

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

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

- the staff report for the third review under the three-year arrangement under the Poverty Reduction and Growth Facility, request for waiver of nonobservance of performance criterion, and financing assurances review, prepared by a staff team of the IMF, following discussions that ended on **October 29, 2003**, with the officials of Albania on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on January 8, 2004.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a Press Release summarizing the **views of the Executive Board as expressed during its January 23, 2004 discussion** of the staff report that completed the request and review.
- a statement by the Executive Director for Albania.

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

Letter of Intent sent to the IMF by the authorities of Albania\*  
Memorandum of Economic and Financial Policies by the authorities of Albania\*  
Technical Memorandum of Understanding\*

\*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](mailto:publicationpolicy@imf.org).

Copies of this report are available to the public from

International Monetary Fund • Publication Services  
700 19<sup>th</sup> Street, N.W. • Washington, D.C. 20431  
Telephone: (202) 623-7430 • Telefax: (202) 623-7201  
E-mail: [publications@imf.org](mailto:publications@imf.org) • Internet: <http://www.imf.org>

Price: \$15.00 a copy

**International Monetary Fund  
Washington, D.C.**

INTERNATIONAL MONETARY FUND

ALBANIA

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

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

Approved by Susan Schadler and G. Russell Kincaid

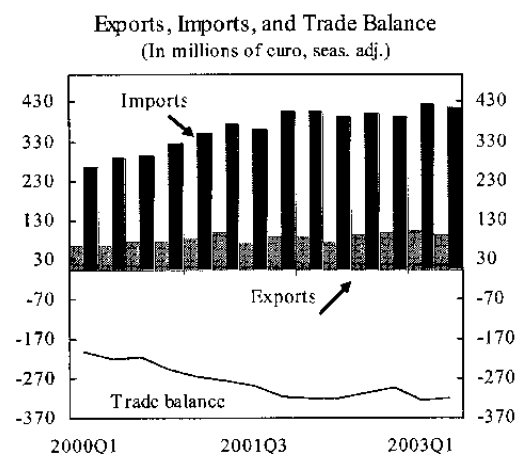
January 8, 2004

- Discussions for the third review under the PRGF arrangement—approved on June 21, 2002—and a financing assurances review were held in Tirana during October 15–29, 2003.
- The staff team—consisting of Messrs. Samiei (head), Martijn, and Oestreicher (all EUR), Ms. Tumbarello (PDR), Ms. Simard (FAD), and Mr. Olters (resident representative)—met with Deputy Prime Minister Meksi, Finance Minister Islami, Bank of Albania Governor Cani, other officials, parliamentarians, and representatives from the banking, business, and donor communities.
- The second review was concluded on July 2, 2003. Executive Directors commended the authorities for the successful promotion of macroeconomic stability, but expressed concern about delays in structural reforms and shortfalls in revenue collection, and emphasized the need to strengthen governance.
- In the attached Letter of Intent and the supplementary Memorandum on Economic and Financial Policies (MEFP), the Albanian authorities request a waiver for the nonobservance of an end-September performance criterion—which they have since carried out as a prior action—and completion of the review and financing assurances review.
- Albania participates in the GDDS, and a ROSC on data dissemination was prepared in June 2000. A safeguards assessment of the Bank of Albania (BoA) was finalized in June 2002, and a fiscal ROSC in June 2003. Albania’s economic program is supported by the World Bank through several sectoral lending programs and a second Poverty Reduction Support Credit (PRSC) approved in July 2003.

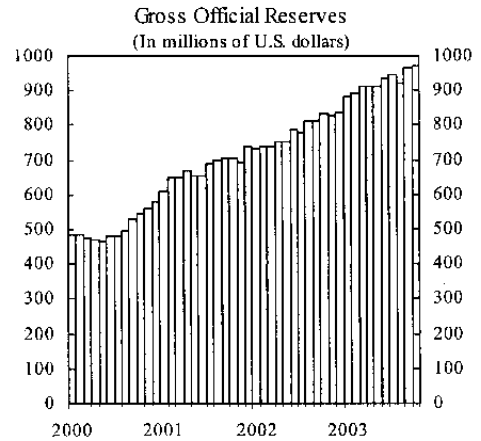
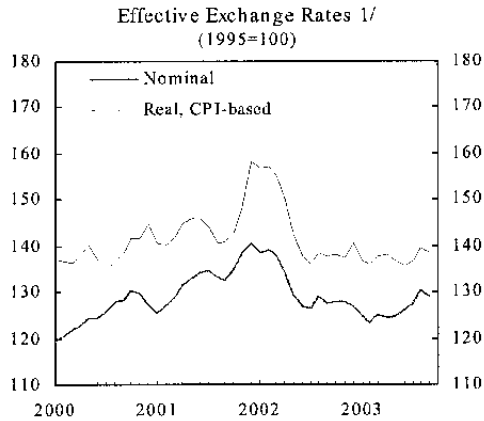
	Page
I. Background .....	3
II. Report on the Discussions .....	6
A. Macroeconomic Outlook .....	6
B. Fiscal Policy .....	7
C. Monetary and Exchange Rate Policy .....	10
D. Governance and Structural Reform .....	11
E. External Outlook .....	12
F. Program Monitoring .....	12
III. Staff Appraisal .....	13
Figure	
1. Economic Developments and Prospects, 1995–2003 .....	16
Text Boxes	
1. Exchange Market Interventions .....	11
2. Structural Conditionality .....	13
Tables	
1. Performance Under the PRGF Arrangement .....	17
2. Basic Indicators and Macroeconomic Framework, 1998–2006 .....	20
3. Balance of Payments, 2000–12 .....	21
4. Monetary Aggregates, 2001–04 .....	22
5. Government Revenues and Expenditure, (in percent of GDP) 2002–04 .....	23
6. Government Revenues and Expenditure, (in millions of Lek) 2002–04 .....	24
7. Priority Expenditure, 1998–2002 .....	25
8. External Debt Stock by Creditors, 1997–2003 .....	26
9. External Financing Requirement and Sources, 2000–06 .....	27
10. Indicators of External and Financial Vulnerability, 1996–2004 .....	28
11. Projected Payments to the Fund, 2003–12 .....	29
12. Schedule of Purchases Under PRGF Arrangement .....	30
Appendices	
I. Fund Relations .....	31
II. World Bank Relations .....	33
III. Statistical Issues .....	38
Attachments	
I. Letter of Intent and Memorandum on Economic and Financial Policies .....	43
II. Technical Memorandum of Understanding .....	59

## I. BACKGROUND

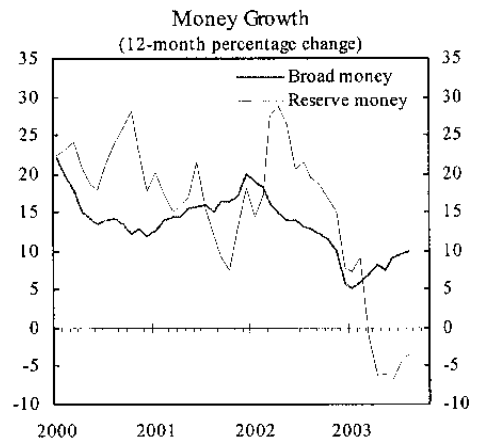
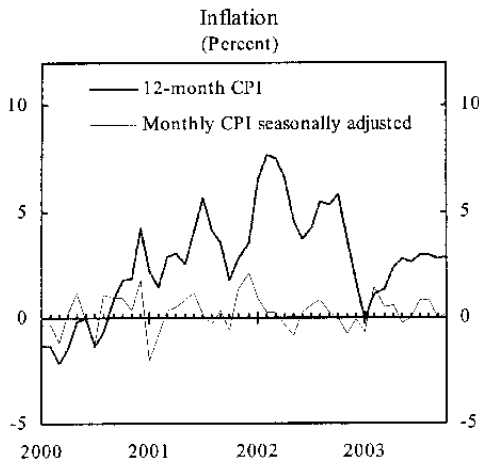
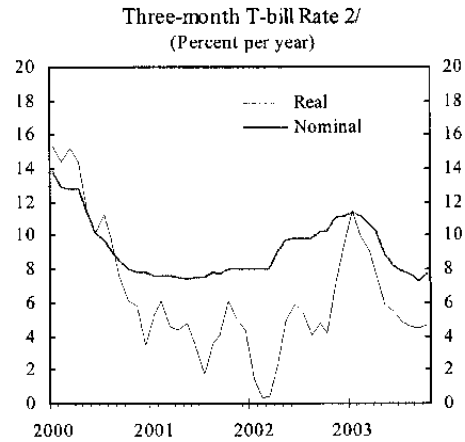
- Performance under the program has remained uneven—although macroeconomic stability has continued and structural reform has accelerated somewhat.** All quantitative performance criteria were met, but tax collection has persistently fallen short of program projections and several structural measures have been delayed (Table 1, MEFP ¶¶6 and 7). In particular, the necessary measures for the end-September performance criterion on regularizing public sector inter-enterprise arrears were only completed as prior action for this review. However, the authorities have recently initiated several important new reform projects.
- Patchy progress in structural reforms during 2003 reflected the difficult political situation,** as political infighting within the ruling socialist party complicated policy-making. These strains have also weakened communication with staff on program issues. At a December party convention, Prime Minister Nano reasserted his party leadership, despite opposition from some parliamentarians. Subsequently, his government was reshuffled—with Mr. Malaj replacing Mr. Islami as finance minister—and two smaller parties joined the coalition. However, political uncertainties remain.
- Weak governance remains the country's Achilles' heel, affecting administrative performance and private sector development, and improvements are progressing slowly.** At the second review, the program was given a stronger focus on governance issues. The authorities have developed a broad policy program in cooperation with the World Bank and the EU. In this context, a new law on asset declaration by public officials became operational on schedule in the fall. Also, abuse by tax officers of their authority to freeze bank accounts has largely been halted, and customs valuation and consultation with business has improved. However, tax harassment remains a serious problem. In November 2003, the European Commission criticized the sluggish implementation of reforms relating to corruption and the judicial sector—putting at risk the negotiation process on a Stabilization and Association Agreement.
- Nonetheless, growth is estimated to have recovered to about 6 percent in 2003, although poverty remains widespread** (Table 2, and Figure 1). The recovery has been supported by improvements in power supply, and is reflected in exports and the sales index for nonagricultural output. However, growth remains unbalanced, concentrated in construction and services rather than tradables—notwithstanding better-than-expected recent export performance. In addition, close to 25 percent of Albanians live below the poverty line. Income inequality has increased over the transition period, with the most severe poverty occurring in rural areas, aggravated by deficiencies in basic services.
- Albania's external position strengthened somewhat during 2003** (Table 3). The trade balance for the first three quarters improved by 1.5 percent of GDP (year on year), driven by strong export performance. The 2003 current account is estimated to



have improved by about ½ percent of GDP relative to 2002, to 8½ percent of GDP. The exchange rate appreciated during most of the year, prompting recurrent interventions to help smooth sharp movements. Owing to these interventions and valuation effects, reserves rose to US\$975 million at end-November (about 4½ months of imports).



6. **With inflationary pressures under control, the BoA has gradually lowered its policy interest rates.** The repo rate was lowered by 200 basis points between April and December 2003, reflected in lower T-bill rates. The latest step was facilitated by a downward correction to the CPI series; on the new basis, annual inflation has remained below 3½ percent since December 2002. The return of deposits to the banking system after the early 2002 bank run—which caused a sharp drop in reserve money—appears to have been completed by mid-2003 (Table 4).



7. **Shortfalls in revenues and foreign project financing seriously constrained public expenditures, while the deficit targets were observed** (Tables 5 and 6). While preliminary estimates suggest that tax revenues in 2003 fell short of budget targets by at least ½ percent of GDP—the shortfall projected in the June 2003 staff report—risks of a larger shortfall have increased. Improvements in tax administration and the new excise tax law led tax revenue to rise by 1 percentage point to about 20 percent of GDP in 2003. Savings on subsidies for imported electricity—facilitated by favorable conditions for hydropower—and delayed and smaller salary increases, kept domestic borrowing within the program limits. Foreign project financing is estimated to have fallen short of the June projections by about 1 percent of GDP (assuming a large—unconfirmed—catch-up in the fourth quarter), as a result of overoptimistic projections by the authorities, inadequate donor coordination, and delays from revised procurement procedures.

8. **The authorities have made progress in initiating and implementing a number of reform efforts to help improve the business climate.**

- **Privatization** is moving forward, with the likely acceptance of a bid by the Austrian Raiffeisen Bank on the dominant Savings Bank, and the sale of a minority stake of the state-owned insurance company.
- A project for **removing administrative barriers** to investment (with a focus on licensing, taxation, and customs), which was started in June 2003 is so far on track.
- A draft law on the **restitution of property**, brokered by the Organization for Security and Cooperation in Europe, is receiving substantial political support. Resolution of this long-standing issue would be key to developing agriculture and tourism. However, the mechanisms of implementation, and the budgetary impact remain unclear.
- The authorities and commercial banks have prepared a campaign to reduce the use of cash in the **payment system**. In this context, banks are cutting transaction costs and RTGS will be implemented in early 2004.
- In the **energy sector**, loss reduction and collection targets through Q3 2003 were met. A 2004–05 action plan was prepared with World Bank assistance.
- Significant progress has been made in concluding bilateral **free trade agreements** with other Balkan countries.<sup>1</sup>

---

<sup>1</sup> Because of low imports from these countries, the impact on customs revenues is expected to be limited.

## II. REPORT ON THE DISCUSSIONS

9. **Discussions focused on ways to ensure adequate resources for the 2004 budget, and further measures to address weaknesses in governance.** Sustainable growth and poverty alleviation depend on improvements in the business climate, combined with well-targeted public spending in priority areas, in particular, health care, education, and infrastructure. In each of these areas, progress has been limited.<sup>2</sup>

- The authorities and staff reached understandings on the 2004 budget, although the authorities expressed concern that the paths for revenue and domestic borrowing placed undue limits on spending.
- The mission emphasized that further actions to enhance governance, fight corruption, and broaden the tax base were necessary to improve the business climate and strengthen revenue mobilization.
- The authorities and the mission agreed that the easing of inflationary pressures allowed for a more relaxed monetary stance.

