...	...	...
Capital Expenditure	6.7	4.5	6.6	5.2	5.9	5.5	5.8	6.3	6.6
Domestically financed	3.0	2.6	3.8	3.9	3.3	3.2	3.7	4.2	4.8
Foreign financed projects	3.6	1.9	2.9	1.3	2.6	2.3	2.2	2.1	1.8
Net lending	-0.1	-0.2	0.0	-0.1	0.0	0.0	0.0	0.0	0.0
Reserve and contingency funds	...	...	0.4	0.0	0.4	0.4	0.4	0.3	0.3
Cash Balance	-6.6	-4.4	-6.2	-4.9	-4.9	-4.2	-3.9	-3.6	-3.3
Current Balance 4/	-0.7	-0.5	0.1	-0.1	0.5	1.0	1.6	2.3	3.0
Financing	6.6	4.4	6.2	4.9	4.9	4.2	3.9	3.6	3.3
Domestic	3.3	3.0	4.5	4.1	3.3	3.0	2.7	2.7	2.7
Privatization receipts	0.1	0.1	2.4	2.0	0.6	0.4	0.2	0.2	0.2
Net borrowing 5/	3.2	2.9	2.0	2.0	2.7	2.6	2.5	2.5	2.5
Foreign	3.3	1.4	1.7	0.8	1.6	1.1	1.1	0.9	0.6
of which : Budget support	0.6	0.3	0.3	0.2	0.1	0.0	0.0	0.0	0.0
Memorandum Items:									
Primary balance	-2.6	-0.2	-2.2	-1.1	-1.4	-0.9	-0.7	-0.4	-0.2
Public Debt (including guarantees)	64.8	60.7	58.6	55.3	54.5	54.0	54.0	53.1	52.0
Domestic general government	41.4	40.4	38.3	38.0	37.3	36.7	36.5	35.9	35.3
External	23.4	20.3	20.3	17.3	17.1	17.2	17.5	17.3	16.8
GDP (in billion of lek)	630	695	780	780	857	939	1015	1113	1220

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.

All budget and staff projection numbers are presented as a percent of revised GDP to facilitate comparison.

2/ Information on grants prior to 2002 are estimates.

3/ Includes statistical discrepancy.

4/ Revenue excluding grants minus current expenditure.

5/ Net borrowing in 2004 takes into account 0.9 percent of GDP Savings Bank privatization receipts used to redeem domestic debt.

Table 5b. Albania: General Government Operations 1/  
(In billions of Lek)

	2002	2003	2004		2005	2006	2007	2008	2009
			Program 4th Review	Estimate	Budget		Staff Projections		
Total Revenue and Grants	154.6	167.2	193.1	184.5	206.5	224.2	244.4	271.7	301.0
Tax Revenue	128.9	145.3	168.8	165.8	182.2	198.9	218.0	242.8	269.9
Tax revenues from Tax and Customs Directorate	100.6	111.7	128.2	126.9	139.1	151.3	166.1	185.7	206.9
Turnover tax /VAT	46.1	50.6	57.3	58.1	63.3	70.4	76.1	84.5	93.7
Profit tax	12.2	13.1	15.1	16.0	16.0	15.6	17.3	19.6	22.1
Excise tax	9.3	12.3	16.6	16.2	18.3	20.4	22.5	25.2	28.3
Small business tax	2.5	2.9	4.0	4.2	3.9	4.3	4.9	5.5	6.3
Personal income tax	6.1	6.4	7.9	6.8	7.6	8.5	9.7	10.9	12.3
National taxes	9.6	9.1	11.7	10.4	12.2	13.3	14.9	16.6	18.6
Customs duties	13.4	13.9	13.9	13.6	15.6	16.3	18.0	20.2	22.0
Other taxes	1.3	3.4	1.6	1.6	2.2	2.4	2.7	3.1	3.6
Property and local taxes	2.7	4.5	6.7	5.4	5.8	6.4	7.0	7.9	8.8
Social insurance contributions	25.6	28.6	33.1	32.9	36.7	40.4	43.9	48.3	53.0
Non-tax revenue:	21.5	19.2	17.7	15.8	17.4	19.0	20.6	22.5	24.7
Grants 2/	4.1	2.6	6.6	3.0	6.9	6.3	5.9	6.3	6.4
Total Expenditure	196.0	198.1	241.2	222.4	248.7	263.4	283.8	312.4	341.8
Current Expenditure	154.6	167.7	186.0	182.3	194.6	207.5	220.8	238.6	257.2
Personnel cost	41.9	44.7	51.1	50.8	55.2	57.4	60.3	63.3	66.5
Interest	24.8	29.8	31.1	28.9	29.9	31.2	32.5	35.9	38.9
Domestic	22.5	28.2	28.6	26.8	27.3	27.7	27.9	30.0	32.4
Foreign	2.3	1.6	2.4	2.1	2.6	3.5	4.6	5.8	6.5
Operations & maintenance	20.5	22.2	21.0	21.6	22.0	25.1	26.6	28.3	30.1
Subsidies	6.2	5.1	4.2	3.7	2.7	2.7	2.5	2.5	2.5
Social insurance outlays	40.2	44.8	49.5	49.5	55.2	60.4	65.3	71.7	78.5
Local government expenditure	12.2	14.2	17.6	16.2	17.7	19.3	21.1	23.4	25.8
Social protection transfers	8.7	8.8	10.0	9.9	10.5	11.4	12.4	13.6	14.9
Arrears settlement	...	...	1.6	1.6	1.5	0.0	0.0	0.0	0.0
Other 3/	0.0	-2.0	...	0.0	...	...	...	...	...
Capital Expenditure	42.0	31.5	51.7	40.8	50.5	52.1	59.2	70.0	80.8
Domestically financed	19.0	18.3	29.3	30.6	28.0	30.4	37.1	46.7	58.8
Foreign financed projects	23.0	13.2	22.4	10.2	22.6	21.7	22.1	23.3	22.0
Net lending	-0.6	-1.1	0.0	-0.8	0.0	0.0	0.0	0.0	0.0
Reserve and contingency funds	...	...	3.5	0.0	3.6	3.8	3.8	3.8	3.8
Cash Balance	-41.4	-30.9	-48.1	-37.9	-42.2	-39.2	-39.4	-40.6	-40.8
Current Balance 4/	-4.1	-3.2	0.4	-0.7	4.0	9.3	16.7	25.8	36.4
Financing	41.4	30.9	48.1	37.9	42.2	39.2	39.4	40.6	40.8
Domestic	20.8	20.9	35.0	31.6	28.3	28.5	27.9	30.4	33.1
Privatization receipts	0.5	0.9	19.0	15.7	5.0	3.6	2.0	2.0	2.0
Net borrowing 5/	20.4	20.0	15.9	15.9	23.4	24.9	25.9	28.4	31.1
Foreign	20.6	10.0	13.1	6.2	13.8	10.7	11.5	10.2	7.7
o/w Budget support	4.0	2.1	2.0	1.8	1.1	0.5	0.0	0.0	0.0
Memorandum Items:									
Primary balance	-16.6	-1.1	-17.0	-8.9	-12.3	-8.1	-6.9	-4.8	-1.9
Public Debt (including guarantees)	408.2	421.6	457.2	431.6	466.9	506.9	548.1	591.7	635.2
Domestic general government	260.8	280.8	298.9	296.7	320.1	345.0	370.8	399.2	430.4
External	147.4	140.8	158.3	134.9	146.8	161.9	177.3	192.5	204.8

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.

All budget and staff projection numbers are presented as a percent of revised GDP to facilitate comparison.

2/ Information on grants prior to 2002 are estimates.

3/ Includes statistical discrepancy

4/ Revenue excluding grants minus current expenditure.

5/ Net borrowing in 2004 takes into account 0.9 percent of GDP Savings Bank privatization receipts used to redeem domestic debt.

Table 6. Albania: Priority Expenditure

	1997	1998	1999	2000	2001	2002	2003	2004 1/	2005 1/
	(In millions of Lek)								
Education	11,197	13,612	16,850	17,192	19,488	19,034	21,269	28,721	25,783
Health	6,269	7,985	12,066	12,334	12,027	13,719	15,699	20,907	22,144
Local government	385	910	8,038	7,669	9,404	12,230	14,244	17,621	17,655
Social security and welfare	25,011	29,723	32,791	37,528	41,924	45,277	49,242	54,388	59,729
Social insurance outlays	18,533	21,934	24,981	28,948	33,104	36,564	40,419	44,353	49,279
Social assistance	4,274	6,168	6,360	6,661	6,939	7,598	7,824	8,735	9,400
Unemployment insurance	2,204	1,621	1,450	1,919	1,881	1,115	999	1,300	1,050
<i>Total</i>	42,862	52,230	69,745	74,723	82,843	90,260	100,454	121,637	125,311
	(In percent of GDP)								
Education	3.5	3.3	3.6	3.2	3.3	3.0	3.1	3.7	3.0
Health	1.9	1.9	2.5	2.3	2.0	2.2	2.3	2.7	2.6
Local government	0.1	0.2	1.7	1.4	1.6	1.9	2.0	2.3	2.1
Social security and welfare	7.8	7.2	6.9	7.1	7.1	7.2	7.1	7.0	7.0
Social insurance outlays	5.8	5.3	5.3	5.5	5.6	5.8	5.8	5.7	5.7
Social assistance	1.3	1.5	1.3	1.3	1.2	1.2	1.1	1.1	1.1
Unemployment insurance	0.7	0.4	0.3	0.4	0.3	0.2	0.1	0.2	0.1
<i>Total</i>	13.3	12.7	14.7	14.1	14.1	14.3	14.5	15.6	14.6
	(In percent of total government expenditure)								
Education	11.1	9.6	10.2	10.1	10.5	9.7	10.7	11.6	10.4
Health	6.2	5.6	7.3	7.3	6.5	7.0	7.9	8.5	8.9
Local government	0.4	0.6	4.9	4.5	5.1	6.2	7.2	7.1	7.1
Social security and welfare	24.8	20.9	19.8	22.2	22.6	23.1	24.9	22.0	24.0
Social insurance outlays	18.3	15.4	15.1	17.1	17.8	18.7	20.4	18.0	19.8
Social assistance	4.2	4.3	3.8	3.9	3.7	3.9	4.0	3.5	3.8
Unemployment insurance	2.2	1.1	0.9	1.1	1.0	0.6	0.5	0.5	0.4
<i>Total</i>	42.4	36.7	42.1	44.1	44.6	46.1	50.7	49.2	50.4
<b>Memorandum items:</b>									
GDP (Lek mns.)	322,186	412,326	474,291	530,906	588,664	630,000	695,068	780,100	857,300
Total Government expenditure (Lek mns.)	101,006	142,304	165,616	169,424	185,751	195,993	198,054	247,038	248,676

Sources: Albanian authorities; and staff estimates.

1/ Budget plans as approved by Parliament for 2004 and 2005. Other years reflect budget outcomes.



Table 7. Albania: Monetary Aggregates, 2002-09 1/  
(In billions of Leks unless otherwise indicated, end-period)

