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Albania: Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility—Staff Report; News Brief and Press Release on the Executive Board Discussion; and Statement by the Executive Director for Albania

In the context of the Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility, the following documents have been released and are included in this package:

- the staff report for the Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility, prepared by a staff team of the IMF, following discussions that ended on **April 17, 2002,** with the officials of Albania on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on June 3, 2002**. 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 News Brief and a Press Release summarizing the **views of the Executive Board as expressed during its June 19, 2002 discussion** of the staff report that completed the review.

- a statement by the Executive Director for Albania.

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

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

*May also be included in Staff Report

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

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

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INTERNATIONAL MONETARY FUND

ALBANIA

Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility

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

Approved by Carlo Cottarelli and G. Russell Kincaid

June 3, 2002

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I. Introduction

1. Following the successful completion of the 1998–2001 program, supported by a Poverty Reduction and Growth Facility (PRGF) arrangement, in July 2001, two missions visited Tirana during October 24–November 8, 2001 and April 2–17, 2002 to discuss a new three-year PRGF arrangement and the 2002 budget.[1] Program documents were issued to the Board in January 2002 (EBS/02/10, 1/24/02). However, after the circulation of these documents, the government resigned over internal political differences and the scheduled Board meeting was postponed. A new government was formed on February 22. The authorities' Growth and Poverty Reduction Strategy (GPRS; EBD/02/14, 1/23/02) was submitted in December 2001, followed by a brief supplement in May 2002. Albania's relations with the Fund are summarized in Appendix I.

2. In concluding the 2001 Article IV consultation and final review under the PRGF arrangement, Executive Directors commended the authorities' sound macroeconomic management and progress in structural reforms, in particular further efforts to improve tax administration and broaden the tax base. Directors stressed the need for ongoing electricity sector reform and continued improvements in the business climate. They encouraged the authorities to give high priority to the timely privatization of the Savings Bank.

3. In the attached Letter of Intent and Memorandum on Economic and Financial Policies (MEFP), the authorities describe the economic program for which they request support under a three-year PRGF arrangement with access equivalent to SDR 28 million (57 percent of quota) (Attachment I). In light of Albania's relatively small balance of payments needs, phasing policies, and continued eligibility for IDA-only resources, no EFF resources are proposed.

4. While the new government, led by former Prime Minister Majko, has been accepted by the feuding factions, political uncertainties have not been eliminated. In particular, presidential elections in June could renew political turmoil. However, support for stability-oriented policies and structural reform, as well as continued close cooperation with the Fund, remains broad based.

5. Albania has received assistance from the World Bank in a number of areas (Appendix II). The Bank is preparing a Poverty Reduction Support Credit (PRSC)—scheduled for June 2002—and several other sectoral credits.

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[1] The staff team—Messrs. Samiei (Head), Martijn, and Moon (all EU1), Ms. Ongley (PDR), Ms. Jenkner (FAD), and Ms. Reyes (Staff Assistant, EU1)—met with President Meidani, Prime Minister Meta and his successor Mr. Majko, Finance Minister Angjeli and his successor Mr. Islami, Bank of Albania Governor Cani, and other ministers and officials. The mission was assisted by the previous and current resident representatives, Mr. Treichel and Mr. Olters, respectively. Mr. Padoan, the Executive Director, was in Tirana during October 28–29, 2001; and Mr. Vittas, the alternate Executive Director, during April 14–16, 2002.

6. The quality of macroeconomic data is adequate for program monitoring, but serious deficiencies remain (Appendix III). Albania participates in the GDDS, and a ROSC on data dissemination was published on the Fund website in May 2000. In relation to the proposed PRGF arrangement, staff conducted a safeguards assessment of the Bank of Albania (BoA) and found that, in general, controls in place to manage resources, including Fund disbursements, are adequate. Staff is finalizing the resulting report and will monitor the continued implementation of minor recommendations to improve the BoA's control systems.

II. Recent Developments

7. **Sound financial policies under the previous PRGF-supported program helped stabilize the economy and restore high growth, but poverty remains widespread.** Under this arrangement, which followed the disastrous 1997 collapse of the pyramid schemes, all quantitative performance criteria were met and most structural measures were implemented, albeit some with delays. Despite rising average incomes, Albania remains one of the poorest countries in Europe. Poverty is most prevalent in rural areas and has led to large-scale emigration.

8. **Real GDP growth in 2001, while still high, was adversely affected by unfavorable weather conditions and other supply shocks.** It is now estimated at 6½ percent compared with an earlier estimate of 7¼ percent (Table 1; Figures 1 and 2). Agricultural growth amounted to only 1½ percent, while construction activity and private sector manufacturing remained relatively strong—as businesses were mostly protected from electricity shortages. Recorded unemployment continued to decline, to 14½ percent at end-2001.

9. **Despite reform efforts, electricity supply has been severely constrained by low rainfall, and power outages have been extensive.** Following an already dry 2001, river flows in the first quarter of 2002 were the lowest in decades. At the same time, since the adoption of an action plan for the electricity sector at end-2000, developed in consultation with the World Bank, efforts toward reducing excessive demand have gained momentum and the quarterly targets for reducing technical losses and improving bill collection have been met. A two-tier tariff system for households was introduced in January 2002, with a lower rate for consumption below a threshold to minimize the impact on the poor (MEFP, ¶10). The updated action plan for 2002–03 foresees further measures to reduce theft and complete installing meters throughout the country.

10. **Due largely to supply shocks, headline inflation rose from 3.5 percent (y-o-y) in December 2001 to over 6 percent in the first four months of 2002.** As with the mid-2001 surge in inflation, this reflected mainly steep increases in fruit and vegetable prices (caused by a bad harvest), import bottlenecks (resulting from severe winter conditions), similar price increases in neighboring countries, and the electricity crisis. Core inflation has remained at around 3 percent.

11. **Interest rates have been raised to help prevent the spread of inflation, in the context of a rise in domestic currency in circulation** (Table 2). The BoA raised the key repo rate from 6½ percent in mid-2001 to 8½ percent by April 2002. A sharp increase in base

money since late 2001 did not reflect a policy loosening but higher demand for lek cash, due to two events:

- As was common throughout the region, the end-2001 **conversion of euro area cash** into domestic currency cash and foreign currency deposits, and consequently recorded money (by 1½ percent of broad money), was larger than expected. However, lek deposits did not rise as anticipated, and the BoA exceeded its projected end-2001 NDA level by Lek 8 billion (6 percent of reserve money).

- During late March and early April 2002, about 10 percent of total bank deposits were withdrawn, as unfounded rumors spawned **a temporary loss of confidence in the two largest banks**. As the BoA—appropriately—provided liquidity to the affected banks, both NDA and currency in circulation rose further, while recorded broad money fell due to the withdrawal of foreign currency deposits.

12. **Recent monetary and electricity developments have influenced the current account, but the exchange rate has remained fairly stable.** Stronger-than-expected end-2001 import growth (due mainly to imports of fuel and electricity generators) was more than accommodated by exceptionally high private remittances, reflecting an inflow of euro area cash held by Albanians working abroad (Table 3). The lek appreciated slightly as a result of euro currency conversion, and has weakened only modestly since mid-March following the withdrawal of bank deposits. At end-March 2002, external reserves remained above their end-2001 level (more than 4½ months of imports).

13. **Notwithstanding end-2001 revenue shortfalls, and further moderate slippages in early 2002, the fiscal deficit has remained well within the budgetary targets** (Table 4). At 8.5 percent of GDP, the end-2001 deficit (excluding grants) was one percentage point below the budget, reflecting lower spending—notably on operations and maintenance and foreign-financed projects. Domestic borrowing, at 3.1 percent of GDP, also stayed below its ceiling. Poor realization of foreign-financed expenditure particularly affected the health sector, where total outlays are estimated at 2½ percent of GDP, vis-à-vis the 3 percent previously projected. During the first quarter of 2002, tax collection improved relative to end-2001, but customs revenues were still below projections, in part owing to rumors of management changes and the eventual dismissal of the director general. Both overall and domestic financing remained within budget projections, with lower capital spending offsetting revenue shortfalls.

14. **Structural reforms have continued, but delays in privatizing Albtelekom have sharply reduced scheduled privatization receipts in 2002.** With the European telecommunications sector weakening further in early 2002, the tender for privatizing Albtelekom, announced in January 2002, yielded no expressions of interest and the process is not expected to be completed this year. Interest in buying the Savings Bank has also been limited—notwithstanding extensive marketing efforts with the IFC's assistance—and only two banks are proceeding to the next stage (due diligence). Selection of a buyer is currently planned for mid-June. (The 2002 budget does not assume any privatization receipts from the sale of the Savings Bank.) Following an interruption caused by political developments, the

legislative process for structural reform was resumed in March with the adoption of the deposit insurance law and the law on the Investment Promotion Agency.

III. The New Program

15. **The authorities' medium-term strategy—described in the GPRS—aims to promote inclusive growth, as the country continues to be plagued by poverty.** Transformation into a market economy over the past decade has been interrupted by episodes of social and political instability. Despite progress in structural reform, private business activity is hampered by still inadequate legal, physical, and financial infrastructure. Albania's growth outlook depends particularly on progress in reducing electricity shortages. Moreover, low productivity in agriculture—which still accounts for as much as half of GDP—and inadequate quality of—and limited access to—education and health care, remain principal sources of poverty (GPRS, Section III.A). Against this background, the GPRS constitutes a comprehensive approach to addressing structural deficiencies. It provides a coordinated framework for donor support that should help eliminate infrastructural bottlenecks—in particular in relation to electricity and transport. This, together with improvements in governance and the legal framework—guided by EU standards—and reductions in administrative barriers, should support private sector activity and help achieve the strategy's growth objective. The GPRS identifies spending priorities consistent with poverty reduction goals, while its fiscal consolidation targets aim to strengthen financial stability and enhance the provision of credit to the private sector. Thus, it provides a sound basis for a new PRGF arrangement.

16. **Within the umbrella of the GPRS, the proposed three-year PRGF Arrangement focuses on ensuring a sound macroeconomic environment as a pre-condition for sustainable growth.** In particular, the program aims to mobilize resources for priority expenditures, while ensuring fiscal and external sustainability. To this end, it includes measures to improve tax administration and limit unproductive spending (including budgetary subsidies to public enterprises). Moreover, the program includes actions to promote private sector activity through privatization, financial sector development, and sustainable provision of electricity (see below).

A. The Macroeconomic Framework

17. **Prospects for price stability and growth remain relatively favorable in the context of a sustainable fiscal strategy.** Assuming essential structural reforms continue, growth is expected to decelerate marginally to 6 percent in 2002, mainly on account of the electricity situation, but return to about 7 percent in subsequent years. Private investment should serve as the engine for growth, with ample scope for an acceleration of mining and other industrial activities, an expansion of tourism, and for further productivity gains in agriculture. Inflation is expected to return to the upper end of the 2–4 percent target range by end-year, as supply constraints ease and higher interest rates start having an impact. The current account deficit is projected to moderate to 5½ percent of GDP by 2005, in part reflecting the programmed fiscal consolidation (see below).

B. Fiscal Policy in 2002 and Beyond

18. **Fiscal policy under the program aims to reconcile financial sustainability with the provision of adequate resources for priority spending.** The overall deficit is targeted to fall from 8 percent of GDP in 2002 to 5½ percent in 2005, with somewhat lower consolidation in 2002 than in later years, reflecting the need for higher electricity subsidies (see below). Albania's public debt ratio—which is already lower than in the majority of other PRGF countries—would drop further by about 6 percent of GDP in 2002, largely owing to debt forgiveness, and continue to decline, albeit more gradually in the medium term (see Box 1 for an analysis of fiscal sustainability).

19. **Over the medium term, the scope for higher priority spending is dependent on improved expenditure management and more effective domestic revenue mobilization.**

- The strategy aims to stabilize total primary **expenditure** at 28½ percent of GDP. The authorities are committed to the continued development and recurrent updating of the medium-term expenditure framework (MTEF) and the GPRS to provide a coherent framework for identifying priorities and ensuring consistency between annual budgets and the wider poverty reduction strategy. They intend to boost spending on primary education and health care, in particular for rural areas, and to implement their fiscal decentralization program, in conjunction with improved tracking of local expenditures. The fiscal ROSC tentatively planned for 2002 is expected to enhance fiscal transparency and facilitate a more timely reporting of expenditures.

- **Revenues** rise from 23 percent of GDP in 2001 to 26½ percent by 2005 through further improvements in tax and customs administration and an expanded tax base. This target is supported by three major considerations: (i) the authorities' successful record in improving collection through reform; (ii) the still high level of fiscal evasion; and (iii) the bold measures for strengthening collection under the program (Box 2; MEFP, ¶16; and GPRS, Section IV.C).

20. **For 2002, the fiscal program aims to reduce the overall deficit by ½ percentage points to 8 percent of GDP—based on an increase in revenue by over 1 percentage point of GDP.** Domestic borrowing is targeted at 3 percent of GDP.

- The budget envisages a reorientation of **expenditure** toward reducing poverty and upgrading basic infrastructure (MEFP, ¶17). The GPRS identifies health and education as priorities for poverty reduction. Accordingly, and given severe problems in retaining and motivating qualified personnel, the provision of health care and education is to be strengthened through relatively higher wage increases—averaging 12 percent—as well as augmented outlays on operations and maintenance to address quality concerns. More broadly, with real public sector wages still below their 1996 levels, adequate salary increases are a key component of efforts to build a more effective public service and, for particular agencies, combat corruption. Nonetheless,

Box 1. Albania: Assessing Fiscal Sustainability

In view of revisions to the macroeconomic framework, this box re-assesses fiscal sustainability in Albania (see the July 2001 staff report for an earlier analysis).

The baseline scenario envisages a gradual decline in the overall government deficit to 5½ percent of GDP by 2005 and 2 percent of GDP by 2010. Accordingly, the debt-to-GDP ratio will be on a declining path, reaching around 48 percent of GDP by 2010. Key assumptions are real GDP growth of 5–7 percent per annum; inflation in the range of 2–4 percent; an unchanged nominal exchange rate (implying an annual real appreciation of 1–2 percent); and an average nominal interest rate of 6¼–6¾ percent (much of which is locked in by long-term concessional loan agreements). The projections also assume a continuation of essential structural reforms to promote private investment and growth, and to mobilize domestic revenue—reflected in a higher revenue-to-GDP ratio (albeit with declining gains after the program period). The fiscal path, while cautious, provides scope for increased expenditure on GPRS-identified priorities—in particular strategic public infrastructure investments with high expected returns and largely foreign financed on concessional terms—although the overall expenditure-to-GDP ratio is projected to decline marginally by 2010, reflecting relatively high up-front infrastructure spending.

Sensitivity of Public Debt Ratio to Macroeconomic Shocks, 2003-2010
(In percent of GDP)

	Historical means (standard deviations)	Projections 2002	2003	2004	2005	2008	2010
Baseline Projections		62.9	61.8	60.0	58.6	52.7	48.1
Overall fiscal balance	-10.9 (1.6)	-8.0	-7.2	-6.5	-5.6	-3.4	-2.0
Primary fiscal balance	-6.2 (2.9)	-4.2	-3.4	-2.8	-2.2	-0.3	0.9
Memorandum items:							
Real GDP growth (in percent per year)	6.2 (5.4)	6.0	7.0	7.0	6.5	6.0	5.0
Interest rate (percent per year)	7.1 (3.2)	6.2	6.7	6.7	6.3	6.2	6.2
GDP deflator (change, in percent per year)	15.1 (14.3)	5.2	3.2	3.3	3.3	3.2	3.2
Implied elasticity of revenues with respect to growth	1.1	1.49	1.39	1.34	1.30	1.17	1.09
Implied elasticity of non-interest expenditure with respect to growth	1.0	1.42	1.01	1.07	1.06	0.92	0.81
Sensitivity Analysis							
1. If interest rate, real GDP growth rate, GDP deflator, primary bal. at average of past 8 yrs.		62.9	66.7	70.0	72.7	79.9	84.7
2. If interest rate is average plus two standard deviations during 2003-05 and returns to the historical mean, others at baseline		62.9	65.7	67.8	70.6	65.3	61.3
3. If real GDP growth rate is average minus two standard deviations in 2003 and returns to the historical mean, others at baseline		62.9	68.8	66.8	65.1	58.1	51.8
4. If GDP deflator is average minus two standard deviations in 2003 and returns to the baseline, others at baseline		62.9	72.8	70.0	67.9	60.6	55.4
5. Combination of 2-4 using one standard deviation		62.9	68.9	69.4	70.2	64.5	59.0

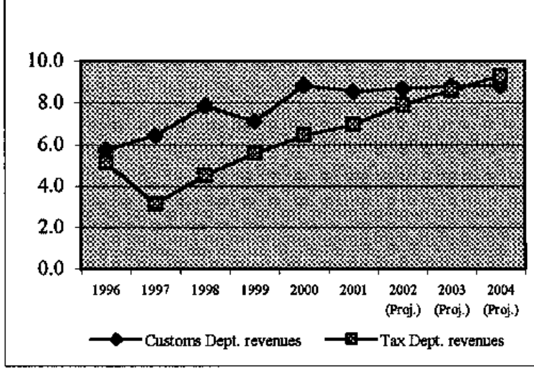
The sensitivity analysis suggests that, even in the event of multiple shocks, Albania's public debt will remain manageable. Using averages and standard deviations for the period 1994–2001, five sensitivity tests are carried out—as summarized in the table.[1/] According to the results while, depending on the shock, debt-to-GDP could initially rise up to 12 percentage points above the baseline, it would soon after revert back to a declining path. Excluding the historical averages scenario, debt in 2010 ranges from 50 to 60 percent of GDP—equivalent to 40 to 50 percent of GDP at market rates, given the highly concessional nature of Albania's external debt. Overall, the results illustrate the importance of ongoing fiscal consolidation. They also highlight the importance of robust growth as well as continued access to concessional donor financing.

[1/] For the GDP deflator, the baseline values (around 3¼ percent) are used instead of the historical mean (15 percent). Using the latter would have significantly (and unreasonably) deflated projected debt. Moreover, the GDP and GDP deflator shocks are assumed to last for one year because of the highly irregular features of these variables in the historical period.

Box 2. Albania: Tax Revenue Mobilization

In recent years the authorities have shown a consistent commitment to tax and customs administration reform, and have reaped the benefits in form of impressive increases in revenue collection. Between 1997 and 2001, collection in the tax and customs departments augmented by 1.5 percentage points of GDP per year, on average (see Chart).[1] In 2000 alone, revenues increased by 30 percent, or 2.6 percentage points of GDP, solely on the basis of administrative improvements, and despite reductions in tariff rates.

Albania: Tax revenue performance
(in percent of GDP)



Much scope remains for further efforts to combat fiscal evasion. Owing to widespread smuggling, underreporting on invoices, falsification of balance sheets, and weaknesses in enforcement, tax collection is by far less than other economies in transition with comparable tax rates (see Table). Latvia and Estonia receive more than twice as much in revenue with almost identical tax rates, while FYR Macedonia and Moldova collect over 30 percent more at similar levels of development.

Tax Revenues: Regional Comparisons

	Tax revenues 1/	VAT rate 2/	Top corporate tax rate	Top personal income tax rate
Albania	**15**	**20**	**25**	**25**
Latvia	32	18	25	25
Estonia	36	18	26	26
Macedonia	24	19	15	35
Moldova	21	20	32	28
Bulgaria	31	22	27	40
Croatia	38	22	35	35
Greece	26	18	40	45
Slovenia	39	20	25	50
Turkey	21	15	27	55

Sources: PWC, *Corporate Taxes 1999-2000, Worldwide Summaries and* PWC, *Individual Taxes 1999-2000, Worldwide Summaries*; and Fund staff estimates.
1/ As a percentage of GDP in 2000, based on Fund staff estimates.
2/ In some countries exceptions apply.

Comprehensive reform of tax and customs administration is programmed to continue under the proposed three-year arrangement (MEFP, ¶15, and the GPRS, ¶164). Staff's medium-term projections imply a stabilization of customs revenues due to continued tariff reductions and further steady improvements in tax revenue collection, albeit slightly below past trends (see Chart). No increases in tax rates are foreseen currently; raising taxes on the relatively small pool of registered taxpayers could well be counterproductive. The measures to be implemented include further computerization and restructuring of the tax department; continued widening of the tax base by registering more taxpayers and reforming tax policy to include the agricultural sector; improved coordination and information exchange between the tax and customs departments and the social security institute; and the implementation of a comprehensive human resource policy involving more training and the introduction of merit-based reward schemes in the tax department. Notably, the sharp increase in customs revenues of 1¾ percent of GDP in 2000 resulted in large part from the introduction of similar schemes in the customs department.