### A. Macroeconomic Outlook

10. **In 2004–06, growth is projected to remain at its medium-term trend of 6 percent, provided reform efforts are strengthened.** While electricity provision during the current winter seems secure, political uncertainties impart downward risks to the 2004 growth outlook. However, short-term risks to macroeconomic stability appear limited. Staff emphasized that achieving broad-based growth over the medium term requires further measures to attract domestic and foreign investment, in particular in mining, industry, agro-processing, and tourism.

11. **The earlier assessment of financial sustainability of the envisaged strategy remains valid, although the large current account deficit is a concern.** Fiscal consolidation and the decline in public debt have been more rapid than foreseen in the June 2003 staff report—owing to lower foreign-financed projects. Total debt is now expected to fall from 63¼ percent of GDP in 2002 to 57¼ percent by 2006, with reductions in both the domestic and external components—albeit with a higher share of domestic debt in the total. While the projected fiscal path would be sustainable, the maturity structure of the external debt and the rescheduling of arrears will cause debt service to peak in 2010 at about 9 percent of exports of goods and nonfactor services, from 5 percent in 2003. External sustainability also hinges on the current account declining from its peak of 9 percent of GDP in 2002 to 6¾ percent by 2006, in line with the scheduled fiscal consolidation. Coupled with a likely decline of remittances, the implied improvement in the trade balance also underscores the importance of expanding the production

---

<sup>2</sup> Expenditure on health and education declined from 5.2 percent of GDP in 1998 to 4.8 percent in 2002 (Table 7).

of tradables. In this context, staff considers that competitiveness is constrained by governance, administrative, and infrastructure problems more than price factors.

12. **While the recently published national accounts have bolstered macroeconomic analysis, further improvements in the database remain essential.** In particular, measuring non-observed activity—and including it in the national accounts—requires further study and technical assistance. More generally, data sources need to be enhanced further to improve the national accounts data.

## **B. Fiscal Policy**

13. **Shortfalls in fiscal resources required a reassessment of the revenue and financing strategies.** The authorities stressed the tension between spending needs and donors' reluctance to sustain foreign aid levels—implying a need for higher domestic resources. The mission considered that both the tax revenue gains in 2003 and the falling debt ratios offered some scope for accommodating this need, but also cautioned that budgeting should be prudent.

14. **Against this background, the revenue strategy needs to balance various conflicting priorities and assumptions:**

- The authorities argued that more ambitious tax revenue targets lead to higher actual collection, as the revenue departments strategically aimed at a pre-determined shortfall. They saw no room for higher tax rates.
- Business representatives—who have become politically more vocal—emphasized the need for tax relief and complained about ongoing harassment by tax collectors. Several representatives also criticized the fast pace at which customs duties were being reduced as detrimental to domestic industry.
- The mission stressed the need for more realistic revenue projections to help minimize haphazard mid-year expenditure cuts, and avoid undue pressure on taxpayers. Staff argued that lower tax rates would only be feasible through a significant broadening of the tax base and a reduction in the size of the informal economy. Moreover, sustainable growth could not be promoted by selective financial incentives or trade barriers. Staff also maintained that tax exemptions or differentiation could complicate the tax system and undermine tax collection.

15. **Staff argued that these needs could only be reconciled over the medium term through improvements in tax administration and policy, and the proper application of tax laws.** This would create a broader and more secure revenue base that would make an expansion of resource mobilization consistent with reductions in tax rates. Current tax revenues are well below comparable ratios of neighboring countries. In this context, the program comprises a range of measures to enhance tax collection, while reducing tax collectors' room for discretion and improving the appeals process (MEFP, ¶14–16). The authorities have requested FAD technical assistance to review tax policies, in particular the high income tax and social security rates, and



the scope for increasing excise duties, which are lower than in other Balkan countries. The mission also noted that the medium-term revenue loss due to tariff reduction under Albania's commitments to WTO would need to be offset more systematically through revising domestic tax rates.

**16. The 2004 budget includes a modest increase in the tax revenue ratio, underpinned by concrete measures, and contingency plans to help contain revenue risks.**

- Tax revenue is budgeted to rise by almost  $\frac{3}{4}$  percent of GDP relative to its projected 2003 level (MEFP, ¶11). The authorities considered this projection overly cautious. Staff argued that the increase was consistent with the few substantive new tax policy revenue measures included in the budget, and that, to the extent that administrative reform results in higher receipts, expenditures could be increased through a supplementary budget. Budgeted nontax revenues are below their 2003 level, reflecting lower transfer of central bank profits.
- The authorities included contingency expenditure plans in the MEFP to protect priority spending (MEFP, ¶13). In particular, as unduly optimistic projections of 2002 revenue were a major cause of the over-estimation of revenue in the 2003 budget, the release of part of the reserve and contingency funds in 2004 has now been made conditional on attaining the 2003 budget revenue estimate. In the context of the fourth review, staff will discuss additional action in the event of further shortfalls in 2004.

**17. With no expected recovery in foreign project financing, the budgeted overall deficit and expenditure to GDP ratios are well below the original program.** The overall deficit (including grants) is budgeted at 5 percent of GDP, 1 percentage point below the June 2002 program and broadly in line with the projections presented in the June 2003 staff report. Expenditure is budgeted at  $29\frac{1}{4}$  percent of GDP, which (adjusting for revisions in GDP) is about  $2\frac{1}{4}$  percentage points below the original program and  $\frac{1}{2}$  percentage point lower than envisaged in June 2003.

- Foreign project financing is programmed to remain at about 2 percent of GDP.
- To help cushion the resulting impact on priority spending, the ceiling on domestic borrowing was raised by  $\frac{1}{4}$  percentage point relative to the June staff report to  $2\frac{3}{4}$  percent of GDP, although the government would have preferred a higher level.
- Budgeted privatization income, at 0.7 percent of GDP, excludes the possible privatization of the Savings Bank or Albtelekom. The likely sale of the former will require a supplementary budget—to be prepared in consultation with Fund staff—to the extent that resources become available for spending during 2004.<sup>3</sup>

---

<sup>3</sup> Up to half of higher-than-projected privatization receipts could be spent in 2004.

- The possible disbursement of EU support amounting to 0.4 percent of GDP was not incorporated in the budget, as this financing source had not been secured. However, as disbursement has become increasingly likely since the budget was prepared, it has been included as a projection in the tables, in which budgetary grants increase by 0.3 percent of GDP and the overall deficit (including grants) rises by 0.1 percent of GDP. The higher assumed spending would be mostly on public investment and would require a supplementary budget.

18. **The mission stressed the need for prudent expenditure management in view of the limited available resources.** It assisted the authorities in identifying savings in administrative costs, both in the budget and in the expenditure contingency plans. In addition, the budgeted wage bill will rise no faster than GDP—despite the higher increase in salaries in priority sectors—and electricity import subsidies will be reduced in line with the action plan. Current and capital spending are budgeted to rise by 0.1 and 0.4 percentage points of GDP respectively, while overall expenditure on health care and education will rise by more than 12 percent, in line with PRSP priorities. The mission emphasized the importance of improved targeting of the limited resources for investment.

19. **Beyond 2004, the pace of fiscal consolidation and the envisaged lower foreign project financing justify some flexibility in setting limits on domestic borrowing,** while keeping the overall deficit within the limits envisaged in that program. Given continued monetary stability and debt sustainability, coupled with limited demand for private sector borrowing, and assuming adequate quality of government spending, staff projections include a smaller decline in domestic borrowing during 2005–06 than in the previous staff report. Nonetheless, government spending would still fall by about 1 percentage point of GDP between 2004 and 2006, and public debt as a share of GDP would remain on a declining path. With risks of a further decline in foreign project financing, additional revisions could be considered in the next program review, depending on the updated budgetary outlook. Any revisions will be conditional on assurances that additional borrowing will be used efficiently and in high-priority areas; and on an analysis of the fiscal cost of the higher interest charges associated with domestic debt, a differential that would be expected to decline over the medium term.

20. **The importance of better preparations for investment projects was highlighted by the discussion on a proposed railway project linking Tirana, the airport, and Durrës.** Staff learned during the mission that this project—costing about 1½ percent of GDP—was at a relatively advanced planning stage, although it had not previously been identified as a priority in the authorities' PRSP and the budgetary program or in the loan-by-loan analysis for setting non-concessional borrowing limits. Both Bank and Fund staff expressed serious concerns about the lack of communication, the absence of proper preparatory assessment, the tender process, and the high cost of the associated loan. Staff noted that while the project would not violate the overall non-concessional borrowing limits, this was due to delays in other already identified priority projects, which could be crowded out. The authorities regretted the breakdown in communications but argued that this project provided a unique opportunity for Albania, which justified putting it ahead of other planned projects. Following the mission, the authorities

provided further information on the project and indicated that they may reassess its execution. The World Bank, which has questioned the adequacy of previous feasibility studies, has offered assistance in this regard. The authorities also agreed to specific measures aimed at improving the overall evaluation and prioritization process for future non-concessional investment projects (MEFP, ¶31).

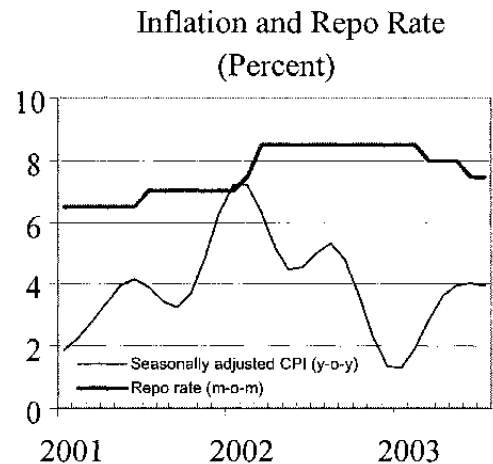
21. **In the context of the 2004 budget, the authorities have started enhancing the budgetary process.** Actions were based on the 2003 fiscal ROSC, and include presenting a more detailed budget document to parliament (MEFP, Text Table 2). While welcoming these initial steps, the mission stressed that the budget process remains relatively nontransparent, with excessive government discretion.

22. **The authorities have presented plans for strengthening payment discipline among public sector entities,** to help enforce the cash settlement of old arrears (with a gross magnitude of 1.8 percent of GDP) and prevent new ones from arising (MEFP, ¶17). A new monitoring unit and oversight over the obligations of the water companies by the Ministry of Finance (given dismal water bill collection) are at the heart of the system.

### C. Monetary and Exchange Rate Policy

23. **Staff supported recent interest rate cuts,** justified by low inflation, monetary stability, low foreign interest rates, and a strong exchange rate. The repo rate at 6.5 percent is now at the mid-2001 level—when inflation started to rise.

24. **Monetary policy remains geared to keeping inflation between 2 and 4 percent, but much remains to be done before an eventual move to formal inflation targeting.** During the past three years, the BoA has made progress in developing a statistical database and, with MFD assistance, has started formal inflation projections. BoA officials agreed that monetary transmission remains poorly understood—in the absence of a meaningful credit channel and with widespread dollarization. However, the authorities maintain adequate control over money supply (M2) through their control over bank credit to the government and interventions in the exchange market (Box 1)—guided by the monetary program. In the coming years, as financial markets and bank credit expand, so should the impact of the BoA's indirect monetary policy instruments. The monetary program for the first half of 2004 is consistent with the inflation target, the fiscal path, and a reserve cover that exceeds four months of imports.



### **Box 1: Exchange Market Interventions**

Albania has a flexible exchange rate regime, but the BoA periodically intervenes in the exchange market. Interventions were relatively large in 2003, with BoA purchases amounting to US\$46 million between January and August, to contain sharp appreciation pressures. By contrast, in 2002, net sales amounted to US\$11 million. This compares with total gross official reserves of about US\$870 million, foreign currency bank deposits of US\$800 million, and commercial banks' foreign exchange holdings of about US\$600 million, excluding deposits at the central bank.

The interventions serve to smooth exchange rate fluctuations (relative to the euro and the dollar), without affecting underlying trends, and achieve the NIR target under the program (and hence the M2 target). They are guided by a cash flow projection that takes into account the scheduled transactions on behalf of the government and spreads the remaining planned reserve growth over the year in a way that limits the expected seasonal exchange rate fluctuation. Further interventions to promote exchange rate stability are executed relative to this schedule. As interventions affect the BoA's profits, they have a minor impact on fiscal revenues.

Smoothing exchange rate fluctuations is considered helpful given the thin foreign exchange market, which is easily affected by large transactions. The NIR floor serves to ensure adequate reserve coverage and is consistent with the monetary program. In this context, the projected growth in demand for M2 (consistent with the inflation target and growth projections) is met in part by scheduled interventions, given the institutional constraints on bank credit. In part for this reason, the impact of interventions on M2 is not systematically sterilized.

### **D. Governance and Structural Reform**

25. **The mission stressed the critical importance of strengthening governance and the integrity and competence of public institutions.** While all but one of the associated measures under the program have been met, and improving governance and fighting corruption have been declared government priorities, staff considered that, overall, progress had been limited, particularly in areas outside the PRGF-supported program such as judicial reform, combating organized crime, enhancing general transparency, and strengthening the rule of law. It maintained that advances would depend critically on credible and consistent leadership, as well as on persistent actions at all levels. Further steps under the program include: (i) extending the civil service law or its equivalent (MEFP, ¶22); (ii) implementing a self-assessment of anti-money laundering legislation (MEFP, ¶22); and (iii) strengthening the transparency and consistency of tax and customs procedures and regulations (MEFP, ¶16).