	2002		2003		2004		2005		2006		2007		2008		2009		
	Dec.	Dec.	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.	4th Review	Dec.	Dec.	Dec.	4th Review	Dec.	Dec.	Dec.	
<b>Monetary survey</b>																	
Broad money	408.1	443.5	450.2	452.6	483.1	493.3	499.3	504.5	544.9	607.5	672.4	681.4	775.5	882.3			
Currency outside banks	130.8	125.2	117.2	118.2	126.2	135.0	135.8	132.7	147.8	160.4	181.0	175.8	195.4	213.5			
Deposits	277.4	318.3	333.0	334.4	356.8	360.8	365.5	371.8	397.1	447.1	491.3	505.6	580.1	668.8			
Domestic currency deposits	190.8	226.1	236.6	237.0	247.0	247.8	253.6	260.0	276.1	280.1	316.3	354.4	416.3	481.8			
Demand deposits	15.1	16.8	20.4	19.5	25.0	...	23.1	22.6	...	24.7	27.3	29.9	33.3	36.3			
Time deposits	175.7	209.3	216.3	217.5	222.0	...	230.5	237.4	...	255.5	289.0	...	383.1	445.5			
Foreign currency deposits	86.5	92.2	96.4	97.4	109.8	113.0	109.9	111.8	121.0	120.9	136.9	143.4	163.7	187.0			
Demand deposits	22.7	21.2	23.6	25.1	27.2	...	...	...	...	...	...	...	...	...			
Time deposits	63.8	71.0	72.8	72.3	82.6	...	...	...	...	...	...	...	...	...			
Net foreign assets	164.4	161.8	165.8	170.2	193.7	185.2	194.4	190.4	189.7	196.3	194.3	207.6	219.6	223.8			
Bank of Albania 2/	96.9	99.8	99.1	107.1	116.5	111.3	117.9	117.7	120.9	130.7	148.6	170.9	196.8	213.4			
Commercial Banks	67.5	62.0	66.7	63.1	77.3	73.9	76.5	72.7	68.9	65.6	56.8	36.6	22.8	10.5			
Net domestic assets	243.8	281.7	284.4	282.4	289.3	310.6	304.9	314.1	355.1	407.0	478.1	473.8	555.9	658.5			
Claims on government (net of deposits)	245.3	260.1	264.4	253.1	258.0	273.8	269.7	273.9	294.2	286.6	336.5	326.8	349.3	374.2			
BOA financing	71.0	64.6	60.5	51.9	51.2	67.2	62.6	61.0	70.5	64.1	70.5	61.9	61.8	70.7			
Other (including T-bills)	174.3	195.5	203.9	201.2	206.8	206.5	207.1	213.0	223.7	222.5	242.2	246.0	287.6	303.5			
Claims on state enterprises and farms	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 3/	39.9	52.3	54.9	58.2	62.4	68.7	69.5	75.3	93.1	97.4	133.0	173.8	234.2	309.0			
In Leks	9.2	10.6	11.1	11.2	11.9	14.8	13.2	13.6	27.0	20.4	33.4	85.4	75.9	117.5			
In foreign currency	30.7	41.7	43.8	47.0	50.5	53.9	56.3	61.7	66.1	77.0	99.6	88.5	126.3	191.4			
Other items, net	-41.5	-30.8	-34.9	-28.9	-31.1	-31.9	-34.3	-35.2	-32.2	-34.3	-32.2	-30.2	-27.6	-24.7			
<b>Memorandum items:</b>																	
Reserve money (billions of Lek)	163.9	160.6	154.4	157.0	166.5	176.2	176.1	173.3	188.8	210.0	204.6	231.9	259.8	287.7			
M1 (billions of Lek)	145.9	142.0	137.5	137.7	151.2	153.1	158.9	155.3	167.6	169.6	187.7	208.1	228.7	249.9			
M2 (Billions of Lek)	321.6	351.3	353.8	355.2	373.2	382.8	389.4	392.7	423.9	425.1	476.7	535.4	577.9	693.3			
Annual broad money growth	5.7	8.7	9.5	7.3	10.5	11.8	12.6	12.1	9.9	9.3	11.3	11.8	12.2	13.8			
Annual reserve money growth	7.7	-2.0	-2.2	3.5	5.9	9.8	9.7	12.2	7.1	7.5	10.8	5.0	10.4	10.8			
Annual growth in private sector credit	41.0	31.1	31.6	26.5	25.7	31.3	32.9	37.3	35.5	40.1	36.6	34.7	33.2	31.9			
Annual M1 growth	6.9	-2.7	0.3	1.5	9.2	7.8	11.9	12.9	9.5	6.7	10.7	11.4	9.6	9.3			
Annual M2 growth	6.4	9.2	8.9	6.0	9.3	9.0	10.8	11.0	10.7	9.2	12.1	13.9	12.8	13.7			
Velocity (annual, GDP/BM)	1.5	1.6	1.6	1.6	1.6	1.7	1.6	1.6	1.7	1.6	1.6	1.6	1.5	1.4			
Money multiplier (absolute values)	2.5	2.8	2.9	2.9	2.9	2.8	2.8	2.9	2.9	2.9	3.3	2.9	3.0	3.1			
Currency/Broad Money ratio	32.0	28.2	26.0	26.1	26.1	27.2	27.2	26.3	27.1	26.5	26.4	26.9	25.8	24.2			
Foreign currency deposits/total deposits	31.2	29.0	28.9	29.1	30.8	31.3	30.2	30.1	30.5	30.1	29.3	27.9	28.4	28.0			
Gross reserves (millions of U.S. dollars)	860	1026	1028	1140	1244	1132	1374	1331	1227	1459	1624	1384	1830	2069			
In percent of broad money	28.2	24.6	24.3	25.6	26.1	24.3	25.5	25.4	23.9	25.8	25.9	21.8	26.2	24.7			
US Dollar Exchange Rate (end of period)	133.9	106.4	106.4	101.5	101.2	...	...	...	...	...	...	...	...	...			
Euro Exchange Rate (end of period)	138.3	133.8	130.1	122.8	124.6	...	...	...	...	...	...	...	...	...			
3-month T-bill rate (in percent)	11.4	7.3	7.1	6.9	6.5	...	...	...	...	...	...	...	...	...			
BoA repo rate (in percent)	8.5	6.5	6.5	5.8	5.5	...	...	...	...	...	...	...	...	...			

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 BART.

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	1190	1408	1446
Public and publicly guaranteed debt (excluding arrears)	404	523	630	706	782	1057	1285	1340
Multilateral	221	304	419	492	523	659	824	868
EBRD	9	9	8	8	9	14	28	35
EIB	0	1	15	27	35	50	72	80
IDA	148	220	296	345	366	476	583	604
IDB	0	1	1	2	5	10	14	14
IFAD	5	8	12	13	15	21	29	30
IMF	56	62	80	89	84	77	85	91
OPEC	2	4	6	7	8	12	14	15
Bilateral	183	218	211	214	259	398	461	472
Rescheduled debt	32	27	20	18	40	117	115	125
Paris club members	32	27	20	18	17	55	52	50
Austria	6	4	3	2	1	1	1	1
France	13	10	8	5	4	3	2	2
Germany	11	10	8	5	7	6	6	5
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	37
Japan	0	0	0	0	0	0	0	0
Non Paris Club Members	0	0	0	0	23	62	62	75
Turkey	0	0	0	0	23	23	23	23
China	0	0	0	0	0	40	40	38
Hungary	0	0	0	0	0	0	0	14
FYR Macedonia	0	0	0	0	0	0	0	1
Post cut-off debt	151	192	191	196	218	281	346	347
Paris Club members	129	157	156	153	158	211	270	273
Austria	5	5	5	4	4	2	2	2
Germany	46	58	50	50	53	72	96	99
Italy	61	74	71	69	76	110	134	131
Japan	17	21	31	29	25	28	37	41
Non-Paris Club	22	34	35	43	60	69	76	74
China	2	2	2	2	2	2	2	2
Greece	0	11	11	11	12	14	17	17
Kuwait	13	15	16	15	16	23	30	30
Norway	3	3	3	11	26	26	23	22
Sweden	4	4	4	4	4	4	4	4
Arrears	473	484	478	467	416	133	124	106
Convertible currency	134	134	134	131	91	68	68	60
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	51	51	44
Non-convertible currency 3/	169	172	172	161	162	13	13	9
Commercial	52	52	39	37	34	33	21	20
Cumulative Overdue Interest 4/	118	126	133	137	129	19	22	17
Memorandum items:								
Total debt (percent of GDP)	40.8	34.5	31.6	31.8	27.8	25.3	21.6	17.2
Total arrears (percent of GDP)	22.0	16.6	13.6	12.7	9.6	2.8	1.9	1.3

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

1/ As of September 30, 2004.

2/ It includes only post-1978 amount.

3/ It consists of bilateral clearing accounts in rubles converted to US\$ assuming an 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, 2001–07  
(In millions of U.S. dollars)

	2001	2002	2003	2004	2005	2006	2007
				Projections			
Current account	262	435	469	528	625	638	623
Amortization	21	42	39	49	91	129	142
o/w: IMF	14	14	10	9	10	12	14
Change in gross reserves (increase = +)	146	58	78	288	85	165	206
Reduction in arrears	29	280	-1	17	62	44	0
<b>Total financing requirement</b>	<b>457</b>	<b>814</b>	<b>585</b>	<b>882</b>	<b>862</b>	<b>976</b>	<b>972</b>
<b>Available financing</b>	<b>457</b>	<b>814</b>	<b>585</b>	<b>882</b>	<b>780</b>	<b>918</b>	<b>967</b>
Official grants	123	125	146	149	157	156	160
Foreign direct investment	204	135	178	326	308	339	407
Private financing flows	-130	53	43	-134	216	220	237
Official medium- and long-term loans	90	121	114	102	177	202	212
Multilateral (excluding IMF)	56	84	85	76	139	144	138
Bilateral	34	37	30	26	38	59	74
IMF disbursements	12	5	11	12	0	0	0
Other 1/	121	64	75	391	-101	2	-48
Debt rescheduling	33	283	0	17	0	0	0
Budget support	4	29	19	0	0	0	0
Identified financing (provisional)	0	0	0	18	22	0	0
o/w: IMF PRGF	0	0	0	0	12	0	0
o/w: WB FSAC/PRSC	0	0	0	18	10	0	0
Financing gap	0	0	0	0	82	58	5
Expected EU macro-financial assistance	...	...	...	...	20	13	0
Debt rescheduling (mostly bilateral official donors)	...	...	...	...	62	44	0
Other	...	...	...	...	0	0	5

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

1/ Includes errors and omissions

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 Est.
Public and publicly guaranteed debt 1/	75.6	68.5	66.7	71.7	66.8	64.8	60.7	55.3
Broad money (percent change, end of period)	28.5	20.6	22.3	12.0	20.2	5.7	8.7	12.6
Private Sector credit (percent change, end of period)	19.0	14.7	13.3	31.8	23.4	41.0	31.1	32.9
Interest rate (3-mth T-bills, end period)	35.9	20.4	15.0	7.8	8.0	11.1	7.3	6.1
Foreign currency deposits (share of total deposits)	28.9	23.5	25.2	27.8	32.3	31.2	29.0	30.2
Exports (annual percent change, in US dollars)	-27.1	22.9	34.2	-7.1	19.3	8.4	35.5	36.0
Imports (annual percent change, in US dollars)	-25.6	20.6	35.7	-4.0	23.7	11.5	20.1	28.0
Current account balance								
(excluding official transfers)	-12.2	-7.1	-7.9	-7.4	-6.4	-9.7	-8.2	-7.0
(including official transfers)	-8.7	-3.9	-3.9	-4.4	-3.3	-7.0	-5.5	-5.0
Capital and financial account balance	3.8	3.6	6.4	8.6	6.9	9.0	7.9	5.4
o/w: Foreign direct investment	1.9	1.6	1.5	3.9	5.0	3.0	3.1	4.3
Gross official reserves (in US dollars, millions)	306	388	485	608	737	860	1026	1374
Official reserves in months of imports (goods and services)	3.8	3.7	3.8	4.1	4.3	4.0	3.7	4.1
Official reserves to broad money (ratio)	0.2	0.2	0.2	0.3	0.3	0.3	0.2	0.3
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)	359.5	391.4	178.6	143.7	138.1	207.1	181.3	188.8
Foreign assets of the banking sector (in US dollars, millions)	261.2	355.5	429.0	456.1	610.5	608.1	728.1	976.5
Foreign liabilities of the banking sector (in US dollars, millions)	13.5	20.4	35.8	47.9	88.2	115.8	161.5	151.6
Total external debt (in US dollars, millions) 2/	877	1007	1108	1173	1200	1180	1420	1644
Total external debt 2/	40.8	34.4	31.6	31.5	27.8	25.1	21.7	19.5
o/w: Public or publicly guaranteed 1/	38.1	32.3	29.3	29.1	25.8	23.4	20.3	17.3
Total external debt to exports (percent)	360.8	357.5	186.7	166.2	142.9	128.9	121.6	100.9
Total short term external debt to reserves (percent) 3/	6.6	6.3	4.4	3.4	2.9	5.6	4.8	4.8
External amortization payments to exports (in percent)	3.1	3.4	1.3	1.2	0.9	3.0	2.5	2.4
External interest payments to exports (in percent)	5.3	5.4	2.3	1.7	1.7	2.3	1.7	1.6
External debt service to exports (excluding IMF, in percent)	8.3	8.7	3.6	2.9	2.5	5.3	4.2	4.1
External debt service to exports (including IMF, in percent)	11.6	9.1	4.1	4.0	4.2	6.8	5.0	4.6
External debt service (excluding IMF)	0.9	0.9	0.6	0.6	0.5	1.1	0.9	0.9
External debt service (including IMF)	1.3	0.9	0.7	0.8	0.9	1.4	1.0	1.0
Change in REER (+ appreciation)	3.3	11.2	14.7	3.9	9.8	-10.9	4.0	2.7
Exchange rate (period average)								
(lek per US dollar)	146.7	151.1	138.1	142.6	143.7	140.2	121.5	103.8
(lek per euro)	168.6	168.4	147.4	132.8	128.9	132.2	138.4	127.7

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

1/ Excludes the IMF.

2/ Includes IMF and external arrears.

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

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

	2002	2003	2004	2005	2006	2007	2008	2009
			Est.			Projections		
Obligations from existing drawings								
1. Principal								
PRGF Repayments	6.2	6.8	6.4	6.2	7.6	9.4	9.6	9.1
GRA repurchases	4.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2. Charges and Interest 1/								
PRGF Interest	0.3	0.2	0.3	0.3	0.2	0.2	0.2	0.1
SDR Net Charges	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Obligations	11.0	7.0	6.7	6.4	7.8	9.6	9.8	9.2
(percent of quota)	23	14	14	13	16	20	20	19
Obligations from prospective drawings								
1. Principal								
PRGF Repayments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2. Charges and Interest 1/								
PRGF Interest	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1
Total Obligations	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1
(percent of quota)	0	0	0	0	0	0	0	0
Cumulative obligations (existing and prospective)								
1. Principal								
PRGF Repayments	10.6	6.8	6.4	6.2	7.6	9.4	9.6	9.1
2. Charges and Interest 1/								
PRGF Interest	0.3	0.2	0.3	0.3	0.3	0.3	0.2	0.2
SDR Net Charges	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Obligations	11.0	7.0	6.7	6.5	7.9	9.7	9.8	9.2
(percent of quota)	23	14	14	13	16	20	20	19
Outstanding Fund credit 2/	59.6	60.8	62.4	64.3	56.7	47.3	37.6	28.5

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

2/ End of year value.