[1] Besides customs duties, the Customs Department collects VAT and excises along with the Tax Department. Personal income taxes, the corporate profit and small business taxes, as well as "national taxes" or fees are collected only by the Tax Department.

differentiation of the pay rises and further streamlining of public employment will keep overall personnel expenses constant in terms of GDP. The judiciary is being granted a salary increase slightly above average to improve governance, while top civil servants—for whom staffing problems are most pressing—have already received even higher pay rises. Parametric reform of the pension system was initiated in consultation with World Bank and Fund staff. It aims to strengthen its financial sustainability, reduce reliance on the budget, and address rural poverty.

- The authorities are implementing strong measures to achieve their ambitious **revenue** collection target. So far, implementation has been broadly on track, but problems persist regarding the proper valuation of imports, transparency of tax assessments, and tax compliance by public enterprises. Also, given ongoing weaknesses in the collection of customs revenues in the wake of senior personnel changes, Fund staff is monitoring the situation closely. It is also important to ensure proper and transparent application of tax laws, in particular concerning tax assessments (MEFP, ¶16).

21. **The 2002 expenditure and revenue plans reflect amendments adopted in May 2002 to the original budget on account of the shortfall in privatization receipts and the need for higher electricity imports.** The shortfall in receipts (1½ percent of GDP) related to the delay in privatizing Albtelekom was met by cuts in budgeted expenditure (1 percent of GDP) and also some increase in domestic borrowing (½ percent of GDP).[2] The spending cuts were designed to minimize the impact on poverty alleviation efforts (MEFP, ¶13) and are in line with contingencies identified at end-2001, in view of the risks to the privatization and Fund staff's concerns about the absence of contingency plans in the GPRS. A large part of the spending adjustment in the revised budget concerns the reserve and contingency funds, and the use of the remaining funds was made conditional on consultation with staff. Other spending cuts focus on the investment and operations and maintenance budgets of low priority sectors. On the other hand, in light of temporary shortfalls in domestic electricity generation due to unexpectedly adverse weather, staff endorsed additional subsidies for electricity imports (of around ½ percent of GDP) relative to the original budget, to be financed by a highly concessional, specific-purpose bilateral loan (Box 3).

22. **The mission strongly supported an FAD Technical Assistance mission's proposals for regularizing inter-enterprise arrears and promoting payment discipline.** As inter-enterprise arrears involving state-owned enterprises, in particular the water-supply companies, complicate enterprise reform and frustrate tax collection, the authorities indicated their intention to address this issue forcefully during 2002 (see Box 4; MEFP, ¶19).

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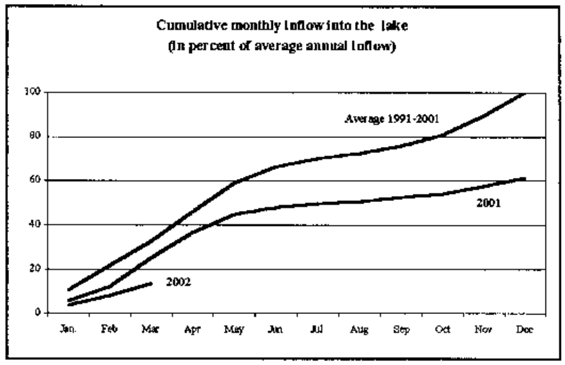
[2] If privatization receipts in 2002 are higher than envisaged, up to ½ percentage point of GDP will be fully utilized to pay down domestic borrowing.

Box 3. Albania: The Need for Additional Budgetary Subsidies for Electricity Imports in 2002

Albania's electricity production is highly dependent on hydropower. Low inflows into the hydropower lake, at 60 percent of the average over the past decade (see Chart), significantly constrained domestic production in 2001. For 2002, the budget agreed in November considered an average rainfall scenario, but the situation deteriorated further in the first quarter of 2002, with inflows falling to 40 percent of the historical average. Domestic production was limited to about 60 percent of the target.



While the underlying performance of KESH has improved as a result of reforms, including better collection and higher electricity tariffs, full cost recovery is not yet feasible. The action plan actively addresses the issue of pricing, but a further sizeable increase in prices in the near term—following the recent introduction of a two-tier tariff system—would likely exacerbate collection problems. Domestic electricity generation, moreover, cannot be expanded in the short term. To limit the impact on economic activity, therefore, further electricity imports and subsidies are necessary to meet the overall supply targets.

Relying on external financing, rather than additional fiscal adjustment, to cover the additional subsidies is justified on several grounds: (i) the shock to supply is both extreme and temporary; (ii) the bilateral loan is highly concessional (over 80 percent grant element) and tied to electricity imports; (iii) the use of subsidies is conditional on continued improvements in KESH's performance; and (iv) the authorities remain committed to eliminating budgetary subsidies over the program period (MEFP, ¶14).

Box 4. Albania: Inter-Enterprise Arrears

For over a decade, poor management, lack of hard budget constraints, and improper pricing have led to the accumulation of a large stock of inter-enterprise arrears and tax obligations within Albania's public sector. These arrears amount to the equivalent of 3.2 percent of GDP in gross overdue receivables (1.2 percent in gross overdue payables) and have led to hidden subsidization, disruptions of commercial relations, and substantial loss in budgetary revenue.

On the initiative of an FAD mission, the process of regularizing the stock of arrears has begun (MEFP, ¶19). As a first step, the authorities plan to reconcile the claims by end-September 2002, by requiring firms to sign bilateral "memoranda of understanding" regarding obligations as of end-December 2001. The amounts that can be cancelled through bilateral nettings or government-assisted multilateral payments will be determined by end-October 2002.

Preventing further arrears accumulation requires dramatic improvements in financial performance and practices of the public sector companies. The FAD mission recommended that the government take over the remaining net obligations and change subsidies paid out to public enterprises to grants that are conditional on explicit contracts with the enterprises, requiring the latter to prepare business plans, publish balance sheets, improve profitability, and ensure timely payment of obligations. While the authorities are committed, implementation will require determined efforts to overcome political obstacles and capacity constraints, as well as close coordination with donors.

C. Monetary and Exchange Rate Policy

23. **The monetary framework—including the use of indirect instruments to keep inflation within the 2–4 percent range, with flexible exchange rates—has served Albania well and will be continued.** Under the program, a ceiling on central bank NDA and a floor for NIR provide supporting anchors for monetary policy. Adopting formal inflation targeting within the program period would be premature as more work needs to be done to improve data collection and gain a better understanding of the transmission mechanisms. In this context, the mission encouraged the BoA's research—in cooperation with MAE—on the determinants of price inflation, with the eventual aim of developing forward-looking inflation targets. Within a flexible exchange rate regime, the BoA seeks to smooth temporary exchange rate fluctuations through selected interventions and by absorbing reserve inflows related to privatization and budgetary support, in line with the objectives for foreign exchange reserves.

24. **Restoring financial sector and price stability is the immediate priority for the monetary authorities.** Given the high rate of inflation in recent months, and risks of further inflationary and depreciation pressures stemming from the enlarged stock of domestic currency in circulation, the BoA saw a need for continued vigilance in setting official interest rates. The mission supported the BoA's effort to reassure the public of the soundness of the banking system and to urge private banks to make concerted efforts to regain the withdrawn funds and to facilitate the purchase of T-Bills by the public.[3] The authorities will also adopt further measures to broaden the government paper market, and support better marketing by commercial banks—which should help offset the deposit withdrawals (MEFP, ¶28; and GPRS, Section IV.D).

25. **Financial targets for 2002 are based on a monetary program that reflects the recent monetary shocks.** The program assumes that, with velocity constant from end-March onward, about half of recent deposit withdrawals will be reversed this year, and thus currency in circulation and reserve money will remain higher than envisaged prior to recent shocks.[4] While the reduced deposit base limits the scope for commercial bank lending, lower growth of private sector credit (following a large one-off expansion at end-2001) together with higher NDA (relative to earlier projections) should allow attainment of targeted government borrowing. The NIR target is consistent with a ratio of reserves to imports of 4½ months by the end of the year.

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[3] The banks affected by the bank run had no nonperforming loans (NPLs), and the share of NPLs in total loans for the banking system as a whole declined from 10 percent at end-2000 to 7 percent at end-2001.

[4] Whereas by end-April the withdrawals had already boosted currency in circulation by about Lek 14 billion and small withdrawals have continued into May, the end-year stock has been raised by only Lek 7.5 billion relative to earlier projections.

26. **The mission urged the authorities to proceed without delay with the full implementation of the anti-money laundering law.** A special unit has been created at the Ministry of Finance for the implementation of the Money Laundering Law, with US Treasury assistance, and the BoA is preparing procedures for the identification of suspicious activity.

D. Structural Reform

27. **Maintaining high growth will require ongoing improvements in financial services, the provision of utilities, the business environment, and governance.**

28. **Further unnecessary delays in the privatization process should be avoided.** A speedy sale of the Savings Bank would be key to creating a more dynamic financial sector, but the limited interest expressed in the sale could jeopardize the process. In addition, this privatization needs to be accompanied by policies for reducing the bank's dominance and strengthening supervision. Regarding Albtelekom, the company's balance sheet is marred by several unresolved financial claims, which need to be resolved to help boost the firm's market value before proceeding with privatization. More generally, the privatization of many entities has been affected by a disorderly reorganization of responsibilities among ministries in the new government, and the authorities acknowledged the urgency of improving coordination.

29. **The mission stressed the overriding importance of implementing a bold strategy for limiting harmful electricity shortages, while phasing out subsidies over the program period** (MEFP, ¶27; and GPRS, Section IV.F). The authorities will seek to reduce excessive demand (especially for space heating) by gradually raising average electricity prices, improving bill collection, and reducing losses. In this context, compliance with the quarterly targets set in the action plan will be monitored by the World Bank. Comprehensive tariff reform based on a World Bank study will help ensure the planned phasing out of import subsidies. While a comprehensive poverty and social impact analyses (PSIA) is not currently planned, the reform will be accompanied by measures to alleviate the impact of higher prices on vulnerable households. The authorities plan to build, with the World Bank's assistance, a new thermal power station.

30. **Efforts to address the various data problems that have hampered policy preparation and evaluation will continue.** The treasury system will be reviewed and, in cooperation with donors and line ministries, the authorities intend to improve the recording of foreign financed capital expenditures.

E. External Outlook and Access under the Program

31. **Albania's current account deficit is projected to widen to 8¼ percent of GDP in 2002, before improving gradually to around 5½ percent of GDP by 2005.** The wider current account deficit in 2002 reflects mainly temporary factors: private remittances will likely return to a more normal level—reflecting a reversal of the end-2001 euro conversion effect—more than offsetting a narrowing of the trade balance (owing to favorable demand in key export markets and a moderation in exceptional import demands). Beyond 2002, the

current account improvement is supported by robust growth in exports and tourism, reflecting more favorable supply-side conditions (improving infrastructure and energy supply, and strengthening the business climate), the planned export promotion strategy, and a resumption of mining production. The level of the real exchange rate does not appear to have posed a serious competitiveness problem as exports have generally continued an upward trend despite a 15 percent appreciation since end-1998 (Figure 1). The appreciation reflects the rising financial inflows from abroad, possibly combined with high productivity growth in the tradable sector, although lack of productivity data hampers a more complete analysis. Moreover, average wages in Albania appear (based on limited data) to be lower than in neighboring transition economies, and the mission's contacts with business suggested that competitiveness continues to be mainly influenced by nonprice, institutional factors— in particular electricity supply, tax administration, and access to credit. Nonetheless, the situation needs to be monitored closely as ongoing appreciation could deter an expansion of export capacity. Over the medium to long term, import growth is also expected to moderate—with higher domestic electricity supply and fiscal consolidation—but is subject to uncertainty given the remaining infrastructure needs. Growth in remittances is likely to slow as outward migration tapers off. External policies seek to strengthen Albania's integration into Europe and the region, and negotiations on the Stabilization and Association Agreement are expected to commence in 2002.

32. **The authorities are continuing to take steps to regularize relations with Paris Club and other external creditors.** They have finalized arrears rescheduling agreements with Turkey, Germany, and Russia, and have settled overdue payments to Russia resulting from delays in approving legislation for the rescheduling agreement. A rescheduling agreement with China (post-1978 arrears) is expected to be ratified shortly. Given the protracted negotiations for some rescheduling agreements, the mission emphasized the need for more determined efforts in regularizing outstanding arrears (Box 5). In particular, the clearance of nonconvertible currency arrears resulting from inoperative bilateral payments agreements would be critical for Albania to accept the obligations of Article VIII, Sections 2, 3, and 4 of the Fund's Articles.[5] The authorities have prepared the first quarterly report on external arrears (MEFP, ¶32), and are developing a strategy for dealing more systematically with these arrears. They are committed to eliminating arrears to official creditors during the arrangement and will discuss specific targets at the time of the first review.

[5] These restrictions are currently maintained under Article XIV and do not require Board approval.

Box 5. Albania: Status of External Arrears[1]

Albania has no external arrears to multilateral or Paris Club creditors and its outstanding arrears to non-Paris Club official and other creditors do not preclude the Fund from providing assistance to Albania. These arrears fall into two categories.

Arrears that are reconciled and subject to good faith negotiation: These arrears, for which the amounts have been agreed with creditors, are around $US55 million. They fall into three categories:

(i) inoperative balances on bilateral U.S. dollar clearing accounts (Czech Republic, Slovak Republic and Romania);
(ii) inoperative balance on bilateral ruble clearing accounts (Czech Republic, Slovak Republic, Poland Hungary and Romania); and
(iii) arrears to private creditors (Hungary, Greece and FYR Macedonia).

The authorities are making good faith efforts to negotiate rescheduling agreements with these creditors.

Arrears that have not yet been reconciled and are therefore regarded as in dispute: These fall into the following four categories:

(i) arrears on official bilateral budgetary loans (Greece);
(ii) inoperative balances on bilateral U.S. dollar clearing accounts (including the former Yugoslavia, Cuba, Greece);
(iii) inoperative balance on bilateral ruble clearing accounts (including Bulgaria, Vietnam, China (pre-1978)); and
(iv) arrears to private creditors (including Austria, Germany, Switzerland).

The authorities are working to identify and reconcile these amounts with creditors, with the objective of reaching rescheduling agreements.

[1] Based on advice from the Albanian authorities.

33. **The mission emphasized the importance of better management of foreign debt.** External public debt is estimated to remain below 24 percent of GDP throughout the program period (having fallen from around 28¼ percent at end-2001 on account of debt forgiveness related to the rescheduling agreement with Russia).[6] [7] In light of the envisaged increase in infrastructural investment, higher limits were included on nonconcessional borrowing by the public sector than under the previous arrangement—reflecting in large part projects related to the Stability Pact or the cofinancing of the World Bank's electricity projects (MEFP, Table 2). Bank and Fund staff consider the targeted infrastructure projects to be feasible and

[6] Excluding transferable ruble arrears for which rescheduling agreements have yet to be reached. The estimated stock could be in the order of ruble 1 billion, including previously unidentified pre-1978 arrears to China.

[7] Data including private sector external debt are not collected by the authorities. Creditor sources suggest that such debt has so far remained negligible.

necessary, and the resulting impact of the increase in nonconcessional lending on debt indicators to be limited (Table 3).

34. **The 2002 program period is fully financed, and a projected remaining financing gap of around $50 million in 2003–05 could be met comfortably by additional World Bank and donor support** (Tables 3 and 5). In the absence of Fund (and other donor) assistance, projected financing in 2002 would be insufficient to cover the current account deficit. Moreover, Albania is expected to remain dependent on concessional donor flows for some time, and current projections are predicated on the continued inflow of private remittances and the expected increase in privatization receipts, both of which are subject to risks. The program aims to reduce the current account deficit over the medium-term and to bolster international reserves anticipating the completion of the privatization program. The need for higher reserves also underlies the balance of payments need during the program period.

35. **Albania should be able to service its obligations to the Fund and other creditors** (Table 6). Albania has serviced its obligations to the Fund in a full and timely way. Its external debt indicators remain comfortable, although the structure of external debt is relatively rigid with almost half owed to multilateral creditors (Tables 3, 7, and 8). Official reserves are projected to rise mainly during the second and third program years, with the inflow of sizable privatization receipts, and would be around 4¾ months of imports at the end of the program period, declining slightly thereafter. Debt service is expected to rise from less than 4 percent of exports in 2001 to 7 percent in 2002. Notwithstanding the increased nonconcessional borrowing limit in 2002, debt service is expected to remain in the range of 6–7½ percent of exports through 2010.

IV. Program Monitoring

36. **Conditionality under the program includes semiannual quantitative performance criteria for the program period April 2002–March 2003.** Disbursements would be semiannual, with the first taking place upon Board approval, and the second upon observance of the end-September 2002 performance criteria and completion of the first review scheduled for January 2003 (Table 9; and MEFP, ¶34). The review will focus on the 2003 budget—especially prospects for tax and privatization receipts—and the electricity sector. Quantitative performance criteria are specified in Table 2 of the MEFP.

37. **Structural conditionality is focused on measures that are crucial to the success of the program and has been developed in close cooperation with the World Bank** (Box 6; and MEFP, Table 3). The authorities have demonstrated their commitment to the program through the implementation of a series of prior actions as well as measures required in the context of the planned World Bank credits.

Box 6. Albania: Structural Conditionality

Coverage of Structural Conditionality in the Proposed Program
Structural conditionality under the PRGF-supported program can be divided into four main categories: fiscal management and control, and payments discipline; budgetary implications of electricity sector reform; financial sector reform; and privatization (MEFP, Table 3). Each of these areas is critical to the macroeconomic success of the program:

- Strengthening tax and customs revenues, and improving budget control of foreign financed projects and state-owned enterprises are essential for safeguarding the programmed fiscal adjustment. The wide range of mutually reinforcing revenue measures aim to support the authorities' efforts to improve tax and customs administration, which are critical to achieving the program's revenue targets. Moreover, actions to regularize inter-enterprise arrears and external arrears help address the issue of contingent budgetary liabilities, as well as ongoing payments discipline and improved public debt management.
- Electricity sector reform aims to limit risks to macroeconomic stability and growth, and reduce the sector's reliance on the budget. Fund conditionality is intended to complement World Bank conditionality by focusing on the budgetary implications and eliminating subsidies for electricity imports by the end of the program period.
- Within the financial sector reform strategy, Fund conditionality focuses on improving monetary policy transmission.
- The privatization process will strengthen private sector activity and provide resources for financing the budget. The World Bank and IFC are providing technical support.

Status of Structural Conditionality from Earlier Programs
The authorities' efforts in meeting the structural conditions under the previous PRGF arrangement were satisfactory. All structural performance criteria and most of the structural benchmarks were met, albeit with delays in some cases (see Table 6 of EBS/01/106, of July 2, 2001).

Structural Areas Covered by World Bank Lending and Conditionality
The planned Country Assistance Strategy for Albania for FY 2003–05 aims at supporting the GPRS and focuses on three priority areas: (i) governance and strengthening institutions; (ii) sustainable private sector growth; and (iii) human development and poverty reduction. For 2002, the Bank is planning a Poverty Reduction Support Credit; a Power Sector Rehabilitation and Restructuring Project; a Financial Sector Adjustment Credit; and a Road Maintenance Project. These Bank lending arrangements involve extensive conditionality, including in the health, education, power, water, and financial sectors. The World Bank's relations with Albania are described in Appendix II.

V. Staff Appraisal

38. **The proposed PRGF arrangement is justified by the authorities' commendable performance under the previous PRGF arrangement and their strong measures for addressing the remaining policy challenges.** Key priorities for the three-year arrangement include reorienting government spending towards identified priority areas, while ensuring fiscal sustainability in the face of declining privatization receipts; and sustaining high private sector growth, including through electricity sector reform and improved financial sector performance. The development of the GPRS is an important step toward a comprehensive and structured approach to economic development and poverty reduction. However, as noted in the Joint Staff Assessment (JSA), the strategy will need to be strengthened over time, in particular through better prioritization and costing of measures, and identifying contingency

plans. Further effort should also be made to enable the authorities to conduct PSIA where appropriate.

39. **In light of fiscal and external vulnerabilities—illustrated most recently by the shortfall in privatization receipts—prudent fiscal policy should remain at the heart of the authorities' economic program.** In this context, the adoption of a medium-term fiscal consolidation path is appropriate, especially as two sources of low cost financing—privatization and concessional external financing—will likely disappear over the longer run. To limit risks to budget execution, revenue performance should be monitored closely, in particular in light of the recent slippage in customs receipts associated with political uncertainty and managerial disruption. Also, well-specified contingencies should be included in both GPRS updates and future budgets.

40. **Ensuring fiscal and external sustainability will require improved debt management.** Staff welcomes the development of a more comprehensive strategy for rescheduling negotiations and encourages the authorities to continue to increase their efforts to properly record and regularize all external arrears. The authorities should move quickly to develop the capacity to assess more systematically the relative merits and financing of large infrastructure projects. Moreover, they should follow a cautious approach to nonconcessional borrowing until the servicing implications of the remaining rescheduling agreements are known with more certainty.

41. **Monetary and financial sector policies need to remain focused on combating inflation and promoting financial stability.** The recent interest rate increases were warranted by the need to contain deposit withdrawals and prevent a generalization of inflationary pressures. The BoA should remain vigilant, given the unpredictability concerning the return to the banking system of funds recently withdrawn.