26. **The mission welcomed the authorities' resolve toward removing barriers to investment** (MEFP, ¶23). Although business representatives also supported this initiative, they attached more importance to the obstacles posed by the tax burden. Regarding the privatization process, the authorities have decided to lengthen the process for selling Albtelekom, allowing time to complete the settlement of its remaining financial claims.

27. **The authorities noted that the banking sector is becoming more effective in facilitating private sector development.** The expected privatization of the Savings Bank and the recent campaign to promote the use of banks should provide a further stimulus (MEFP, ¶26). Staff welcomed these developments, and concurred with the authorities on the importance of upgrading financial sector supervision, in close cooperation with the MFD advisor. In this context, the supervisors acknowledged the need for scrutiny concerning the widespread provision

of credit in foreign currency, as not all borrowers may have adequate foreign currency earnings. The authorities have requested an FSAP, which is tentatively scheduled for 2006.

28. **Staff urged that the favorable power supply conditions in 2003 should not weaken reform efforts.** It welcomed plans to complete the installation of meters in 2004. It also supported the goals of the authorities' pricing policy—to raise prices to a cost recovery level and phase out price differentiation—but argued that progress had fallen behind schedule. The authorities confirmed their commitment to eliminate the subsidy on electricity imports in 2005 (MEFP, ¶25). They are, in consultation with the World Bank, introducing a targeted subsidy scheme to help the poor directly.

### E. External Outlook

29. **Trade relations are driven by the goals of European and regional integration, and by WTO membership,** resulting in ongoing reductions in—already moderate—import tariffs (MEFP, ¶27 and 28). Despite good faith efforts, such as the removal of the import surcharge as part of the 2004 budget, there has been some slippage in implementing past WTO commitments, reflecting, in part, a rapid initial timetable. The mission emphasized the importance of addressing these slippages.

30. **The decline in concessional project financing has motivated renewed efforts to enhance cooperation with donors.** As a priority, the authorities seek to strengthen project monitoring and coordination within the government of negotiations with donors (MEFP, ¶30).

31. **Albania should have no difficulty in meeting its current and future external debt service obligations to the Fund.** Obligations to the Fund have been met on time, external vulnerability appears limited, and reserve coverage through 2005 is set to remain above 4 months of imports and around 23½ percent of broad money (Tables 8, 9, 10, and 11).

32. **The program for 2004 is fully financed**—assuming disbursement of the supplementary macro-financial EU support (Table 9). The gap for the remaining program period is expected to be met by additional donor support.

33. **The authorities remain committed to rescheduling the remaining external arrears with official creditors within the program period.** Rescheduling agreements with Hungary and with Macedonian private creditors are being submitted to Parliament for ratification. Negotiations concerning arrears in nonconvertible currencies are progressing more slowly, notwithstanding the authorities' good faith efforts.

### F. Program Monitoring

34. **It is proposed that the fifth disbursement under the arrangement will be conditioned upon observance of March 31, 2004 quantitative performance criteria and January 31, 2004 and March 31, 2004 structural performance criteria and upon completion of the fourth review scheduled for July 2004 (Table 12).** Quantitative performance criteria and

structural conditionality are specified in Tables 1 and 2 of the MEFP. The proposed structural conditionality is consistent with the priorities identified in the PRSP and the progress report, and has been set in collaboration with the World Bank (Box 2).

### **Box 2. Structural Conditionality**

#### ***Coverage of Structural Conditionality in the Current Program***

Since the second review of the program, structural conditionality (MEFP, Table 2) has had a strong focus on improving governance. All conditions are deemed critical to the goals of the program: fiscal and external sustainability, and private sector-led growth. Along with parliamentary approval of the agreed 2004 budget, conditionality includes:

- Measures to strengthen **governance and improve the business climate**—including extending provisions of the civil service law to a greater range of government employees; initiating and implementing an integrity audit of the new ASYCUDA system; and carrying out the action plan for removing administrative barriers to investment.
- **Tax and customs administration** measures to strengthen revenue collection, including further computerization, the implementation of ASYCUDA in the Tirana and Durrës Port customs offices, improving the functioning of the VAT, and redrafting VAT and customs laws to ensure mutual consistency.
- Completion of the process of regularizing **domestic inter-enterprise arrears**, essential to manage contingent fiscal liabilities.
- Actions to support **fiscal and external sustainability** include adopting a contingency plan for action if the revenue outturn is less than projected, and reporting quarterly on the stock of external arrears.

#### ***Status of Previous Structural Conditionality and Relevant Measures***

Performance against structural conditionality for the second review of arrangement was mixed (Table 1).

#### ***Structural Areas Covered by World Bank Lending and Conditionality***

The Bank's lending and conditionality focuses on governance and institution building sustainable private sector development, human development, and a continuation of several sectoral lending projects (Appendix II).

### **III. STAFF APPRAISAL**

35. **The economy has thus far been fairly resilient to recent political uncertainties, although the reform process has been adversely affected.** Private sector resilience is evidenced by the modest recovery of economic growth in 2003, likely reflecting the stable macroeconomic environment. But political divisions have diverted attention from the reform process.

36. **Continued growth will depend to a large extent on higher private investment, which will require further improvements in governance and the implementation of reform.** Several donors' programs with Albania seek to bring about a turnaround in the administrative culture; weed out corruption and tax harassment, and enhance transparency. However, success requires enduring political determination and stability of purpose. Creation of a more business-friendly regulatory framework—as targeted by the project to remove administrative barriers—is also crucial.

37. **A further condition will be the mobilization of adequate resources for infrastructure and poverty alleviation.** Revenue shortfalls and reduced foreign financed projects have constrained spending, particularly on investments. Creating scope over the medium term for both

lower tax rates and higher public spending in priority areas, will require broadening the tax base by capturing a greater share of the informal sector and widening the coverage of certain taxes. Hence, measures to strengthen revenue collection by improving the transparency, efficiency, and perceived equity of the tax system are a key focus of the program, and need to be pursued with determination.

38. **In this context, the 2004 budget reflects a reasonable balance between fiscal prudence and urgent expenditure needs.** In view of the experience of the past two years, the budget incorporates contingency plans to help guard against haphazard budget cuts. Overall fiscal consolidation has proceeded more rapidly than in the original program, but with the aim of accommodating priority expenditure needs, and in the context of reduced donor support, domestic borrowing is programmed to remain somewhat larger than initially foreseen. The program also allows for higher spending on well-targeted high-quality projects in case receipts from taxation, privatization, or foreign donors exceed the budgeted amounts.

39. **The scarcity of public resources heightens the need for improved expenditure management, in particular with respect to the evaluation of foreign-financed projects.** Increasingly, foreign suppliers approach the Albanian authorities with projects to be financed on commercial terms. While some of these offers may indeed be worthwhile, it is important that this be established within the context of an independent and transparent process, consistent with the authorities' objective of enhancing governance.

40. **The combination of a better investment climate—in particular for tradables—and sound fiscal management is essential for ensuring external viability.** The sizable external deficit will need to be reduced over the medium term as foreign donor inflows and worker remittances diminish. While gradual fiscal consolidation will help reduce these deficits, the structural reforms included in the program should lead to an expansion of tradables production that is critical to maintaining external viability alongside rapid economic growth.

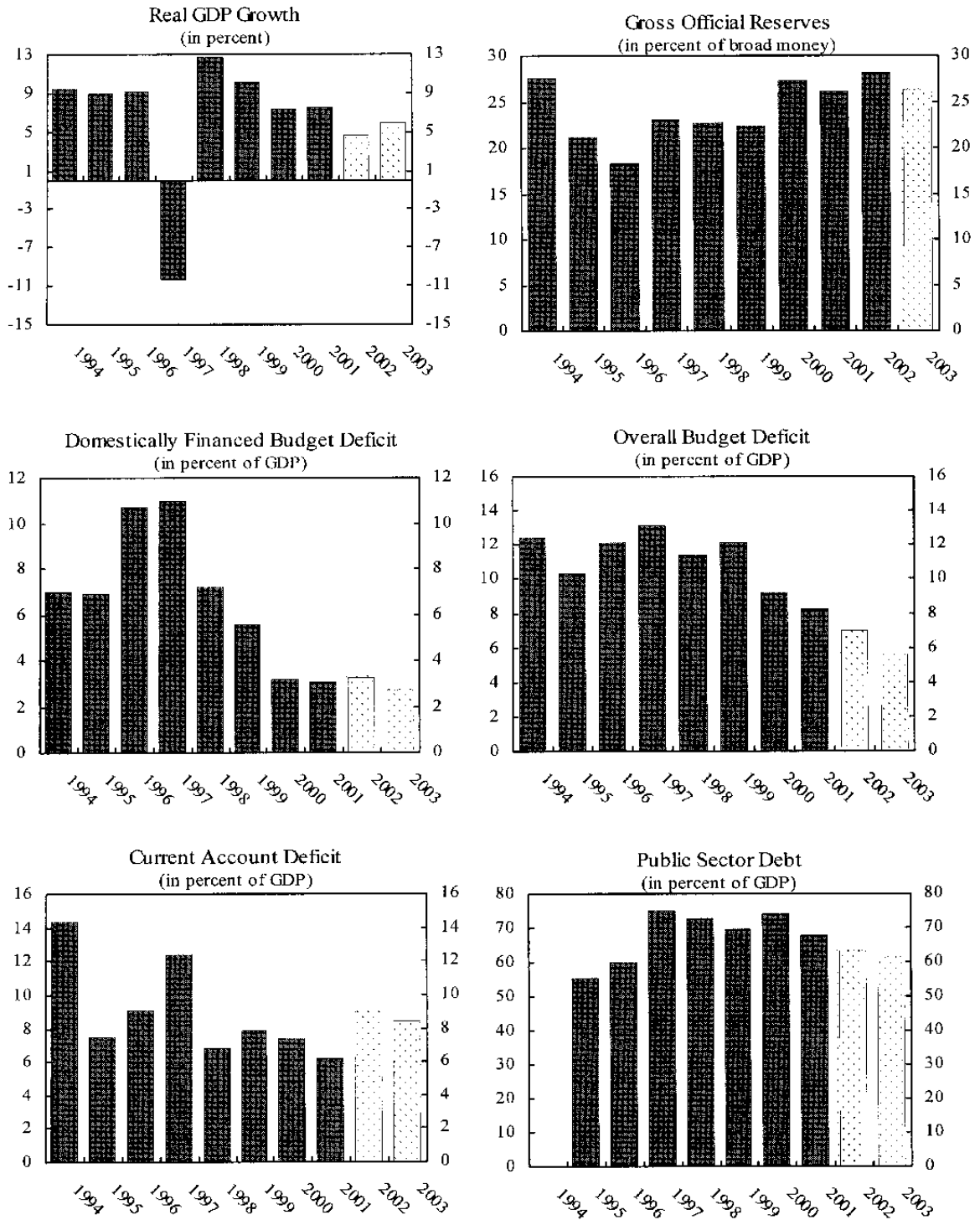
41. **Monetary policy has been successful, but rapid changes in the financial system call for continued vigilance.** Inflation has been under control, and the BoA has gained credibility as the guardian of monetary stability. Maintaining this success requires safeguarding its independence. Monetary management and financial supervision will face new challenges as the scope for bank credit to the private sector expands, in particular with the privatization of the Savings Bank. The flexible exchange rate regime has served Albania well and remains appropriate.

42. **Program implementation has been uneven, but satisfactory.** The authorities are committed to implementing the program, which has helped financial policies stay on track in spite of political uncertainty, and helped sustain focus on targeted structural reforms—the repeated delays notwithstanding. However, the execution of the authorities' broader reform agenda needs to be accelerated, to reduce the existing risks to growth and the execution of the poverty reduction strategy. This effort requires both political stability and commitment. Further risks emanate from limits to administrative capacity and resistance to efforts to addressing governance issues.

43. Staff supports the authorities' request for completing the third review and a waiver of the non-observance of a structural performance criterion, and for completing the financing assurances review. The supplementary MEFP provides a solid basis for economic policies aimed at sustaining growth and preserving macroeconomic stability. A waiver for the nonobservance of the structural performance criterion on regularizing inter-enterprise arrears within the public sector is justified based on the authorities' successful efforts to complete the intrinsically complicated operation with a minimal delay, and their credible follow-up program. As regards good faith efforts toward a collaborative settlement of arrears with private creditors, the authorities are submitting one rescheduling agreement to parliament and negotiations are progressing with other private creditors.



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



Sources: Albanian authorities; and Fund staff estimates.

1/ Dotted bars indicate staff estimates.