Table 12. Albania: Indicators of Fund Credit, 1998-2004  
(SDR Million unless otherwise indicated)

	1998	1999	2000	2001	2002	2003	2004 Est.
<b>Outstanding credit</b>							
Stand-By Arrangement	8.8	8.8	8.8	4.4	0.0	0.0	0.0
ESAF/PRGF	36.9	49.9	58.6	61.8	59.6	60.8	62.4
Total	45.8	58.7	67.5	66.3	59.6	60.8	62.4
In percent of quota	129.7	120.5	138.5	136.0	122.4	124.9	128.2
In percent of exports (GNFS)	22.0	13.5	12.6	10.0	8.4	7.3	5.4
In percent of total public external debt	6.2	7.2	7.6	7.0	6.6	6.0	5.7
<b>Purchases and Disbursements</b>							
Stand-By Arrangement	0.0	0.0	0.0	0.0	0.0	0.0	0.0
ESAF/PRGF	5.9	15.5	14.3	9.4	4.0	8.0	8.0
Total	5.9	15.5	14.3	9.4	4.0	8.0	8.0
In percent of quota	16.7	31.8	29.3	19.3	8.2	16.4	16.4
In percent of exports (GNFS)	2.8	3.6	2.7	1.4	0.6	1.0	0.7
<b>Debt Service</b>							
Principal	0.9	2.5	5.5	10.6	10.6	6.8	6.4
Interest and charges	0.6	0.6	0.7	0.7	0.4	0.3	0.3
Total	1.4	3.1	6.2	11.3	11.0	7.1	6.7
In percent of exports (GNFS)	0.7	0.7	1.2	1.7	1.6	0.9	0.6
In percent of total external debt service	7.6	17.3	29.4	41.8	24.5	18.2	12.4
Net Fund Financing	4.4	12.3	8.0	-1.9	-7.0	0.9	1.3
<b>Memorandum items:</b>							
Exchange Rate (US dollars per SDR)	1.36	1.37	1.32	1.27	1.30	1.40	1.41
Quota (in millions of SDRs)	35.3	48.7	48.7	48.7	48.7	48.7	48.7
Exports of GNFS (in millions of US dollars)	281.6	593.7	705.5	839.5	915.2	1167.1	1609.9
Public external debt (millions of US dollars) 1/	1006.7	1108.3	1172.6	1198.4	1178.2	1408.6	1549.4
External debt service (millions of US dollars)	25.8	24.6	28.0	34.3	58.2	54.6	76.1

Source: Albanian authorities, Fund staff estimates.

1/ Includes IMF and arrears.

Table 13. Albania: Schedule of Disbursements 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.
March 2005	4.0	8.21	Observance of end-September 2004 performance criteria and completion of fifth review.
October 2005 2/	4.0	8.21	Observance of end-March 2005 performance criteria and completion of sixth review.
Total	28.0	57.49	

1/ Albania's quota is SDR 48.7 million.

2/ Assumes an extension of the program until November 2005.

**ALBANIA: FUND RELATIONS**

As of December 31, 2004

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

II. <b>General Resources Account:</b>	<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. <b>SDR Department:</b>	<u>SDR Million</u>	<u>Percent Allocation</u>
Holdings	64.90	N/A
IV. <b>Outstanding Purchases and Loans:</b>	<u>SDR Million</u>	<u>Percent Quota</u>
PRGF arrangements	62.43	128.20

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	20.00
PRGF	05/13/1998	07/31/2001	45.04	45.04
PRGF	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):

	Forthcoming				
	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
Principal	6.17	7.60	9.41	9.62	9.08
Charges/Interest	0.30	0.26	0.22	0.17	0.12
Total	6.47	7.86	9.63	9.79	9.21

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 June 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 exchange rate stood at 92.7 lek per U.S. dollar on December 31, 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 scheduled for early 2005. 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: IMF-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 emphasizes 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 55 operations amounting to US\$764 million, of which US\$605.9 millions have been disbursed. For the remainder of FY05, the Bank will continue to use 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 completed its Poverty Reduction Support Credit (PRSC) program, and is still planning up to 4 possible investment operations in power, transport, and environment expected to be approved before July 2005.

The PRSC-1 was presented to the Board in June 2002, the PRSC-2 in July 2003 and the PRSC-3 in early December 2004. The disbursement of the PRSC3 took place at end December 2004. The PRSCs provided 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. Beyond the PRSC program, the Government confirmed its commitment to continue with the necessary actions to enhance performance in priority areas, improve governance and give a new impetus to private sector development as outlined in their Letter of Development Policy.

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 (FSAC), 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. The second and final tranche of the Bank's FSAC is expected to be disbursed in late 2004. Progress gained further momentum during 2004, on other elements of the program as well, such as, insurance sector legal and regulatory framework and bankruptcy framework, resulting in completion of all the Government's obligations under the FSAC. The second and final tranche of the FSAC was disbursed on December 24, 2004. The Government has reconfirmed its commitment and has indicated its intention to continue with the overall reforms beyond the FSAC Closing Date of December 31, 2004. The upcoming FSAP will lay down a structured program of reform that the Bank would support in close collaboration with the IMF.

- *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 resulted 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, at the end of 2000 the Government began to develop, in consultation with the World Bank, the multi-year power sector action plan. The main objectives of this action plan are: to curtail illegal use of electricity; to improve the financial situation of KESH; to reduce excessive demand and budgetary subsidies; and to increase domestic generating capacity. Implementation of this plan has been largely successful and there have been significant improvements in power sector performance. However, much still remains to be done and significant investments are required to increase domestic generation capacity and to upgrade the existing transmission and

distribution network. The power sector action plan for the period 2005-2007 was recently finalized. It takes into account the progress achieved so far in improving the electricity situation within Albania, as well as additional proposals and requirements to further improve performance and secure funding for additional investments.

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, with cofinancing from EBRD and EIB. The Bank and the Fund support the Government's strategy for overcoming the crisis in the electricity sector and agree with the authorities that sustained implementation of the agreed measures to improve the performance in the power sector 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 Social Insurance Institute (SII) reports that the deficit of the social insurance system, had fallen to 0.25 percent of GDP in 2003, compared with 3.3 percent of GDP in 1993. This needs to be considered, however, in conjunction with arrangements whereby the state budget now finances unemployment and maternity benefits, for which the Social Insurance Institute continues to collect social insurance contributions. Projections made in 2002 showed that the deficit would have increased significantly in the medium to longer term in the absence of the reforms that the Government has adopted.

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 related conditionality 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. The Bank has completed and submitted to Government for comments a comprehensive SSNS (Social Safety Net Study) in November 2004.

- *Public expenditure management*

Key challenges include: (i) ensuring that Government efforts 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 NSSD with the preparation of the MTBP. Continuing work to improve the linkages of the annual budget with the MTBP, and the latter with the NSSD is an important focus of both the Bank and the Fund.

To increase the effectiveness of the NSSD 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 NSSD. 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.<sup>1</sup> 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 been improved in 2003. 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 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

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



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 and later in the year preliminary estimates for 2001 GDP. Preliminary estimates for the 2002 GDP and revised estimates for the 2001 GDP were published in September 2004. 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 (November 2003–November 2005). The project is aimed at further improving the national accounts estimates and basic source data. The Italian National Institute of Statistics (Istat) and the National Statistics Office of Finland (Statistics Finland) are providing technical assistance to INSTAT following the project contract.

A STA statistical mission visited Albania in November 2004 to assist the authorities in improving the timeliness of the national accounts data. The authorities agreed with the proposed approaches for compiling and disseminating early annual estimates and experimental quarterly estimates..

### **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*. 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 about 130 SCAs throughout the country and they report data to the BoA using a simplified report form.

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 November 2004 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. It also recommended incorporating the results of the direct investment survey as well as investigation and follow up of the net errors and omissions observed at the level of individual reporting banks. 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 January 26, 2005)

	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	Jan 14	Jan 13	November	November	November	Jan 11	December	August	June	November	2002	September
Date Received	Jan 14	Jun 14	December	December	January	Jun 13	January 10	January	September	December	September 2004	November
Frequency of Data	Daily	Daily	Monthly	Monthly	Monthly	Weekly	Monthly	Monthly	Quarterly	Monthly	Annual	Quarterly
Frequency of Reporting	Daily	Daily	Monthly	Monthly	Monthly	Weekly	Monthly	Quarterly	Variable	Monthly	Annual	Variable
Frequency of Publication	Daily	Monthly	Monthly	Monthly	Monthly	Weekly	Monthly	Quarterly	Variable	Monthly	Annual	--
Source of Update	BoA	BoA	BoA	BoA	BoA	BoA	INSTAT	Customs/ BoA/INSTAT	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	E-mail	Fax/Mission	Mission
Confidentiality	UR	UR	UR	UR	UR	UR	UR	UR	UR	UR	UR	UR

List of abbreviations:

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

### DEBT SUSTAINABILITY ANALYSIS

**Albania's external debt sustainability has strengthened significantly in the past ten years.** Rapid growth, cautious public indebtedness policies, and debt restructuring have allowed a continuous decrease in the debt-to-GDP ratio and debt-to-exports ratio (both in NPV and nominal terms). Over the medium-term, external indebtedness is projected to decline as a share of GDP, with the projected total debt service-to-exports ratio remaining at manageable levels, between 5 and 7 percent. This outcome appears fairly robust to several stress scenarios. It is sensitive, however, to an adverse export shock (of one historical standard deviation) at the beginning of the projection period. This is partly due to the high historical volatility of export growth in Albania (the standard deviation during 1996–2003 was 39.5 percentage points compared to the average growth of 23.3 percent). But this result also highlights the need to significantly raise and diversify exports as a way to improve economic growth potential, and reduce external vulnerability and dependence on migrant remittances and other transfers from abroad. Other bound tests also impact negatively on debt sustainability ratios compared to the baseline but not to the extent of compromising debt sustainability in the long run.

**The ratio of total public debt to GDP has been steadily declining and is projected to be 55 percent at end-2004 compared with 72 percent in 2000.** In 2003–2004 the debt ratios declined at a faster pace thanks to the accounting effect of the lek appreciation. The baseline scenario is based on the continuation of current patterns of indebtedness and incorporates a gradual switch to less concessional credit sources.

**The most significant risk to total public debt sustainability pertains to the case of a shortfall in growth.** The stress test based on a one standard deviation decline in the real growth rate in 2005 and 2006 indicates a 17 percentage points of GDP increase in the NPV of debt stock relative to the baseline scenario. While this is a very stringent test due to the high standard deviation of the historical growth rate (6.4 percent) and the assumption of no fiscal response, it also helps underline the importance of sustained growth in keeping the debt burden manageable. None of the other stress tests and alternative scenarios result in an increase in the NPV of debt stock of more than 5 percent of GDP in the five year projection period, implying an end-2009 debt stock about or below its 2003 level.

Table Ia. Albania: External Debt Sustainability Framework, Baseline Scenario, 1995-2023 1/  
(In percent of GDP, unless otherwise indicated)