42. **Addressing the severe electricity shortages is indispensable for growth and macroeconomic stability.** Further tariff reform, to be developed in consultation with the World Bank, should help create proper incentives and phase out subsidies, while protecting the poorer segments of the population. KESH's financial problems in part stem from lack of payment by other public entities, which testifies to the importance of the planned resolution of inter-enterprise arrears. To reduce reliance on hydropower, it is appropriate to expand thermopower capacity rather than proceed with the Bushati hydropower plant.

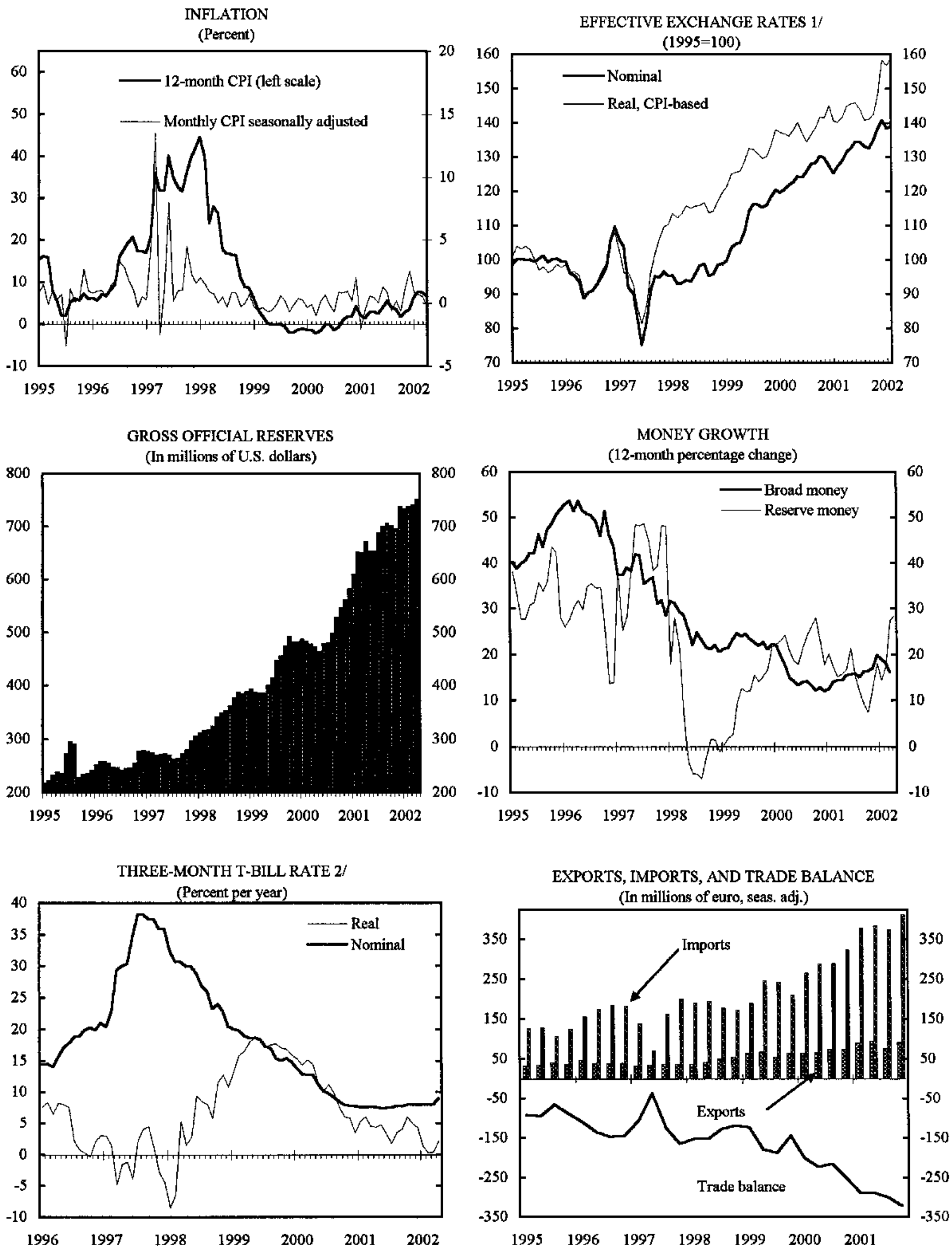
43. **Promoting private sector activity also hinges on further improvements in the business climate and governance, and financial sector reform.** The program foresees renewed efforts at successfully completing the privatization program. Ensuring fairness in tax and customs legislation and avoiding arbitrary assessments will also be crucial to supporting both tax compliance and the investment climate.

44. **In addition to risks emanating from electricity shortages, the political and financial situation also remain fragile.** The underdeveloped financial system entails a risk of renewed confidence problems, as evidenced by the recent bank run, which did not reflect any real solvency issue. Further risks to the macroeconomic outlook stem from domestic

political developments and their implications for revenue collection, as well as uncertainties regarding investor interest in the remaining major privatizations, inflows of private remittances, and sustained export growth.

45. **The staff considers the authorities' proposed policies ambitious but realistic.** While the authorities have a strong track record of program implementation, continued success will require maintaining political stability, implementing structural solutions to the electricity shortages, and addressing coordination problems among different ministries and agencies. In addition, close cooperation with and assistance from international organizations will be required to help alleviate capacity constraints and ensure the timely execution of key measures. The staff recommends Executive Board approval of the authorities' request for a new arrangement under the PRGF.

Figure 1. Albania: Monthly Economic Indicators, 1995-2002

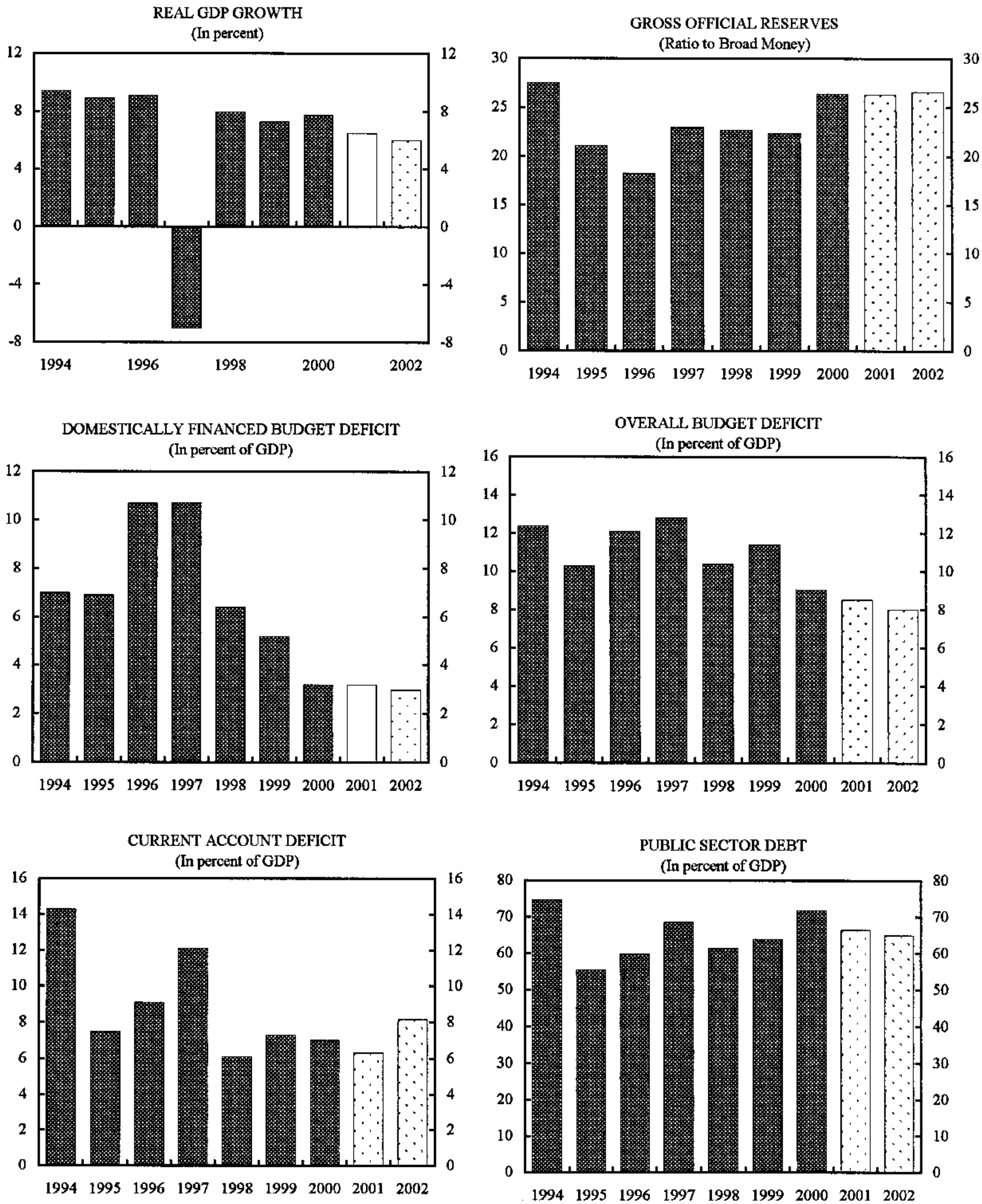


Sources: Bank of Albania, Ministry of Finance, INSTAT, and Fund staff estimates.

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

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

Figure 2. Albania: Economic Developments and Prospects, 1994-2002 1/



Source: Albanian authorities and Fund staff estimates.

1/ Program projections for 2001 and 2002.

Table 1. Albania: Basic Indicators and Macroeconomic Framework, 1998-2005

	1998	1999	2000	2001	2002		2003	2004	2005
				Est.	Dec01 Proj.	Proj.	Proj.	Proj.	Proj.
					(Percent change)				
Real GDP	8.0	7.3	7.8	6.5	7.0	6.0	7.0	7.0	6.5
Retail prices (avg.)	20.9	0.4	0.0	3.1	3.0	5.3	3.0	3.0	3.0
Retail prices (end-period)	8.7	-1.0	4.2	3.5	3.0	3.9	3.0	3.0	3.0
					(In percent of GDP)				
Saving-investment balance 1/									
Foreign saving 2/	6.1	7.3	7.2	6.3	8.2	8.1	7.1	6.3	5.4
Domestic saving	9.9	9.5	11.4	13.1	14.2	12.7	15.4	16.7	18.6
Public 3/	-5.2	-4.0	-2.6	-1.2	-0.4	-0.4	1.0	1.8	2.7
Private	15.1	13.5	14.2	14.3	14.7	13.0	14.4	14.9	15.9
Investment	16.0	16.8	18.6	19.4	22.4	20.8	22.5	23.0	24.0
Public	5.2	7.4	6.5	7.3	8.0	7.6	8.2	8.3	8.3
Private	10.8	9.4	12.1	12.1	14.4	13.2	14.3	14.7	15.7
Fiscal sector									
Revenues	20.3	21.3	22.4	23.0	24.1	24.2	25.0	25.8	26.5
Tax revenue	12.3	12.9	15.6	15.9	17.2	17.1	18.0	18.7	19.4
Expenditures	30.7	32.7	31.4	31.5	32.5	32.2	32.2	32.3	32.1
Primary	22.9	25.7	25.7	27.1	28.8	28.4	28.4	28.6	28.7
Interest 4/	7.8	7.0	5.7	4.3	3.7	3.8	3.8	3.7	3.4
Overall balance	-10.4	-11.4	-9.1	-8.5	-8.5	-8.0	-7.2	-6.5	-5.6
Primary balance	-2.6	-4.4	-3.4	-4.2	-4.8	-4.2	-3.4	-2.8	-2.2
Primary balance (excl. foreign financed projects)	0.3	-1.0	-0.4	-1.0	-0.8	-0.2	0.4	1.1	1.7
Domestic borrowing	-6.4	-5.2	-3.2	-3.1	-2.6	-3.0	-2.2	-1.7	-1.8
Privatization receipts	0.0	0.2	1.7	2.1	1.6	0.2	1.3	1.3	0.2
Foreign finance	-4.0	-6.1	-4.3	-3.3	-4.2	-4.9	-3.7	-3.5	-3.6
Public Debt	64.3	64.1	72.1	69.0	63.2	62.9	61.6	59.8	58.6
Domestic 5/	32.4	35.1	41.9	40.9	39.8	39.6	38.0	36.1	34.8
External (including publicly guaranteed) 6/	31.8	29.1	30.2	28.2	23.4	23.3	23.6	23.7	23.9
Monetary indicators									
Broad money growth (in percent)	20.7	22.3	12.0	19.9	11.4	6.0	9.3	9.3	9.3
Private credit growth (in percent)	14.7	29.4	26.9	43.1	28.5	28.8	29.3	...	...
Velocity	1.9	1.7	1.6	1.5	1.6	1.6	1.6	1.6	1.6
Interest rate (3-mth T-bills, end-period)	20.4	14.8	7.8	8.0	...	...	...	...	...
					(In millions of U.S. dollars)				
External sector									
Trade balance 7/	-621	-663	-821	-1027	-1039	-1072	-1116	-1180	-1229
(in percent of GDP)	-20.4	-18.0	-21.9	-25.0	-22.1	-23.4	-22.3	-21.3	-20.2
Current account balance	-187	-270	-270	-258	-384	-372	-357	-348	-330
(in percent of GDP)	-6.1	-7.3	-7.2	-6.3	-8.2	-8.1	-7.1	-6.3	-5.4
(in percent of GDP; incl. official transfers)	-3.2	-3.4	-4.0	-3.4	-5.9	-5.9	-4.9	-4.4	-3.8
Official transfers	89	139	111	119	106	104	109	104	98
(in percent of GDP)	2.9	3.8	3.0	2.9	2.3	2.3	2.2	1.9	1.6
Gross international reserves	384	485	608	737	799	750	828	923	973
(in months of imports of goods and services)	3.7	3.8	4.3	4.7	4.7	4.5	4.6	4.8	4.7
(relative to external debt service)	21.8	29.3	25.8	23.5	12.7	11.9	14.6	13.7	13.0
(in percent of broad money)	22.6	22.4	26.4	25.6	26.4	26.1	26.3	26.7	25.6
Change in real effective exchange rate	18.3	12.5	7.0	...	...	...	...	...	...
Memorandum item									
Nominal GDP (in millions of lek)	460,631	506,205	539,210	590,237	657,030	658,753	727,218	803,790	884,115

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

1/ Estimated based on indirect information in the absence of national accounts.
2/ Current account excluding official transfers.
3/ Revenue minus current expenditure.
4/ Including interest payments for bank restructuring.
5/ Including bonds for bank restructuring (lek 24.6 bn for 2000).
6/ Includes arrears, with the exception of those transferable ruble arrears for which the value is subject to reconciliation and rescheduling agreements have yet to be reached with creditors.
7/ For 1999 excluding imports of direct humanitarian aid related to the Kosovo crisis.

Table 2. Albania: Monetary Aggregates, 2000-03 1/

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

	2000	2001				2002						2003
	Dec.	March	June	Sep	Dec.	March Proj. Dec.01 2/	March Act.	June Proj.	Sep. Proj.	Dec. Proj. Dec.01 2/	Dec. Proj.	Proj.
Monetary survey												
Broad money	328.1	337.9	347.0	362.5	393.6	389.3	392.4	393.2	401.3	423.7	417.3	456.1
Currency outside banks	99.2	94.8	101.2	106.2	119.1	113.3	124.7	130.8	132.7	125.9	138.0	149.0
Deposits	228.9	243.2	245.8	256.2	274.5	276.0	267.8	262.4	268.6	297.8	279.3	307.1
Domestic currency deposits	165.3	170.6	173.4	177.8	186.2	195.6	181.6	177.4	181.3	207.6	187.5	203.7
Foreign currency deposits	63.6	72.5	72.4	78.4	88.2	80.4	86.2	85.0	87.3	90.2	91.8	103.4
M1	124.0	116.6	124.6	129.1	143.1	137.8	148.5	155.8	158.0	153.0	164.3	177.4
M2	264.5	265.4	274.6	284.1	305.3	308.9	306.2	308.2	314.0	333.5	325.5	352.7
Net foreign assets	130.8	146.7	147.2	153.6	158.7	157.0	159.2	156.6	157.0	170.6	161.2	174.8
Bank of Albania	71.8	79.9	82.3	84.7	86.0	88.7	92.1	92.3	92.7	98.2	94.9	106.0
Commercial Banks	58.9	66.7	64.9	69.0	72.7	68.4	67.1	64.3	64.3	72.4	66.3	68.8
Net domestic assets	197.3	191.3	199.8	208.8	234.9	232.3	233.2	236.6	244.3	253.2	256.1	281.3
Claims on government (net of deposits)	215.3	216.0	212.3	217.2	231.0	233.1	233.5	234.7	239.5	246.8	248.0	260.0
Claims on state enterprises and farms	1.1	0.6	0.7	0.6	0.5	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Claims on the private sector	22.2	23.2	25.3	21.9	27.4	24.9	29.0	31.2	34.2	32.1	37.4	50.6
Of which:												
in leks	7.5	8.2	8.7	3.2	4.8	3.6	4.4	5.0	5.7	5.5	6.5	10.5
in foreign currency	14.6	15.0	16.6	18.7	22.6	21.3	24.6	26.2	28.5	26.6	31.0	40.1
Other items, net	-41.3	-48.6	-38.5	-30.8	-24.0	-26.3	-29.9	-29.9	-29.9	-26.3	-29.9	-29.9
Monetary authorities												
Reserve money	128.8	125.3	135.1	135.7	152.1	145.1	159.6	161.8	164.4	160.1	171.0	185.2
Program NIR (millions of U.S. dollars) 3/	...	...	...	...	542.6	...	547.5	548.1	548.8	...	560.6	...
Program NDA 3/	...	...	...	...	78.1	...	84.8	86.9	89.5	...	94.4	...
Memorandum items:												
Broad money growth during the year	12.0	3.0	5.8	10.5	19.9	2.4	-0.3	-0.1	2.0	11.4	6.0	9.3
Of which:												
Net foreign assets	10.4	4.8	5.0	7.0	8.5	1.0	0.1	-0.5	-0.4	4.6	0.6	3.3
Net domestic assets	1.7	-1.8	0.8	3.5	11.4	1.4	-0.4	0.4	2.4	6.8	5.4	6.0
Claims on government	4.8	0.2	-0.9	0.6	4.8	0.3	0.6	1.0	2.2	3.9	4.3	2.9
Domestically bank-financed deficit	14.1	0.6	-3.0	1.9	15.6	1.1	2.6	3.7	8.5	14.7	17.0	12.0
in percent of GDP	2.6	0.1	-0.5	0.3	2.6	0.2	0.4	0.6	1.3	2.2	2.6	1.7
Cumulative change in banks' NFA during the year	5.5	7.8	5.9	10.0	13.8	2.1	-5.6	-8.5	-8.5	6.2	-6.4	2.5
Annual broad money growth (y-o-y; in percent)	12.0	14.4	15.7	16.3	19.9	15.2	16.1	13.3	10.7	11.4	6.0	9.3
Annual reserve money growth (y-o-y; in percent)	17.8	15.1	21.5	9.2	18.1	15.8	27.4	19.8	21.1	10.7	12.4	8.3
Annual growth in private sector credit (y-o-y; in percent)	31.8	26.3	28.0	-1.2	23.4	7.3	24.7	23.4	56.1	37.8	36.8	35.2
Annual growth in private sector credit (y-o-y; in percent) 4/	26.9	22.5	24.2	19.9	43.1	27.6	43.5	41.0	41.7	28.5	28.8	29.3
Annual M1 growth (y-o-y; in percent)	20.4	12.2	16.2	14.3	15.3	18.2	27.3	25.0	22.4	10.3	14.9	8.0
Annual M2 growth (y-o-y; in percent)	10.4	11.2	13.1	14.2	15.4	16.4	15.4	12.2	10.5	10.0	6.6	8.4
Velocity (Quarterly GDP/BM)	42.6	42.6	42.0	40.9	38.7	40.7	40.9	41.1	41.1	40.5	41.1	40.9
Money multiplier (absolute values)	2.55	2.70	2.57	2.7	2.59	2.68	2.46	2.43	2.44	2.65	2.44	2.46
Currency/Broad Money ratio	30.2	28.0	29.2	29.3	30.3	29.1	31.8	33.3	33.1	29.7	33.1	32.7
Currency/deposit ratio	43.4	39.0	41.2	41.5	43.4	41.1	46.6	49.9	49.4	42.3	49.4	48.5
Deposits/broad money	69.8	72.0	70.8	70.7	69.7	70.9	68.2	66.7	66.9	70.3	66.9	67.3
Foreign currency deposits/total deposits	27.8	29.8	29.5	30.6	32.1	29.1	32.2	32.4	32.5	30.3	32.9	33.7
Gross reserves (millions of U.S. dollars)	607.8	648.3	651.6	704.1	737.1	737.1	739.1	739.1	739.1	799.1	750.1	828.1
in percent of broad money	26.4	28.2	27.9	27.5	25.6	26.5	27.1	27.3	26.7	26.4	26.1	26.3
US Dollar Exchange Rate (end of period)	142.6	146.9	148.6	141.7	136.6	140.0	143.8	145.0	145.0	140.0	145.0	145.0
3-month T-bill rate (in percent)	7.8	7.6	7.5	7.5	8.0	...	8.7	...	...	...	...	...
Bank of Albania repo rate (in percent)	...	6.5	6.5	6.5	7.0	...	7.5	...	...	...	...	...