Table 1. Albania: Performance Under the PRGF Arrangement

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

Table 1. Albania: Performance Under the PRGF Arrangement (Continued)

Measures	Deadline	Current Status
<b>D. Prior Actions for the First Review</b>		
1. Parliament to approve the 2003 budget consistent with this Supplementary Memorandum of Financial and Economic Policies.		Completed
2. Parliament to pass legislation to close duty-free shops at all land crossings in border areas to reduce scope for smuggling and tax evasion.		Completed
<b>E. Structural Benchmarks for the Second Review</b>		
1. To strengthen tax and customs administration: recruit around 40 additional appropriately skilled and experienced staff in the Tax Department's headquarters; revise procedures and manuals for the enforced collection of taxes; and establish a post-clearance control unit with a staff of up to 10 senior inspectors, concentrating on valuation, classification, origin, exemption, and suspension claims, while updating reference prices regularly.	End-May 2003	Completed, except for establishment of post-clearance control unit, which was converted to a Structural Benchmark for end-July 2003
2. Determine the amount of domestic arrears within the public sector that can be cancelled through government-assisted multilateral repayments and design strategies for promoting the full and timely payment of all obligations contracted thereafter.	End-March 2003	Conditionality was strengthened and converted to a Performance Criterion with test-date end-September 2003
3. To promote the privatization process: complete the transfer of pension functions from Savings Bank to Albapost; and settle the remaining financial claims of Albtelekom.	End-March 2003	Pension functions were transferred on time. Settlement of remaining financial claims of Albtelekom was converted to a Structural Benchmark for the Third Review with test-date end-September 2003
4. Prepare quarterly reports (within one month of the end of each quarter) on the stock of external arrears and progress in clearing these arrears.	Throughout	In observance, as of March 2003
<b>F. Prior Actions for the Second Review</b>		
1. Develop expenditure contingencies for the second half of 2003—in close consultation with line ministries and in line with the NSSED—and submit these to IMF staff.		Completed
<b>G. Performance Criteria for the Third Review</b>		
1. Execute the government-assisted netting and final settlement of public sector inter-enterprise arrears as of end-2001, and present to Fund staff strategies for ensuring the full and timely payment of all obligations contracted thereafter.	End-September 2003	Implemented as a prior action for the Third Review
<b>H. Structural Benchmarks for the Third Review</b>		
1. Strengthen governance in relation to the public administration by starting the enforcement of procedures to implement the law on the asset declaration of public officials developed in consultation with the World Bank (NSSED, ¶183; Progress Report, ¶104).	End-September 2003, and ongoing	Completed
2. Improve governance and transparency in the delivery of fiscal policy, in line with the recommendations of the fiscal ROSC, by: (i) ensuring the consistency of VAT and customs duties laws in time for the 2004 budget law to reduce discretion (NSSED, ¶177; Progress Report, ¶103).	End-December 2003	Converted to Structural Benchmark for End-October 2004

Table 1. Albania: Performance Under the PRGF Arrangement (Continued)

Measures	Deadline	Current Status
(ii) extending the appropriation structure in the 2004 budget document to cover program classification of capital expenditure and , and significantly reducing the scope for transfers in the appropriation of one ministry to another without approval of parliament, from the current maximum of 10 percent of the total (NSSED, ¶186; Progress Report, ¶86).	End-December 2003	Completed
(iii) (a) strengthening tax appeals procedures, including by publishing decisions of the tax appeals commission; and (b) including instructions on tax procedures in the official gazette and in pamphlets distributed to taxpayers (NSSED, ¶164; Progress Report, ¶106).	End-December 2003	In progress
3. Strengthen tax and customs administration through:		
(i) a decision by the Council of Ministers to amend the structure of the Customs Department to establish a post-clearance control unit of around 10 senior inspectors concentrating on valuation, classification, origin, exemption, and suspension claims (NSSED, ¶164; Progress Report, ¶85).	End-July 2003	Completed
(ii) establishing at the Treasury a separate account for VAT refunds, funded with around 5 percent of gross VAT receipts already collected, and requiring the GDT to report on VAT refunds along with the monthly publication of data on revenue collected (NSSED, ¶198; Progress Report, ¶85).	Throughout, starting end-June 2003	In progress
4. To prepare for privatization:		
(i) settle Albtelekom's remaining financial claims (NSSED, ¶266; Progress Report, ¶132).	End-September 2003	Not completed, despite good faith efforts, due to a delay in negotiations with a major counterpart
(ii) transfer a further part of the fiscal functions of the Savings Bank to private banks, by completing the auctioning of these functions in 5 cities (NSSED, ¶207; Progress Report, ¶122).	End-December 2003	Converted to full liberalization of these services in January 2004
5. Regarding external arrears:		
(i) prepare quarterly reports (within one month of the end of each quarter) on the stock of external arrears.	Throughout	In compliance
(ii) submit to Parliament for ratification the protocol agreements for restructuring of arrears with Hungary.	End-December 2003	Completed

Table 2. Albania: Basic Indicators and Macroeconomic Framework, 1998–2006

	1998	1999	2000	2001	2002	2003		2004		2005	2006
						Est.	SR 06/03 1/	Proj.	SR 06/03 1/	Proj.	Proj.
	(Percent change)										
Real GDP 2/	12.7	10.1	7.3	7.6	4.7	6.0	6.0	6.0	6.0	6.0	6.0
Retail prices (avg.)	20.9	0.4	0.0	3.1	5.2	2.3	3.0	3.0	3.0	3.0	3.0
Retail prices (end-period)	8.7	-1.0	4.2	3.5	1.7	2.8	3.6	3.0	3.0	3.0	3.0
	(In percent of GDP)										
Saving-investment balance											
Foreign saving 3/	7.1	7.9	7.4	6.2	9.0	8.5	8.5	8.1	8.0	7.3	6.8
Domestic saving	6.9	9.3	13.8	18.7	13.0	13.8	14.0	14.3	15.3	15.5	16.3
Public 4/	-5.1	-3.2	-1.6	-0.6	-0.1	0.5	0.2	0.8	1.0	0.9	1.3
Private	12.0	12.5	15.4	19.3	13.2	13.3	13.8	13.5	14.3	14.6	15.1
Investment	14.0	17.2	21.3	24.9	22.0	22.3	22.6	22.4	23.3	22.8	23.1
Public	5.8	6.1	6.6	7.1	6.2	5.5	6.7	5.9	7.0	5.7	5.5
Private	8.2	11.1	14.7	17.9	15.8	16.8	15.9	16.5	16.3	17.1	17.6
Fiscal sector 5/											
Revenues and grants 6/	23.4	25.5	23.8	22.8	22.7	23.6	23.9	24.1	25.0	23.9	24.1
Tax revenue	17.4	17.6	19.6	19.0	19.0	20.1	20.2	20.8	21.2	21.0	21.2
Of which: social security contributions	3.8	3.8	3.8	3.7	3.8	4.0	4.1	4.1	...	4.3	4.5
Expenditures	34.3	34.8	31.9	30.4	29.0	28.5	29.6	29.3	30.2	28.7	28.3
Primary	25.5	27.4	26.1	26.3	25.3	24.5	26.0	25.5	26.4	25.0	24.6
Interest 7/	8.8	7.5	5.8	4.2	3.7	4.1	3.6	3.8	3.8	3.7	3.7
Overall balance (excluding grants)	-11.4	-12.1	-9.2	-8.2	-6.9	-5.6	-6.4	-6.0	-6.0	-5.5	-4.8
Overall balance (including grants)	-10.9	-9.3	-8.2	-7.6	-6.3	-5.0	-5.8	-5.1	-5.2	-4.8	-4.2
Primary balance (excluding grants)	-2.6	-4.6	-3.4	-4.1	-3.3	-1.6	-2.8	-2.2	-2.2	-1.7	-1.0
Domestic borrowing	7.2	5.6	3.2	3.0	3.2	2.7	2.7	2.8	2.4	2.5	2.3
Privatization receipts	0.0	0.2	1.7	2.1	0.1	0.2	0.1	0.7	0.3	0.3	0.3
Foreign finance	4.4	6.5	4.4	3.2	3.0	2.1	2.9	1.7	2.4	2.0	1.6
Public Debt	73.1	69.7	74.4	67.7	63.2	61.3	61.8	59.7	61.7	58.7	57.7
Domestic 8/	36.2	37.4	42.6	39.5	38.8	38.0	37.9	37.2	37.0	36.4	35.5
External (including publicly guaranteed) 9/	36.9	32.3	31.8	28.2	24.4	23.3	23.9	22.5	24.7	22.2	22.1
Monetary indicators											
Broad money growth (in percent)	20.6	22.3	12.0	20.2	5.7	9.0	8.5	10.6	9.2	9.7	9.6
Private credit growth (in percent)	14.7	29.4	26.9	43.1	32.1	28.0	28.0	27.4	27.1	27.4	27.4
Velocity	1.7	1.6	1.6	1.5	1.7	1.7	1.6	1.7	1.6	1.7	1.7
Interest rate (3-mth T-bills, end-period)	20.4	14.8	7.8	8.0	11.2	...	...	...	...	...	...
	(In millions of U.S. dollars)										
External sector											
Trade balance 10/	-621	-663	-821	-1027	-1155	-1371	-1292	-1469	-1375	-1558	-1654
(in percent of GDP)	-22.8	-19.3	-22.3	-24.2	-23.9	-22.8	-23.3	-21.5	-22.9	-20.8	-20.1
Current account balance (excluding official transfers)	-187	-270	-274	-263	-435	-509	-471	-555	-482	-551	-556
(in percent of GDP)	-7.1	-7.9	-7.4	-6.2	-9.0	-8.5	-8.5	-8.1	-8.0	-7.3	-6.8
(in percent of GDP; incl. official transfers)	-3.9	-3.9	-4.4	-3.2	-6.5	-6.3	-6.1	-6.1	-5.7	-5.4	-5.0
Official transfers	89	139	111	126	121	128	134	138	138	145	147
(in percent of GDP)	3.3	4.0	3.0	3.0	2.5	2.1	2.4	2.0	2.3	1.9	1.8
Gross international reserves	384	485	620	754	860	974	898	1019	932	1053	1098
(in months of imports of goods and services)	3.7	3.8	4.2	4.3	4.3	4.4	4.4	4.4	4.3	4.2	4.1
(relative to external debt service)	16.3	21.7	24.1	21.9	14.8	17.7	16.0	13.8	12.9	11.5	10.7
(in percent of broad money)	22.7	22.4	27.2	26.1	28.2	26.3	26.8	24.8	25.5	23.4	22.3
Change in real effective exchange rate	18.3	12.5	7.0	4.3	-0.4	...	...	...	...	...	...
Memorandum items											
Nominal GDP (in millions of lek)	412,326	474,291	530,906	610,426	677,684	744,585	739,048	821,620	810,276	901,071	987,712

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

1/ In ratios to nominal GDP as reported in June 2003 staff report.

2/ Data for 1997-2000 is the first official publication of national accounts and includes estimates of the unobserved economy. Reported growth is growth in the observed economy.

3/ Negative of current account excluding official transfers.

4/ Revenue minus current expenditure.

5/ Budget figures for 2004.

6/ Grants for 1998-2001 are estimated.

7/ Includes interest payments for bank restructuring.

8/ Includes bonds issued for bank restructuring (lek 24.6 bn in 2000).

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

10/ For 1999, excludes imports of direct humanitarian aid related to the Kosovo crisis.

Table 3. Albania: Balance of Payments, 2000-12

(In millions of US dollars)

	2000	2001	2002	2003		2004				2005	2006	2008	2010	2012		
				Est.	SR/06/03	Q1	Q2	Q3	Q4						2004	2004
						Proj.	Proj.	Proj.	Proj.						Proj.	SR/06/03
Current account	-274	-263	-435	-509	-471	-100	-153	-156	-146	-555	-482	-551	-556	-569	-605	-629
Trade balance	-821	-1,027	-1,155	-1,371	-1,292	-348	-351	-390	-381	-1,469	-1,375	-1,558	-1,654	-1,860	-2,144	-2,469
Exports	255	305	330	426	391	113	119	120	138	490	430	539	593	717	868	1,050
Imports	1,076	1,332	1,485	1,797	1,683	460	469	510	519	1,959	1,806	2,097	2,247	2,577	3,011	3,519
Services and income	111	224	120	170	159	46	33	46	41	166	184	214	265	389	588	868
of which: Interest due	12	14	21	20	22	5	8	5	8	26	27	31	35	65	81	100
Private transfers	439	543	597	692	663	202	165	187	194	748	709	793	833	903	951	972
Capital account	319	282	362	451	416	75	128	126	145	474	420	508	529	522	544	602
Official transfers	111	126	121	128	134	33	37	36	32	138	138	145	147	128	128	128
Direct investment	143	204	135	192	150	34	63	52	69	217	180	225	235	253	283	342
Other capital	-6	-131	8	21	19	-21	10	5	5	-1	-17	2	10	10	10	10
Short-term capital (incl. trade credits, net)	25	-3	7	20	15	2	7	2	1	12	10	2	10	10	10	10
Other financial flows	-30	-128	2	1	4	-23	3	3	3	-13	-27	0	0	0	0	0
of which: Change in NFA of commercial banks (incr -)	-30	-128	42	-14	-9	-23	3	3	3	-13	-27	0	0	0	0	0
Official medium- and long-term loans (net)	71	83	97	110	113	28	19	32	40	120	119	135	137	131	123	123
New borrowing	79	90	121	136	138	35	32	39	53	158	155	187	193	197	208	219
Multilateral loans	60	56	84	96	86	22	20	25	34	100	101	113	113	110	117	127
World Bank	40	34	50	40	40	10	10	13	18	50	50	58	58	50	50	50
EBRD	2	4	11	16	14	4	3	4	5	15	14	20	20	16	18	20
Other	18	18	22	40	32	8	7	9	12	35	37	35	35	44	49	57
Bilateral loans	19	34	37	40	52	13	12	14	19	58	54	73	79	87	91	91
Amortization	-9	-7	-24	-26	-25	-6	-13	-7	-13	-39	-36	-52	-56	-66	-85	-96
Errors and omissions 1/	44	108	154	148	70	21	42	0	0	62	40	60	60	60	60	60
Net balance	90	127	81	90	15	-4	17	-30	-1	-18	-22	16	33	14	-1	34
Financing requirement	-90	-127	-81	-90	-15	4	-17	30	1	18	22	-16	-33	-14	1	-34
Available financing	-90	-127	-81	-93	-42	-2	-17	-22	-13	-54	-42	-42	-56	-55	-85	-57
Change in net reserves (increase = -)	-123	-135	-115	-112	-42	-2	-17	-22	-13	-54	-42	-42	-56	-55	-85	-57
Change in gross reserves, (increase = -)	-135	-134	-107	-114	-38	0	-15	-20	-10	-45	-34	-34	-45	-41	-74	-50
Use of Fund Resources (net)	12	-1	-9	2	-4	-2	-2	-2	-3	-9	-9	-9	-11	-13	-11	-7
BOP support	29	4	31	18	0	0	0	0	0	0	0	0	0	0	0	0
Changes in arrears (increase = +) 2/	4	-29	-280	1	-31	-10	-15	-10	-15	-51	-21	-41	-31	0	0	0
Overdue debt forgiveness	0	10	207	0	0	0	0	0	0	0	0	0	0	0	0	0
Rescheduling 2/	0	23	76	0	32	10	15	10	15	51	21	41	31	0	0	0
Financing gap	0	0	0	3	26	6	0	52	14	72	65	26	23	41	87	24
Identified Financing	0	0	0	3	26	6	0	24	0	29	19	11	0	0	0	0
IMF PRGF	0	0	0	0	6	6	0	6	0	11	11	11	0	0	0	0
EU	0	0	0	3	3	0	0	0	0	0	0	0	0	0	0	0
WB ESAC/PRSC	0	0	0	0	18	0	0	18	0	18	8	0	0	0	0	0
Remaining gap	0	0	0	0	0	0	0	29	14	43	46	15	23	41	87	24
Expected from EU 3/	...	...	...	...	...	0	0	13	13	26	...	...	...	...	...	...
Others (mostly official bilateral donors)	...	...	...	...	...	0	0	16	1	17	...	...	...	...	...	...
Memorandum items:																
Gross usable reserves	620	754	860	974	898	974	989	1,009	1,019	1,019	932	1,053	1,098	1,173	1,307	1,436
(months of imports of goods and services)	4.2	4.3	4.3	4.4	4.4	...	...	...	...	...	4.4	4.3	4.2	4.1	3.8	3.6
Trade balance (percent of GDP)	-22.3	-24.2	-23.9	-22.8	-23.3	...	...	...	...	...	-21.5	-22.9	-20.8	-20.1	-18.8	-18.4
Current account (percent of GDP)	-7.4	-6.2	-9.0	-8.5	-8.5	...	...	...	...	...	-8.1	-8.0	-7.3	-6.8	-5.8	-5.2
Current account (percent of GDP incl. official transfers)	-4.4	-3.2	-6.5	-6.3	-6.1	...	...	...	...	...	-6.1	-5.7	-5.4	-5.0	-4.5	-4.1
Debt service (percent of exports of goods and services)	4.0	4.2	6.4	5.1	5.5	...	...	...	...	...	6.2	6.5	7.2	7.4	8.8	9.0
External debt stock (percent of GDP) 4/	31.8	28.2	24.4	23.3	23.9	...	...	...	...	...	22.5	24.7	22.3	22.1	21.9	22.0
Debt service (percent of central government revenues)	3.4	3.7	5.5	3.9	4.3	...	...	...	...	...	4.5	5.0	5.0	5.0	6.1	5.9
Merchandise exports (percent growth)	-7.1	19.3	8.4	29.0	18.5	...	...	...	...	...	15.0	10.0	10.0	10.0	10.0	10.0
Merchandise imports (percent growth)	14.8	23.7	11.5	21.0	13.4	...	...	...	...	...	9.0	7.3	7.1	7.1	7.1	8.1
Merchandise exports (percent growth in euro)	7.3	23.0	2.9	8.9	...	...	...	...	...	...	15.2	...	11.2	10.8	10.8	10.0
Merchandise imports (percent growth in euro)	32.6	27.6	5.8	2.1	...	...	...	...	...	...	9.2	...	8.3	7.9	7.8	8.1
Exports (GNFS) (percent growth)	18.8	19.0	9.0	18.5	12.6	...	...	...	...	...	9.4	...	7.4	8.3	9.3	9.3
Imports (GNFS) (percent growth)	21.3	17.7	16.2	16.8	11.1	...	...	...	...	...	8.6	...	6.7	6.7	7.0	7.9