	Actual												Est.											
	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2008	2009	2010	2011	2012	2015	2018	2023				
External debt (nominal) 1/	29.0	28.1	40.8	34.5	31.6	31.8	27.8	25.1	21.7	19.5	19.5	19.3	18.7	18.0	18.4	16.9	17.4	16.8	16.1	14.4				
o/w public and publicly guaranteed (PPG) 2/	29.0	28.1	40.8	34.5	31.6	31.8	27.8	25.0	21.6	18.4	18.2	18.1	17.8	17.1	17.5	16.1	16.7	16.1	15.5	13.8				
o/w private	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.2	1.2	1.3	1.2	0.9	0.8	0.9	0.7	0.7	0.7	0.6	0.5				
Change in external debt	-21.1	-1.0	12.7	-6.2	-2.9	0.2	-4.0	-2.7	-3.3	-2.2	0.0	-0.2	-0.4	-0.7	0.4	-1.5	0.5	-0.2	-0.2	-0.3				
Identified net debt-creating flows	-10.3	0.2	17.3	-5.7	-4.7	-1.6	-4.8	1.4	-0.3	-2.6	0.4	1.5	-0.3	-0.5	-1.1	-0.5	-0.2	-1.1	-1.2	-1.4				
Non-interest current account deficit	6.1	8.4	11.6	6.6	7.5	7.1	6.0	9.2	7.9	6.7	6.5	6.0	4.9	4.9	4.4	4.5	4.8	4.0	4.0	4.1				
Deficit in balance of goods and services	19.7	24.4	26.3	25.5	19.2	22.1	23.2	25.8	24.8	22.9	22.2	20.8	19.5	19.3	19.1	17.4	17.7	17.3	17.8	18.7				
Exports	11.1	11.6	11.1	10.3	17.3	19.1	20.5	20.4	20.4	21.7	22.9	24.8	29.2	31.3	32.9	30.0	30.2	32.5	34.2	37.3				
Imports	30.8	36.0	37.3	35.8	36.5	41.3	43.7	45.2	45.2	44.6	45.2	45.6	48.7	50.6	52.0	47.4	47.9	49.8	52.0	56.0				
Net current transfers (negative = inflow)	-11.1	-14.1	-11.4	-16.1	-9.5	-11.9	-13.2	-13.3	-13.7	-14.0	-13.4	-12.6	-12.1	-11.9	-12.1	-10.6	-10.8	-11.4	-12.0	-13.2				
Other current account flows (negative = net inflow)	-2.5	-1.8	-3.2	-2.8	-2.2	-3.1	-3.9	-3.3	-3.3	-2.3	-2.2	-2.2	-2.5	-2.5	-2.6	-2.3	-2.2	-1.9	-1.7	-1.4				
Net FDI (negative = inflow)	-3.3	-3.2	-1.9	-1.6	-1.5	-3.9	-5.0	-3.0	-3.1	-4.3	-3.5	-3.5	-4.3	-4.6	-4.5	-4.2	-4.3	-4.4	-4.6	-4.9				
Official transfers (negative = inflow)	-4.3	-2.6	-3.5	-3.3	-4.1	-3.0	-2.8	-2.8	-2.6	-2.0	-1.9	-1.6	-1.5	-1.3	-1.3	-1.1	-1.0	-0.8	-0.7	-0.5				
Endogenous debt dynamics 3/	-8.8	-2.5	11.0	-7.4	-6.7	-1.8	-2.8	-2.0	-5.0	-7.4	-6.8	-6.8	-6.8	-6.8	-6.8	-6.8	-6.8	-6.8	-6.8	-6.8				
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	0.6	0.7	0.7	0.6	0.6	0.6	0.6	0.6	0.5				
Contribution from real GDP growth	-3.7	-2.4	4.0	-4.2	-2.8	-2.2	-2.1	-0.9	-1.2	-1.0	-1.0	-1.1	-1.1	-1.0	-1.0	-1.0	-0.9	-0.9	-0.9	-0.8				
Contribution from price and exchange rate changes	-5.4	-0.5	6.5	-3.8	-4.3	0.0	-1.1	-1.6	-4.2	-4.2	-2.1	-0.5	-0.5	-0.5	-0.6	-0.3	-0.3	-0.3	-0.3	-0.3				
Residual 4/	-10.8	-1.2	-4.6	-0.5	1.8	1.8	0.8	-4.2	-0.5	2.3	1.4	-0.1	1.3	1.1	2.8	0.1	1.7	1.7	1.0	1.1				
o/w exceptional financing	1.1	-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 5/	...	...	...	...	...	...	...	...	16.2	15.6	15.6	14.7	13.2	12.7	13.3	11.9	11.8	11.0	9.6	6.6				
In percent of exports	...	...	...	...	...	...	...	...	90.8	80.5	68.0	58.9	45.0	40.4	40.1	39.5	39.0	33.9	28.0	17.7				
NPV of PPG external debt	...	...	...	...	...	...	...	...	16.1	14.4	14.4	13.5	12.3	11.8	12.4	11.1	11.0	10.3	9.0	6.1				
In percent of exports	...	...	...	...	...	...	...	...	89.9	74.5	62.5	54.3	42.0	37.7	37.5	37.0	36.6	31.8	26.2	16.3				
Debt service-to-exports ratio (in percent)	3.2	7.5	11.6	9.1	4.1	4.0	4.1	6.8	5.0	4.6	6.6	7.7	6.8	6.4	5.5	5.5	5.4	5.1	4.6	3.7				
PPG debt service-to-exports ratio (in percent)	3.2	7.5	11.6	9.1	4.1	4.0	4.1	6.4	4.7	4.1	4.6	5.3	5.1	4.9	4.1	4.2	4.1	4.0	3.7	2.9				
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	0.4	0.3	0.4	0.4	0.3	0.1	0.1	0.2	0.1	0.1	0.0				
Non-interest current account deficit that stabilizes debt ratio	27.2	9.4	-1.0	12.8	10.5	6.9	10.1	11.9	11.2	8.9	6.6	6.2	5.3	5.6	4.0	6.0	4.2	4.2	4.2	4.4				
Key macroeconomic assumptions																								
Real GDP growth (in percent)	8.9	9.1	-10.3	12.7	10.1	7.3	7.2	3.4	6.0	5.9	6.0	6.0	6.0	6.0	6.0	5.9	6.0	6.0	6.0	6.0				
GDP deflator in US dollar terms (change in percent)	12.1	1.8	-18.7	10.2	14.4	0.0	3.7	6.1	20.1	24.0	11.9	2.8	2.9	2.8	3.5	1.9	1.9	1.9	1.9	1.9				
Effective interest rate (percent) 5/	0.7	1.6	1.5	1.7	1.3	1.1	1.2	1.7	1.6	1.9	2.7	3.2	4.1	4.1	3.6	3.6	3.7	3.8	3.7	4.0				
Growth of exports of G&S (US dollar terms, in percent)	...	15.5	-30.4	15.9	110.9	18.8	19.0	9.0	27.5	39.6	25.2	18.0	16.9	16.8	9.4	8.9	11.6	9.9	9.9	9.9				
Growth of imports of G&S (US dollar terms, in percent)	...	29.6	-24.3	19.1	28.4	21.3	17.6	15.9	24.6	29.6	19.8	10.3	12.7	13.1	6.9	9.3	9.4	9.4	9.6	9.7				
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	...	...	...	...	30.0	32.5	22.3	18.1	17.7	16.8	16.3	16.2	17.5	16.9	16.0				
Memorandum item:																								
Nominal GDP (billions of US dollars)	2.7	3.0	2.2	2.7	3.4	3.7	4.1	4.5	5.7	7.5	8.9	9.7	11.4	12.4	12.9	15.5	16.8	21.1	26.6	39.1				
Averages and Standard Deviations																								
Real GDP growth (in percent)	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...				
GDP deflator in US dollar terms (change in percent)	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...				
Effective interest rate (percent) 6/	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...				
Growth of exports of G&S (US dollar terms, in percent)	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...				
Growth of imports of G&S (US dollar terms, in percent)	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...				
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...				
Non-interest current account deficit	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...				
Net current transfers (negative = inflow)	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...				
Net FDI (negative = inflow)	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...				
Average 2004-08	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...				
Average 2009-23	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...				

Source: Staff simulations.

1/ Includes both public and private sector external debt.

2/ Includes IMF.

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

4/ 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.

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

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

Table 1b. 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	2016	2018	2020	2023										
<b>Baseline</b>	16	14	14	14	14	13	12	12	12	11	11	11	10	9	8	6										
<b>A. Alternative Scenarios</b>																										
A1. Key variables at their historical averages in 2004-23 1/	16	17	21	23	24	25	27	29	31	31	32	34	36	36	35	34										
A2. New public sector loans on less favorable terms in 2004-23 2/	16	14	14	14	13	12	12	12	14	15	16	17	18	19	19	19										
<b>B. Bound Tests</b>																										
B1. Real GDP growth at historical average minus one standard deviation in 2004-05	16	17	17	18	18	19	19	20	19	20	20	20	19	17	14	11										
B2. Export value growth at historical average minus one standard deviation in 2004-05 3/	16	24	34	47	47	47	47	46	44	42	41	39	35	30	25	19										
B3. US dollar GDP deflator at historical average minus one standard deviation in 2004-05	16	21	24	24	25	25	25	26	27	26	26	26	25	22	19	14										
B4. Net non-debt creating flows at historical average minus one standard deviation in 2004-05 4/	16	23	27	29	31	32	34	36	35	35	35	34	32	29	26	26										
B5. Combination of B1-B4 using one-half standard deviation shocks	16	27	35	35	36	36	36	36	35	35	34	34	32	29	25	20										
B6. One-time 30 percent nominal depreciation relative to the baseline in 2005 5/	16	16	21	21	22	22	23	24	23	23	23	23	22	19	16	12										
<b>NPV of debt-to-GDP ratio</b>																										
<b>Baseline</b>	90	75	63	54	48	42	38	38	37	37	35	34	30	26	21	16										
<b>A. Alternative Scenarios</b>																										
A1. Key variables at their historical averages in 2004-23 1/	90	76	82	86	85	86	89	97	107	110	115	123	133	139	141	144										
A2. New public sector loans on less favorable terms in 2004-23 2/	90	75	69	62	55	48	45	50	54	57	59	60	60	60	58	55										
<b>B. Bound Tests</b>																										
B1. Real GDP growth at historical average minus one standard deviation in 2004-05	90	83	76	72	68	64	61	65	61	62	61	59	55	47	39	29										
B2. Export value growth at historical average minus one standard deviation in 2004-05 3/	90	210	427	534	405	460	424	419	399	379	356	333	289	239	191	136										
B3. US dollar GDP deflator at historical average minus one standard deviation in 2004-05	90	83	76	71	67	63	59	61	63	59	58	57	52	45	36	26										
B4. Net non-debt creating flows at historical average minus one standard deviation in 2004-05 4/	90	119	135	132	129	127	123	132	126	126	123	120	112	100	89	75										
B5. Combination of B1-B4 using one-half standard deviation shocks	90	147	192	176	165	155	145	147	140	138	133	129	117	101	84	63										
B6. One-time 30 percent nominal depreciation relative to the baseline in 2005 5/	90	84	77	72	68	64	60	64	60	60	59	57	53	44	35	25										
<b>NPV of debt-to-exports ratio</b>																										
<b>Baseline</b>	5	4	5	5	5	5	5	4	4	4	4	4	4	4	3	3										
<b>A. Alternative Scenarios</b>																										
A1. Key variables at their historical averages in 2004-23 1/	5	4	3	4	4	4	4	4	5	5	6	6	7	8	9	10										
A2. New public sector loans on less favorable terms in 2004-23 2/	5	4	3	4	4	4	3	3	3	3	3	4	5	5	5	5										
<b>B. Bound Tests</b>																										
B1. Real GDP growth at historical average minus one standard deviation in 2004-05	5	4	4	4	4	4	4	4	4	4	4	4	4	4	4	3										
B2. Export value growth at historical average minus one standard deviation in 2004-05 3/	5	6	12	17	19	18	21	25	31	30	29	28	27	25	23	18										
B3. US dollar GDP deflator at historical average minus one standard deviation in 2004-05	5	4	4	4	4	4	4	4	4	4	4	4	4	4	4	3										
B4. Net non-debt creating flows at historical average minus one standard deviation in 2004-05 4/	5	4	4	4	4	4	4	4	4	4	4	4	4	4	4	3										
B5. Combination of B1-B4 using one-half standard deviation shocks	5	5	7	9	8	8	9	9	10	10	10	10	10	10	10	9										
B6. One-time 30 percent nominal depreciation relative to the baseline in 2005 5/	5	4	4	4	4	4	4	4	4	4	4	4	4	4	4	3										
<b>Debt service ratio</b>																										
<b>Baseline</b>	...	23	23	23	23	23	23	23	23	23	23	23	23	23	23	23										
<b>A. Alternative Scenarios</b>																										
A1. Key variables at their historical averages in 2004-23 1/	...	23	23	23	23	23	23	23	23	23	23	23	23	23	23	23										
A2. New public sector loans on less favorable terms in 2004-23 2/	...	23	23	23	23	23	23	23	23	23	23	23	23	23	23	23										
<b>B. Bound Tests</b>																										
B1. Real GDP growth at historical average minus one standard deviation in 2004-05	...	23	23	23	23	23	23	23	23	23	23	23	23	23	23	23										
B2. Export value growth at historical average minus one standard deviation in 2004-05 3/	...	23	23	23	23	23	23	23	23	23	23	23	23	23	23	23										
B3. US dollar GDP deflator at historical average minus one standard deviation in 2004-05	...	23	23	23	23	23	23	23	23	23	23	23	23	23	23	23										
B4. Net non-debt creating flows at historical average minus one standard deviation in 2004-05 4/	...	23	23	23	23	23	23	23	23	23	23	23	23	23	23	23										
B5. Combination of B1-B4 using one-half standard deviation shocks	...	23	23	23	23	23	23	23	23	23	23	23	23	23	23	23										
B6. One-time 30 percent nominal depreciation relative to the baseline in 2005 5/	...	23	23	23	23	23	23	23	23	23	23	23	23	23	23	23										
<b>Memorandum item:</b>																										
Grant element assumed on residual financing (i.e., financing required above baseline)	...	23	23	23	23	23	23	23	23	23	23	23	23	23	23	23										

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.

Table 2a. Albania: Public Sector Debt Sustainability Framework, Baseline Scenario, 1997-2009  
(In percent of GDP, unless otherwise indicated)