Sources: Bank of Albania; and Fund staff estimates.

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

2/ Projections made before data on the Dec. 2001 outturn, and the sizeable end-year currency conversion, were available.

3/ Derived using end-December 2001 exchange rates.

4/ Including credit transferred to the BART.

Table 3. Albania: Balance of Payments, 1999-2010

(In millions of US dollars)

	1999 Est. 1/	2000	2001 Prelim.	2002 Dec '01 Proj.	q1 Proj	q2 Proj	q3 Proj	q4 Proj	2002 Proj.	2003 Proj.	2004 Proj.	2005 Proj.	2008 Proj.	2010 Proj.
I. Current account	-270	-270	-258	-384	-76	-115	-102	-79	-372	-357	-348	-330	-295	-280
Trade balance	-846	-821	-1,027	-1,039	-236	-262	-294	-280	-1,072	-1,116	-1,180	-1,229	-1,375	-1,458
Exports	275	255	305	336	85	89	77	90	342	391	454	529	769	987
Imports	1,121	1,076	1,332	1,375	321	351	372	370	1,414	1,507	1,634	1,758	2,144	2,445
Of which: Humanitarian aid related to the Kosovo crisis	183	0	0	0	0	0	0	0	0	0	0	0	0	0
Services and income	66	112	226	152	43	47	39	61	190	206	234	256	325	381
Of which: Interest due	11	10	11	24	7	6	3	8	24	25	30	35	50	58
Private transfers	327	439	543	504	117	100	153	140	510	554	598	643	755	797
Official transfers related to the Kosovo crisis	183	0	0	0	0	0	0	0	0	0	0	0	0	0
II. Capital account	219	315	289	417	74	83	87	86	331	414	423	364	332	318
Official transfers	139	111	119	106	18	26	25	36	104	109	104	98	72	66
Direct investment	51	143	204	264	35	37	40	42	153	215	205	149	166	182
Other capital including short-term flows	-44	-9	-116	-39	11	5	1	-15	2	-17	0	0	0	0
Short-term capital	0	25	-3	0	0	0	0	0	0	0	0	0	0	0
Other financial flows (increase = -)	-44	-33	-113	-39	11	5	1	-15	2	-17	0	0	0	0
Of which: Change in NFA of commercial banks (incr=-)	-44	-33	-113	-39	50	22	1	-15	57	-17	0	0	0	0
Official medium- and long-term loans (net) 2/	72	70	81	86	11	17	22	22	72	108	114	117	94	70
New borrowing	80	79	89	111	14	25	25	34	97	132	143	149	151	150
Multilateral loans 2/	54	60	54	72	11	17	19	26	73	87	94	89	83	81
Bilateral loans	26	19	34	39	2	7	6	8	24	45	49	60	68	69
Amortization 2/	-8	-9	-7	-26	-3	-8	-3	-12	-26	-24	-29	-32	-57	-80
III. Errors and omissions	28	36	95	0	0	0	0	0	0	0	0	0	0	0
IV. Net balance = I+II+III	-23	80	125	33	-1	-32	-15	6	-42	57	75	34	37	37
V. Financing requirement = - IV	23	-80	-125	-33	1	32	15	-6	42	-57	-75	-34	-37	-37
Available financing	23	-80	-125	-76	1	-10	-2	-15	-27	-87	-103	-58	-62	-60
Change in net reserves (increase = -)	-83	-111	-131	-76	-4	-4	-2	-15	-26	-87	-103	-58	-62	-60
Change in gross reserves, (increase = -)	-101	-123	-129	-62	-2	0	0	-11	-13	-78	-95	-50	-50	-50
Use of Fund Resources (net)	17	12	-1	-14	-2	-4	-2	-4	-13	-9	-8	-8	-12	-10
Fund (PRGF)	21	19	12	0	0	0	0	0	0	0	0	0	0	0
Repayments to Fund	-3	-7	-14	-14	-2	-4	-2	-4	-13	-9	-8	-8	-12	-10
BOP support	96	29	4	0	0	0	0	0	0	0	0	0	0	0
Bilateral (grants+loans)	46	5	4	0	0	0	0	0	0	0	0	0	0	0
Multilateral	50	24	0	0	0	0	0	0	0	0	0	0	0	0
Changes in arrears (increase = +) 3/ 4/	5	2	-32	-281	6	-287	0	0	-282	0	0	0	0	0
Overdue debt forgiveness 3/ 4/	0	0	10	207	0	207	0	0	207	0	0	0	0	0
Debt service relief (rescheduling) 3/ 4/	5	0	23	75	0	75	0	0	75	0	0	0	0	0
Financing gap	0	0	0	43	0	42	18	9	68	29	28	24	25	22
Identified financing (provisional)	0	0	0	43	0	42	18	9	68	10	10	10	0	0
Of which:														
IMF PRGF	0	0	0	10	0	5	0	0	5	10	10	10	0	0
EU Budgetary Support	0	0	0	5	0	0	4	0	4	0	0	0	0	0
WB SAC/PRSC	0	0	0	28	0	28	0	0	28	0	0	0	0	0
Greece	0	0	0	0	0	0	5	0	5	0	0	0	0	0
Italy	0	0	0	0	0	9	9	9	26	0	0	0	0	0
Remaining gap	0	0	0	0	0	0	0	0	0	19	17	14	25	22
Memorandum items:														
Gross usable reserves	485	608	737.1	799	739.1	739.1	739.1	750.1	750.1	828.1	923	973	1,123	1,223
(months of imports of goods and services) 5/	3.8	4.1	4.7	4.7	...	...	...	...	4.5	4.6	4.8	4.7	4.5	...
(relative to external debt service)	21.7	23.7	23.2	12.7	...	...	...	...	11.9	14.6	13.7	12.9	9.4	8.3
Total Debt service (including IMF)	22.4	25.7	31.8	63.1	12.5	18.2	8.6	23.6	62.8	56.9	67.3	75.2	119.6	147.8
Trade balance (percent of GDP) 6/	-23.0	-21.9	-25.0	-22.1	...	...	...	...	-23.4	-22.1	-21.1	-20.0	-17.0	-15.4
Current account (percent of GDP)	-7.3	-7.2	-6.3	-8.2	...	...	...	...	-8.1	-7.1	-6.2	-5.4	-3.6	-3.0
Total debt service (percent of GDP)	0.6	0.7	0.8	1.3	...	...	...	...	1.4	1.1	1.2	1.2	1.5	1.6
Debt service (percent of exports of goods and services)	3.8	3.6	3.8	7.2	...	...	...	...	7.0	5.8	6.2	6.2	7.4	7.6
External debt (percent of GDP) 7/	29.1	30.2	28.2	23.4	...	...	...	...	23.3	23.6	23.7	23.7	22.1	20.6
Merchandise exports (percent growth)	34	-7	19	13	...	...	...	...	12	14	16	16	13	13
Merchandise imports (percent growth) 5/	13	15	24	11	...	...	...	...	6	7	8	8	7	7

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

1/ Estimated revisions to 1999 tourism services receipts and expenditures based on new methodology introduced in 2000. Staff estimate.

2/ Excluding IMF.

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

4/ The figure for 2002 corresponds *principally* to the clearance of arrears to Russia (Rbl 142.8 million converted at official rate of USD1=Rbl0.6 to USD 238.0 million; after an up-front discount of 70%, 50% debt reduction was applied under the 1998 Paris Club agreement; the remaining USD 35.7 million will be rescheduled at Libor+2%, 6 years grace, 23 years maturity) and China (USD38.9 million rescheduled at 3.5%, from 2004 to 2015). Both agreements are expected to be finalized in 2002Q2.

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

6/ Includes imports (official transfers) related to the Kosovo crisis; excluding Kosovo-related imports the trade deficit in 1999 would be 18.0 per cent of GDP.

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

Table 4. Albania: Government Revenues and Expenditures, 1999-2002
(In percent of GDP)

	1999	2000	2001 Amended Budget	2001 Outturn (Est.)	2002 Budget	2002 Revised Budget
Total Revenue	**21.3**	**22.4**	**23.9**	**23.0**	**24.1**	**24.2**
I Tax Revenue:	**12.9**	**15.6**	**16.1**	**15.9**	**17.2**	**17.1**
1.1 Tax revenues from Tax directorate and Customs	12.7	15.3	15.8	15.5	16.7	16.7
1. Turnover tax / VAT	5.9	7.1	7.4	7.0	7.8	7.8
2. Profit tax	1.2	1.5	1.5	1.7	1.7	1.7
3. Excise tax	1.4	1.7	1.9	1.6	2.1	2.1
4. Small business tax	0.2	0.3	0.4	0.3	0.4	0.4
5. Personal income tax	0.6	0.9	1.0	1.1	1.0	1.0
6. National taxes 1/	1.2	1.4	1.4	1.6	1.5	1.5
7. Customs duties	2.3	2.5	2.3	2.2	2.3	2.3
1.2 Property and local taxes	0.2	0.2	0.3	0.3	0.5	0.5
II. Social insurance contributions	**3.6**	**3.7**	**3.9**	**3.8**	**4.0**	**4.0**
1. Social insurance	3.3	3.4	3.6	3.5	3.7	3.7
2. Health insurance	0.3	0.3	0.3	0.3	0.3	0.3
III. Non-tax revenue:	**4.8**	**3.1**	**3.9**	**3.3**	**2.9**	**3.1**
1. Profit transfer from BOA	3.5	1.9	1.9	1.8	1.4	1.4
2. Income of budgetary institutions	1.1	0.9	1.1	0.7	1.0	1.0
3. Other	0.2	0.3	0.9	0.7	0.5	0.7
Total Expenditure	**32.7**	**31.4**	**33.2**	**31.5**	**32.5**	**32.2**
I. Current Expenditure	**25.3**	**24.9**	**25.7**	**24.2**	**24.6**	**24.6**
1. Personnel cost	**6.1**	**6.5**	**6.9**	**7.0**	**6.9**	**6.9**
Wages and other personnel expenditures	4.7	5.1	5.5	5.6	5.2	5.2
Social insurance contributions	1.4	1.4	1.4	1.4	1.2	1.2
Local government wage expenditures 2/					0.5	0.5
2. Interest	**7.0**	**5.7**	**4.5**	**4.3**	**3.7**	**3.8**
a. Domestic 3/	6.9	5.2	4.2	4.1	3.2	3.3
b. Foreign	0.1	0.4	0.3	0.2	0.5	0.5
3. Operations & maintenance	4.7	**4.3**	**4.2**	**3.9**	**4.6**	**4.5**
a. general govt op. & maintenance	3.3	3.2	3.1	2.9	3.2	3.0
b. local (through grants) 2/	1.1	0.9	0.8	0.8	1.0	1.0
c. local (own finance)	0.2	0.3	0.3	0.1	0.5	0.5
4. Subsidies 4/	**0.4**	**1.0**	**1.5**	**1.3**	**1.0**	**1.5**
a. subsidies for KESH	0.0	0.6	1.0	1.0	0.6	0.6
additional subsidies for KESH (conditional on performance)			...	...	...	0.6
b. subsidies for the water companies			0.2	...	0.1	0.1
c. others	0.0	0.4	0.3	0.3	0.3	0.3
5. Social insurance outlays	**5.4**	**5.8**	**6.0**	**6.1**	**6.1**	**6.0**
a. Social insurance	4.9	5.4	5.4	5.6	5.5	5.5
b. Other social insurance schemes	0.0	0.0	0.1	0.0	...	0.0
c. Health insurance	0.5	0.5	0.5	0.5	0.6	0.6
6. Other expenditures	**1.6**	**1.6**	**2.5**	**1.5**	**2.3**	**1.9**
a. Unemployment insurance benefits	0.3	0.4	0.3	0.3	0.3	0.3
b. Social assistance 4/	1.3	1.2	1.2	1.2	1.3	1.2
c. Housing subsidy/other	0.1	0.0	0.0	0.0	...	0.0
d. Reserve Fund/contingency	0.0	0.0	1.1	0.0	0.8	0.5
II. Capital Expenditure	7.4	**6.5**	**7.5**	**7.3**	**8.0**	**7.6**
1. Domestically financed	**2.4**	**2.9**	**3.6**	**4.1**	**3.9**	**3.6**
a. from the budget	2.2	2.9	3.3	3.3	3.6	3.3
b. other	0.2	0.1	0.3	0.8	0.3	0.3
2. Foreign financed projects	**3.4**	**3.0**	**4.0**	**3.2**	**4.0**	**4.0**
3. Kosovo related costs	1.6	0.6	0.0	0.0	0.0	0.0
Cash Balance	**-11.4**	**-9.1**	-9.4	**-8.5**	-8.5	**-8.0**
Cash Balance(including grants)	-7.1	-6.8	-7.7	-6.9	-6.2	-5.7
Financing	11.5	9.1	9.4	8.5	8.5	8.0
Sources of financing						
Domestic Financing	**5.4**	**4.8**	**5.4**	**5.3**	**4.1**	**3.1**
- Privatization receipts	0.2	1.7	2.1	2.1	1.7	0.2
- Bank Financing and non banks	5.2	3.2	3.3	3.1	2.4	3.0
Foreign Financing	**6.1**	**4.3**	4.0	**3.3**	**4.3**	**4.9**
of which grants	***4.2***	***2.2***	***1.7***	***1.6***	***2.4***	***2.4***
Budget support	2.9	1.5	0.3	0.2	0.8	1.4
Development (gross)	3.4	3.0	4.0	3.2	4.0	4.0
Memorandum items:						
GDP (in millions of leks)	506,205	539,210	594,346	590,237	657,030	658,753
Primary balance	-4.4	-3.4	-4.9	-4.2	-4.8	-4.2
Primary balance (excluding foreign financed projects)	-1.0	-0.4	-0.9	-1.0	-0.8	-0.2
Customs Department Revenues (in billions of Lek)	36	48	52	51	56	56
Expenditures by function as percentage of GDP 5/						
Health	2.4	2.3	3.0	2.5	2.9	2.8
Education	3.3	3.2	3.3	3.3	3.5	3.5

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

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

2/ From 2002 part of the wage bill will be transferred to local authorities in form of unconditional grants in the course of fiscal decentralization. This amount has been taken out of the total grant amount to show total wage allocations explicitly. Local governments may spend on local infrastructure besides operations and maintenance.

3/ Includes interest cost of bank restructuring.

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

5/ The expenditure figures based on the functional classification prior to 2001 are provisional.

Table 5. Albania: External Financing Requirement and Sources, 2000-05
(In millions of U.S. dollars)

	2000	2001	2002	2003	2004	2005
		Prelim.		Projections		
Current account	270	258	372	357	348	330
Amortization	16	21	39	32	37	40
Of which:						
IMF	7	14	13	9	8	8
Change in reserves (increase = +)	123	129	13	78	95	50
Reduction in arrears 1/	-2	32	282	0	0	0
Total financing requirement	408	440	706	467	480	420
Available financing	379	403	356	438	453	396
Official grants	111	119	104	109	104	98
Foreign direct investment	143	204	153	215	205	149
Short-term private financing flows	-9	-116	2	-17	0	0
Official medium- and long-term loans	79	89	97	132	143	149
Multilateral	60	54	73	87	94	89
Bilateral	19	34	24	45	49	60
Other loans	0	0	0	0	0	0
IMF disbursements	19	12	0	0	0	0
Other	36	95	0	0	0	0
Financing gap = I-II	29	37	350	29	28	24
Debt relief 1/	0	33	281	0	0	0
Balance of payments support	29	4	0	0	0	0
Multilateral	24	0	0	0	0	0
Bilateral	5	4	0	0	0	0
Remaining gap	0	0	68	29	28	24
Identified financing (provisional)	0	0	68	10	10	10
Of which: IMF PRGF	0	0	5	10	10	10
Of which: EU Budgetary Support	0	0	4	0	0	0
Of which: WB SAC/PRSC	0	0	28	0	0	0
Of which: Greece	0	0	5	0	0	0
Of which: Italy	0	0	26	0	0	0
Unfinanced gap	0	0	0	19	17	14

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

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

Table 6. Albania: Indicators of External and Financial Vulnerability, 1994-2002
(In percent of GDP, unless otherwise indicated)

	1994	1995	1996	1997	1998	1999	2000	2001 Prelim.	2002 Proj.
Financial Indicators									
Public sector debt	74.7	56.2	60.8	72.1	64.3	64.0	72.1	69.0	62.9
Broad money (percent change, end of period)	40.6	51.8	43.8	28.5	20.6	22.3	12.0	19.9	6.0
Private Sector credit (percent change, end of period)	61.4	15.9	30.5	19.0	14.7	29.4	26.9	43.1	28.8
Interest rate (3-mth T-bills, end period)	...	...	21.1	35.9	20.4	14.8	7.8	8.0	...
Foreign currency deposits (share of total deposits)	30.8	30.6	31.8	28.9	23.5	25.2	27.8	32.1	32.9
External indicators									
Exports (annual percent change, in US dollars)	...	44.9	11.8	-27.1	22.9	34.2	-7.1	19.3	12.2
Imports (annual percent change, in US dollars) 1/	...	13.0	35.6	-25.6	20.6	13.5	14.8	23.7	6.2
Current account balance									
(excluding official transfers) 1/	-14.2	-7.3	-9.2	-12.3	-6.3	-7.3	-7.2	-6.3	-8.1
(including official transfers)	-6.1	-2.4	-6.4	-8.9	-3.4	-3.6	-4.3	-3.4	-5.9
Capital and financial account balance	9.1	8.3	6.2	3.7	3.2	6.0	8.4	7.0	7.2
Of which: Foreign direct investment	3.3	3.7	3.6	1.8	1.5	1.4	3.8	5.0	3.3
Gross official reserves (in US dollars, millions)	204.3	240.3	275.3	306.2	384.0	484.6	607.8	737.1	750.1
Official reserves in months of imports (goods and services)	2.9	2.7	4.0	3.8	3.7	3.8	4.1	4.7	4.5
Official reserves to broad money (ratio)	0.3	0.2	0.2	0.2	0.2	0.2	0.3	0.3	0.3
Official reserves to reserve money (ratio)	0.5	0.4	0.5	0.5	0.6	0.6	0.7	0.7	0.6
Central bank foreign liabilities (in US dollars, millions)	621.5	357.1	357.1	361.1	392.0	178.8	143.6	138.7	...
Foreign assets of the banking sector (in US dollars, millions)	177.3	249.0	343.8	261.2	355.5	429.0	456.1	611.4	...
Foreign liabilities of the banking sector (in US dollars, millions)	19.0	12.1	11.8	13.5	20.4	35.8	47.9	88.2	...
Total external debt (in US dollars, millions) 2/	1,074.5	755.7	811.3	841.3	969.8	1,068.2	1,130.1	1,156.8	1,066.8
Total external debt 2/	54.2	31.2	30.2	36.8	31.8	29.1	30.2	28.2	23.3
Total external debt to exports (percent)	477.1	250.1	232.6	346.2	344.4	179.9	160.2	137.8	119.7
Total short term external debt to reserves (percent) 3/	23.6	2.7	5.7	5.9	5.8	3.9	3.0	2.5	6.6
External amortization payments to exports (in percent)	2.7	0.2	1.5	3.1	3.4	1.3	1.2	0.9	2.9
External interest payments to exports (in percent)	18.7	2.0	3.0	4.4	4.6	1.9	1.4	1.3	2.7
External debt service to exports (excluding IMF, in percent)	21.4	2.1	4.5	7.5	8.0	3.2	2.6	2.2	5.6
External debt service to exports (including IMF, in percent)	21.4	2.5	6.9	10.7	8.4	3.8	3.6	3.8	7.0
External debt service (excluding IMF)	2.4	0.3	0.6	0.8	0.7	0.5	0.5	0.4	1.1
External debt service (including IMF)	2.4	0.3	0.9	1.1	0.8	0.6	0.7	0.8	1.4
Change in REER (+ appreciation)	32.4	-1.5	-3.2	0.3	18.3	12.5	7.0	...	...
Exchange rate (period average)									
(lek per US dollar)	95.4	93.0	104.8	149.6	151.2	138.1	144.0	143.6	...
(lek per euro)	114.8	127.0	136.1	168.6	168.4	147.4	132.8	128.9	...