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

1/ Includes unidentified flows and valuation changes. In 2002, reflects \$64 million of valuation effect on gross reserves, in January-October 2003, valuation effects amounted to \$63 million.

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

3/ In 2004 it refers to macro-financial assistance from the EU Commission.

4/ Includes arrears.

Table 4. Albania: Monetary Aggregates, 2001-04 1/

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

	Previous reporting standard		2002 Dec.	2003					2004				
	2001 Dec.	2002 Dec.		March	June	Sep. Est.	Dec. Est.	Dec. SR06/03 2	March Proj.	June Proj.	Sep. Proj.	Dec. Proj.	Dec. SR06/03 2
	Monetary survey												
Broad money	394.3	416.7	408.1	411.3	422.0	436.0	445.0	446.1	458.0	468.9	479.2	492.0	486.4
Currency outside banks	119.1	130.8	130.8	121.3	118.9	121.6	126.8	133.3	128.2	131.3	134.1	140.7	145.5
Deposits	275.2	285.9	277.4	290.0	303.1	314.4	318.2	312.8	329.8	337.6	345.0	351.3	340.9
Domestic currency deposits	186.2	194.0	190.8	205.7	216.2	218.1	221.7	215.6	227.5	231.2	234.5	237.1	230.9
Foreign currency deposits	89.0	92.0	86.5	86.3	86.9	96.3	96.5	97.2	102.3	106.4	110.5	114.3	110.0
M1	142.9	152.7	145.9	137.1	135.7	138.8	144.8	151.2	146.4	149.8	153.1	160.6	165.0
M2	305.3	324.7	321.6	325.0	335.1	339.7	348.5	345.5	355.7	362.4	368.7	377.8	372.8
Net foreign assets	158.6	162.1	164.4	165.0	156.5	164.2	164.4	171.7	166.4	169.1	171.6	173.2	180.5
Bank of Albania 3/	86.0	95.0	96.9	99.0	93.7	96.5	99.6	102.1	99.1	101.1	103.1	104.7	107.2
Commercial Banks	72.7	67.1	67.5	66.0	62.7	67.7	64.8	69.6	67.3	68.0	68.5	68.5	73.3
Net domestic assets	235.7	254.6	243.8	246.4	265.5	271.8	280.6	274.3	291.6	299.7	307.6	318.9	305.9
Claims on government (net of deposits)	231.0	245.2	245.3	245.8	249.3	256.9	261.8	264.0	269.0	273.2	276.8	283.5	280.8
Claims on state enterprises and farms	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Claims on the private sector	27.4	38.6	39.9	41.7	46.1	49.2	53.1	53.8	56.9	60.8	65.1	69.6	71.0
of which in leks	4.8	8.1	9.2	9.4	10.3	9.8	10.7	15.0	11.6	12.6	13.7	14.8	23.5
in foreign currency	22.6	30.5	30.7	32.3	35.8	39.4	42.4	38.8	45.2	48.2	51.4	54.8	47.4
Other items, net	-23.2	-29.3	-41.5	-41.2	-29.9	-34.3	-34.3	-43.4	-34.3	-34.3	-34.3	-34.3	-45.9
Monetary authorities													
Reserve money	152.1	163.9	163.9	157.9	151.7	157.2	162.9	172.9	165.5	169.5	173.2	180.4	188.7
Program NIR (millions of U.S. dollars) 4/	542.6	562.2	562.2	596.2	606.5	614.8	628.6	583.6	620.0	633.6	646.5	656.7	609.1
Program NDA 3/	78.1	87.1	87.1	76.5	68.9	73.3	77.0	93.2	80.9	82.9	84.9	90.8	105.5
Memorandum items:													
Broad money growth during the year	20.2	5.7	5.7	0.8	3.4	6.8	9.0	8.4	2.9	5.4	7.7	10.6	9.0
Of which:													
Net foreign assets	8.5	0.9	0.9	0.1	-1.9	0.0	0.0	1.8	0.4	1.1	1.6	2.0	2.0
Net domestic assets	11.7	4.8	4.8	0.6	5.3	6.9	9.0	6.6	2.5	4.3	6.1	8.6	7.1
Claims on government	4.8	3.6	3.5	0.1	1.0	2.8	4.0	4.6	1.6	2.6	3.4	4.9	3.8
Domestically bank-financed deficit in percent of GDP	15.6	14.2	14.2	0.6	4.0	11.2	16.1	18.3	7.2	11.4	15.0	21.7	16.8
Annual broad money growth (y-o-y; in percent)	20.2	5.7	5.7	6.8	9.0	9.5	9.0	9.3	11.3	11.1	9.9	10.6	9.0
Annual reserve money growth	18.1	7.7	3.8	-1.1	-6.8	-2.3	-0.6	5.5	4.9	11.7	10.1	10.8	9.1
Annual private sector credit growth 5/	43.1	32.1	32.1	31.1	28.1	28.2	28.0	28.5	31.0	27.8	28.3	27.4	27.1
Annual M1 growth	15.2	6.9	6.9	-3.3	-9.2	-5.1	-0.8	3.6	6.8	10.4	10.3	10.9	9.2
Annual M2 growth	15.4	6.4	6.4	7.2	8.6	8.9	8.4	7.4	9.4	8.1	8.5	8.4	7.9
Velocity (Quarterly GDP/BM)	40.5	42.1	42.9	43.9	43.9	43.0	43.0	42.9	43.3	43.3	43.3	43.3	43.8
Money multiplier (absolute values)	2.59	2.54	2.49	2.61	2.78	2.77	2.73	2.58	2.77	2.77	2.77	2.73	2.58
Currency/Broad Money ratio	30.2	31.4	32.0	29.5	28.2	27.9	28.5	29.9	28.0	28.0	28.0	28.6	29.9
Currency/deposit ratio	43.3	45.7	47.1	41.8	39.2	38.7	39.8	42.6	38.9	38.9	38.9	40.0	42.7
Currency/lek deposit ratio	64.0	67.4	68.5	59.5	55.0	55.8	57.2	61.8	56.4	56.8	57.2	59.3	63.0
Deposits/broad money	69.8	68.6	68.0	70.5	71.8	72.1	71.5	70.1	72.0	72.0	72.0	71.4	70.1
Foreign currency deposits/total deposits	32.3	32.2	31.2	29.8	28.7	30.6	30.3	31.1	31.0	31.5	32.0	32.5	32.3
Lek deposits/total deposits (percent)	67.7	67.8	68.8	70.2	71.3	69.4	69.7	68.9	69.0	68.5	68.0	67.5	67.7
FX deposits/broad money (percent)	22.6	22.1	21.2	21.0	20.6	22.1	21.7	21.8	22.3	22.7	23.1	23.2	22.6
Gross reserves (millions of U.S. dollars)	737.1	860.1	860.1	908.5	934.8	964.3	973.8	898.5	973.8	988.8	1008.8	1018.8	932.5
in percent of broad money	25.5	27.6	28.2	28.5	26.2	26.1	26.3	24.2	25.5	25.3	25.3	24.8	23.0
US Dollar Exchange Rate (end of period)	136.6	133.7	133.7	129.2	118.5	118.1	...	...	...	...	...	...	...
Euro Exchange Rate (end of period)	120.3	140.8	140.8	140.6	134.9	135.3	...	...	...	...	...	...	...
3-month T-bill rate (in percent)	8.0	11.2	11.2	10.5	8.2	7.3	...	...	...	...	...	...	...
BuA repo rate (in percent)	7.0	8.5	8.5	8.5	8.0	7.5	...	...	...	...	...	...	...

Sources: Bank of Albania, and staff estimates.

1/ As of December 2002, data are based on a new reporting standard, in accordance with the 2000 Monetary and Financial Statistics Manual. The main changes are the exclusion of blocked deposits from broad money (Lek 10.7 billion at end-2002) and the inclusion of accrued interest in assets at the end-and liabilities.

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

2/ The data from the June 2002 staff report have been adjusted to reflect the new reporting standard.

3/ The series (on the old reporting standard) includes a break at end-2002, as a change in definitions lowered NFA by Lek 1.4 billion, raising other items net by the same amount.

4/ Derived using end-December 2001 exchange rates.

5/ Including credit transferred to the BART.

Table 5. Albania: Government Revenues and Expenditures, 2002-04 1/

(In percent of GDP)