	Actual										Estimate				Projections				2004-09 Average
	1997	1998	1999	2000	2001	2002	2003	Historical Average 4/ Standard Deviation 4/	2004	2005	2006	2007	2008	2009	2004-09 Average				
<b>Public sector debt 1/</b>	75.6	68.5	66.7	71.7	66.8	64.8	60.7		55.3	54.5	54.1	54.2	53.3	52.2					
o/w foreign-currency denominated	38.1	32.3	29.3	29.1	25.8	23.4	20.3		17.3	17.1	17.3	17.5	17.4	16.9					
Change in public sector debt	22.1	-7.1	-1.8	5.0	-4.9	-2.0	-4.1		-5.3	-0.9	-0.4	0.1	-0.8	-1.1					
Identified debt-creating flows	20.9	-12.4	-0.9	0.8	-2.4	1.6	-6.2		-6.1	0.0	-0.7	-0.2	-1.2	-1.4					
Primary deficit	7.3	1.6	1.9	2.4	3.6	2.6	0.2	2.8	1.1	1.4	0.9	0.7	0.4	0.2	0.8				
Revenue and grants	18.3	24.2	25.5	23.8	23.6	24.5	24.0		23.7	24.1	23.9	24.1	24.4	24.7					
of which: grants	0.7	1.6	2.8	1.0	0.6	0.7	0.4		0.4	0.8	0.7	0.6	0.6	0.5					
Primary (noninterest) expenditure	25.5	25.8	27.5	26.1	27.2	27.2	24.2		24.8	25.5	24.7	24.7	24.8	24.8					
Automatic debt dynamics	13.9	-14.0	-2.6	0.1	-3.8	-0.9	-6.2		-5.3	-0.9	-1.2	-0.7	-1.4	-1.4					
Contribution from interest rate/growth differential	7.5	-8.8	-0.8	-0.7	-2.2	0.1	-1.2		-2.2	-1.3	-1.0	-0.8	-1.3	-1.4					
of which: contribution from average real interest rate	5.3	4.1	5.5	3.8	2.6	2.3	2.5		1.2	1.8	2.0	2.3	1.7	1.6					
of which: contribution from real GDP growth	6.1	-8.5	-6.3	-4.5	-4.8	-2.2	-3.7		-3.4	-3.1	-3.1	-3.1	-3.1	-3.0					
Contribution from real exchange rate depreciation	6.4	-5.2	-1.8	0.8	-1.6	-1.1	-5.0		-3.0	0.5	-0.1	0.1	-0.1	0.0					
Other identified debt-creating flows	-0.3	0.0	0.0	-0.2	-1.7	-2.2	-0.1		-2.0	-0.6	-0.4	-0.2	-0.2	-0.2					
Privatization receipts (negative)	-0.3	0.0	0.0	-0.2	-1.7	-2.2	-0.1		-2.0	-0.6	-0.4	-0.2	-0.2	-0.2					
Recognition of implicit or contingent liabilities	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					
Debt relief (HIPC and other)	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					
Other	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					
Residual, including asset changes	1.2	5.4	-0.9	4.1	-2.5	-3.6	2.0		0.8	-0.9	0.3	0.3	0.4	0.3					
<b>NPV of public sector debt</b>	...	...	...	...	...	...	58.6		52.5	51.7	50.3	49.7	48.3	47.3					
o/w foreign-currency denominated	...	...	...	...	...	...	18.2		14.4	14.4	13.5	13.0	12.3	11.9					
o/w external	...	...	...	...	...	...	18.2		14.4	14.4	13.5	13.0	12.3	11.9					
NPV of contingent liabilities (not included in public sector debt)	...	...	...	...	...	...	...		...	...	...	...	...	...					
NPV of public sector debt-to-revenue ratio	...	...	...	...	...	...	243.7		221.8	214.6	210.8	206.6	198.2	191.8					
o/w external	...	...	...	...	...	...	75.8		61.0	59.6	56.7	54.2	50.6	48.2					
Debt service-to-revenue ratio (in percent) 2/3/	33.8	37.6	30.1	25.1	18.9	17.7	19.3		17.3	16.8	16.2	15.3	15.7	15.6					
Primary deficit that stabilizes the debt-to-GDP ratio	...	...	...	-2.6	8.5	4.7	4.3		6.5	2.3	1.2	0.6	1.3	1.2					
<b>Key macroeconomic and fiscal assumptions</b>																			
Real GDP growth	-10.2	12.7	10.1	7.3	7.2	3.4	6.0	6.4	5.9	6.0	6.0	6.0	6.0	6.0	6.0				
Average nominal interest rate on forex debt	0.8	0.7	0.4	1.7	0.7	1.5	1.1	0.9	1.5	1.9	2.4	2.8	3.3	3.4	2.5				
Average real interest rate on domestic currency debt	10.8	13.8	18.0	11.1	7.1	5.6	6.5	9.1	5.5	3.4	5.3	6.2	4.5	4.5	4.9				
Real exchange rate depreciation (+ indicates depreciation)	20.1	-15.5	-6.2	3.1	-5.9	-4.2	-22.5	-3.8	-16.0	...	...	...	...	...	...				
Inflation rate	9.8	13.6	4.5	4.3	3.4	3.5	4.1	10.4	6.0	3.7	3.0	1.8	3.4	3.5	3.6				
Growth of real primary spending	-2.3	13.8	17.3	2.2	11.6	3.2	-5.6	4.1	8.5	9.1	2.9	6.0	6.4	5.9	6.4				
Grant element of new external borrowing	...	...	...	...	...	...	...	...	30.0	32.5	22.3	19.6	18.1	17.7	23.4				

Sources: Albania authorities, and Fund staff estimates and projections.

1/ Gross debt of the general government including government guaranteed debt.

2/ Revenues including grants.

3/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.

4/ Historical averages and standard deviations are derived over the past 10 years, subject to data availability.



Table 2b. Albania: Sensitivity Analyses for Key Indicators of Public Sector Debt , 2005-2009  
(In percent)

	Actual	Estimate		Projections			
	2003	2004	2005	2006	2007	2008	2009
<b>NPV of Debt-to-GDP Ratio</b>							
<b>Baseline</b>	59	52	52	50	50	48	47
<b>A. Alternative scenarios</b>							
A1. Real GDP growth and primary balance are at historical averages	57	52	53	53	54	54	55
A2. Primary balance is unchanged from 2004	57	52	51	50	50	49	49
A3. Permanently lower GDP growth 1/	57	52	53	53	54	54	55
<b>B. Bound tests</b>							
B1. Real GDP growth is at historical average minus one standard deviations in 2005-2006	57	52	56	60	62	63	64
B2. Primary balance is at historical average minus one standard deviations in 2005-2006	57	52	55	57	56	55	53
B3. Combination of B1-B2 using one half standard deviation shocks	57	52	55	58	57	55	54
B4. One time 30 percent real depreciation in 2005	57	52	58	56	55	53	51
B5. 10 percent of GDP increase in other debt-creating flows in 2005	57	52	61	59	58	56	55
<b>NPV of Debt-to-Revenue Ratio 2/</b>							
<b>Baseline</b>	244	222	215	211	207	198	192
<b>A. Alternative scenarios</b>							
A1. Real GDP growth and primary balance are at historical averages	237	222	219	222	224	222	223
A2. Primary balance is unchanged from 2004	237	222	213	211	208	203	200
A3. Permanently lower GDP growth 1/	237	222	219	220	222	221	223
<b>B. Bound tests</b>							
B1. Real GDP growth is at historical average minus one standard deviations in 2005-2006	237	222	232	252	258	257	259
B2. Primary balance is at historical average minus one standard deviations in 2005-2006	237	222	228	240	234	224	216
B3. Combination of B1-B2 using one half standard deviation shocks	237	222	230	243	237	226	218
B4. One time 30 percent real depreciation in 2005	237	222	241	234	227	216	209
B5. 10 percent of GDP increase in other debt-creating flows in 2005	237	222	253	247	240	230	221
<b>Debt Service-to-Revenue Ratio 2/</b>							
<b>Baseline</b>	19	17	17	16	15	16	16
<b>A. Alternative scenarios</b>							
A1. Real GDP growth and primary balance are at historical averages	19	17	17	18	19	21	22
A2. Primary balance is unchanged from 2004	19	17	17	16	15	16	17
A3. Permanently lower GDP growth 1/	19	17	17	17	17	19	20
<b>B. Bound tests</b>							
B1. Real GDP growth is at historical average minus one standard deviations in 2005-2006	19	17	18	20	22	25	27
B2. Primary balance is at historical average minus one standard deviations in 2005-2006	19	17	17	21	24	22	20
B3. Combination of B1-B2 using one half standard deviation shocks	19	17	17	21	23	21	20
B4. One time 30 percent real depreciation in 2005	19	17	17	17	16	17	17
B5. 10 percent of GDP increase in other debt-creating flows in 2005	19	17	17	30	25	23	21

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

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of 20 (i.e., the length of the projection period).

2/ Revenues are defined inclusive of grants.

Tirana, February 3, 2005

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, approved in June 2002, has been instrumental in promoting macroeconomic stability and economic growth, and improving governance in Albania.

All quantitative and structural performance criteria under the program have been observed. We request completion of the fifth review as well as the financing assurances review under the arrangement. We also request a five-month extension of the program until November 2005 in order to allow the sixth program review and final disbursement to take place within the program period.

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 (NSSED) 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 the 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/  
Ardian Fullani  
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 remainder of the program period.** It is consistent with the November 2001 National Strategy for Socio-Economic Development (NSSD) and the May 2003 and May 2004 Progress Reports; and supplements the June 2002, January 2003, June 2003, January 2004, and July 2004 MEFPs.

### II. PERFORMANCE UNDER THE PROGRAM

2. **The Albanian economy continued to register strong, non-inflationary growth in 2004, underpinned by firm macroeconomic policies and ongoing structural reforms.** We estimate output growth at 6 percent in 2004, led by rising retail trade and other services—partially due to higher tourism—and by agricultural and electricity production boosted by favorable weather and sectoral restructuring. Ongoing fiscal consolidation, firm monetary policy, and improved supply of agricultural products held price increases to the lower end of our 2-4 percent target range in the second half of the year. Largely due to trade gains, we now expect a current account deficit of 7 percent of GDP, a full percentage point of GDP lower than our projection at the time of the last review—representing a considerable improvement given the substantial increase in oil import prices.<sup>1</sup> Confidence in the lek has increased further, as the currency component of broad money continued to decline and the exchange rate to appreciate, despite a 50 basis point reduction in the Bank of Albania (BoA) policy rate and the accumulation of an additional US\$234 million of reserves in the second half of the year. Some indicators of absolute poverty have improved due to high growth, remittances, selected social assistance programs, and micro credit programs. Real incomes have risen rapidly, and improvements have been registered in such basic indicators as life expectancy, child mortality, maternal health, literacy, and gender equality. However, service provision to the more vulnerable groups in our country, will need to be strengthened.

3. **Despite shortfalls in budgeted resources, we stayed the course of fiscal consolidation, meeting targeted reductions in domestic borrowing through expenditure reduction, substantially outperforming the programmed deficit, and achieving a 5½ percentage point of GDP reduction in public debt—which stood at 55½ percent of GDP at end-2004.** The 2004 outturn for total revenue and grants was 1¾

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<sup>1</sup> All figures quoted in percent of GDP, including references to values from our previous MEFPs, use as their base the revised GDP series published by INSTAT in September 2004.

percentage points of GDP below budget. While tax revenue increased relative to 2003 due to higher receipts from VAT, corporate income tax, excise rate increases, and other revenue-enhancing tax policy measures, it fell somewhat short of budget projections. Nontax revenue and financing sources undershot budgeted levels owing to shortfalls in external grants and reduced central bank profit transfers. The latter resulted from lower interest rates and sterilized intervention. Finally, the envisaged privatization of ARMO had to be postponed and some development loan disbursements failed to materialize. However, we met our domestic borrowing target under the program as we offset these budget resource shortfalls through commensurate measures to reduce expenditure by about 3 percentage points of GDP relative to the budget—mainly on the capital budget but also including savings in personnel and interest costs. Our underlying domestic borrowing requirement declined by 0.2 percentage point of GDP with respect to 2003 and was further reduced by 0.7 percentage point of GDP through the use of half of the Savings Bank privatization proceeds to retire treasury bills, as agreed under the program. Also, the overall deficit was about 1 percentage point of GDP below the programmed level.

**4. Without allowing the mid-2005 elections to distract us from the path of fiscal consolidation, we have adopted a strong 2005 budget consistent with further declines in public debt, domestic borrowing, and current expenditure.** In light of past experience, the budget is based on a realistic projection of revenue, similar to the 2004 revenue outturn. The accompanying fiscal package that implements most FAD technical assistance (TA) recommendations. Representing a significant improvement in transparency and budget process, the budget was sent to Parliament accompanied by a detailed list of investment programs and the updated medium-term budget framework (MTBP<sup>2</sup>), all of which were published along with the fiscal package on our official website prior to the parliamentary debate and discussed widely with stakeholders.

**5. We have improved the performance of the customs administration and are advancing in the reform of other fiscal institutions.** After the deployment of the ASYCUDA system in the Tirana and Durrës customs houses in time for the fourth review of the program, we have continued expanding the coverage of the system. We drastically reduced rotation of personnel, particularly at the managerial level; and stepped up training. As a result, the average customs clearance period has declined from more than 5 days in 2003 to less than 2 days and seizure of smuggled goods and cases submitted to the public prosecutor have increased sharply—the latter by more than 500 percent. Regarding the General Directorate of Taxes (GDT), the improvement in outcomes has been weaker but we have passed several pieces of legislation (mainly as part of the 2005 fiscal package) and approved regulations that will significantly strengthen procedures, including appeals, VAT refunds, and control of the individual income tax. With bilateral TA, we are improving our treasury and debt management systems.

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<sup>2</sup> The MTBP is the Albanian name for the Medium Term Expenditure Framework.

**6. We have continued to direct monetary policy towards maintaining price stability and strengthening the financial sector and its prudential supervisory framework.** In the absence of inflationary pressures, the BoA has continued its easing stance through successive reductions in the repo rate while maintaining tight monetary conditions partly prompted by the strength of the lek. Foreign exchange market interventions have aimed at smoothing exchange rate fluctuations and preserving reserve cover—about 4 months of imports at end-2004. After the privatization of the Savings Bank, the whole commercial banking system is under private management and is showing welcome dynamism. We continued to improve and expand our banking supervisory and AML/CFT capacity, with the help of MFD and World Bank assistance. The inter-bank real-time gross settlement system (AIPS) and its associated intra-day credit facility, introduced in 2004, are functioning well and we have prepared legislation that will establish the evidential value of electronic signatures. We are advancing in our plans to pay government employees through the banking system. We met the end-December 2004 structural performance criterion of paying 10,000 employees through the banking system, and we are fully committed to a rapid expansion of these numbers. We amended the Insurance Law to permit foreign citizens to sit on the boards of Albanian insurance companies—thus, facilitating foreign investment in the industry—and introduced “fit and proper” requirements for vetting managers and board members.

**7. We continued our determined implementation of the privatization agenda and sectoral restructuring, and made progress in other structural reforms.** We concluded the sale of Savings Bank and advanced our privatization program in strategic areas by completing the initial stage in which we solicited internationally expressions of interest in the sale of Albtelekom and ARMO; and abolished Albtelekom’s monopoly on international telecommunication connections. We completed the pre-privatization sale of a stake in INSIG to the IFC and EBRD, and with their collaboration are restructuring the company. Results achieved in rationalizing the energy sector under KESH’s Action Plan, carried out with World Bank assistance, have been encouraging. Electricity production has increased significantly for the second year in a row, collection rates have improved, and technical losses were reduced, resulting in a financial profit in 2004. This allowed the elimination of the subsidy for electricity imports in the 2005 budget as scheduled under the action plan. We have implemented a subsidy to low-income electricity consumers (incorporated in their electricity bill) to shield them from tariff increases. We made progress in reconciling inter-enterprise arrears—concerned enterprises have signed memorandums of understanding covering arrears incurred in 2002-03, and most of these have already been cleared. We enacted the new law on statistics, published national accounts for 2002, and revised the estimates for previous years, in accordance with the plan drafted with STA TA.