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

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

Table 7. Albania: Stock of Public Sector External Debt, 1994-2001

	1994	1995	1996	1997	1998	1999	2000	2001 Prelim.
	(In millions of U.S. dollars; end of period)							
Total External Debt	1,074	756	811	841	970	1,068	1,130	1,157
Multilateral	119	182	208	221	304	419	492	523
EBRD	0	5	10	9	9	8	8	9
EIB	0	0	0	0	1	15	27	35
World Bank	65	109	137	148	220	296	345	366
Islamic Development Bank	0	0	0	0	1	1	2	5
IFAD	1	2	5	5	8	12	13	15
IMF 1/	53	66	54	56	62	80	89	84
OPEC	0	0	1	2	4	6	7	8
Bilateral	113	145	170	183	218	211	214	259
Austria	10	13	13	11	10	7	6	5
Germany	33	46	53	57	68	58	56	59
Greece	0	0	0	0	11	11	11	12
Italy	41	48	58	63	75	72	75	81
Japan	8	11	9	17	21	31	29	26
China	0	0	0	2	2	2	2	2
Kuwait	1	7	12	13	15	16	15	16
Norway	0	0	3	3	3	3	11	26
Sweden	0	0	4	4	4	4	4	4
Turkey 2/	0	0	0	0	0	0	0	23
United Kingdom	0	0	0	0	0	0	0	0
Denmark	0	0	0	0	0	0	0	0
France	19	20	17	13	10	8	5	4
Netherlands	1	1	1	1	1	0	0	0
Russia	0	0	0	0	0	0	0	0
Arrears 3/ 4/	842	428	433	438	447	438	424	375
	(In percent of GDP)							
Total External Debt	54	31	30	37	32	29	30	28
Of which:								
Multilateral	6	8	8	10	10	11	13	13
Bilateral	6	6	6	8	7	6	6	6
Arrears	42	18	16	19	15	12	11	9
	(In percent of exports of goods and services)							
Total External Debt	477	250	233	234	344	180	160	138
Of which:								
Multilateral	53	60	60	61	108	71	70	62
Bilateral	50	48	49	51	78	36	30	31
Arrears	374	142	124	122	159	74	60	45

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

1/ PRGF (formerly ESAF) and ordinary resources.

2/ End-2001 stock reflects amounts rescheduled during 2001.

3/ Excludes those transferable ruble arrears for which the value is subject to reconciliation and rescheduling agreements have yet to be reached with creditors.

4/ Amended from previously reported (pre-2001) arrears to reflect apportionment of penalty and overdue interest arising from rescheduling agreements and not previously included in arrears.

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

	2002 1/	2003	2004	2005	2006	2007	2008	2009	2010	2011	Beyond	Total
Obligations from existing drawings												
1. Principal												
GRA Repurchases	3.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	3.3
PRGF Repayments	3.8	6.8	6.4	6.2	7.6	9.0	8.4	6.3	3.5	1.4	0.0	59.4
2. Charges and Interest 2/												
Periodic Charges	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1
PRGF Interest	0.3	0.3	0.2	0.2	0.2	0.1	0.1	0.0	0.0	0.0	0.0	1.4
SDR Net Charges	-0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.4
Total Obligations	7.1	7.1	6.6	6.4	7.8	9.1	8.5	6.3	3.5	1.4	0.0	63.9
(percent of quota)	15	15	14	13	16	19	17	13	7	3	0	131
Obligations from prospective drawings												
1. Principal												
PRGF Repayments	0.0	0.0	0.0	0.0	0.0	0.4	1.2	2.8	4.4	5.6	13.6	28.0
2. Charges and Interest 2/												
PRGF Interest	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	1.1
Total Obligations	0.0	0.0	0.1	0.1	0.1	0.5	1.3	2.9	4.5	5.7	13.7	29.1
(percent of quota)	0	0	0	0	0	1	3	6	9	12	28	60
Cumulative obligations (existing and prospective)												
1. Principal												
GRA Repurchases	3.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	3.3
PRGF Repayments	3.8	6.8	6.4	6.2	7.6	9.4	9.6	9.1	7.9	7.0	13.6	87.4
2. Charges and Interest 2/												
PRGF Interest	0.3	0.3	0.3	0.3	0.3	0.3	0.2	0.2	0.1	0.1	0.1	2.5
SDR Net Charges	-0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.4
Total Obligations	7.1	7.1	6.7	6.5	7.9	9.7	9.8	9.2	8.1	7.1	13.7	92.9
(percent of quota)	15	15	14	13	16	20	20	19	17	15	28	191
Outstanding Fund credit	59.6	60.8	62.4	64.3	56.7	47.3	37.6	28.6	20.6	13.6	...	...
Memorandum items:												
Outstanding Fund credit												
In percent of:												
Exports of goods & services	8	8	7	7	5	4	3	2	1	...	...	...
External public debt	7	6	6	6	5	4	3	2	1	...	...	...
Gross official reserves	10	9	8	8	7	6	4	3	2	...	...	...
GDP	2	2	1	1	1	1	1	0	0	...	...	...
Quota	122	125	128	132	116	97	77	59	42	28	...	...
Total Obligations												
In percent of:												
Exports of goods & services	1.0	0.9	0.8	0.7	0.7	0.8	0.8	0.7	0.5	...	...	...
External public debt	0.8	0.7	0.6	0.6	0.6	0.7	0.7	0.6	0.5	...	...	...
Gross official reserves	1.2	1.1	0.9	0.8	1.0	1.1	1.1	1.0	0.8	...	...	...
GDP	0.2	0.2	0.2	0.1	0.1	0.2	0.2	0.1	0.1	...	...	...
Quota	15	15	14	13	16	20	20	19	17	15	28	191

1/ May 1, 2002 to December 31, 2002.

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

Table 9. Albania: Schedule of Purchases Under Proposed PRGF Arrangement

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

1/ Albania's quota is SDR 48.7 million.

Albania: Fund Relations
As of April 30, 2002

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

II. **General Resources Account**:	SDR Million	%Quota
Quota	48.70	100.00
Fund Holdings of Currency	48.66	99.92
Reserve position in Fund	3.35	6.89

III. **SDR Department**:	SDR Million	%Allocation
Holdings	64.14	N/A

IV. **Outstanding Purchases and Loans**:	SDR Million	%Quota
ESAF arrangements	59.44	122.06
First Credit Tranche	3.31	6.80

V. **Financial Arrangements**:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
ESAF/PRGF	05/13/1998	07/31/2001	45.04	45.04
ESAF	07/14/1993	07/13/1996	42.36	31.06
Stand-by	08/26/1992	07/14/1993	20.00	13.13

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

	Forthcoming				
	2002	2003	2004	2005	2006
Principal	7.1	6.8	6.4	6.2	7.6
Charges/Interest	0.3	0.3	0.2	0.2	0.2
Total	7.4	7.1	6.6	6.4	7.8

VII. **Safeguards Assessments**:

Under the Fund's safeguards assessment policy, the Bank of Albania is subject to a full safeguards assessment with respect to the proposed PRGF arrangement. A safeguards assessment of the Bank of Albania is in the process of being finalized, 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 preliminary conclusions suggest that recent improvements in the central bank's accounting, auditing, and control systems have addressed previously identified weaknesses.

VIII. **Exchange Rate Arrangement**:

On July 1, 1992 the Albanian authorities announced the removal of virtually all exchange and quantitative trade restrictions, unified the exchange markets, and adopted a floating exchange rate system (an independent float). The unified exchange rate stood at 144.9 lek per U.S. dollar on April 30, 2002.

IX. **Article IV Consultation**:

The conclusion of the Article IV consultation and the final review under the third annual PRGF arrangement took place in July 2001 (Report number 01/117). The next Article IV consultation is scheduled for January 2003.

X. **FSAP Participation and ROSCs**:

An FSAP is being planned, but no date has been set yet. A ROSC on data dissemination was published in the Fund's wedsite in May 2000. A fiscal ROSC is scheduled for July 2002. Albania participates in the General Data Dissemination System (GDDS), and a complete set of GDDS metadata for the external, financial, fiscal, and real sectors, as well as for the socio-demographic indicators is posted on the Fund's Dissemination Standards Bulletin Board (http://dsbb.imf.org).

XI. **Technical Assistance**:

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

IX. **Resident Representative**:

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

Albania: World Bank Relations

Partnership in Albania's Development Strategy

The Government's development objectives place increased emphasis on poverty reduction. This shift in emphasis is reflected in the Growth and Poverty Reduction Strategy (GPRS) that the Albanian Government prepared in November 2001. The GPRS process enabled the country to articulate, for the first time, a medium and long term development vision that identifies Albania's main development challenges and explicitly addresses poverty.

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

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

Bank Group Strategy

The Bank's operations have been designed to support Albania in the implementation of its new development strategy. Therefore, in line with the objectives of the GPRS, the Bank supports Albania on three strategic 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 investment, 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 will reflect a cross-sectoral emphasis on reducing poverty and on strengthening institutions and increasing transparency and accountability. In addition, the Bank will integrate more effectively fiduciary issues into its lending operations and will focus its attention on related policy discussions. To date, the Bank has approved a total of 44 operations amounting to US$575.1 million, of which 22 are completed. Under the active Bank portfolio (US$265.1million), 22 percent of the credits support agriculture, 43 percent infrastructure, 15 percent social sectors, and 19 percent technical assistance. During the next three years, the Bank will use a mix of adjustment and investment lending as well as country analytic work to best support the GPRS. In line with its new Country Assistance Strategy, the Bank is planning on three successive Poverty Reduction Support Credits (PRSCs) plus 10 possible investment operations in education, health, power, transport, environment, municipal water, and community works.

The PRSCs will provide a strong core for the Bank lending program and will focus on multi-sectoral and thematic policy reforms which 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 will be complementary and mutually reinforcing: the PRSCs will support reforms crucial for investment projects, while investment projects will help build the capacity needed to implement reforms.

The Bank will continue work to strengthen external partnerships, including with the EU, to ensure continued complementarity and consistency among the Bank's objectives to assist Albania. In particular, the Bank will continue to ensure a close collaboration with the IMF in the major areas of reforms. The two institutions broadly support the Government's reform program.

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 started the implementation of 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 GPRS and aims at divesting the State from the banking and insurance sector and at the establishment of sound governance structures in the financial institutions. Its priority has been the revival of banking sector reforms, which are now well underway. All state-owned banks, with the exception of the Savings Bank have been privatized.

The proposed Financial Sector Adjustment Credit, to be presented to the Board on June 20, 2002, will help to advance reforms in banking sector. The measures that the Bank is going to support include the privatization of the Savings Bank, the development of a deposit insurance system, improvement of the bankruptcy framework and collateral enforcement, and strengthening of bank regulation and supervision, which will also assist the Government's anti-money laundering efforts. The IMF has provided technical assistance to the Bank of Albania. The IMF is also funding a resident adviser to support the implementation of the institutional development program for banking supervision developed by the Bank of Albania.

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

- *Power sector*

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

The Bank has played the lead role in coordinating a unified stance among power sector donors on major sector issues, and has assisted the Government in shaping sector policy. Conditionality related to improving sector performance, sector restructuring, and strengthening the regulatory and legislative framework is included in the proposed Power Sector Rehabilitation and Restructuring Project which is to be presented to the Board on June 20, 2002. The Fund-supported conditionality proposed for the three-year arrangement under the PRGF focuses on the budgetary implications and the elimination of subsidies for electricity imports by the end of the program period.

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

- *Pension reform and Social Services*

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

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

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

- *Public expenditure management*

Key challenges include: (i) ensuring that recently initiated efforts to create a transparent budget decision making process becomes 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 made the MTEF framework the centerpiece of its budget formulation process to prioritize expenditures more efficiently and to strengthen the linkages between policy objectives and budget planning. As a first step in this process, and as part of the PRSC, the Government has closely linked the preparation of the GPRS with the preparation of the 2002–04 MTEF.

To increase the effectiveness of the GPRS 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 of budget systems, procedures, and monitoring of budget outputs as well as training of 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 measures related to improvement in financial reporting and audit functions.

The PRGF arrangement complements the above mentioned measures by focusing on fiscal management and control, payment discipline, and mobilizing adequate resources for expenditure priorities under the GPRS. 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 Bank's staff view these measures will help maintain fiscal sustainability, and together with monetary and exchange rate policy of the PRGF program, will help ensure a sound macroeconomic environment for sustainable growth.

Prepared by World Bank staff. Questions may be addressed to Ms. Masutti, Senior Country Officer at 473 4751; or Mr. Farsad, Senior Economist at 473 2963.

Albania: Statistical Issues

Albania has made significant progress in improving its statistical database with extensive technical assistance, including from the Fund. The multisector statistics mission of February 1999 secured the agreement of the authorities on an action plan for each of the major statistical areas, identifying the concrete steps and timetable for improving Albania's macroeconomic statistics. This mission was followed by several other missions in the areas identified as priority, and a resident national accounts advisor assisted the Institute of Statistics (INSTAT) in establishing a compilation system for producing GDP estimates from July to December 1999. The authorities have thus far made progress in implementing the action plan. The Council of Statistics has been established and its constitution and functions have been ratified. However, much still remains to be done, in particular as regards the compilation of the national accounts.

Albania was selected as a pilot country for the preparation of the data dissemination module in the Report on Observance of Standards and Codes (ROSC), and the ROSC was published in the Funds' website in May 2000. Albania participates in the General Data Dissemination System (GDDS), and a complete set of GDDS metadata for the external, financial, fiscal, and real sectors, as well as for the socio-demographic indicators is posted on the Fund's Dissemination Standards Bulletin Board (http://dsbb.imf.org). The metadata also includes a comprehensive summary of plans for improving data compilation and dissemination across all statistical sectors, including socio-demographic indicators.

Real sector

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

In the absence of official national accounts aggregates since 1990, Fund staff have relied on their own estimates prepared in consultation with the authorities. These estimates are based on very partial data on (gross) agricultural output, activity in state industrial production, and extremely limited information on private sector activity.

The STA resident advisor on national accounts assisted the INSTAT to establish a compilation system for producing GDP estimates using existing and new data sources. As a result, preliminary annual GDP estimates for 1996–1998 using both the production and expenditure approaches at current and constant prices were produced during his assignment. However, these data do not include estimates for the underground economy. In addition to coverage problems, these estimates suffer from the poor quality of the source data and the lack of appropriate price indicators for deflating current price estimates. To improve basic data sources, the mission recommended changes to the design of new surveys and advised the authorities on establishing a framework within which the collaboration among government agencies involved in statistics could be institutionalized. The STA mission of January 2001 assisted the INSTAT to develop national accounts statistics in accordance with the *System of National Accounts 1993 (1993 SNA)*. The mission worked with the authorities in improving the annual GDP estimates for 1996–99 by using the results of the recent survey and of the recently available 1999 PPI results. However, the compilation of GDP estimates continues to be hampered by weaknesses in basic data sources and incomplete coverage of the private sector. A follow-up STA mission in April 2002 recommended further enhancements and agreed on an action plan aimed at dissemination of the annual GDP data by end-December 2002.

As regards trade statistics, data collection suffered extensively during the 1997 crisis as a number of customs posts were damaged or destroyed, and there was most likely a large temporary increase in the volume of unreported transactions. After some delays due to the Kosovo crisis, the compilation and dissemination of foreign trade indices has started again. Plans for improving the quality of trade statistics include the forthcoming introduction of the Automated System of Customs Data (ASYCUDA) with EU assistance.

Government finance

Albania reported fiscal data (for 1995) for the first time in 1996 for publication in the 1996 *Government Finance Statistics Yearbook* and *IFS*. In March 1998, the authorities started to publish a new quarterly bulletin of government statistics. The STA multisector statistics mission in 1999 assisted in upgrading the quality of the data reported in this publication to GFS standards and developing a system for the regular and timely reporting of data to the Fund for publication. Data for 1997 and 1998 have since been reported for inclusion in the *GFS Yearbook*; although data for 1999 and 2000 have not yet been reported. Some improvement in the collection of data on disbursement of foreign loans and grants has been achieved under the technical assistance provided by UNCTAD. A foreign debt database has been established and is nearly operational, requiring only auditing for final implementation. Nonetheless, further improvements are urgently required regarding the accuracy and timeliness of information on foreign financed capital expenditures.

Monetary accounts

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

The new plan of accounts for the commercial banks has been implemented. The commercial banks started reporting balance sheet data to the BoA in June 1999 on revised reporting forms prepared by the BoA. The money and banking statistics mission of November 1999 assisted the BoA in revising the reporting forms with a view to reducing the reporting burden of the commercial banks and ensuring consistency of the data reported to the various departments of the BoA. Efforts were being made to extend the time series of monetary data on a consistent basis.

The recording of repos and reverse repos in the balance sheets of the BoA and other depository corporations deviates from the guidelines of the *MFSM.* STA is corresponding via e-mail with the authorities to provide advice concerning the proper statistical treatment of repos and reverse repos.

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 (BOPM5).* The BoA reports quarterly data to STA on a regular and timely basis. In 2000, 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 Albanian authorities have not yet initiated compiling data on foreign currency liquidity in line with the Data Template on International Reserves and Foreign Currency Liquidity. While the definition of data on official reserve assets in principle is consistent with that of the data Template, the data may not be adequate for monitoring the economy because other foreign currency assets and currency drains are not included.

External debt statistics

External debt statistics for government and government-guaranteed debt are compiled by the Ministry of Finance (MoF). These data are generally 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 do not collect data on private sector external debt and should work to extend coverage to include private sector liabilities.

Albania: Core Statistical Indicators
(as of May 23, 2002)

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Governmt. Balance	GDP/GNP	External Public Debt/Debt Service
Date of Latest Observation	May 22	Mar. 22	End-Apr.	End-Apr.	End-Mar	May 7	Apr.	Jan.	Dec.	End-Apr.	2001	End-Mar
Date Received	May 23	May 23	May 6	May 6	May 8	May 8	May 8	Apr.	Apr.	May	April 2002	Apr.
Frequency of Data	Daily	Daily	Monthly	Monthly	Monthly	Bi-weekly	Monthly	Monthly	Quarterly	Weekly/ Monthly	Annual	Quarterly
Frequency of Reporting	Daily	Daily	Monthly	Monthly	Monthly	Bi-weekly	Monthly	Monthly	Variable	Weekly/ Monthly	Annual	Variable
Frequency of Publication	Daily	Monthly	Monthly	Monthly	Monthly	Bi-weekly	Monthly	Monthly	Variable	Variable	Annual	--
Source of Update	BoA	BoA	BoA	BoA	BoA	BoA	INSTAT	Customs/ BoA/INSTAT	BoA	BoA/MoF	Estimated in consultation with the authorities	MoF/ Donors
Mode of Reporting	Fax	Fax	E-mail	E-mail	E-mail/ Pouch	E-mail/ Pouch	Fax	Fax/ Mission	Mission	Fax	Mission	Mission
Confidentiality	UR	UR	UR	UR	UR	UR	UR	UR	UR	UR	UR	UR

List of abbreviations:

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

Tirana, 12 June, 2002

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

Dear Mr. Köhler,

1. Since 1998, Albania has made much progress in restoring macroeconomic stability and in implementing market-oriented structural reforms. We have benefited from close cooperation with the Fund in the context of our 1998-2001 PRGF arrangement. To further strengthen policy making, we have developed our Growth and Poverty Reduction Strategy (GPRS), which was submitted to the World Bank and the IMF in December 2001, with an update in May 2002.

2. Based on Albania's performance under the previous arrangement and to support our program for the period ahead, as described in the attached Memorandum of Economic and Financial Policies (MEFP) and consistent with the GPRS, we are hereby requesting a new three-year arrangement under the Poverty Reduction and Growth Facility, in an amount equivalent to SDR 28 million (57 percent of quota). We have reached understandings with Fund staff on an amended 2002 budget. We have already implemented the prior actions for the presentation of the program to the Board of the IMF.

3. The Government and the Bank of Albania believe that the policies outlined in the attached memorandum are sound basis for achieving the targets of the program. During the period of this arrangement, Albania will consult with the IMF on the adoption of any further measures that may be appropriate, at the initiative of the Government or Bank of Albania or whenever the Managing Director of the IMF requests such a consultation. In addition, the authorities will provide the IMF with such information as the IMF may request in connection with the implementation of the program. The Government and the Bank of Albania will conduct with the Fund two reviews of the first year of the program supported by the new arrangement, the first not later than end-January 2003 and the second before end-July 2003.

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

Albania's economic and financial policies. These consultations may include correspondence and visits of officials of the IMF to Albania or of representatives of Albania to the IMF.

Sincerely yours,

/s/	/s/	/s/
Pandeli Majko	Kastriot Islami	Shkëlqim Cani
Prime Minister	Minister of Finance	Governor, Bank of Albania

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

I. Background

A. Introduction

1. **This memorandum describes our economic program for the period April 2002–March 2003, based on Albania's Growth and Poverty Reduction Strategy (GPRS).** It also outlines our medium-term strategy for the period 2002–05, for which support is being requested from the IMF under a new three-year PRGF arrangement.