	2002		2003				2004	2004
	Outturn	Budget	SR 06/03	Jan-Sept		Est.	Budget	Proj. 2/
				Target	Outturn			
Total Revenue and Grants	22.7	25.2	23.9	23.3	21.4	23.6	24.1	24.4
Tax Revenue	19.0	21.4	20.4	19.9	19.1	20.1	20.8	20.8
Tax revenues from Tax directorate and Customs	14.9	16.5	15.4	15.3	14.5	15.4	15.8	15.8
Turnover tax / VAT	6.8	7.6	6.9	7.0	6.5	6.8	7.0	7.0
Profit tax	1.8	1.8	1.7	1.7	1.7	1.8	1.9	1.9
Excise tax	1.4	1.6	1.4	1.4	1.6	1.7	2.0	2.0
Small business tax	0.4	0.4	0.6	0.4	0.5	0.5	0.5	0.5
Personal income tax	0.9	1.0	0.9	1.0	0.8	0.9	1.0	1.0
National taxes 3/	1.4	1.5	1.4	1.5	1.2	1.3	1.5	1.5
Customs duties	2.0	2.0	2.1	1.8	1.8	2.0	1.8	1.8
Road tax	0.2	0.4	0.4	0.4	0.4	...	...	...
Tax on vehicles	...	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Automobile circulation tax	...	...	...	...	...	...	0.2	0.2
Property and local taxes	0.4	0.6	0.7	0.5	0.7	0.6	0.8	0.8
Social insurance contributions	3.8	4.3	4.1	4.0	3.8	4.0	4.1	4.1
Social insurance	3.5	3.9	3.8	3.6	3.4	3.7	3.8	3.8
Health insurance	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Non-tax revenue:	3.0	3.0	3.0	2.7	2.3	2.8	2.5	2.5
Profit transfer from BOA	1.5	1.4	1.4	1.2	1.1	1.3	0.9	0.9
Income of budgetary institutions	0.9	1.1	1.1	1.0	0.7	0.9	1.1	1.1
Other	0.6	0.6	0.6	0.5	0.4	0.5	0.5	0.5
Grants 4/	0.6	0.7	0.7	0.7	0.0	0.7	0.8	1.1
Budgetary	0.0	0.1	0.0	0.0	...	0.0	0.0	0.0
Project	0.6	0.6	0.6	0.6	...	0.6	0.8	0.8
Total Expenditure	29.0	31.1	29.6	29.4	25.1	28.5	29.3	29.6
Current Expenditure	22.8	23.4	...	23.3	21.5	22.5	22.6	22.7
Personnel cost	6.2	6.4	...	6.1	5.5	6.1	6.2	6.2
Wages and other personnel expenditures	4.9	5.0	...	4.8	4.4	4.7	4.9	4.9
Social insurance contributions	1.3	1.4	...	1.3	1.2	1.3	1.3	1.3
Interest	3.7	3.8	...	3.6	4.0	4.1	3.8	3.8
Domestic	3.3	3.3	...	3.3	3.8	3.8	3.5	3.5
Foreign	0.3	0.4	...	0.4	0.2	0.3	0.3	0.3
Operations & maintenance	3.0	2.8	...	2.7	2.8	2.6	2.7	2.7
Subsidies 5/	0.9	0.9	...	0.9	0.5	0.6	0.5	0.5
Social insurance outlays	5.9	6.3	...	6.1	5.8	6.0	6.0	6.0
Social insurance	5.4	5.6	...	5.5	5.3	5.4	5.4	5.4
Health insurance	0.5	0.6	...	0.6	0.5	0.6	0.6	0.6
Local government expenditure	1.8	2.0	...	1.9	1.8	1.9	2.1	2.1
Local budget (grant)	1.3	0.9	...	0.9	0.9	0.8	0.8	0.8
Local budget (local revenues)	0.5	0.6	...	0.5	0.9	0.5	0.8	0.8
Small business tax	...	0.4	...	0.4	...	0.5	0.5	0.5
Tax on vehicles	...	0.1	...	0.1	...	0.1	0.1	0.1
Social protection transfers	1.3	1.3	...	1.3	1.1	1.2	1.2	1.2
Unemployment insurance benefits	0.2	0.2	...	1.1	0.1	0.2	0.2	0.2
Social assistance 5/	1.1	1.1	...	0.2	0.9	1.1	1.1	1.1
Capital Expenditure	6.2	6.8	6.7	5.4	3.6	5.5	5.9	6.1
Domestically financed	2.8	3.0	2.9	2.3	2.1	2.8	3.0	3.3
Foreign financed projects	3.4	3.9	3.8	3.1	1.5	2.7	2.9	2.9
Reserve and contingency funds	...	0.8	...	0.7	...	0.5	0.7	0.8
Cash Balance	-6.3	-5.9	-5.8	-6.1	-3.7	-5.0	-5.1	-5.2
Cash Balance (excluding grants)	-6.9	-6.6	-6.4	-6.8	-3.7	-5.6	-6.0	-6.3
Sources of Financing	6.3	5.9	5.8	5.4	3.7	5.0	5.1	5.2
Domestic	3.3	2.9	2.9	3.0	2.4	2.9	3.4	3.4
Privatization receipts	0.1	0.1	0.1	0.1	0.1	0.2	0.7	0.7
Net borrowing	3.2	2.8	2.7	2.9	2.4	2.7	2.8	2.7
Foreign	3.0	3.0	2.9	2.4	1.2	2.1	1.7	1.8
Budget support	0.6	0.3	0.3	0.4	0.0	0.3	0.3	0.4
Development (gross)	2.8	3.3	3.2	2.5	1.5	2.1	2.1	2.1
minus: principal repayment	0.4	0.6	0.5	0.5	0.3	0.4	0.7	0.7
Memorandum items:								
GDP (in billions of leks) 6/	677.7	718.6	739.0	558.4	558.4	744.6	821.6	821.6
Dutiable imports (in billions of leks)	163.2	...	...	...	...	186.6	193.1	193.1

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

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

2/ Based on the 2004 budget adopted by the Parliament, but including the EU grant and higher projections for subsidies and the funds allocated to the settlement of inter-enterprise arrears and our lower projections for net domestic borrowing

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

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

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

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



Table 6. Albania: Government Revenues and Expenditures, 2002-04 1/

(In millions of Lek)

	2002	2003					2004
		Outturn	Budget	Jan-Sept		Est.	
				SR 06/03	Target		
<b>Total Revenue and Grants</b>	153,606	180,775	176,303	130,102	119,478	175,574	198,052
<b>Tax Revenue</b>	128,948	153,887	150,415	111,081	106,664	149,687	170,624
Tax revenues from Tax directorate and Customs	100,635	118,228	113,756	85,341	81,195	114,518	129,636
Turnover tax / VAT	46,113	54,584	50,995	39,106	36,105	50,760	57,148
Profit tax	12,198	13,001	12,564	9,760	9,743	13,200	15,200
Excise tax	9,324	11,599	10,347	7,969	9,012	12,830	16,232
Small business tax	2,548	3,054	4,434	2,104	2,578	3,354	4,044
Personal income tax	6,149	7,435	6,652	5,635	4,401	6,600	8,162
National taxes 3/	9,637	10,882	10,347	8,262	6,890	9,533	12,550
Customs duties	13,387	14,673	15,461	10,255	9,998	15,041	14,700
Road tax	1,281	3,000	2,956	2,250	2,468	...	...
Tax on vehicles	...	1,000	1,000	740	470	600	800
Automobile circulation tax	...	...	...	...	...	...	1,600
Property and local taxes	2,677	4,000	5,000	2,850	3,867	4,620	6,500
Social insurance contributions	25,637	30,659	30,659	22,150	21,132	29,949	33,688
Social insurance	23,548	28,200	28,200	20,374	19,214	27,490	30,888
Health insurance	2,088	2,459	2,459	1,776	1,918	2,459	2,800
<b>Non-tax revenue:</b>	20,538	21,879	21,879	15,265	12,814	20,879	20,806
Profit transfer from BOA	10,291	10,000	10,000	6,664	6,325	10,000	7,500
Income of budgetary institutions	6,302	7,800	7,800	5,728	4,157	6,800	9,006
Other	3,945	4,079	4,079	2,873	2,332	4,079	4,300
<b>Grants 4/</b>	4,119	5,009	5,009	3,756	0	5,009	6,622
Budgetary	325	365	365	273	...	365	0
Project	3,794	4,644	4,644	3,483	...	4,644	6,622
<b>Total Expenditure</b>	196,549	223,420	218,949	164,318	139,940	212,432	240,360
<b>Current Expenditure</b>	154,582	168,453	...	129,884	119,789	167,721	185,744
Personnel cost	41,942	46,340	...	34,297	30,815	45,340	51,052
Wages and other personnel expenditures	33,438	35,659	...	26,784	24,329	34,938	40,414
Social insurance contributions	8,504	9,966	...	7,513	6,486	9,966	10,638
Interest	24,762	27,050	...	20,326	22,477	30,318	31,082
Domestic	22,468	23,997	...	18,297	21,328	28,200	28,650
Foreign	2,294	3,053	...	2,029	1,149	2,118	2,432
Operations & maintenance	20,524	19,770	...	14,911	15,436	19,270	22,286
Subsidies 5/	6,243	6,250	...	4,765	2,843	4,550	4,165
Social insurance outlays	40,168	45,032	...	33,995	32,403	45,032	49,503
Social insurance	36,564	40,473	...	30,595	29,382	40,473	44,353
Health insurance	3,604	4,559	...	3,400	3,021	4,559	5,150
Local government expenditure	12,230	14,354	...	10,524	9,863	14,154	17,621
Local budget (grant)	9,014	6,300	...	4,830	4,929	6,300	6,277
Local budget (local revenues)	3,216	4,000	...	2,850	4,934	3,900	6,500
Small business tax	...	3,054	...	2,104	...	3,354	4,044
Tax on vehicles	...	1,000	...	740	...	600	800
Social protection transfers	8,713	9,657	...	7,066	5,952	9,057	10,035
Unemployment insurance benefits	1,115	1,477	...	5,981	669	1,127	1,300
Social assistance 5/	7,598	8,180	...	1,085	5,283	7,930	8,735
<b>Capital Expenditure</b>	41,967	49,167	49,167	30,434	20,151	40,711	48,516
Domestically financed	19,013	21,206	21,206	13,073	11,669	20,481	24,925
Foreign financed projects	22,954	27,961	27,961	17,361	8,482	20,229	23,591
Reserve and contingency funds	...	5,800	...	4,000	...	4,000	6,100
<b>Cash Balance</b>	-42,943	-42,646	-42,647	-34,215	-20,462	-36,857	-42,308
<b>Cash Balance (excluding grants)</b>	-47,063	-47,654	-47,655	-37,912	-20,462	-41,866	-48,930
<b>Sources of Financing</b>	42,943	42,645	42,647	30,319	20,462	36,857	42,308
Domestic	22,383	21,143	21,143	16,650	13,659	21,342	28,300
Privatization receipts	485	1,077	1,077	650	478	1,277	5,680
Net borrowing	21,898	20,066	20,066	16,000	13,181	20,065	22,620
Foreign	20,560	21,502	21,504	13,669	6,803	15,515	14,008
Budget support	4,032	1,897	2,232	2,323	-66	2,596	2,500
Development (gross)	19,160	23,650	23,317	13,878	8,482	15,585	16,969
minus: principal repayment	2,632	4,045	4,045	2,532	1,613	2,666	5,461

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

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

2/ Based on the 2004 budget adopted by the Parliament, but including the EU grant and higher projections for subsidies and the funds allocated to the settlement of inter-enterprise arrears, and lower projections for net domestic borrowing

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

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

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

Table 7. Albania: Priority Expenditure, 1998-2002

	1998	1999	2000	2001	2002
(In millions of lek)					
Total	61,209	68,946	72,835	81,675	86,094
Education	13,612	16,850	17,192	19,488	19,034
Health	7,985	12,066	12,334	12,027	13,719
Agriculture	5,500	5,043	4,788	5,450	7,158
Social Security and Welfare	34,112	34,987	38,521	44,710	46,183
(In percent of GDP)					
Total	14.8	14.5	13.7	13.4	12.7
Education	3.3	3.6	3.2	3.2	2.8
Health	1.9	2.5	2.3	2.0	2.0
Agriculture	1.3	1.1	0.9	0.9	1.1
Social Security and Welfare	8.3	7.4	7.3	7.3	6.8
(In percent of total expenditure)					
Total	43.3	41.6	43.0	44.0	43.8
Education	9.6	10.2	10.1	10.5	9.7
Health	5.6	7.3	7.3	6.5	7.0
Agriculture	3.9	3.0	2.8	2.9	3.6
Social Security and Welfare	24.1	21.1	22.7	24.1	23.5
(In millions of lek)					
Memorandum items					
Nominal GDP	412,326	474,291	530,906	610,426	677,684
Total Government expenditure	141,393	165,616	169,424	185,751	196,549

Source: Government of Albania MTEF as of June 2003 (Table 14).

Table 8. Albania: External Debt Stock by Creditors, 1997-2003 1/

	1997	1998	1999	2000	2001	2002	2003 1/
(In millions of U.S. dollars)							
Total	877	1007	1108	1173	1198	1178	1308
Public and publicly guaranteed debt (excluding ar	404	523	630	706	782	1057	1184
Multilateral	221	304	419	492	523	659	746
EBRD	9	9	8	8	9	14	24
EIB	0	1	15	27	35	50	68
IDA	148	220	296	345	366	476	522
IDB	0	1	1	2	5	10	10
IFAD	5	8	12	13	15	21	25
IMF	56	62	80	89	84	77	85
OPEC	2	4	6	7	8	12	12
Bilateral	183	218	211	214	259	398	439
Rescheduled debt	32	27	20	18	40	117	116
Paris club members	32	27	20	18	17	55	54
Austria	6	4	3	2	1	1	1
Britain	0	0	0	0	0	0	0
France	13	10	8	5	4	3	3
Germany	11	10	8	5	7	6	6
Italy	2	1	1	6	5	5	5
Netherlands	1	1	0	0	0	0	0
Russia	0	0	0	0	0	39	39
Japan	0	0	0	0	0	0	0
Non Paris Club Members	0	0	0	0	23	62	62
Turkey	0	0	0	0	23	23	23
China	0	0	0	0	0	40	40
Post cur-off debt	151	192	191	196	218	281	322
Paris Club members	129	157	156	153	158	211	248
Austria	5	5	5	4	4	2	2
Germany	46	58	50	50	53	72	88
Italy	61	74	71	69	76	110	124
Japan	17	21	31	29	25	28	35
Non-Paris Club	22	34	35	43	60	69	74
China	2	2	2	2	2	2	2
Greece	0	11	11	11	12	14	16
Kuwait	13	15	16	15	16	23	28
Norway	3	3	3	11	26	26	24
Sweden	4	4	4	4	4	4	4
Arrears	473	484	478	467	416	122	123
Convertible currency	134	134	134	131	91	56	56
Budgetary	60	60	60	57	21	17	17
China 2/	5	5	5	4	4	0	0
Greece	19	19	19	17	17	17	17
IDB	0	0	0	0	0	0	0
Turkey	14	14	14	14	0	0	0
PTT	15	15	15	15	0	0	0
Railway	7	7	7	7	0	0	0
Other	0	0	0	0	0	0	0
Bilateral (USD) clearing accounts	74	74	74	74	71	40	39
Non-convertible currency 3/	168	171	171	160	161	13	13
Commercial	52	52	39	37	34	33	33
Cumulative Overdue Interest 4/	119	127	134	138	130	19	21
Memorandum items:							
Total debt (percent of GDP)	39.9	36.9	32.3	31.8	28.2	24.4	....
Total arrears (percent of GDP)	21.5	17.7	13.9	12.7	9.8	2.6	....
GDP in million of US\$	2196	2728	3434	3687	4249	4834	....

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

1/ As at end-September 2003.

2/ It includes only post-1978 amount.