### III. POLICIES AND MEASURES FOR JANUARY-DECEMBER 2005

#### A. Overall Strategy

8. **We remain committed to our growth and poverty-reduction strategy.** We will continue to direct monetary and fiscal policy towards ensuring macroeconomic stability. But looking forward, we believe that maintaining the current growth pace will also require attracting high quality domestic and foreign investment to improve productivity and competitiveness. Improving the investment climate is therefore an important precondition that will require not only significant improvements in infrastructure but also our full commitment to entrenching the rule of law, strengthening institutions, and improving governance—including by stepping up our fight against corruption. We expect that ongoing reforms of our revenue and budget institutions will generate the additional resources needed to fund this investment and expand essential poverty-reducing services without rekindling inflation or generating an unsustainable debt profile. Our strategy will require broad-based support and we will continue to deepen our policy dialogue with all stakeholders.

#### B. Macroeconomic Outlook

9. **Against the background of macroeconomic stability and progress in structural reforms, non-inflationary growth of 6 percent can be sustained—initially by buoyant domestic demand, but then increasingly by gains in productivity and export volumes.** Despite higher-than-envisaged oil prices, the current account is expected to improve slightly in 2005 driven by rising exports, with further improvements over the medium term. We expect public and private domestic savings to increasingly replace foreign savings in financing a rise in investment over the medium term—facilitated by an expansion of financial intermediation.

#### C. Fiscal Policy

10. **The 2005 budget envisages further reductions in public debt and in the underlying domestic borrowing requirement (before privatization) through substantial savings in current spending—thus buttressing the sustainability of our public finances and allowing the non-inflationary expansion of private sector credit.** Current expenditure is projected to decrease by a further 0.9 percentage points of GDP—mainly as a consequence of reduced subsidies, wage bill, and operational costs—while protecting social expenditures. As a consequence, current revenues will suffice to fund current outlays for the first time since the beginning of the transition process—that is, borrowing and privatization proceeds will be devoted only to investment. We expect our domestic borrowing requirement to be 2.7 percentage points of GDP in 2005, about 0.2

percentage points of GDP lower than domestic borrowing in 2004 before the use of the Savings Bank proceeds to retire debt. Our stock of public debt will decline by a further 0.8 percentage points to 54.5 percent of GDP—17 percentage points down from its level in 2000. The receipts from the privatization of Albtelekom and the sale of the remaining public stake in INSIG have not been included in the budget owing to uncertainty as to their amount and timing. However we intend to privatize these companies as soon as feasible and will allocate the proceeds of their privatization in equal parts to domestic debt redemption and investment in priority areas.

**11. Savings in current expenditure will allow an expansion of infrastructure and poverty-reducing investment, significantly contributing to our growth and poverty reduction efforts.** With the decline in current expenditure broadly matched by an expansion in capital expenditure, we will be able to increase allocations on infrastructure and poverty-alleviating investment by about 0.7 percentage points of GDP relative to 2004. Moreover, as the budget is predicated on prudent revenue projections, we expect to avoid the haphazard end-year expenditure cuts that have characterized budget implementation in the past. This will provide security of funding to our line ministries and lay the foundation for improvements in budget planning and prioritization.

**12. We have introduced tax reforms to streamline the tax system and reduce distortions and will press ahead with the reform of the revenue administration.**

- **The 2005 fiscal package** eliminated the deduction of social insurance contributions from the base for personal income tax; reduced the number of personal income tax brackets; and subjected to VAT the first sale of residential buildings, effective 2006. To stimulate investment, the fiscal package reduced the corporate income tax rate from 25 to 23 percent in 2005 and to 20 percent in 2006, with the projected 0.15 percent of GDP cost in 2005 offset through savings in other areas. We have introduced individual income tax returns and filing requirements that will be gradually applied to those groups with the highest noncompliance risk. We are eliminating the requirement for small businesses to renew their registration with the GDT every year.
- In the **General Directorate of Customs (GDC)** we will extend the ASYCUDA system to a total of 5 customs houses (PC; end-March 2005), representing more than 75 percent of all customs traffic. We will also implement the ASYCUDA module for risk assessment to trigger inspections in 5 customs houses, including in Tirana and Durrës (PC; end-March 2005), significantly reducing officers' room for discretion. In light of the assessment carried out by the EU Customs Assistance Mission in Albania (CAM-A), we will also develop and issue a new set of instructions to the customs warehouses in order to unify the different procedures currently being applied and to strengthen the existing controls against smuggling and other illegal activities.
- As to the **GDT**, we have introduced accrual of interest on tax refunds overdue more than 60 days; and have reduced from 6 to 3 months the carry forward period before which application for VAT credit refunds can be made. For low-risk exporters we



will implement a system of rapid VAT refunds, with audits carried out ex post according to risk assessment methods (PC; end-June 2005). We will also clear in 2005 overdue VAT refunds originated prior to June 2004, estimated at lek 700 million—an amount that has been included in the 2005 budget VAT revenue projection. We will earmark each quarter an amount equal to 1 percent of the VAT collected during the previous quarter for paying overdue VAT refunds until the stock or arrears is eliminated (SB; ongoing). We will provide quarterly reports on this matter (SB; ongoing). Concerning current requests for VAT refunds, we will also provide quarterly reports on the aggregate amount of such refunds requested, refunds paid, and refunds rejected (SB; ongoing) We will advance the process of computerization by implementing the software modules for excises and national taxes in the second and third quarters of 2005 respectively. By the end of 2005, we expect 15 branches to be fully computerized, covering 80 percent of all taxpayers and 95 percent of tax collections. We are in the process of receiving FAD TA on tax administration to update our reform agenda and expand the use of information technology.

**13. We will carry out measures to improve our budget process and raise the efficiency and transparency of expenditure.** We will continue the practice of including a prioritized list of investment projects and the updated MTBP in future budget submissions to Parliament. In 2006, we also plan to include projections of recurrent costs of proposed investment programs as part of the budget documents. We have reduced the maximum allowable transfer between budget appropriations to 5 percent for the 2005 fiscal year. We are working towards a wage structure in the public sector that promotes efficiency and allows the retention of skilled personnel. For 2005, we will discontinue across-the-board public sector wage increases and instead allocate the wage bill increase to raise the pay of workers in education, health and other priority areas, and skilled specialists; and to fund the civil service reform designed with World Bank assistance. We will formally repeal the existing automatic price indexation of wages prior to presentation of the 2006 budget. Over the course of 2005, we will enhance expenditure control and monitoring by extending the treasury automation system to regional branches and increase the use of the banking system in budgetary transactions.

**14. Our fiscal policies over the medium term will continue consolidating the public finances aiming at offsetting the likely decline in concessional assistance, while undertaking preparations to access international capital markets.** In 2006–07, we intend to reduce domestic borrowing further in order to crowd in private sector credit and maintain the declining trend in public debt. We remain committed to improving revenue mobilization and combating tax noncompliance. In order to keep budget revenue projections prudent and conservative, we have not included revenue gains from tax administration improvements in the 2005 budget. However, we expect these gains to materialize and become sizable over the medium term. In addition, as output grows, we plan to reduce further the current expenditure share of GDP, thus generating a current surplus to fund higher investment in priority areas. Nevertheless, investment projects with high growth impact will continue to exceed domestic resources. Thus, in anticipation of an

eventual decline in foreign concessional assistance, we intend to begin preparations to obtain a sovereign credit rating with a view to tap international capital markets. This would also facilitate international financing for domestic private firms.

#### **D. Monetary and Financial Sector Policies**

15. **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 will remain our main policy instrument to ensure adherence to our monetary program. Over the remainder of the program period, we expect a continuation of existing trends: money demand will remain broadly stable as share of GDP; private sector credit will grow rapidly from its low base; and the share of currency in broad money will continue to decline, reflecting rising intermediation and confidence in the banking system. We will maintain a flexible exchange rate regime, with foreign exchange interventions used mainly for smoothing short-term shocks unrelated to fundamentals and for maintaining a level of reserves broadly equivalent to 4 months of imports of goods and services.

16. **We will continue reforms aimed at improving the efficiency, transparency, and volume of banking sector intermediation and financial services.** In this regard, we view the upcoming FSAP exercise as a well-timed means of evaluating progress to date and of refining further our reform agenda.

- **To deepen financial intermediation and combat the informal economy, we will continue to foster the use of the banking system in the regular conduct of business.** We view the payment of public sector salaries through the banking system as a catalyst for this process. We will increase the total number of public employees paid in this manner to 25,000 by end-March 2005 (PC) and to 50,000 by end-June 2005 (PC). In consultation with the industry, we will implement an inter-bank bulk clearing system for small transactions in 2005 to facilitate automated bill payments, wage deposits, and other customer services.
- **Over the course of 2005, we intend to strengthen the market infrastructure and legal framework underpinning our financial system in preparation for the anticipated expansion of banking activity.** We are considering options to increase the depth of the T-bill market, such as extending participation in the market to large nonfinancial firms and introducing market-making and brokerage arrangements. We are also exploring the feasibility of developing additional financial markets, such as foreign currency swaps and collateralized inter-bank money markets. The banking law, currently in the drafting stage, will introduce greater clarity to the rules and procedures governing the operation of commercial banks—including the powers of the supervisory authority concerning receivership and conservatorship; as well as mandating greater transparency and consumer protection. The Electronic Record Law will establish the evidential value of electronic signatures. A draft of this law has

been prepared by the BoA with assistance from the World Bank and passage is expected in 2005.

17. **We recognize that significant improvement in practices, standards, transparency, and the effectiveness of supervision will be required in the insurance sector to ensure its proper development.** As first steps in this process, we have secured resident advisors in the insurance regulatory agency and in INSIG. We anticipate that the upcoming FSAP exercise will also be useful in identifying the broad direction of reform and we will request additional TA as required in order to formulate a comprehensive restructuring plan for this sector.

18. **We remain committed to support the integrity of our monetary framework and the independence of the central bank.** We will ensure that the BoA retains its policy and operational autonomy, and we will take no legislative or regulatory action that weakens its full control over the bank's budget—including staff compensation levels—currently exercised by the BoA's Supervisory Board. As required by law, and to preserve the integrity and independence of our central bank, the government will issue interest-bearing securities to the BoA in the amount required to cover reserve valuation losses due to the appreciation of the lek. Those corresponding to 2003 valuation losses, amounting to Lek 7.7 billion, have already been issued; while those corresponding to 2004 valuation losses—estimated at Lek 4 billion—will be issued in April 2005 following certification of the 2004 BoA audited accounts. Although drawings under the Treasury's overdraft facility with BoA have been minimal, brief, and unconnected to the financing of the budget, we intend to eliminate the facility gradually, as alternative commercial and market-based options develop and the Treasury's liquidity management capacity improves. Specifically, we intend to reduce the statutory limit for the overdraft facility from its current level of 5 percent of budget revenues to 4.5 percent over the course of 2005 and then by a further 0.5 percent in each successive year.

#### **E. Structural Policies**

19. **The privatization agenda for 2005 includes Albtelekom and ARMO, as well as our remaining minority stake in AMC and two commercial banks.** We will strive to privatize other publicly-owned companies such as SERVCOM and Albpetrol as rapidly as feasible. In preparation for the sale of Albtelekom, we will fully regularize the company's outstanding financial obligations to private creditors; and institute reforms to the rural and small operators regime along transparent lines and in accordance with international standards. We will fully support the restructuring of INSIG—currently being carried out in conjunction with its partial pre-privatization to EBRD and IFC—in preparation for its eventual sale. We have started a pilot project to restructure four water companies, with assistance from the World Bank and other donors, but further actions will be needed ensure the viability of this sector.

20. **We will fully implement our 2005–07 action plan, with World Bank assistance, to modernize KESH and restructure the electricity sector.** We will keep a stabilization fund with KESH's profits in years with pluvial conditions to finance imports in less favorable years, with the funds invested abroad, managed by a well-established international financial firm, and audited regularly.

21. **We intend to implement a number of reforms aimed at enhancing governance, efficiency, and transparency.** We will carry out independent feasibility studies for large projects funded by non-concessional borrowing (SB; ongoing) and subject them to open tenders, except in exceptional circumstances such as in cases of national security. We will continue to provide a quarterly listing and status report on all projects being considered for nonconcessional foreign financing (SB; ongoing). We will continue implementing our action plan for removing barriers to investment, and will carry out a survey to assess its impact and update the plan accordingly. We have implemented the law on asset declaration, and plan to proceed with the conflict of interest legislation. To improve external assistance coordination, we have presented an integrated planning system to the donor community and expect to implement an agreed methodology following a period of dialogue.

#### **F. External Policy**

22. **We will retain our liberal trade regime.** We aim at concluding a Stabilization and Association Agreement with the EU and an eventual EU-Albania free trade agreement. On a regional level, we have successfully concluded free trade agreements with Bosnia-Herzegovina, Bulgaria, Croatia, Kosovo, FYR Macedonia, Moldova, Serbia and Montenegro, and Romania. All agreements have been ratified by the respective parliaments and trade volumes are rising rapidly, albeit from a low base—in the first half of 2004 the share of these countries in total trade rose from 2.6 to 8.3 percent.