2. **Under the previous Fund-supported program, we made considerable progress in achieving macroeconomic stability and financial sustainability, as well as in moving toward a market-based economy.** Notwithstanding an often adverse regional environment and episodes of political instability, output growth has been strong, inflation has remained under control, and the external reserves position has improved markedly. Key elements underlying this performance include enhanced fiscal management—especially in regards to revenue administration—wide-ranging structural reforms, and the Bank of Albania's (BoA) steadfast pursuit of price stability.

3. **Despite some unfavorable developments since late-2001, stemming from political events, severe weather conditions, and a weakened global environment, our commitment to reform has remained firm.** We have made efforts to reverse the temporary slippages in the legislative agenda and revenue collection. However, the privatization of Albtelekom, initially scheduled for 2002, has been delayed because of the lack of interest by foreign investors, partly reflecting a further weakening of the international telecommunication sector. The 2002 budget will be revised in response to these shocks (prior action). Accordingly, the macroeconomic framework presented in Table 1 updates the outlook as presented in the December 2001 GPRS document, and the revisions are explained in our May 2002 supplement to the GPRS.

4. **In spite of high growth in recent years, poverty remains widespread and unemployment high.** Based on a poverty diagnosis conducted in the context of the GPRS, and using1998 data, about one-third of Albanians are poor, with poverty being particularly pervasive in rural areas. We are committed to working to reduce the incidence of poverty by promoting sustainable and inclusive economic growth. The key challenge in these efforts will be the establishment of strong institutions that will facilitate private sector development and ensure an equitable application of the law.

5. **The GPRS recognizes that inclusive growth and poverty reduction require a sound macroeconomic framework, and sustainable fiscal and financial policies.** In this regard, it aims at balancing increased spending to reduce poverty against the need to ensure macroeconomic stability. The main priorities under the GPRS in support of poverty reduction

include: (i) reorienting expenditure toward poverty-sensitive areas—in particular health and education, where indicators have deteriorated sharply since the early 1990s; (ii) improving vital infrastructure, especially the provision of electricity and water, which are key requirements for both the welfare of households and supporting productive capacity; (iii) strengthening governance and public administration, including reform of the civil service; (iv) deepening market institutions and fostering an economic environment conducive to private investment, notably FDI; and (v) promoting rural development, as well as agricultural and food-processing activities.

6. **We made concerted efforts—with assistance from the international community–to make the development of the GPRS a participatory process**. A framework for dialogue with civil society, local government, and the private sector was set up and civil society advisory groups were established in the areas of education, health, labor and social affairs, and agriculture/rural development. To coordinate these activities, a National Civil Society Advisory Council and a GPRS technical secretariat were formed. A GPRS core donors' group will continue to meet on a monthly basis to discuss GPRS-related developments. The GPRS was submitted to the IMF and the World Bank in December 2001, and a brief supplement reflecting the updated macroeconomic framework for the strategy was sent in May 2002.

B. Recent Economic Developments

7. **Economic performance in 2001 and thus far in 2002 has been mostly favorable, despite electricity shortages and harsh winter weather**. GDP growth decelerated to about 6½ percent in 2001, somewhat lower than initially expected, owing to weak agricultural growth and the worsening electricity situation, while construction and private sector manufacturing remained strong. Registered unemployment declined from 17 percent at end-2000 to 14½ percent at end-2001. Reflecting principally the electricity shortages and bottlenecks in the supply of agricultural products, inflation rose to around 7 percent in the first quarter of 2002, well above the target range. The conversion of euro-area cash at end-2001 and large deposit withdrawals from the two largest banks in March and April 2002—triggered by unfounded rumors of solvency problems—led to a sizable increase in domestic currency in circulation. To counter resulting depreciation risks and to moderate inflationary pressures, the BoA has raised the repo rate by 1½ percentage points so far during 2002. The current account deficit narrowed in 2001 to 6¼ percent of GDP, from 7¼ percent of GDP a year earlier. The widening trade deficit was more than accommodated by rapid growth in private remittances in the last quarter of 2001, as well as an increase in net tourism receipts.

8. **Fiscal performance has been mostly on track since the end of the previous program, but end-2001 tax revenue collection was Lek 1.8 billion below target.** Nontax revenues also fell short of the target by Lek 4.2 billion. We exercised spending restraint to ensure that, for 2001 as a whole, the overall and domestically financed deficits (respectively, 8.5 percent and 3.1 percent of GDP) remained within the budget. We have taken strong measures to prevent further tax revenue slippages in 2002 (see below). Nonetheless, some

problems remain, in particular with excise collection in the customs department, and total revenue for the first quarter reached only 98 percent of budget.

9. **We have proceeded with the reform of tax and customs administration.** In the area of customs administration, we have established regional customs directorates and enhanced cooperation with the EU-financed customs assistance mission (CAM-Albania) and the Tax Directorate to improve the valuation of imports and fight underinvoicing. With regard to tax administration, we have provided adequate office space to the Large Taxpayers Unit (LTU), introduced a performance-based reward scheme for tax department staff, and initiated controls on the use of cash registers. In addition, an independent taxpayer appeals commission has been set up and the appeals procedure has been simplified.

10. **We have made progress in structural reform, in particular in relation to the electricity sector.**

- A two-tier tariff system was introduced on January 1, 2002, doubling electricity tariffs for household consumption in excess of the threshold level of 300 KWh. The new system aims to: (i) encourage the shift from electricity to LPG for heating and cooking, and (ii) protect the poor by maintaining a low price below the threshold—which is above the average consumption of households with income below the poverty line. In consultation with the World Bank, a new two-year energy sector action plan was finalized in January 2002, which aims to improve the financial situation of KESH, reduce excessive demand and budgetary subsidies, and increase domestic generating capacity. A donors' meeting in early April endorsed our Power Sector Policy Statement in which we defined our action plan. Following weak electricity bill collection in early 2002, we took strong action to ensure that the end-March target in the action plan was met.

- The registry on movable property has become operational and, albeit after some delay, in 2002 new laws have been approved on a deposit insurance scheme and the Investment Promotion Agency. To improve public sector transparency and accountability, an Internal Audit Law and a Law on Organization and Functioning of the Council of Ministers have been prepared, and measures have been adopted to increase the transparency of the procurement process and strengthen management and control of treasury operations.

II. Objectives and Policies

A. Macroeconomic Framework

11. **Our macroeconomic policies for 2002–05 will aim at supporting robust GDP growth, while maintaining low inflation and ensuring financial viability** (see Table 1). To sustain annual GDP growth of around 7 percent over the medium term, we intend to proceed rapidly with structural reforms, improve governance, and complete the privatization projects described below. The achievement of high sustainable growth is subject to risks,

particularly from the uncertain energy situation as well as potentially adverse regional developments. We are confident, however, that the pursuit of rigorous reform of the electricity sector will control the risks emanating from power outages and that our prudent medium-term policy framework will mitigate the impact of external uncertainties. Monetary policy will aim at restoring and maintaining inflation within a target range of 2–4 percent. Fiscal policy will include a continued strengthening of revenue collection, thus allowing simultaneously for increased spending in priority areas and a steady decline in the deficit. Reserve coverage is envisaged to remain at a comfortable level, at or above 4½ months of imports of goods and services, which is prudent given the dependence of the balance of payments on potentially volatile workers' remittances and official transfers, and the disappearance of privatization receipts over the medium term. After an expected widening in 2002, the external current account deficit is projected to narrow by about 3 percentage points of GDP by 2005. A modest amount of additional resources from the international community will be needed to ensure that the balance of payments is fully financed after 2002.

B. Fiscal Policy

12. **While reorienting our expenditure policy to support the poverty-reduction objectives identified in the GPRS, we will simultaneously pursue fiscal consolidation to ensure long-term debt sustainability.** We aim at reducing the overall deficit to 5½ percent of GDP by 2005. This will be mainly accomplished by increasing tax revenue from 16 percent of GDP in 2001 to about 19½ percent of GDP in 2005, largely as a result of continued improvements in tax and customs administration, an expanded tax base and a strong political commitment to fighting fiscal evasion.

13. **The revised 2002 budget envisages an overall deficit of 8 percent of GDP—with a ceiling of 3 percent of GDP on domestic borrowing—and targets an increase in tax and customs revenue of 1.1 percent of GDP.** In line with the ceilings envisaged under the program (Table 1), foreign financing will consist mainly of resources provided on concessional terms by international organizations and bilateral donors. The budget has been revised to take into account lower privatization receipts, which are now programmed at 0.2 percent of GDP, compared with the original 1.6 percent of GDP. To this end, the reserve and contingency funds and expenditures in nonpriority areas have been cut on the basis of contingency measures identified at end-2001. The remaining allocation for the reserve and contingency funds will be used only in emergencies and after discussion with Fund staff. In addition, the use of the Lek 1 billion remaining in the reserve fund is strictly conditional on realization of the nontax revenues projected in the revised budget. More generally, given the uncertainties involved in projecting revenues in general, great caution will be exerted in executing the budget.[1] Parliamentary approval of a revised budget will be a prior action for Board consideration of the requested PRGF arrangement.

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[1] If privatization receipts are higher in 2002 than programmed, up to ½ percent of GDP of the excess will be fully used to pay down domestic debt (in order to offset the increase in borrowing relative to the original budget), as will 25 percent of any additional excess.

14. **In view of the unusually severe hydrological conditions and the availability of highly concessional foreign financing, and conditional on KESH's good performance, subsidies for electricity imports in 2002 are allowed to be higher than in the original budget.** Consistent with World Bank advice, the increase in imports will help offset the shortfall in domestic production and restore the water reservoir—in order to reduce the likelihood of future electricity crises. The additional subsidies will be made available to KESH on a quarterly basis, proportional to the planned quarterly additional imports, on the condition that: (i) the previous quarter's targets on collection and reduction of losses have been strictly met; and (ii) the total cumulative electricity supply to the transmission network for the year up to the end of each quarter does not exceed the amounts foreseen in the agreed action plan.[2] The additional imports will be financed by a highly concessional foreign loan. Delays in the disbursement of the designated loan will not increase the ceiling on domestic borrowing.

15. **To ensure achievement of our fiscal targets, we have developed a medium-term revenue framework.** This framework aims at modernizing our tax and customs administration and fighting fiscal evasion and smuggling more effectively. Key features of this strategy are: (i) widening the tax base by increasing the number of registered taxpayers and reforming tax policy; (ii) fully computerizing and restructuring the Tax Department along functional lines; (iii) adopting a comprehensive human resources policy, including training for tax inspectors and offering merit-based reward schemes; (iv) developing the internal audit function to ensure continuous quality control of operations and valuation in accordance with the customs code; (v) improving coordination/information exchange both between the Tax and Customs Departments as well as between the social insurance institutes and the Tax Department; (vi) adopting comprehensive taxpayer education programs to promote voluntary compliance; and (vii) improving relations with taxpayers, including through the adoption of a new and more independent taxpayer appeals process. Also, we intend to implement a comprehensive plan to improve public enterprises' financial performance, reduce their dependence on budget subsidies, and ensure tax compliance.

16. **Within this framework, we have identified specific measures to attain the targeted increase in tax revenue in the 2002 budget, while continuing to improve relations with taxpayers.**

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[2] The quarterly collection targets (including payment of arrears) for 2002 are, respectively, 82.9 percent, 90.2 percent, 94.8 percent, and 92.8 percent; the quarterly loss targets are 48.9 percent, 39.1 percent, 34.8 percent, and 41.9 percent; and end-quarter cumulative targets for electricity supply to the transmission network are1,615 GWh, 2,914 GWh, 4,100 GWh, and 5,585 GWh.

In the area of customs administration:

- Following the development and implementation of an action plan to improve valuation of imports with assistance from CAM-Albania, we will continue to update the reference price file regularly.

- The internal audit unit will continue to produce quarterly reports on the functioning of customs systems, especially the implementation of valuation in accordance with the customs code, including specific recommendations for the remedy of identified shortcomings; the Director-General will also continue to prepare quarterly reports on the implementation of corrective measures based on these reports (structural benchmark).

- We will pass legislation to close down duty-free shops in all land crossing points in border areas, to reduce smuggling and fiscal evasion, by end-September 2002 (performance criterion).

- The Customs and Tax Departments will cooperate more closely to fight fiscal evasion through underinvoicing. To this end, a joint working group has been created to systematically investigate undervaluation of imports through controls and cross-checks of real market prices. A report on the results will be prepared and an action plan to combat this problem effectively will be adopted by end-June (structural benchmark).

In the area of tax administration:

- We will continue to improve tax administration, including through the implementation of merit-based reward schemes for tax inspectors and improvements in the operation of the LTU, inter alia, by strictly enforcing the requirement of all large taxpayers to report to it.

- We will aim to increase the number of registered taxpayers to 57,000 in 2002, starting from a level of 47,000 at end-2001 (structural benchmark).

- We will prepare quarterly reports on the controls of the use of cash registers and penalties imposed by the Tax Department on companies found to be in violation (structural benchmark).

- To improve relations with taxpayers further and ensure the fair and careful application of tax legislation, we will establish taxpayer service centers in the tax department and each local tax branch. The blocking of bank accounts for securing the payment of tax liabilities will be executed in accordance with the law and only after prior communication.

- To enhance the effectiveness of the collection of personal income taxes and social security contributions, we will enhance cooperation with the Social Security Institute (SSI), for example, through frequent information exchange on SSI contributors' and taxpayers' identities and joint enforcement measures.

In the area of tax policy:

- We will form a working group involving the Ministry of Environment to develop new environmental taxes, with a view to introducing them by September 1, 2002 (structural benchmark).

- We will introduce a tax on the ownership of agricultural land by October 1, 2002, thereby raising revenue for local governments (structural benchmark).

17. **Over the program period, we will reorient expenditures, in line with expenditure priorities identified in the GPRS.** In particular:

- Between 2002 and 2004, we intend to increase expenditure allocations for health and education by about 30 percent and 20 percent in real terms (from 2.8 percent of GDP to 3.2 percent of GDP and from 3.5 percent of GDP to 3.7 percent of GDP, respectively). Within these categories, nonwage recurrent expenditure on operations and maintenance is to expand the most, by more than 15 percent annually (in nominal terms). In order to address poverty more effectively, we will refocus health and education expenditures on rural areas and toward improving the quality of primary education and health care. Specific measures in 2002 to improve the access of the poor to health care are the construction or rehabilitation of local health centers and ambulatory clinics as well as the expansion of counseling services for young mothers.

- The quality and motivation of teachers and health care workers will be strengthened by reducing wage differentials vis-à-vis the private sector, increasing wage differentiation within these sectors, and conducting specific training programs for teachers. To this end, following consultation with the World Bank, the 2002 budget envisages salary increases in the health and education areas by 12 percent as of July 1, 2002. A similar increase will be granted to the judiciary, to improve governance.

- In line with the civil service reform strategy, the average salary of top-ranking civil servants was increased by around 60 percent in January 2002, to enhance motivation and retain high-skilled personnel. The overall salary increase for the public sector, however, will be limited to 8 percent in 2002, so that the total budgetary allocation for personnel expenses will not rise by more than 10 percent. To further assist efforts at building a more effective public administration, a database on all employees will become fully functional before the end of the year.

- Allocations for social assistance (*ndihma ekonomike*) will be maintained as a percent of GDP, and we will aim to improve targeting.

- A comprehensive reform of the pension fund to reduce budgetary transfers and ensure its long-term financial viability is being developed and adopted in cooperation with the World Bank. Specifically, we raised the contribution ceiling from three to five times the minimum wage (in January 2002, effective February 2002) and we will increase the retirement age by six months (by July 2002) and reduce contribution rates by four percentage points (in July 2002). In the rural scheme, we raised per capita contributions from Lek 1,000 to Lek 2,400 (in January 2002) to finance the planned increase in rural pension benefits. As a first step, and in line with our poverty-reduction strategy, rural pensions will increase by 25 percent in July 2002. To better motivate collections of payroll taxes in rural areas, we plan to introduce by June 1, 2002, a new incentive scheme for rural inspectors that foresees traditional compensation linked to collections. As a result of these measures, we expect the system to move toward financial sustainability and the subsidies to the pension fund to decline gradually over the program period. The initial budgetary impact for 2002 is expected to be neutral.

- The subsidy to the electricity company will be phased out by end-2004 in the context of the reform of the electricity sector (see below).

- We will give local communities more decision-making authority within our program of decentralization, with further increases in grants to local authorities envisaged in the 2002 budget. We will ensure that the pace of decentralization is in line with progress in developing administrative capacity.

18. **We will also improve expenditure management.** To enhance the reporting of foreign-financed capital expenditures, we will sensitize donors on the need to provide timely information on disbursements and expenditures made under their projects, at a meeting planned for May 2002. At the same time, we will issue a new regulation requiring PIUs in the line ministries to report systematically on their projects, penalizing noncompliance. We will continue with computerizing regional treasury offices in order to improve reporting.

19. **With regard to arrears within the public sector,** we have carried out, with Fund assistance, a preliminary inventory of all outstanding inter-enterprise arrears and arrears to the Tax and Customs Departments and the Social Security Institute. By end-September 2002, we will finalize the recording of these arrears, complete the reconciliation process, and sign bilateral Memoranda of Understanding indicating the amount of net overdue payables/receivables as of December 31, 2001 (structural benchmark). Before end-October and in consultation with Fund staff, we will determine the amount of arrears that can be cancelled through government-assisted multilateral repayments of arrears and follow the proposed strategies for promoting the full and timely payment of all obligations contracted thereafter (structural benchmark). We are also developing a strategy for restructuring the water supply sector, in consultation with donors.

C. Monetary Policy

20. **The BoA will continue to conduct monetary policy with the objective of restoring and maintaining inflation within a 2–4 percent range, while safeguarding financial sector stability.** The re-emergence of inflationary pressures in early 2002 and the further risks to inflation and exchange rate stability from the large recent deposit withdrawals

necessitated an increase in official interest rates and the BoA stands ready to increase the rate further if necessary. The BoA will continue to conduct its monetary operations in the context of a flexible exchange rate regime, while smoothing excessive fluctuations.

21. **In order to improve the effectiveness of its monetary policy framework, the BoA will continue to strengthen its analytical capacities.** While the BoA intends to move to a formal inflation targeting regime over the medium term, the switch is not intended to take place within the program period, during which the focus will be on developing the necessary supporting framework. Specifically, the BoA will strengthen data collection, improve the quality of its monthly monetary policy report, conduct research on the determinants of inflation, and further refine its policy instruments, with technical assistance from the Fund's Monetary and Exchange Affairs Department (MAE).

22. **The proposed monetary program is consistent with the inflation objectives, and a reserves to import ratio of about 4½ months.** The program assumes that financial stability will be maintained, but with no rapid reversal of the decline in bank deposits. This is reflected in the low growth of broad money (which excludes foreign currency cash), projected at 5½ percent at end-2002, and a continued high share of domestic currency cash. It is also reflected in a higher (relative to earlier projections) contribution by the BoA in financing the domestic component of the fiscal deficit. Targets for net international reserves and net domestic assets of the BoA have been set in accordance with this framework, and will serve as performance criteria under the program.

23. **The BoA will continue to strengthen banking supervision, as commercial banks diversify their activities and lending picks up.** In order to enhance banks' ability to manage risks more appropriately, we will begin to offer, with assistance from MAE, specific training programs for bankers on the use of modern techniques of risk management. Training will also be provided to supervisors, in the context of the new Supervisory Development Plan developed in consultation with the World Bank. The BoA will use its legal tools in order to ensure compliance with prudential regulations. Furthermore, the Savings Bank will not be allowed to resume its lending activities until it has been privatized.

24. **Based on the results of the March 2002 safeguards monitoring visit of the IMF, the BoA is in the process of strengthening its control, accounting, and auditing systems.** Efforts are guided by a work plan adopted for implementing the recommendations of the report. The BoA will continue to cooperate with the safeguards policy and provide updated documents and data as necessary.

D. Structural Policies

25. **Structural reforms in support of sustainable growth and poverty reduction will focus on four key areas**: completion of the remaining steps on the privatization agenda; comprehensive reform of the electricity sector; improvements in the financial sector; and measures to improve the environment for private sector activity. The first program review, scheduled for January 2003, will focus on the electricity sector and the privatization process.

26. **Under our privatization program, the fixed-lines telecommunications company and the largest state-owned bank are the principal remaining entities to be privatized.**

- In relation to Albtelekom, we will improve the marketability of the company and settle the remaining unresolved legal and financial claims by end-September (structural benchmark), before setting new deadlines for the privatization. Moreover, we will improve the company's management, strengthen coordination of the privatization process, and clarify responsibilities within the government in this regard.

- Following the announcement of the privatization tender for the Savings Bank in June 2001, a short-list of interested banks was compiled in April 2002. These banks have been invited to submit detailed offers and the selection of the buyer and the initiation of negotiations will take place by end-June 2002 (structural benchmark). In the meantime, we will continue to reduce reliance on the Savings Bank for carrying out fiscal functions and by October 2002 we will prepare a program to promote the continued provision of banking services throughout the country.