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

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

Table 9. Albania: External Financing Requirement and Sources, 2000-06

(In millions of U.S. dollars)

	2000	2001	2002	2003	2004	2005	2006
				Est.	Projections		
Current account	274	263	435	509	555	551	556
Amortization	16	21	37	35	48	60	66
o/w: IMF	7	14	14	10	9	9	11
Change in reserves (increase = +)	135	134	107	114	45	34	45
Reduction in arrears	-4	29	280	-1	51	41	31
<b>Total financing requirement</b>	<b>420</b>	<b>446</b>	<b>858</b>	<b>657</b>	<b>698</b>	<b>687</b>	<b>699</b>
<b>Available financing</b>	<b>420</b>	<b>446</b>	<b>858</b>	<b>654</b>	<b>626</b>	<b>661</b>	<b>676</b>
Official grants	111	126	121	128	138	145	147
Foreign direct investment	143	204	135	192	217	225	235
Short-term private financing flows	-6	-132	8	21	0	2	10
Official medium- and long-term loans	79	90	121	136	158	187	193
Multilateral	60	56	84	96	100	113	113
Bilateral	19	34	37	40	58	73	79
Other loans	0	0	0	0	0	0	0
IMF disbursements	19	12	5	11	0	0	0
Other	44	109	154	148	62	60	60
Debt relief	0	33	283	0	51	41	31
Balance of payments support	29	4	31	18	0	0	0
<b>Financing gap</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>3</b>	<b>72</b>	<b>26</b>	<b>23</b>
Identified financing (provisional)	0	0	0	3	29	11	0
o/w: IMF PRGF	0	0	0	0	11	11	0
o/w: EU Budgetary Support	0	0	0	3	0	0	0
o/w: WB SAC/PRSC	0	0	0	0	18	0	0
<b>Remaining gap</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>43</b>	<b>15</b>	<b>23</b>
Expected from EU 1/	...	...	...	...	26	...	...
Others (mostly official bilateral donors)	...	...	...	...	17	...	...

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

1/ In 2004 it refers to macro-financial assistance from the EU Commission.

Table 10. Albania: Indicators of External and Financial Vulnerability, 1996-2004

(In percent of GDP, unless otherwise indicated)

	1996	1997	1998	1999	2000	2001	2002	2003 Est.	2004 Proj.
<b>Financial Indicators</b>									
Public sector debt	55.3	76.6	73.1	69.7	74.4	67.7	63.2	61.3	59.7
Broad money (percent change, end of period)	43.8	28.5	20.6	22.3	12.0	20.2	5.7	9.0	10.6
Private Sector credit (percent change, end of period)	30.5	19.0	14.7	29.4	26.9	43.1	32.1	28.0	27.4
Interest rate (3-mth T-bills, end period)	21.1	35.9	20.4	14.8	7.8	8.0	11.2	...	...
Foreign currency deposits (share of total deposits)	31.8	28.9	23.5	25.2	27.8	32.3	31.2	30.3	32.5
<b>External indicators</b>									
Exports (annual percent change, in US dollars)	11.8	-27.1	22.9	34.2	-7.1	19.3	8.4	29.0	15.0
Imports (annual percent change, in US dollars) 1/	35.6	-25.6	20.6	13.5	14.8	23.7	11.5	21.0	9.0
Current account balance									
(excluding official transfers) 1/	-8.3	-12.9	-7.1	-7.9	-7.4	-6.2	-9.0	-8.5	-8.1
(including official transfers)	-5.8	-9.4	-3.9	-3.9	-4.4	-3.2	-6.5	-6.3	-6.1
Capital and financial account balance	5.6	3.8	3.6	6.4	8.7	6.6	7.5	7.5	6.9
o/w: Foreign direct investment	3.2	1.9	1.6	1.5	3.9	4.8	2.8	3.2	3.2
Gross official reserves (in US dollars, millions)	275.3	306.2	384.0	484.6	619.8	753.5	860.0	973.8	1018.8
Official reserves in months of imports (goods and services)	4.0	3.8	3.7	3.8	4.2	4.3	4.3	4.4	4.4
Official reserves to broad money (ratio)	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.2
Official reserves to reserve money (ratio)	0.5	0.5	0.6	0.6	0.7	0.7	0.7	0.7	0.7
Central bank foreign liabilities (in US dollars, millions)	357.1	361.1	392.0	178.8	143.6	138.7	...	...	...
Foreign assets of the banking sector (in US dollars, millions)	343.8	261.2	355.5	429.0	456.1	610.5	...	...	...
Foreign liabilities of the banking sector (in US dollars, millions)	11.8	13.5	20.4	35.8	47.9	88.2	...	...	...
Total external debt (in US dollars, millions) 2/	844.4	876.6	1006.7	1108.3	1172.6	1198.4	1178.3	1404.7	1540.0
Total external debt 2/	28.0	39.9	36.9	32.3	31.8	28.2	24.4	23.3	22.5
Total external debt to exports (percent)	242.1	360.8	357.5	186.7	166.2	142.8	128.7	129.5	129.7
Total short term external debt to reserves (percent) 3/	6.5	6.6	6.4	4.4	3.4	2.8	5.2	4.7	6.4
External amortization payments to exports (in percent)	1.5	3.1	3.4	1.3	1.2	0.9	2.6	2.4	3.3
External interest payments to exports (in percent)	3.6	5.3	5.4	2.3	1.7	1.7	2.3	1.8	2.2
External debt service to exports (excluding IMF, in percent)	5.2	8.4	8.8	3.6	2.9	2.6	4.9	4.2	5.5
External debt service to exports (including IMF, in percent)	7.5	11.7	9.2	4.2	4.0	4.2	6.4	5.1	6.2
External debt service (excluding IMF)	0.6	0.9	0.9	0.6	0.6	0.5	0.9	0.8	0.9
External debt service (including IMF)	0.9	1.3	0.9	0.7	0.8	0.8	1.2	0.9	1.1
Change in REER (+ appreciation)	-3.2	0.0	0.0	0.0	7.0	4.3	-0.4	...	...
Exchange rate (period average)									
(lek per US dollar)	104.8	149.6	151.2	138.1	144.0	143.6	132.2	...	...
(lek per euro)	136.1	168.6	168.4	147.4	132.8	128.9	132.2	...	...

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

1/ In 1999, it 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 11. Albania: Projected Payments to the Fund as of December, 2003–12  
(in millions of SDRs)

	2003 1/	2004	2005	2006	2007	2008	2009	2010	2011	2012	Beyond	Total
Obligations from existing drawings												
1. Principal												
PRGF Repayments	0.0	6.4	6.2	7.6	9.4	9.6	8.7	5.9	3.8	2.0	1.2	60.8
2. Charges and Interest 2/												
PRGF Interest	0.2	0.3	0.3	0.1	0.2	0.2	0.1	0.1	0.0	0.0	0.0	1.4
SDR Net Charges	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Obligations	0.2	6.7	6.4	7.7	9.6	9.8	8.8	6.0	3.8	2.0	1.2	62.2
(percent of quota)	0.3	13.7	13.2	15.8	19.7	20.1	18.1	12.4	7.9	4.1	2.5	127.8
Obligations from prospective drawings												
1. Principal												
PRGF Repayments	0.0	0.0	0.0	0.0	0.0	0.0	0.4	2.0	3.2	3.2	7.2	16.0
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	0.0	0.0	0.5
Total Obligations	0.0	0.0	0.1	0.1	0.1	0.1	0.5	2.1	3.3	3.2	7.2	16.5
(percent of quota)	0	0	0	0	0	0	1	4	7	7	15	34
Cumulative obligations (existing and prospective)												
1. Principal												
PRGF Repayments	0.0	6.4	6.2	7.6	9.4	9.6	9.1	7.9	7.0	5.2	8.4	76.8
2. Charges and Interest 2/												
PRGF Interest	0.2	0.3	0.3	0.2	0.3	0.2	0.2	0.2	0.1	0.0	0.0	1.9
SDR Net Charges	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Obligations	0.2	6.7	6.5	7.8	9.7	9.9	9.3	8.1	7.1	5.2	8.4	78.8
(percent of quota)	0.3	13.8	13.3	16.0	19.9	20.2	19.0	16.6	14.6	10.7	17.2	161.7
Outstanding Fund credit	60.8	62.4	64.3	56.7	47.3	37.6	28.54	20.6	13.6	8.4	...	...

1/December 12, 2003 to December 31, 2003.

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

Table 12. Albania: Schedule of Purchases Under PRGF Arrangement

Date	Amounts in millions of SDRs	In percent of quota 1/	Conditions
June 2002	4.0	8.21	Board approval of PRGF arrangement
January 2003	4.0	8.21	Observance of end-September 2002 performance criteria and completion of first review.
July 2003	4.0	8.21	Observance of end-March 2003 performance criteria and completion of second review.
January 2004	4.0	8.21	Observance of end-September 2003 performance criteria and completion of third review.
July 2004	4.0	8.21	Observance of end-March 2004 performance criteria and completion of fourth review.
January 2005	4.0	8.21	Observance of end-September 2004 performance criteria and completion of fifth review.
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 October 31, 2003

<b>I. Membership Status:</b> Joined: 10/15/1991; Article XIV						
<b>II. General Resources Account:</b>						
		<u>SDR Million</u>	<u>Percent Quota</u>			
Quota		48.70	100.00			
Fund Holdings of Currency		45.35	93.12			
Reserve position in Fund		3.35	6.89			
<b>III. SDR Department:</b>						
		<u>SDR Million</u>	<u>Percent Allocation</u>			
Holdings		62.18	N/A			
<b>IV. Outstanding Purchases and Loans:</b>						
		<u>SDR Million</u>	<u>Percent Quota</u>			
ESAF/PRGF arrangements		62.12	127.56			
<b>V. Financial Arrangements:</b>						
	<u>Approval</u>	<u>Expiration</u>	<u>Amount Approved</u>	<u>Amount Drawn</u>		
<u>Type</u>	<u>Date</u>	<u>Date</u>	<u>(SDR Million)</u>	<u>(SDR Million)</u>		
PRGF	06/21/2002	06/20/2005	28.00	12.00		
ESAF/PRGF	05/13/1998	07/31/2001	45.04	45.04		
ESAF	07/14/1993	07/13/1996	42.36	31.06		
<b>VI. Projected Obligations to Fund:</b> (SDR Million; based on existing use of resources and present holdings of SDRs):						
			<u>Forthcoming</u>			
		<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>
Principal		1.29	6.39	6.17	7.60	9.41
Charges/Interest		0.16	0.29	0.26	0.22	0.18
Total		1.45	6.69	6.43	7.82	9.59

**VII. Safeguards Assessments:**

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



### **VIII. Exchange Rate Arrangement:**

On July 1, 1992 the Albanian authorities adopted a floating exchange rate system (an independent float). Under the Fund's de facto exchange rate regime classification, Albania follows an independently floating exchange rate regime—although the monetary authorities occasionally intervene in the foreign exchange market with the objective of smoothing temporary fluctuations. Albania's exchange rate arrangement is free from exchange restrictions and multiple currency practices subject to Fund jurisdiction under Article VIII. However, the country still avails itself of the transitional arrangements under Article XIV and maintains exchange restrictions in the form of outstanding debit balances on inoperative bilateral payment agreements, which were in place before Albania became a Fund member. Albania has not imposed new restrictions under Article VIII. The unified exchange rate stood at 116 lek per U.S. dollar on October 31, 2003.

### **IX. Article IV Consultation:**

The conclusion of the 2002 Article IV consultation and the first review under the three-year PRGF arrangement took place in February 2003 (Document Number EBS/03/01). Albania has moved from a 12-month cycle to a 24-month cycle, in line with the decision on consultation cycles approved on July 15, 2002.

### **X. FSAP Participation and ROSCs:**

An FSAP is being planned, but no date has been set yet. A ROSC on data dissemination was published on the Fund's website in May 2000. A fiscal ROSC was completed in June 2003. Albania participates in the General Data Dissemination System (GDDS), and a complete set of GDDS metadata for the external, financial, fiscal, and real sectors, as well as for the socio-demographic indicators is posted on the Fund's Dissemination Standards Bulletin Board (<http://dsbb.imf.org>).

### **XI. Technical Assistance:**

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

### **IX. Resident Representative:**

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

## ALBANIA: WORLD BANK RELATIONS

### Partnership in Albania's Development Strategy

The National Strategy for Socio-Economic Development (NSSED), presented to the Boards of the IMF and the Bank in June 2002 and updated in May 2003, is a comprehensive development strategy that increases the government's emphasis on poverty reduction. The NSSED has two pillars—strengthening governance and achieving high economic growth—and gives priority to improving education, healthcare, and infrastructure.

The IMF will continue to take the lead in assisting Albania to maintain macroeconomic stability and financial sustainability through setting quantitative targets within the framework of its Poverty Reduction and Growth Facility (PRGF)-supported program in 2002 and the subsequent reviews of the program in February and July 2003. In addition, the IMF's structural conditionality focuses on three main categories: fiscal management and control; payments discipline; and privatization.

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

### Bank Group Strategy

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

- *Improve governance and strengthen institutions*, by strengthening transparency and accountability at all levels, increasing the contestability of the policy formulation process, and improving policy monitoring and evaluation.
- *Promote sustainable private sector growth*, through improving the environment for private sector development, continuing financial sector reforms, sustaining agricultural growth, improving infrastructure and promoting environmentally sustainable use of natural resources.
- *Foster human development*, by improving access to and quality of education and healthcare, strengthening the sustainability and equity of the social insurance system, and improving targeting and efficacy of social assistance and community social services.

Overall, the Bank's lending operations reflect a cross-sectoral emphasis on reducing poverty, strengthening institutions, and increasing transparency and accountability. To date, the Bank has approved a total of 52 operations amounting to US\$718 million, of which 29 are completed. During the next 18 months, the Bank will continue to use a mix of adjustment and investment

lending as well as country analytic work to support the NSSD. In line with its Country Assistance Strategy, which covers FY03–05, the Bank has initiated its Poverty Reduction Support Credit (PRSC) program, and is planning a total of 10 possible investment operations in education, health, power, transport, environment, municipal water, and community works. Four of these operations have been approved to date.