23. **We made progress in rescheduling our arrears on inoperative payments agreements with official creditors (Article XIV) in 2004 and will continue these efforts in 2005.** The agreement with Hungary has been finalized and was implemented in the first half of 2004. Balances due to the Czech and Slovak Republics, Poland, and Romania have been reconciled. In the latter case, the terms of payment are already negotiated. We expect to conclude agreements with these four countries in the first half of 2005. Although in some of the remaining cases the process has been more protracted than expected, we still strive to conclude this process by the end of the program with official creditors and by end-2006 with private creditors.

#### **G. Data Issues**

24. **We are improving the quality and coverage of economic statistics in cooperation with STA and other technical assistance partners.** Building on the new

statistical law, we have signed memoranda of understanding for the provision of data between INSTAT and other government institutions. We will present to Parliament our 5-year statistical program (SB; March 2005). We will further improve the scope and collection of data on FDI and remittances and accelerate the production of national accounts. We will publish the preliminary 2003 national accounts by March 2005 (SB) and introduce a pilot project on the preparation of quarterly GDP estimates by June 2005. We plan to issue the 2004 national accounts, based on sampling techniques, by end-2005.

#### **H. Program Monitoring**

25. The seventh disbursement under the PRGF-supported program will be based on the end-March 2005 quantitative performance criteria (Table 1 and the TMU); the end-March and end-June 2005 structural performance criteria (Table 2); and completion of the sixth review and the financing assurances review. The sixth review is expected to be completed no later than November 10, 2005. 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 2003–05 1/

	End-Dec. 2003			End-Mar. 2004 2/			End-Jun. 2004			End-Sep. 2004 2/			End-Dec. 2004			End-Mar. 2005 2/			End-Jun. 2005		
	Actual	Prog.	Prog. (Adj.)	Actual	Prog.	Prog. (Adj.)	Actual	Prog.	Prog. (Adj.)	Actual	Prog.	Prog. (Adj.)	Actual	Prog.	Prog. (Adj.)	Actual	Prog.	Prog. (Adj.)	Actual	Prog.	Prog. (Adj.)
	(In billions of lek)																				
Ceiling on net domestic credit to the government 3/	20	21	21	6	6	6	6	6	6	6	6	6	6	6	6	6	6	6	6	6	6
Ceiling on net domestic assets of the BOA 4/	-19	6	6	-24	-7	-7	-7	-7	-7	-7	-7	-7	-7	-7	-7	-7	-7	-7	-7	-7	-7
Indicative target for revenues collected by Tax Department	57	59	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Indicative target for revenues collected by Customs Department	54	59	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Indicative targets for Social Insurance Revenues	29	31	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Indicative total tax revenue targets, millions of Lek 5/	...	...	...	36	36	36	36	36	36	36	36	36	36	36	36	36	36	36	36	36	36
	(In millions of US dollars)																				
Floor for net international reserves of the BOA 4/ 6/	112	21	18	104	57	57	57	57	57	57	57	57	57	57	57	57	57	57	57	57	57
	(In millions of Euros)																				
Ceiling on contracting or guaranteeing of public and publicly-guaranteed non-concessional external debt 7/ 8/ of which: 1-5 years	19	107	107	19	120	120	120	120	120	120	120	120	120	120	120	120	120	120	120	120	120
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	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	0	0	0	0	0

1/ The performance criteria and indicative targets envisaged under the program, and their adjusters, 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 March 2005 refer to targets set during the fourth 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, 2004, and 2005, data is cumulative within each calendar year.

4/ For end-December 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

	<b>Test-date</b>
<b>A. Proposed Performance Criteria for the Sixth Review</b>	
1. Deployment of the ASYCUDA system in 5 customs houses.	End-March 2005
2. Implement the risk assessment module of the ASYCUDA system in 5 customs houses to perform inspections.	End-March 2005
3. The salaries of 25,000 employees of budgetary institutions to be paid through the banking system.	End-March 2005
4. The salaries of 50,000 employees of budgetary institutions to be paid through the banking system.	End-June 2005
5. Implement a system of quick VAT refunds with audits carried out ex post based on risk assessment selection for qualified taxpayers.	End-June 2005
<b>B. Proposed Structural Benchmarks under the Sixth Review</b>	
1. Presentation to Parliament of 5-year Statistical Program.	End-March 2005
2. Completion of preliminary 2003 national accounts.	End-March 2005
3. Government of Albania's 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.	Ongoing
5. Clear overdue VAT refunds originated prior to June 2004 by allocating to this end 1 percent of VAT gross revenue on a quarterly basis.	Ongoing
6. Prepare quarterly reports on the aggregate amounts of the VAT refunds requested, refunds paid and refunds rejected.	Ongoing
7. 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.	Ongoing
(ii) Provide a quarterly listing and status report on all projects being considered for nonconcessional foreign financing.	Ongoing

## 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;<sup>1</sup> 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 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

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<sup>1</sup> 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.



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 value<sup>2</sup>.

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)<sup>3</sup>.

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

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<sup>2</sup> 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.

<sup>3</sup> 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.

6. The breakdown of the categories of net domestic credit to the central government as 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 2004.

### **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.<sup>4</sup> Reserve assets and reserve liabilities will both be expressed in U.S. dollars.

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<sup>4</sup> 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.

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-March 2005	Lek 15.9 billion, (US\$138.5 million).
End-June 2005	Lek 16.0 billion, (US\$138.5 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-March 2005	US\$ 19.0 million.
End-June 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 excess<sup>5</sup>.

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

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<sup>5</sup> 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.

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 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**

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, Dec. 2003–Jun. 2005  
(In millions of lek)**

	Dec-03	Sep-04	Dec-04	Mar-05	Jun-05
<b>1. Treasury bills held outside central government</b>	271,417	277,272	...	...	...
<b>Of which:</b>					
1. (i) Held by Bank of Albania 1/	70,372	62,935	...	...	...
1. (ii) Held by deposit money banks 1/	184,203	192,742	...	...	...
1. (iii) Held by savings and loan institutions 2/	0	0	...	...	...
1. (iv) Held by other domestic lenders (excluding holdings of HHI and SSI) 2/ Of which:	16,842	21,594	...	...	...
1. (iv) (i) INSIG	1,548	1,535	...	...	...
1. (iv) (ii) Individuals and firms	15,294	20,059	...	...	...
1. (iv) (ii) (i) Of which: BoA window	9,528	12,510	...	...	...
<b>Plus:</b>					
<b>2. Other central government debt held outside central government (millions of lek)</b>	6,449	10,974	...	...	...
<b>Of which:</b>					
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	10,010	...	...	...
2. (ii) (i) Fixed income securities 4/	5,000	10,010	...	...	...
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	...	...	...
<b>Equals gross domestic credit to government:</b>	277,866	288,246	...	...	...
<b>Less:</b>					
<b>3. Assets of central government (excluding HHI and SSI)</b>	7,534	13,960	...	...	...
3. (i) Deposits held at Bank of Albania 6/	4,914	11,541	...	...	...
3. (i) (i) In domestic currency	3,295	2,962	...	...	...
3. (i) (i) (i) Transferable deposits in lek	2,902	2,481	...	...	...
3. (i) (i) (ii) Deposits in lek for projects	393	481	...	...	...
3. (i) (ii) In foreign currency at program exchange rates and program price of gold 7/ 8/	1,619	8,579	...	...	...
3. (i) (ii) (i) In foreign currency evaluated at current exchange rates	1,619	8,067	...	...	...
3. (i) (ii) (i) (i) Transferable deposits in foreign currency evaluated at program exchange rate 7/	0	6,964	...	...	...
3. (i) (ii) (i) (i) (i) Transferable deposits in foreign currency evaluated at current exchange rate 9/	0	6,547	...	...	...
3. (i) (ii) (i) (ii) Standard gold deposits of government evaluated at fixed exchange rate and gold price (Lek m)	1,619	1,615	...	...	...
3. (i) (ii) (i) (ii) (i) Standard gold deposits of government at current exchange rate and gold price (Lek mns.) 8/	1,619	1,519	...	...	...
3. (i) (ii) (i) (ii) (i) (i) Number of ounces of gold equivalent	36,484	36,408	...	...	...
3. (ii) Assets held at deposit money banks	2,621	2,419	...	...	...
3. (ii) (i) Deposits 10/	1,757	1,160	...	...	...
3. (ii) (i) (i) Deposits in domestic currency	91	223	...	...	...
3. (ii) (i) (i) (i) Transferable deposits in domestic currency	91	223	...	...	...
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	937	...	...	...
3. (ii) (i) (ii) (i) In foreign currency evaluated at current exchange rates 7/	1,666	881	...	...	...
3. (ii) (i) (ii) (i) (i) Transferable deposits in foreign currency evaluated at current exchange rates	1,666	881	...	...	...
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	402	...	...	...
3. (ii) (iii) DMB payables to government	364	857	...	...	...
3. (iii) Held at savings and loan institutions 10/	0	0	...	...	...
<b>Less:</b>					
<b>4. Deposits of HHI and SSI</b>	2,230	2,740	...	...	...
<b>Equals:</b>					
<b>5. Stock of Net domestic credit to central government (1+2-3-4)</b>	268,102	271,546	...	...	...
5. (i) Change since December 2003	...	3,444	...	...	...
<b>6. Memorandum items:</b>					
6. (i) Current exchange rate (Lek/SDR, cop)	158.1104	148.6618	...	...	...
6. (ii) Current exchange rate (Lek/US dollar, cop)	106.4	101.2	...	...	...
6. (ii) Program exchange rate (Lek/SDR, cop) 11/	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	412.4	...	...	...
6. (vi) Current exchange rate (US dollar per SDR, cop)	1.4860	1.46899	...	...	...

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 # 8). 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/ Including account set up to hold the Savings Bank privatization revenue (Account No: 11.2.2.1.4)

10/ Includes all deposits of central government.

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



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February 28, 2005

International Monetary Fund  
Washington, D.C. 20431 USA

### **IMF Executive Board Completes Fifth Review Under PRGF Arrangement with Albania and Approves US\$6.1 Million Disbursement**

The Executive Board of the International Monetary Fund (IMF) today completed the fifth review of Albania's economic performance under the Poverty Reduction and Growth Facility (PRGF) arrangement. In doing so, the Board also approved a request for an extension of the PRGF arrangement period from June 20, 2005 to November 20, 2005. The Board's decision enables Albania to draw an amount equivalent to SDR 4 million (about US\$6.1 million), which will bring total disbursements under the arrangement to the equivalent of SDR 24 million (about US\$36.6 million). The Executive Board also completed a financing assurances review.

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\$42.7 million).

Following the Executive Board's discussion of Albania, Ms. Anne O. Krueger, First Deputy Managing Director and Acting Chair, stated:

“Albania’s macroeconomic performance so far during the third year of the government’s PRGF-supported economic program has been commendable. Growth has remained robust, inflation generally has been low, the current account deficit has declined, and the lek has strengthened reflecting increased confidence. A firm monetary policy stance, continued fiscal consolidation, privatization, and progress in structural reforms have underpinned this performance.

“Economic growth is expected to remain robust in 2005 and over the medium term, supported increasingly by productivity and external trade gains. However, maintaining this growth performance will require significant improvements in infrastructure and in the investment climate, including reforms to strengthen governance, property rights protection, and the rule of law.

“The financial sector has become increasingly dynamic since the privatization of the Savings Bank. The Bank of Albania is appropriately supporting the development of the financial sector and stepping up prudential vigilance. In this connection, the program includes steps to expand the financial infrastructure and to curtail the use of cash, including by paying public wages



through the banking system. A financial sector assessment is to be undertaken shortly to help chart the course of further reforms and build prudential supervisory capacity.

“The fiscal component of the program is consistent with the 2005 budget and envisages further fiscal consolidation and improvements in the composition of budgetary spending. The program is based on realistic assumptions about revenue, and envisages a surplus in the current balance in order to free resources for public investment. In addition, the reduction in the underlying domestic borrowing requirement aims at allowing the expansion of credit to the private sector, without triggering inflation, and maintaining the public debt on a downward trend.

“The program also envisages progress in structural reforms to strengthen fiscal institutions, improve governance, advance the privatization process further, and improve the business climate,” 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  
Carlo Gola, Senior Advisor to Executive Director  
February 28, 2005**

At the outset, my authorities would like to express their appreciation for the valuable work and collaboration with staff during the duration of the program that is now coming to a conclusion.

## **1. Introduction**

Albania has done well in the last years, progressively coming to what staff defines as a “commendable performance.” In fact, this is perhaps the first time we are not discussing a waiver. Albania has made remarkable progress since the 1997 crisis and the system has been able to absorb shocks like the huge influx of refugees during the Kosovo war or the other one in 2002, when 20 billion leks went out of the banking system in a matter of days.

## **2. A sound macroeconomic policy has generated strong results.**

Few numbers represent well the results that authorities, with the collaboration of the Fund, have achieved over the course of the programs.