- The state-owned insurance company INSIG will be privatized based on a strategy developed in consultation with IFIs.

- In the oil sector, we will bring SERVCOM's strategic and nonstrategic parts to the point of sale before end-2002 and aim to finalize privatization of the refinery by end-2002.

27. **The performance of the electricity sector remains a significant threat to growth and macroeconomic stability, and electricity sector reform is a key priority.** Reforms will focus on diversifying energy supply sources, curtailing excessive demand (especially for heating), and improving the financial position of the electricity company, KESH. Key elements of the strategy are tariff reform and improvements in bill collection, including the introduction of effective measures for reducing theft, and the promotion of alternative energy sources and energy conservation. Based on these efforts, the government subsidies to KESH were initially planned to be reduced to Lek 3.8 billion in the 2002 budget. However, as explained above, severe and unexpected constraints to domestic production have since necessitated additional support. Nevertheless, we remain fully committed to phasing out subsidies for electricity by the end of 2004, with no subsidies to be allocated in the 2005 budget. As specific steps within our 2002–03 policy program:

- We will improve bill collection and reduce power losses based on the new electricity sector action plan. The end-2001 targets envisaged under the previous action plan were met, and we will ensure that the cumulative end-April 2002 targets under the new plan will also be met (prior action).

- We have asked the Prosecutor General's office to vigorously prosecute cases of electricity theft submitted by KESH. We are also conducting a review of building licenses granted since October 2000 to ascertain that, as required, all buildings are equipped with central heating systems.

- We have initiated, in cooperation with the World Bank, a major study of the energy sector, to be finalized before end-2002 (structural benchmark), with the aim of preparing an electricity tariff reform based on long-run marginal costs. We will, on the basis of an evaluation of the impact of the estimated tariff rates on the total expenditure on energy of households, and in consultation with the World Bank, undertake measures to alleviate the impact of higher energy costs on vulnerable households.

- Regarding power generation, we will only proceed with the Bushati project in consultation with the World Bank and after assessing its environmental impact. We will first focus our efforts on expanding the capacity for thermal power production with assistance from the World Bank and other donors.

28. **We are committed to improving the infrastructure of our financial system to promote a better allocation of resources.**

- The Law on Deposit Insurance has been approved and the necessary institutions will be prepared by January 2003.

- We have improved the accessibility of the BoA's window for selling treasury bills, have also opened such windows in its local branches, and are helping the post office to start the sale of treasury bills. In addition, we will start issuing government securities with a maturity of at least two years by end-June 2002 (structural benchmark).

- In the context of privatizing INSIG, the state-owned insurance company, we will strengthen significantly the supervision of the insurance market, with technical assistance provided by IFIs.

- The Bankruptcy Law was submitted to Parliament in March 2002. Implementation of the law will be supported by a program funded by external donors.

- We will adopt improvements to the Money Laundering Law during 2002 and strengthen its implementation.

- We intend to improve the interbank settlement system, with the introduction of RTGS before end-2002, supported by the World Bank.

29. **We will increase our efforts to create a more conducive environment for attracting foreign investors.** While foreign direct investment flows have risen sharply in recent years, these have mainly been associated with the privatization process; other FDI remains below levels elsewhere in transition economies. We will therefore establish, in cooperation with FIAS, an investment promotion agency (IPA) and conduct a study of

administrative barriers by end-December 2002. By mid-2002, we will also establish a mediation center with the aim of improving relations with the business community by providing alternative forms of conflict resolution. In order to create better conditions for the development of the agricultural sector, we will prepare a law to regulate private ownership of land, complete the registration of most lots by 2004, and establish offices for land in every district.

30. **We will improve further the quality and coverage of economic statistics.** Following the IMF's Statistics Department technical assistance mission in early 2002, INSTAT has started publishing a revised CPI—with updated weights in the basket based on recent household budgetary survey. The new PPI will be also published in 2002. However, publication of the first official GDP estimates for 1996–2000 has been delayed due to problems in retaining qualified staff at INSTAT, and is now scheduled for end-2002 To help upgrade our macroeconomic analysis, the Ministry of Finance, the Bank of Albania, and INSTAT will establish a system for prompt data sharing, involving other ministries as appropriate (in particular, the Ministry of Agriculture).

E. External Policies

31. **With the envisaged foreign support, we expect that the balance of payments position will remain sustainable.** However, Albania's sizeable investment and infrastructure needs and, in the near term, the need for electricity imports, will put pressure on the current account deficit, which is expected to amount to nearly 8¼ percent of GDP in 2002. By 2005, the current account balance is expected to improve by about 3 percentage points. While private remittances are expected to increase further over the medium term, they should moderate in 2002 with a possible reversal of the exceptional inflows at end-2001. Inflows of foreign direct investment and bilateral and multilateral support are expected to finance the current account deficit, although moderate financing gaps are projected to continue into the medium term that are expected to be filled by other donors, including the World Bank. We intend to ensure the sustainability of foreign borrowing by observing ceilings on medium- and long-term nonconcessional borrowing (performance criteria).

32. **We will intensify our efforts to regularize relations with external creditors.** Despite our progress in the past 12 months toward finalizing rescheduling agreements, a significant number of arrears remain outstanding. Delays in finalizing domestic processes for the rescheduling agreement with Russia have prevented the agreed payments schedule from being observed, resulting in the accumulation of new sovereign arrears. These amounts will be eliminated prior to Board consideration of the requested PRGF arrangement (prior action). We are committed to eliminating our external arrears to official creditors during the period of the requested PRGF arrangement. As a first step, we are preparing a comprehensive strategy for dealing with these arrears. In this context, the Ministry of Finance, with assistance from the BoA, will prepare quarterly reports updating information on the stock of arrears, and identifying plans for and progress in the clearance of these arrears. The report for the first quarter of 2002 was completed in May (prior action) and we will complete reports for each quarter of the remainder of 2002 with a lag of one month (structural benchmarks). At the

time of the first review, we will discuss specific targets for the clearance of arrears, including those nonconvertible currency arrears, with a view to working toward acceptance of our obligations of Article VIII, Sections 2, 3, and 4 of the Fund's Articles.

33. **We are committed to maintaining a liberal trade regime and enhancing regional cooperation.** Since 1998, the top tariff rate has been cut from 30 percent to 15 percent, and further cuts are foreseen in line with our WTO commitments. We are in the process of negotiating a number of regional free trade agreements and, under the terms of the Memorandum of Understanding signed in June 2001, we are working toward concluding these negotiations by end-2002.

F. Program Monitoring

34. The first year of the three-year PRGF-supported program will be monitored on the basis of quantitative performance criteria for end-September 2002 and end-March 2003, and quantitative benchmarks for end-June and end-December 2002 (see Table 2). The quantitative targets are set on a cumulative basis from end-2001, and the details are set out in the Technical Memorandum of Understanding. Prior actions, structural performance criteria, and benchmarks are presented in Table 3. The quantitative performance criteria for end-March 2003 will be set at the time of the first program review, scheduled to be completed by end-January 2003 This review will focus on the electricity sector and the prospects for tax and privatization receipts, while the second review, to be completed in July 2003, will focus on financial sector developments. During the program period, Albania will not impose or intensify restrictions on the making of payments and transfers for current international transactions, or introduce or modify multiple currency practices, or conclude bilateral payments agreements inconsistent with Article VIII, or impose or intensify import restrictions for balance of payments reasons.

Table 1. Albania: Basic Indicators and Macroeconomic Framework, 1998-2005

	1998	1999	2000	2001	2002		2003	2004	2005
				Est.	Dec01 Proj.	Proj.	Proj.	Proj.	Proj.
					(Percent change)				
Real GDP	8.0	7.3	7.8	6.5	7.0	6.0	7.0	7.0	6.5
Retail prices (avg.)	20.9	0.4	0.0	3.1	3.0	5.3	3.0	3.0	3.0
Retail prices (end-period)	8.7	-1.0	4.2	3.5	3.0	3.9	3.0	3.0	3.0
					(In percent of GDP)				
Saving-investment balance 1/									
Foreign saving 2/	6.1	7.3	7.2	6.3	8.2	8.1	7.1	6.3	5.4
Domestic saving	9.9	9.5	11.4	13.1	14.2	12.7	15.4	16.7	18.6
Public 3/	-5.2	-4.0	-2.6	-1.2	-0.4	-0.4	1.0	1.8	2.7
Private	15.1	13.5	14.2	14.3	14.7	13.0	14.4	14.9	15.9
Investment	16.0	16.8	18.6	19.4	22.4	20.8	22.5	23.0	24.0
Public	5.2	7.4	6.5	7.3	8.0	7.6	8.2	8.3	8.3
Private	10.8	9.4	12.1	12.1	14.4	13.2	14.3	14.7	15.7
Fiscal sector									
Revenues	20.3	21.3	22.4	23.0	24.1	24.2	25.0	25.8	26.5
Tax revenue	12.3	12.9	15.6	15.9	17.2	17.1	18.0	18.7	19.4
Expenditures	30.7	32.7	31.4	31.5	32.5	32.2	32.2	32.3	32.1
Primary	22.9	25.7	25.7	27.1	28.8	28.4	28.4	28.6	28.7
Interest 4/	7.8	7.0	5.7	4.3	3.7	3.8	3.8	3.7	3.4
Overall balance	-10.4	-11.4	-9.1	-8.5	-8.5	-8.0	-7.2	-6.5	-5.6
Primary balance	-2.6	-4.4	-3.4	-4.2	-4.8	-4.2	-3.4	-2.8	-2.2
Primary balance (excl. foreign financed projects)	0.3	-1.0	-0.4	-1.0	-0.8	-0.2	0.4	1.1	1.7
Domestic borrowing	-6.4	-5.2	-3.2	-3.1	-2.6	-3.0	-2.2	-1.7	-1.8
Privatization receipts	0.0	0.2	1.7	2.1	1.6	0.2	1.3	1.3	0.2
Foreign finance	-4.0	-6.1	-4.3	-3.3	-4.2	-4.9	-3.7	-3.5	-3.6
Public Debt	64.3	64.1	72.1	69.0	63.2	62.9	61.6	59.8	58.6
Domestic 5/	32.4	35.1	41.9	40.9	39.8	39.6	38.0	36.1	34.8
External (including publicly guaranteed) 6/	31.8	29.1	30.2	28.2	23.4	23.3	23.6	23.7	23.9
Monetary indicators									
Broad money growth (in percent)	20.7	22.3	12.0	19.9	11.4	6.0	9.3	9.3	9.3
Private credit growth (in percent)	14.7	29.4	26.9	43.1	28.5	28.8	29.3	...	...
Velocity	1.9	1.7	1.6	1.5	1.6	1.6	1.6	1.6	1.6
Interest rate (3-mth T-bills, end-period)	20.4	14.8	7.8	8.0	...	...	...	...	...
					(In millions of U.S. dollars)				
External sector									
Trade balance 7/	-621	-663	-821	-1027	-1039	-1072	-1116	-1180	-1229
(in percent of GDP)	-20.4	-18.0	-21.9	-25.0	-22.1	-23.4	-22.3	-21.3	-20.2
Current account balance	-187	-270	-270	-258	-384	-372	-357	-348	-330
(in percent of GDP)	-6.1	-7.3	-7.2	-6.3	-8.2	-8.1	-7.1	-6.3	-5.4
(in percent of GDP; incl. official transfers)	-3.2	-3.4	-4.0	-3.4	-5.9	-5.9	-4.9	-4.4	-3.8
Official transfers	89	139	111	119	106	104	109	104	98
(in percent of GDP)	2.9	3.8	3.0	2.9	2.3	2.3	2.2	1.9	1.6
Gross international reserves	384	485	608	737	799	750	828	923	973
(in months of imports of goods and services)	3.7	3.8	4.3	4.7	4.7	4.5	4.6	4.8	4.7
(relative to external debt service)	21.8	29.3	25.8	23.5	12.7	11.9	14.6	13.7	13.0
(in percent of broad money)	22.6	22.4	26.4	25.6	26.4	26.1	26.3	26.7	25.6
Change in real effective exchange rate	18.3	12.5	7.0	...	...	...	...	...	...
Memorandum items									
Nominal GDP (in millions of lek)	460,631	506,205	539,210	590,237	657,030	658,753	727,218	803,790	884,115

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

1/ Estimated based on indirect information in the absence of national accounts.
2/ Current account excluding official transfers.
3/ Revenue minus current expenditure.
4/ Including interest payments for bank restructuring.
5/ Including bonds for bank restructuring (lek 24.6 bn for 2000).
6/ Includes arrears, with the exception of those transferable ruble arrears for which the value is subject to reconciliation and rescheduling agreements have yet to be reached with creditors.
7/ For 1999 excluding imports of direct humanitarian aid related to the Kosovo crisis.

Table 2. Albania: Quantitative Performance Criteria and Indicative Targets for 2002 1/

(Cumulative changes from end-December 2001)

	End-Dec. 2001 Level (Prel.)	End-Mar. 2002 Est.	End-Jun. 2002 Prog.	End-Sep. 2002 2/ Prog.	End-Dec. 2002 Prog.
			(In billions of Lek)		
1. Ceiling on net domestic credit to the government 3/	237.5	3	4.5	9.5	19.5
2. Ceiling on net domestic assets of the BOA	78.1	6.8	9	12	17
3. Indicative target for tax revenues	92	22	49	78	110
4. Indicative target for revenues collected by Customs Department	51	11	24	39	56
			(In millions of U.S. Dollars)		
5. Floor for net international reserves of the BOA 4/	542.6	4	3	4	16
6. Ceiling on contracting or guaranteeing of public and publicly-guaranteed non-concessional external debt 5/	...	26.2	100	130	160
Of which: 1-5 years	...	0	0	0	0
7. Ceiling on the public and publicly-guaranteed external debt stock with original maturities up to and including 1 year 6/	...	0	0	0	0
8. Nonaccumulation of new external payments arrears, excluding interest on pre-existing arrears 6/	...	...	0	0	0

1/ The performance criteria and indicative targets envisaged under the program, and their adjustors, are defined in the Technical Memorandum of Understanding (TMU).
2/ Performance criteria, except for tax revenues and revenues collected by the Customs Department, which are indicative targets.
3/ The targets for 2002 assume privatization receipts of Lek 1.1 billion and budget support of Lek 9 billion (evaluated at an exchange rate of 144 lek per dollar).
4/ The targets are derived using the end-December 2001 exchange rates.
5/ This performance criterion applies to the contracting or guaranteeing by the central government or the Bank of Albania as specified in the accompanying TMU.
6/ These performance criteria apply on a continous basis.

Table 3. Albania: Prior Actions, Structural Performance Criteria, and Structural Benchmarks Under the First Annual PRGF Arrangement

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

ALBANIA

TECHNICAL MEMORANDUM OF UNDERSTANDING

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

A. Net Domestic Credit to the Central Government

1. For the purposes of the program, the **central government** covers the State Budget, the Social Security Institute (SSI), and the Health Insurance Institute (HII).

2. **Net domestic credit to the government** (NCG) is defined as the sum of credits in lek and in foreign currency, except for onlending of foreign project loans to all parts of the central government as defined above, including Treasury bills and bonds held by the Bank of Albania, domestic commercial banks, and other domestic lenders, less the sum of central government deposits with the banking system (but excluding foreign currency deposits related to foreign financed projects), and the deposits of the SSI and the HII.[1] Credits comprise bank loans and advances to the government (excluding advances on profit transfers by the Bank of Albania), holdings of government securities, and negative balances in government deposits with banks.

3. The component of the domestic credit to government in the form of securities will be calculated based on data on their outstanding stock valued at issue price, with the adjustment for the amount held by the units of central government as defined above (in particular, the SSI and the HII). Sales of Treasury bills will be counted excluding the discount. Reported repayments of Treasury bills and other government securities will not include interest payments, either as coupon interest or the discount. Those components of net domestic credit to the government denominated in foreign currencies are to be valued as stipulated in the GFS. Data on other components of credit to government, if any, will be reported by the Bank of Albania.

4. According to the above definition, the level of **net domestic credit** to government was Lek 237.5 billion at end-December, 2001.[2] Gross loans were composed of (i) total outstanding T-bills at issue price in the amount of Lek 241.5 billion, of which Lek 67.8 billion was held by the Bank of Albania, Lek 164.2 billion by commercial banks,

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

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

and Lek 9.5 billion by nonbank institutions; (ii) other government lek securities, loans, and other claims on government in the amount of Lek 4.0 billion. From these gross loans, the following items were deducted: (i) central government deposits (excluding social security funds) in the amount of Lek 0.9 billion; and (ii) SSI and HII deposits and T-bill holdings in the amount of Lek 7.1 billion.

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

B. Net Domestic Assets

6. The **net domestic assets (NDA) of the Bank of Albania** are defined as the difference between reserve money—defined as the sum of currency issue (less lek notes and coins held by the Bank of Albania) and commercial bank reserves held by the Bank of Albania—less the net international reserves of the Bank of Albania (Section C), with all foreign currency assets and liabilities valued in local currency for program monitoring purposes at an exchange rate at end-December 2001. Under this definition, the level of the NDA was Lek 79.4 billion as of end-December 2001. The NDA limits will be cumulative changes from end-December 2001 and will be monitored from the accounts of the Bank of Albania.

C. Net International Reserves

7. **Net international reserves (NIR)** are defined as reserve assets minus reserve liabilities of the Bank of Albania. **Reserve assets** are readily available claims of the Bank of Albania on nonresidents denominated in foreign convertible currencies, and held for the purpose of meeting balance of payments financing needs, intervention in exchange markets, and other purposes. They include Bank of Albania holdings of monetary gold, SDRs, Albania's reserve position in the IMF, foreign currency cash, and deposits abroad. Excluded from reserve assets are any assets that are pledged, collateralized, other otherwise encumbered; claims on residents; precious metals other than 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 governments foreign currency deposits at the Bank of Albania.[3] Reserve assets and reserve liabilities will both be expressed in U.S. dollars.

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

(continued)

8. During this program, for monitoring purposes, the exchange rates of the SDR and non-dollar currencies will be kept at their end-December 2001 levels and holdings of monetary gold will be valued at SDR 35 per ounce. Excluded from gross international reserves are holdings of nonconvertible currencies, claims on nonresident financial institutions denominated in nonconvertible currencies, and other claims, which are not readily available.

D. Adjusters for NCG, NDA, and NIR

9. The NCG ceiling is defined on the assumption that **privatization proceeds** will amount, on a cumulative basis, from January 1, 2002 to:

End-March 2002	Lek 0.116 billion
End-June 2002	Lek 0.116 billion
End-September 2002	Lek 0.406 billion
End-December 2002	Lek 1.119 billion.

In cases when total privatization proceeds exceed of this projection in 2002, the NCG ceiling will be adjusted downward (i) up to ½ percent of GDP, and (ii) by 25 percent of any additional excess of total privatization proceeds. In cases when total privatization proceeds fall short of this projection, the NCG ceiling will be adjusted upward by 50 percent of any shortfall of total privatization proceeds.

The NIR and NDA targets are defined on the assumption that privatization proceeds **from abroad** will amount, on a cumulative basis, from January 1, 2002 to:

End-March 2002	Lek 0.00 billion
End-June 2002	Lek 0.00 billion
End-September 2002	Lek 0.145 billion
End-December 2002	Lek 0.191 billion.

The NIR floor will be adjusted upward (downward) and the NDA ceiling adjusted downward (upward) by any excess (shortfall) in these receipts.

10. The NCG, NDA, and NIR targets are defined based on the assumption that **foreign budgetary and/or balance of payments financing** (excluding project and commodity loans) will amount, on a cumulative basis, from January 1, 2002 to:

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

End-March 2002	US$ 0 million
End-June 2002	US$37 million
End-September 2002	US$54 million
End-December 2002	US$62 million.

In cases when total foreign financing exceeds (falls short) of this projection, the target for the net domestic credit to the government (except in the case of the Italian electricity loan in 2002 up to the assumed amount of US$8.5 million for each of the second, third, and fourth quarters) and the net domestic assets of the Bank of Albania will be adjusted downward (upward), and for the net international reserves upward (downward), with the proviso that the upward adjustment to the NCG and NDA ceilings and the downward adjustment to the NIR floor should not exceed US$15 million[4].

11. The NDA ceilings will be also adjusted to reflect the impact of any change in the required reserve ratio of commercial banks with the Bank of Albania.