- Since 1997 the economic growth has been strong, averaging 7.5 percent annually for the period from 1998 to 2004. In the same period per capita GDP increased almost three times. GDP growth in 2004 reached 6 percent.
- Between 1997 and 2004 public debt declined from 84.6 to 55.7 percent of GDP; external debt has been reduced from 40.8 percent to 19.7 percent of GDP, over the same period. In 2004, the current balance, for the first time since the transition, has balanced, while the budget financing (including privatization receipts) has funded capital expenditures, which reached, at the end of 2004, 4.62 percent of GDP.
- Following a skillful conduct of monetary policy, inflation, since 2001, has been within the limits set by the Bank of Albania, 2-4 percent. In 2004 average inflation was 2.9 percent, declining at the end of the year to 2.2 percent.
- The Albanian economy continues to register strong growth rates supported by firm macroeconomic policies and implementation of structural reforms. The authorities have adopted a strong 2005 budget, committed to reducing public debt, domestic borrowing and current expenditure, despite mid-2005 elections pressures. This budget and the fiscal package accompanying it, are not only fully in line with staff recommendations and advice, but have also been transparently and widely discussed with all stakeholders.
- Conscious of the need to ensure fiscal sustainability, the authorities have improved the performance of customs administration and are taking steps to further the reform in other fiscal institutions. As we speak ASYCUDA is operating in 5 customs houses and by the end of March, it will be installed in a sixth one, thus covering more than

80 percent of the entire customs transactions. The authorities are extending the Civil Service law to ensure a stable and supportive work environment to customs and tax administration officials. A tender to equip two sensitive customs houses with the latest-technology scanner system is under preparation, aimed at improving the quality of controls and facilitating trade. In addition, authorities have applied, and hope to be supported by the MCA program, for a Prime Advisor for the Tax administration.

### **3. Despite the success, the authorities are aware that many challenges remain.**

Albanian authorities are aware of the numerous challenges to be faced. They are proud of the achievements, but also fully aware that a long way remains to reach the standards of other European countries. There is a need to improve the fiscal structure and discipline, and major efforts need to be channeled to reduce the sizeable informal economy. Further efforts are needed to enhance tax administration and expenditure management. The need for better infrastructure will of course take up significant financial resources before allowing Albania to fully exploit its geographical position as part of major regional networks. Further efforts are required by the authorities in enforcing the rule of law and improving governance before bringing the business climate indicators to regional levels. Authorities will have to cope with poverty by firmly addressing the needs of different social groups and the disparities between various areas in the country, and ensure that priorities set forth in the National Strategy for Socio-Economic Development are duly matched in the Medium-Term Budget Program.

We visited Albania a few days ago, and had extensive discussions there with the authorities. The speed of changes and the advancement of economic reforms in the country are impressive. Albania has established a very good track record of sustainable economic growth with low inflation, and has entered a path of sustainable fiscal consolidation. The banking system is increasing its contribution to economic growth and private sector development. While the active role of strategic investors has enhanced market competition in the financing sector, the authorities are, as we speak, closely working with an IMF and WB team to conduct a FSAP.

Let us assure you that the Albanian authorities are totally committed to continuing the implementation of important policies and structural reforms. Reforming the public administration, consolidating institutions and fighting corruption, enhancing accountability, and improving governance are all items that lie well at the top of the government's policy agenda. In this regard, we find the program to have been an effective, and indeed quite powerful, mechanism to support the consolidation of critical economic reforms.

### **4. Future engagement with the Fund.**

To conclude, let us convey that the Albanian authorities believe that Albania is still some distance away from graduating from Fund involvement. Despite improved macroeconomic conditions, the country has not yet fully developed its policy implementation capabilities. The authorities feel that Fund assistance and advice could play a key role in the design and implementation of macroeconomic policies and reforms focusing on the budget and treasury management and the banking sectors as well. This said, given the progress made in both

macroeconomic and structural sectors, authorities also feel that Albania must elaborate an exit strategy that is sound, credible, and that demonstrates that policy decision and implementation capacities have been significantly strengthened over the recent past, also thanks to Fund support. Needless to say, enhancing ownership of the reform process is key for a timely and successful exit strategy. For these reasons, the authorities believe that Albania would benefit from another mid-term program with the Fund, the typology of which will be discussed in due course.



INTERNATIONAL MONETARY FUND

*Public Information Notice*

EXTERNAL  
RELATIONS  
DEPARTMENT

Public Information Notice (PIN) No.05/30  
FOR IMMEDIATE RELEASE  
March 10, 2005

International Monetary Fund  
700 19<sup>th</sup> Street, NW  
Washington, D. C. 20431 USA

## **IMF Executive Board Concludes 2004 Article IV Consultation with Albania**

On February 28, 2005 the Executive Board of the International Monetary Fund (IMF) concluded the 2004 Article IV consultation with Albania.<sup>1</sup>

### **Background**

The macroeconomic performance of the Albanian economy has been remarkable by both regional and international standards. After a slowdown in 2002, economic growth recovered to about 6 percent in 2003–04; inflation declined, generally remaining within the 2–4 percent target range of the Bank of Albania; and the external current account deficit narrowed by almost 3 percentage points of GDP reflecting trade gains. The public debt-to-GDP ratio has been reduced by 11½ percentage points to 55¼ percent in 2002-04 and confidence in the lek has been restored, as reflected in its appreciating trend. Rising incomes underpinned progress along some basic dimensions of poverty—although some education and health care indicators have deteriorated. However, a self-sustained, across-the-board expansion of tradable output has not yet taken root. At 23 percent of GDP in 2004, the external goods and services trade deficit remains high, as does the economy's dependence on migrant remittances and other transfers from abroad. Poor transport, telecommunications, and other infrastructure and a weak institutional environment are considered the main obstacles to investment.

The Bank of Albania's tight monetary policy stance since early 2002 has prevailed on inflation and buttressed confidence in the lek—against the backdrop of a strengthening banking sector.

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

With inflation subdued and the lek appreciating, the Bank of Albania's policy interest rate has gradually eased since 2002 to 5¼ percent, although monetary conditions have remained tight. The successful privatization of the Savings Bank has revamped banking activity, supported by the Bank of Albania's provision of financial market infrastructure. Increased confidence and interest rate differentials have supported an increase in deposits—mostly contributed by lek deposits—and a reduction in the cash-to-broad money ratio. Foreign reserve cover was at a comfortable four months of imports at end-2004.

The public finances have strengthened over the past few years but fiscal institutional reforms have lagged behind. Budget and expenditure management were hindered by over-optimistic budget revenue projections that, when they failed to materialize, prompted haphazard spending cuts to meet financing targets. In 2004, after revised revenue and expenditure projections during the fourth program review, domestic revenue has broadly met forecasts and budget implementation has improved. However, shortfalls in external project-related financing and grants prompted spending reductions and an overall deficit overperformance of 1¼ percentage points of GDP relative to program. In 2004, the current budget was broadly balanced for the first time since transition. The enacted 2005 budget embodies further fiscal consolidation and savings on current spending—premised on a much improved revenue projection.

Some structural reforms gained momentum in 2004—notably privatization and sectoral restructuring. The authorities have initiated the privatization of several public enterprises—INSIG (insurance), Albtelecom (fixed-line telecom) and ARMO (refinery)—and are successfully restructuring the electricity sector.

Albania has been engaged in a series of Fund-supported programs since the beginning of the transition in 1992. The macroeconomic objectives of these programs were generally achieved and financial policies were decisively implemented, fostering macroeconomic stability and growth. The implementation of structural reforms was satisfactory overall, particularly in macro-critical areas, but the pace of the reforms was uneven. In addition, the achievements remained fragile on account of pervasive poverty, lingering administrative capacity weaknesses, and slow progress in improving governance.

### **Executive Board Assessment**

Executive Directors commended Albania's good macroeconomic performance in recent years, observing that growth has been strong, inflation has generally remained low, and the current account deficit, although still high, has declined. Moreover, confidence in the domestic currency and the financial sector has firmed up. This favorable performance has been underpinned by fiscal consolidation, a firm monetary policy stance, and progress in privatization and other structural reforms. Directors cautioned, however, that a self-sustained broad-based expansion of net exports has not yet taken root, and that the external balance remains dependent on migrant remittances and other transfers which could be expected to decline over time. Furthermore, although the number of people living in absolute poverty has declined, poverty remains a key challenge.

Directors expected growth to continue at a brisk pace in 2005 and over the medium term. They emphasized, however, that this outlook is contingent on improvements in governance and the investment climate and on acceleration of the pace of reform, including in areas such as property rights protection and law enforcement. Directors concurred that vulnerabilities are limited by the moderate external indebtedness, but stressed that attainment of external sustainability will depend on improving competitiveness and attracting strategic export-oriented investment. Directors also pointed out that the possibility of softer demand in trading partner countries poses risks to the outlook, particularly since the strength of the lek might have eroded competitiveness in some sectors.

Directors were encouraged by the progress in building a sound monetary policy framework based on a clear inflation and financial stability mandate of the Bank of Albania, central bank independence, and a flexible exchange rate regime. With inflation within the Bank of Albania's target range, Directors considered that the gradual easing of the monetary policy stance since 2002 has been appropriate, and that the current neutral bias is warranted. Directors emphasized that the Bank of Albania should avoid having any explicit or implicit exchange rate target in its foreign exchange interventions, as monetary policy should remain focused on price stability.

Directors welcomed the increased dynamism of the financial sector in the wake of the Savings Bank privatization. They commended the authorities' ongoing initiatives to deepen financial intermediation and reduce the use of cash in the economy, and encouraged the authorities to take measures to develop the treasury bill, foreign exchange, and interbank money markets. Directors also noted the need to step up prudential vigilance in light of increasing credit to the private sector and the level of dollarization. They urged the authorities to monitor closely the health of the financial sector, and in this regard looked forward to the findings and recommendations of the upcoming Financial Sector Assessment Program.

Directors commended the progress made in strengthening the public finances in recent years. They welcomed the adoption of a 2005 budget that appropriately aims at further debt retrenchment in anticipation of a likely decline of concessional assistance, and the authorities' intention to use future large privatization proceeds solely for debt reduction and investment. They supported the emphasis on curtailing current spending to a level commensurate with a realistic projection of recurrent revenue, thus providing resources for investment. Directors also welcomed the authorities' commitment to refrain from across-the-board public wage increases and to formally repeal wage indexation before the 2006 budget. They encouraged efforts to build capacity in expenditure management and to monitor public investment.

Directors emphasized the importance of accelerating the reform of fiscal institutions and of capacity building. They noted the steps taken in this direction in the 2005 fiscal package and other ongoing initiatives. Priority also needs to be put on broader reform of tax administration to boost tax compliance and mobilize revenue. A few Directors recommended reform of the tax system to give more weight to income taxes. In addition, increased efforts are required to reduce the size of the informal economy. Directors also called for a strengthening of the budget process and of expenditure and debt management.

Directors were encouraged by the progress made in privatization and electricity sector reform, but noted that the unfinished reform agenda remains large and urged the authorities to intensify structural and institutional reform. In particular, further progress is needed in infrastructure provision and other measures to improve the investment climate, including a stepped-up fight against corruption. Directors observed that while indicators of absolute poverty have improved in recent years owing to income growth, efforts to strengthen the safety net and targeting of social programs are well placed.

Directors welcomed the findings of the Ex Post Assessment, which indicate that Fund engagement in Albania has been successful in achieving macroeconomic stability with robust economic growth. They believed that strong ownership of policies has been the key to this success. Most Directors considered that, given the extensive remaining reform agenda, the authorities' intention to seek a successor three-year arrangement with the Fund is well-placed. They noted the Ex Post Assessment's conclusion that the Fund needs to remain engaged with Albania at the present time, given the need to build capacity in macroeconomic management, catalyze donor assistance, and mobilize domestic support for reforms. Directors stressed that the authorities would need to remain committed to pursuing their reform objectives and develop a sound strategy for exiting from the use of Fund resources. These will be important considerations in any decision regarding a follow-up arrangement, and will require a political commitment to move the reform agenda forward.

Directors stressed the need to improve the quality and timeliness of Albania's statistics. They welcomed the technical assistance provided by the Fund and other donors, and encouraged the authorities to persist in their efforts in this area.

**Public Information Notices (PINs)** form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The Staff Report for the 2004 Article IV Consultation with Albania is also available.



**Albania: Selected Economic Indicators**

	2000	2001	2002	2003	2004 Est.	2005 Proj.
(Percent change)						
Real GDP	7.3	7.2	3.4	6.0	5.9	6.0
Retail prices (avg)	0.0	3.1	5.2	2.4	2.9	2.4
Retail prices (end-period)	4.2	3.5	1.7	3.3	2.2	2.7
(In percent of GDP)						
Fiscal Sector						
Revenues	23.8	23.6	24.5	24.0	23.7	24.1
Expenditures	31.9	31.6	31.1	28.5	28.5	29.0
Overall balance	-8.2	-7.9	-6.6	-4.4	-4.9	-4.9
Net domestic borrowing	3.2	3.1	3.2	2.9	2.0	2.7
Public Debt	71.3	66.8	64.8	60.7	55.3	54.5
Domestic	41.9	41.0	41.4	40.4	38.0	37.3
External	29.4	25.8	23.4	20.3	17.3	17.1
Monetary Indicators						
Broad money growth (in percent)	12.0	20.2	5.7	8.7	12.6	9.3
Interest rate (3-month T- bills, end period)	7.8	8.0	11.2	7.3	6.1	...
(In millions of U.S. Dollars)						
External Sector						
Trade Balance (goods and services)	-816	-951	-1159	-1419	-1723	-1974
(in percent of GDP)	-22.1	-23.2	-25.8	-24.8	-22.9	-22.2
Current account balance	-274	-263	-435	-469	-528	-625
(in percent of GDP)	-7.4	-6.4	-9.7	-8.2	-7.0	-7.0
Gross international reserves	608	737	860	1026	1374	1459
(in months of imports of goods and services)	4.1	4.3	4.0	4.0	4.1	4.0
Memorandum items						
Nominal GDP (in billions of lek)	530.9	588.7	630.0	695.1	780.1	857.3
Nominal GDP (in billions of U.S. dollars)	3.7	4.1	4.5	5.7	7.5	8.9

Sources: Albanian authorities and IMF Staff estimates and projections.