E. External Debt and Arrears

12. As set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-00/85) August 24, 2000), the term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows: (i) loans, i.e., advances of money to obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and (iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the

[4] For the NCG adjuster, the lek equivalent of deviations from the programmed amounts in terms of dollars is converted at an exchange rate of Lek 144 per dollar, in order to ensure consistency with the budget projections.

title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property. Arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

13. The limit on medium- and long-term external debt **applies to** the contracting or guaranteeing by the central government or the Bank of Albania, of new nonconcessional external debt with an original maturity of more than one year, **with sublimits** on external debt with an original maturity of more than one year and up to and including five years. It applies not only to debt as defined in paragraph 12 of this memorandum, but also to commitments contracted or guaranteed for which value has not been received. External debt will be considered to have been contracted at the point the loan agreement or guarantee is ratified by the Albanian parliament. **Excluded** from the limits are refinancing credits and rescheduling operations (including the deferral of interest on commercial debt), credits extended by the IMF, and credits on concessional terms, defined as those with a grant element of at least 35 percent. The grant element is to be calculated using the OECD Commercial Interest Reference Rates (CIRRs): for maturities of less than 15 years, the grant element will be calculated based on six-month averages of CIRRs; and, for maturities longer than 15 years, the grant element will be calculated based on ten-year averages. Debt falling within the limit shall be valued in U.S. dollars at the exchange rate prevailing at the time the contract or guarantee becomes effective.

14. The limit on **short-term external debt applies** on a continuous basis to the stock of short-term external debt owed or guaranteed by the central government or the Bank of Albania, with an original maturity of up to and including one year. It applies to debt as defined in paragraph 12 of this memorandum. **Excluded** from the limit are rescheduling operations (including the deferral of interest on commercial debt), and normal import-related credits. Debt falling within the limit shall be valued in U.S. dollars at the exchange rate prevailing at the time the contract or guarantee becomes effective.

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

F. Tax Revenues

16. Collection of total and the customs department tax revenue will be monitored on the basis of quarterly indicative floors. Tax revenues are defined as revenues collected by the central tax department and/or the customs department.

G. Monitoring and Reporting Requirements

17. Performance under the program will be monitored from information supplied monthly to the Fund by the Bank of Albania and the Ministry of Finance. The following information will be communicated monthly to the Fund by the Ministry of Finance: the summary fiscal table, including the overall budget deficit, on a cash basis, their issuance of Treasury bills including gross value and cash received, and privatization receipts; and by the Bank of Albania; the balance sheets of the Bank of Albania, and the consolidated accounts of the commercial banks; the monetary survey; the net domestic credit to the government; the NFA of the Bank of Albania: the foreign exchange cashflow of the Bank of Albania, including the level of official reserves; daily average exchange rates; trade flows. The following information will be communicated quarterly to the Fund by the Ministry of Finance: information on the contracting and guaranteeing of new debt; information on the stock of short-term, and on medium- and long-term debt; and, with assistance from the Bank of Albania, information on all overdue payments on short-term debt and on medium- and long-term debt. The Bank of Albania will also communicate to the Fund periodic updates of balance of payments estimates.

INTERNATIONAL MONETARY FUND

NEWS BRIEF

FOR IMMEDIATE RELEASE

News Brief No. 02/52
FOR IMMEDIATE RELEASE
June 21, 2002

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

IMF Gives Final Approval of PRGF Arrangement for Albania

The Executive Board of the International Monetary Fund (IMF) has given its final approval of the three-year arrangement under the Poverty Reduction and Growth Facility for SDR 28 million (about US$36 million) for Albania to support the government's economic program (see Press Release No. 02/30).

The final decision by the IMF Executive Board was contingent on the World Bank Executive Board's endorsement of Albania's Growth and Poverty Reduction Strategy (GPRS) today. The decision will enable Albania to draw SDR 4 million (about US$5 million) under the PRGF from the IMF immediately.

INTERNATIONAL MONETARY FUND EXTERNAL RELATIONS DEPARTMENT

Press Release No. 02/30
FOR IMMEDIATE RELEASE
June 19, 2002

International Monetary Fund
Washington, D.C. 20431 USA

IMF Approves In Principle 3-year, US$36 Million PRGF Loan to Albania

The Executive Board of the International Monetary Fund (IMF) today approved in principle a three-year arrangement under the Poverty Reduction and Growth Facility for SDR 28 million (about US$36 million) for Albania. The IMF Board's decision will become effective after the World Bank Executive Board's endorsement of Albania's Growth and Poverty Reduction Strategy (GPRS) on June 20. Upon effectiveness of the IMF's Board decision, Albania will be able to draw SDR 4 million (about US$5 million) under the PRGF.

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

"On the basis of the fiscal and monetary policies the Albanian authorities have followed, as well as the ongoing structural reforms, the Albanian economy is on a path of high GDP growth and moderate inflation. External reserves are also at a comfortable level.

"The new PRGF-supported program aims to build on the progress made under the previous arrangement and, consistent with the authorities' Growth and Poverty Reduction Strategy, strengthen the poverty-reduction focus of policies. The GPRS provides a comprehensive basis for the arrangement, with the expectation that it will be updated regularly, in particular to strengthen its links to the budget process.

"Policies in the first year of the program will address in particular the problems in the energy sector and recent problems in tax collection. The recent—albeit apparently temporary—rise in inflation, and the large-scale withdrawal of deposits from the two largest banks caused by unfounded rumors of their insolvency, underscore the importance of continued cautious monetary policy and strengthening of bank supervision.

"Achieving medium-term fiscal sustainability while raising priority spending hinges crucially on ambitious planned improvements in tax collection. Recent revenue slippages point to the need for continued resolve in improving the efficiency of tax administration and monitoring its performance closely, as well as identifying contingency measures on a timely basis.

"Sustaining high growth and ensuring a sustainable external position over the medium term will require a wide range of reforms to improve the business climate and establish a fully functioning market economy. Reforming the electricity sector, reconciling inter-enterprise arrears within the public sector, strengthening governance and the rule of law, and completing the privatization process will be crucial in this regard," Ms. Krueger said.

ANNEX

Recent Developments

Sound financial policies and structural reform under the previous PRGF-supported program, which expired in July 2001, helped stabilize the economy and restore high growth, but poverty remains widespread. Despite rising average incomes and ongoing reforms, Albania remains one of the poorest countries in Europe. Poverty is most prevalent in rural areas and has led to large-scale emigration.

Real GDP growth in 2001, while still high at an estimated 6.5 percent, was adversely affected by unfavorable weather conditions and other supply shocks. Despite reform efforts, electricity supply has been severely constrained by low rainfall, and power outages have been extensive. As a result of supply shocks, headline inflation rose from 3.5 percent year-on-year in December 2001 to over 6 percent in the first four months of 2002. However, core inflation has remained at around 3 percent. Interest rates have been raised to help prevent the spread of inflation, in the context of a rise in domestic currency in circulation. Although recent monetary and electricity developments have influenced the current account, the exchange rate has remained fairly stable. The fiscal deficit has remained well within the budgetary target at 8.5 percent of GDP at end-2001, despite end-year revenue shortfalls.

Program Summary

Within the umbrella of the GPRS, the proposed three-year PRGF arrangement focuses on ensuring a sound macroeconomic environment as a pre-condition for sustainable growth. In particular, it aims to mobilize resources for priority expenditures, while ensuring fiscal and external sustainability. To this end, it includes measures to improve tax administration and limit unproductive spending, including budgetary subsidies to public enterprises. Moreover, the program includes actions to promote private sector activity through privatization, financial sector development, and sustainable provision of electricity.

Prospects for price stability and growth remain relatively favorable in the context of a sustainable strategy. Assuming essential structural reforms continue, growth is expected to decelerate marginally to 6 percent in 2002, mainly on account of the electricity situation, but return to about 7 percent in subsequent years. Private investment should serve as the engine for growth, with ample scope for acceleration of mining and other industrial activities, and expansion of tourism, and further productivity gains in agriculture. Inflation is expected to return to the upper end of the 2-4 percent target range by end-2002, as supply constraints ease and higher interest rates start having an impact.

Fiscal policy under the program aims to reconcile financial sustainability with the provision of adequate resources for priority spending. The fiscal deficit is projected to moderate to 5.5 percent of GDP by 2005 from 8 percent in 2002.Consolidation will be somewhat lower in 2002 than in later years, reflecting the need for higher electricity subsidies. Albania's public debt ratio—

which is already lower than in the majority of other PRGF countries—would drop further by about 6 percent of GDP in 2002, owing largely to debt forgiveness, and continue to decline, albeit more gradually in the medium term. The current account deficit is projected to narrow over the medium term, in part reflecting the programmed fiscal consolidation.

Over the medium term, the government's strategy aims to stabilize primary expenditure at 28.5 percent of GDP. The authorities intend to boost spending on primary education and health care, in particular for rural areas, and to implement in stages their fiscal decentralization program, in conjunction with improved tracking of local expenditures. Revenues are projected to rise from 23 percent of GDP in 2001 to 26.5 percent by 2005 through further improvements in tax and customs administration and an expanded tax base.

The monetary framework—including the use of indirect instruments to keep inflation within the 2-4 percent range, with flexible exchange rates—has served Albania well and will be continued. Restoring financial sector and price stability is the immediate priority of the monetary authorities. Given the high rate of inflation in recent months, and the risks of further inflationary and depreciation pressures stemming from the enlarged stock of domestic currency in circulation, the Bank of Albania intends to continue exercising vigilance in setting policy interest rates.

Maintaining high growth will require ongoing improvements in financial services, the provision of utilities, the business environment, and governance. The privatization process should continue expeditiously. A speedy sale of the Savings Bank would be key to creating a more dynamic financial sector, but the limited interest expressed in the sale could jeopardize the process. Priority will be given to implementing a bold strategy for limiting harmful electricity shortages, while phasing out subsidies over the program period. The authorities will seek to reduce excessive demand, especially for space heating, by gradually raising average electricity prices, improving bill collection, and reducing losses.

Structural conditionality under the PRGF-supported program focuses on four categories: fiscal management and control, and payments discipline; budgetary implications of electricity sector reform; financial sector reform; and privatization. Improvements in each of these is critical to the macroeconomic success of the program.

Albania joined the IMF on October 15, 1991. Its quota[1] is SDR 48.7 million (about US$63 million), and its outstanding use of IMF resources is SDR 60.9 million (about US$79 million).

[1] A member's quota in the IMF determines, in particular, the amount of its subscription, its voting weight, its access to IMF financing, and its allocation of SDRs.

Albania: Basic Indicators and Macroeconomic Framework, 1998-2005

	1998	1999	2000	2001 Est.	2002 Dec01 Proj	2002 Proj.	2003 Proj.	2004 Proj.	2005 Proj.
				(Percent change)					
Real GDP	8.0	7.3	7.8	6.5	7.0	6.0	7.0	7.0	6.5
Retail prices (avg.)	20.9	0.4	0.0	3.1	3.0	5.3	3.0	3.0	3.0
Retail prices (end-period)	8.7	-1.0	4.2	3.5	3.0	3.9	3.0	3.0	3.0
				(In percent of GDP)					
Saving-investment balance 1/									
Foreign saving 2/	6.1	7.3	7.2	6.3	8.2	8.1	7.1	6.3	5.4
Domestic saving	9.9	9.5	11.4	13.1	14.2	12.7	15.4	16.7	18.6
Public 3/	-5.2	-4.0	-2.6	-1.2	-0.4	-0.4	1.0	1.8	2.7
Private	15.1	13.5	14.2	14.3	14.7	13.0	14.4	14.9	15.9
Investment	16.0	16.8	18.6	19.4	22.4	20.8	22.5	23.0	24.0
Public	5.2	7.4	6.5	7.3	8.0	7.6	8.2	8.3	8.3
Private	10.8	9.4	12.1	12.1	14.4	13.2	14.3	14.7	15.7
Fiscal sector									
Revenues	20.3	21.3	22.4	23.0	24.1	24.2	25.0	25.8	26.5
Tax revenue	12.3	12.9	15.6	15.9	17.2	17.1	18.0	18.7	19.4
Expenditures	30.7	32.7	31.4	31.5	32.5	32.2	32.2	32.3	32.1
Primary	22.9	25.7	25.7	27.1	28.8	28.4	28.4	28.6	28.7
Interest 4/	7.8	7.0	5.7	4.3	3.7	3.8	3.8	3.7	3.4
Overall balance	-10.4	-11.4	-9.1	-8.5	-8.5	-8.0	-7.2	-6.5	-5.6
Primary balance	-2.6	-4.4	-3.4	-4.2	-4.8	-4.2	-3.4	-2.8	-2.2
Primary balance (excl. foreign financed projects)	0.3	-1.0	-0.4	-1.0	-0.8	-0.2	0.4	1.1	1.7
Domestic borrowing	-6.4	-5.2	-3.2	-3.1	-2.6	-3.0	-2.2	-1.7	-1.8
Privatization receipts	0.0	0.2	1.7	2.1	1.6	0.2	1.3	1.3	0.2
Foreign finance	-4.0	-6.1	-4.3	-3.3	-4.2	-4.9	-3.7	-3.5	-3.6
Public debt	64.3	64.1	72.1	69.0	63.2	62.9	61.6	59.8	58.6
Domestic 5/	32.4	35.1	41.9	40.9	39.8	39.6	38.0	36.1	34.8
External (incl. publicly guaranteed) 6/	31.8	29.1	30.2	28.2	23.4	23.3	23.6	23.7	23.9
Monetary indicators									
Broad money growth (in percent)	20.7	22.3	12.0	19.9	11.4	6.0	9.3	9.3	9.3
Private credit growth (in percent)	14.7	29.4	26.9	43.1	28.5	28.8	29.3	...	...
Velocity	1.9	1.7	1.6	1.5	1.6	1.6	1.6	1.6	1.6
Interest rate (3-monthT-bills, end-period)	20.4	14.8	7.8	8.0	...	...	...	...	...
				(In millions of U.S. dollars)					
External sector									
Trade balance 7/	-621	-663	-821	-1,027	-1,039	-1,072	-1,116	-1,180	-1,229
(in percent of GDP)	-20.4	-18.0	-21.9	-25.0	-22.1	-23.4	-22.3	-21.3	-20.2
Current account balance	-187	-270	-270	-258	-384	-372	-357	-348	-330
(in percent of GDP)	-6.1	-7.3	-7.2	-6.3	-8.2	-8.1	-7.1	-6.3	-5.4
(in percent of GDP, incl. official transfers)	-3.2	-3.4	-4.0	-3.4	-5.9	-5.9	-4.9	-4.4	-3.8
Official transfers	89	139	111	119	106	104	109	104	98
(in percent of GDP)	2.9	3.8	3.0	2.9	2.3	2.3	2.2	1.9	1.6
Gross international reserves	384	485	608	737	799	750	828	923	973
(in months of imports of goods and services)	3.7	3.8	4.3	4.7	4.7	4.5	4.6	4.8	4.7
(relative to external debt service)	21.8	29.3	25.8	23.5	12.7	11.9	14.6	13.7	13.0
(in percent of broad money)	22.6	22.4	26.4	25.6	26.4	26.1	26.1	26.7	26.6
Change in real effective exchange rate	18.3	12.5	7.0	...	...	...	...	...	...
Memorandum item									
Nominal GDP (in millions of lek)	460,631	506,205	539,210	590,237	657,030	658,753	727,218	803,790	884,115

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

1/ Estimated based on indirect information in the absence of national accounts.
2/ Current account excluding official transfers.
3/ Revenue minus current expenditure.
4/ Including interest payments for bank restructuring.
5/ Including bonds for bank restructuring (lek 24.6 bn for 2000).
6/ Includes arrears, with the exception of those transferable ruble arrears for which the value is subject to reconciliation and rescheduling agreements have yet to be reached with creditors.
7/ For 1999 excluding imports of direct humanitarian aid related to the Kosovo crisis.

Statement by Pier Carlo Padoan, Executive Director for Albania
June 19, 2002

On behalf of my Albanian Authorities, I would like to thank Staff for very fruitful discussions and consultations and for preparing a comprehensive and well-focused set of papers, which aims to support the medium-term priorities in achieving strong sustainable economic growth and reducing poverty.

Introduction

Since the introduction of market reforms Albania has shown an impressive track record of macroeconomic stability and program implementation. Sound macroeconomic policies have led to a stable economic environment while structural reforms have been implemented and the privatization of large sectors of the economy completed. As a result of that, real GDP growth averaged about 7 percent in the period from 1998 to 2001 with annual inflation well under control within the range of 2-4 percent. With fiscal performance broadly on track, domestic borrowing declined from 11 percent in 1996 to 3 percent of GDP in 2001. Monetary policy has proved highly effective in controlling price developments while the exchange rate has benefited from the sound macroeconomic environment remaining broadly stable. The trade regime has been largely liberalized and Albania became a WTO member last September.

Recent Macroeconomic Developments

Macroeconomic policies have been geared towards stability and growth-oriented policies. The recent surge in inflation to over 6 percent in the first quarter of this year was largely due to supply shocks, as the Staff Report clearly points out. Monetary policy acted promptly so as to avoid that inflationary pressures would become entrenched in agents' expectations with the BoA increasing the intervention rate by 200 b.p. by the end of April. In March and April of this year, monetary policy was confronted with another shock stemming from a sudden withdrawal of about 10 percent of the total stock of banking deposits as a result of unfounded rumors on the health of the two largest banks. The BoA promptly injected liquidity to neutralize the impact of the withdrawals and was fully successful in avoiding that the loss of confidence would spread to the whole system.

The fiscal stance aims to support the economy's development within the limits of a stable and sustainable financial path. The end-2001 deficit closed at 8.5 percent of GDP, one point below budget, reflecting lower spending. In 2002, authorities have amended their non-priority expenditures in the face of lower receipts stemming from the delayed privatization of Albtelekom, due to the current difficulties faced by the telecommunication industry worldwide. The government will continue its policy of fiscal consolidation in the years ahead. The overall deficit is targeted to decline to 5½ percent of GDP in 2005 from 8 percent in 2002, through increases in revenue, improved expenditure management, and reorientation of spending towards reducing poverty and improving access to health and education. As sensitivity analysis shows, even in the event of multiple shocks, Albania's public debt will remain manageable.

Challenges Ahead

The past performance and the 2002-2005 program envisaged under the proposed PRGF arrangement indicate the strong commitment by the Albanian authorities to address in a comprehensive manner difficult long-term issues, such as poverty and growth, governance and institutional capacity, business environment and private-sector development. On the macroeconomic front, prudent fiscal and monetary policies and improved debt management will remain at the top of the agenda.

A strong economic growth of 7 percent per annum in the medium term is the way forward for achieving sustained improvements in the living conditions and poverty reduction in Albania. The Growth and Poverty Reduction Strategy represents a comprehensive medium- and long-term development program that sets clear priorities and goals for significantly improving education, healthcare, and infrastructure. The GPRS fully reflects the multidimensional aspects of poverty, high unemployment, and structural deficiencies. The outlined policies aim at reducing the number of poor from 47 percent in 1998 to 38 percent in 2005, reducing the infant mortality rate by 15 percent, further improving elementary and secondary education, and making considerable improvements in basic infrastructure services. The GPRS recognizes widely the need for stronger institutions, public accountability, and increased public participation. Therefore, considerable efforts are focused on strengthening the public sector's capacity and improving monitoring and evaluation of reforms in the social sector.

The GPRS has been finalized under a comprehensive successful framework for dialogue with the civil society, the private sector, local government, and other groups involved in the areas of health, education, environment, labor, and social affairs. It is also a result of a fruitful cooperation and continuous consultation with the international community, the IMF and the World Bank, and for which the authorities are very grateful.

Structural Reforms

Sustained growth requires successful implementation of structural reforms in the Albanian economy. In addition, faster growth requires substantial improvements in the investment climate. Authorities are well aware of the weak performance in the energy sector and the significant threats it poses to growth and overall macroeconomic stability. Therefore, reforms are focused on diversifying the energy supply sources, curtailing excessive energy demand, and improving the financial position of the sector. While targets of the Power Sector Policy Statement have been met, considerable work remains to be done in implementation of the legal framework and improvement of collection rates. The review of the tariff system and the commitment to phasing out subsidies for electricity are also important steps in the right direction. In this context, the proposed Power Sector Rehabilitation and Restructuring Project and the planned Thermal Power Project are of significant support to Albanian's efforts to resolve the crisis.

The successful privatization of the Savings Bank, the largest bank in the country, represents a major step in the development of the Albanian banking system. It should be noted that the IFC has played a crucial role in the process of restructuring and privatizing of state-owned banks, developing corporate governance, and enhancing market competition. In the telecommunication sector, while the mobile system has advanced very well, the authorities are taking a broad set of measures to avoid further delay in the privatization of Albtelekom, by solving its financial claims and improving the regulatory framework in support of fair competition. Efforts are also focused on creating a more conducive environment for private-sector development and foreign investments. A Bankruptcy Law was approved last March, while the Law on Deposit Insurance is under implementation. Albania is strongly committed to combat money laundering, fight organized crime and combat financing of terrorism. In this context, the appropriate legal and regulatory framework is in place and technical assistance is under way for efficient implementation.

Conclusion

The Albania authorities strongly endorse the underlying objectives of the proposed PRGF arrangement, which will be enormously helpful to efforts for reducing poverty and enhancing a broad-based economic development. Governance, business environment, and human development are at the heart of the government's agenda. The authorities are committed to a timely and successful implementation of the program, as a way to yield sustainable growth and lead to Albania's closer economic integration in the international community.