The PRSC-1 was presented to the Board in June 2002 and the PRSC-2 in July 2003. The PRSCs provide a strong core for the Bank's lending program and focus on multi-sectoral and thematic policy reforms that are best addressed through a single adjustment operation. The four key areas supported under the PRSCs are: promoting sustainable growth and private sector development; strengthening capacity to monitor and evaluate the policy agenda; improving service delivery and social safety net effectiveness; and improving core public functions and institutional arrangements. The PRSCs and the investment operations are complementary and mutually reinforcing: the PRSCs support reforms crucial for investment projects, while investment projects help build the capacity needed to implement reforms.

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

### **Bank-Fund Collaboration in Specific Areas**

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

- *Financial sector reforms*

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

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

to support the implementation of the institutional development program for banking supervision developed by the Bank of Albania.

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

- *Power sector*

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

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

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

- *Social Sectors and Pension Reform*

The Government's pension reform aims to reduce the reliance of the pension system on budgetary transfers, while addressing the overall, longer-term problems of coverage, affordability, equity, and adequacy. The pension system's deficit currently amounts to about one percent of GDP, and projections suggest that this deficit will worsen over time in the absence of reform. Compliance is low, and high social insurance contribution rates discourage willing

participation in the pension scheme and in formal employment. At the same time, pensions play an important role in rural poverty alleviation and as a social safety net for the elderly.

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

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

- *Public expenditure management*

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

PRSC, the Government has closely linked the preparation of the NSSED with the preparation of the MTBP. Continuing work to improve the linkages of the MTBP with the NSSED is an important focus of both the Bank and the Fund.

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

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

Prepared by World Bank staff. Questions may be addressed to Mr. Celestin Monga at 473-5125 or Mr. Timothy Gilbo at 458-2449.

## ALBANIA: STATISTICAL ISSUES

Albania has made significant progress in improving its statistical database with extensive technical assistance, including technical assistance from the Fund. The multisector statistics mission of February 1999 secured the agreement of the authorities on an action plan for each of the major statistical areas, identifying the concrete steps and timetable for improving Albania's macroeconomic statistics. This mission was followed by several other missions in the areas identified as priority. The authorities have thus far made progress in implementing the action plan agreed with the multisector statistics mission as well as the recommendations of follow-up missions. The Council of Statistics has been established and its constitution and functions have been ratified. However, much still remains to be done, in particular as regards the medium-term objective of improving the compilation of the national accounts.

Albania was selected as a pilot country for the preparation of the data dissemination module of the Report on the Observance of Standards and Codes (ROSC), and the ROSC was published in the Funds' website in May 2000.<sup>4</sup> Albania participates in the General Data Dissemination System (GDDS). A complete set of GDDS metadata for the external, financial, fiscal, and real sectors, as well as for the socio-demographic indicators is posted and regularly updated on the Fund's Dissemination Standards Bulletin Board (<http://dsbb.imf.org>). The metadata also include a comprehensive summary of plans for improving data compilation and dissemination across all statistical sectors, including socio-demographic indicators.

### A. Real Sector

#### Price statistics

STA has provided considerable technical assistance to Albania on price statistics. Data on consumer price index (CPI) are reported regularly for publication in the Albania page in *International Financial Statistics (IFS)*. In 2001, a revision of CPI weights was initiated by INSTAT based on a new household budgetary survey and a revised CPI was finalized in February 2002. The compilation of the CPI generally follows international standards, and the estimation of imputed rent within the CPI has recently been improved. As regards the producer price index (PPI), STA missions of May 2000 and January 2002 assisted INSTAT in finalizing the development of this index. The official monthly PPI has been published on a quarterly frequency since March 2002.

---

<sup>4</sup> Albania's ROSC (data module) was undertaken before the formal adoption of the Data Quality Assessment Framework.

### **National accounts**

Until recently, and in the absence of official national accounts aggregates since 1990, Fund staff relied on their own estimates prepared in consultation with the authorities. These estimates were based on very partial data on (gross) agricultural output, activity in state industrial production, and extremely limited information on private sector activity. With technical assistance from STA, consisting of a resident advisor in 1999 and follow-up missions in 2001 and 2002, INSTAT published in January 2003 the first official GDP estimates for 1996–2000. However, the estimates continue to be hampered by weaknesses in basic data sources and incomplete coverage of the private sector.

STA has recently prepared a technical assistance project for which the Italian government has agreed to commit \$500,000 from its subaccount with the IMF over a period of two years. The project is aimed at further improving the national accounts estimates and basic source data. The project identifies the required technical assistance inputs/activities (from the authorities and the technical assistance provider) and the measurable indicators of implementation/deliverables of the project. In October 2002, the project was offered for competitive bid under a fixed-price contract, an innovation in the way STA contracts technical assistance, to targeted national statistical agencies in statistically advanced countries. The Italian National Institute of Statistics (Istat) and the National Statistics Office of Finland (Statistics Finland) expressed interest. Subsequently, the two agencies reached an agreement that Istat would take the lead as primary contractor and subcontract portions of the work to Statistics Finland. The terms of reference for the project were agreed with the executing agency—Istat—and the contract for professional services (Agreement/Purchase No. 4905) was signed on November 15, 2003.

### **External trade**

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

## **B. Government Finance**

Albania reported fiscal data (for 1995) for the first time in 1996 for publication in the 1996 *Government Finance Statistics Yearbook* and *IFS*. In March 1998, the authorities started to publish a new quarterly bulletin of government statistics. The STA multisector statistics mission in 1999 assisted in upgrading the quality of the data reported in this publication to *GFSM 1986* standards and developing a system for the regular and timely reporting of data to the Fund for publication. Data for 1997 and 1998 have since been reported for inclusion in the *GFS Yearbook* although data for 1999–2002 have not yet been reported. Some improvement in the collection of data on disbursement of foreign loans and grants has been achieved under the technical assistance



provided by UNCTAD. A foreign debt database has been established and is nearly operational, requiring only auditing for final implementation. Nonetheless, further improvements are urgently required regarding the accuracy and timeliness of information on foreign financed capital expenditures.

### **C. Monetary Accounts**

The existing data compilation framework conforms to the methodology recommended in the *Monetary and Financial Statistics Manual*, and data are compiled on a timely basis. Following the multisector statistics mission's recommendation to expand the coverage of monetary statistics to include the accounts of the savings and credit associations (SCAs), in 2002, Parliament passed a law providing the necessary authority to the Bank of Albania (BoA) to request the required data from the SCAs. There are currently 180–200 SCAs throughout the country and they have started reporting data to the BoA using a simplified report form. However, data from SCAs are not yet included in the monetary survey.

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

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

### **D. Balance of Payments**

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

While this should improve the measurement of tourism services, further refinements are required. More generally, problems remain in the areas of service transactions and remittances, and in the monitoring of financial account transactions, foreign assistance and external debt. These problems could be addressed by strengthening existing data sources and improving estimation methods. The May 2003 technical assistance mission noted that the coverage and accuracy of the data should be improved through the strengthening of the legal framework and the use of the banks reporting system to verify data from enterprises surveys. The Albanian authorities have not yet initiated compiling data on foreign currency liquidity in line with the Data Template on

International Reserves and Foreign Currency Liquidity. While the definition of data on official reserve assets in principle is consistent with that of the data Template, the data may not be adequate for monitoring the economy because other foreign currency assets and currency drains are not included.

#### **E. External Debt Statistics**

External debt statistics for government and government-guaranteed debt are compiled by the Ministry of Finance (MoF). These data are generally good. The MoF's external debt database, developed with technical assistance from UNCTAD, became fully operational in mid-2000. The external debt database ensures timely and accurate reporting of external government debt (including commitments of state-owned enterprises). However, the coverage of external debt data could be improved. There have been some irregularities in the presentation and recording of old external arrears. The External Debt Committee needs to work to improve coordination to ensure the timely and accurate reporting of the stock of external arrears and changes resulting from rescheduling agreements. The authorities did make an attempt to collect data on private sector external debt albeit limited to foreign direct investment enterprises.

Albania: Core Statistical Indicators  
(as of December 8, 2003)

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/GNP	External Public Debt/Debt Service
Date of Latest Observation	Dec 5	Dec 4	Oct	Oct	Sept	Nov 18	Oct	Sept	Jun	Sept	2002	Aug
Date Received	Dec 8	Dec 8	Nov	Nov	Nov	Nov 20	Nov	Dec	Oct	October	Apr	Oct
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	E-mail/ Mission	Mission	Fax/Mission	Mission	Mission
Confidentiality	UR	UR	UR	UR	UR	UR	UR	UR	UR	UR	UR	UR

List of abbreviations:

BoA: Bank of Albania

MoF: Ministry of Finance

INSTAT: Statistical Agency of the Republic of Albania

UR: Unrestricted use

Tirana, January 9, 2004

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

Dear Mr. Köhler,

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

All quantitative performance criteria under the program have been observed. We met, as a prior action for completion of the third review, the actions specified in the end-September 2003 structural performance criterion on the settlement of public sector inter-enterprise arrears. As the short delay does not compromise program objectives, we request a waiver for the non-observance of this performance criterion, and request completion of the third review as well as the financing assurances review under the arrangement.

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

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

Moreover, after the end of this arrangement and while Albania has outstanding financial obligations to the IMF arising from loan disbursements under this arrangement, Albania will consult with the IMF from time to time on economic and financial policies, at the initiative of the Government or Bank of Albania or whenever the Managing Director of the IMF requests such consultation. These consultations may include correspondence and visits of officials of the IMF to Albania or of representatives of Albania to the IMF.

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

Sincerely yours,

/s/  
Fatos Nano  
Prime Minister

/s/  
Arben Malaj  
Minister of Finance

/s/  
Shkëlqim Cani  
Governor, Bank of Albania

**SUPPLEMENTARY MEMORANDUM ON ECONOMIC AND FINANCIAL POLICIES (MEFP) OF  
THE GOVERNMENT OF THE REPUBLIC OF ALBANIA FOR 2003–04**

**I. BACKGROUND**

1. **This memorandum reviews the implementation of the PRGF-supported program, updates the macroeconomic framework for 2004–06, and lays out our policies for the period December 2003–June 2004.** It is consistent with the November 2001 National Strategy for Socio-Economic Development (NSSD) and the May 2003 progress report; and supplements the June 2002, January 2003, and June 2003 MEFPs.

**II. PERFORMANCE UNDER THE PROGRAM**

2. **Macroeconomic developments during 2003 have been encouraging.** Economic growth has strengthened from an estimated 4.7 percent in 2002 to an estimated 6 percent, while a cautious monetary policy stance has contributed to the maintenance of low inflation (3.4 percent in November). Our external position strengthened during the first nine months of 2003, reflecting a pick-up in export of goods and services, while the exchange rate underwent some nominal appreciation.

3. **Fiscal discipline was also maintained, albeit in a less than optimal manner.** Budget targets for domestic borrowing and the overall deficit were met. However, tax revenue continued to fall short of the indicative targets—by  $\frac{3}{4}$  percent of GDP in September—although it was  $\frac{3}{4}$  percent of GDP higher than during the same period in 2002. This shortfall required offsetting action on the expenditure side, in line with the contingency plans prepared in June 2003, consisting mainly of discretionary savings on electricity subsidies (helped by improved supply conditions) and personnel spending. In addition, expenditure on foreign financed projects is estimated to have fallen about 1 percentage point of GDP short of planned levels, indicating the importance of addressing problems related to donor-financed activities. Strong GDP growth and ongoing fiscal consolidation—together with debt forgiveness—reduced public debt to an estimated 61 percent of GDP in 2003 from 74 percent in 2000.

4. **We met all end-September 2003 quantitative performance criteria (PCs) under the program.** The floor for net international reserves of the BoA and the ceiling on net domestic assets of the BoA were observed by comfortable margins. The actual level of contracted and guaranteed nonconcessional debt was lower than the ceiling, reflecting difficulties in prioritizing projects and in getting more favorable conditions from creditors. No new external payment arrears were accumulated, excluding interest on pre-existing arrears.

5. **On public sector inter-enterprise arrears, we carried out the required measures stipulated in the end-September PC in December 2003 as a prior action for completing**

**this review.** We executed the government-assisted netting and final settlement of the end-December 2001 stock of arrears in November, and finalized a draft strategy for ensuring the full and timely payment of all subsequent obligations. These actions represented important steps towards normalizing fiscal relations and improving transparency and budgetary revenue collection.

6. **We have improved policy implementation and made progress in carrying out the policies described in our June 2003 Supplementary MEFP.** In addition to actions carried out in relation to the 2004 budget, which are described in Text Tables 1 and 2, we completed the following measures.

- To improve **tax administration**, we enacted a new excise law; transferred responsibility for the collection of social insurance contributions for large taxpayers to the General Directorate of Taxation (GDT); and brought on line a new computer system for profits tax. We also separated the internal audit services and the internal investigation services of the GDT into two distinct structures. The GDT has started to provide monthly reports on total VAT refunds paid.
- We instituted significant reforms and **organizational changes within the General Directorate of Customs (GDC)**. The GDC has continued to prepare quarterly reports on corrective measures to deal with problems identified by the internal audit function. We have also approved the enabling legislation to establish tax policy and revenue forecasting units in the Ministry of Finance (MoF). The **post-clearance control unit** of the GDC was established in July, fully empowered with the legal competence to perform its functions and conduct off-site audits (SB; end-July).
- As part of our strategy to strengthen the **business environment**, we completed an action plan for the removal of administrative barriers to investment. We abolished licensing requirements in the non-food sector, and we also met all targets under the **electricity sector** action plan.
- **To improve governance**, we established and funded the Office of Asset Declaration, which has begun implementing the law on asset declaration. We also strengthened tax appeal procedures (SB; end-December 2003); and reviewed and strengthened anti-money laundering legislation.
- Regarding our remaining **external arrears**, we submitted to Parliament agreements with Hungary (SB; end-December) and Macedonia. Negotiations with the Czech and Slovak Republics, Romania, Poland, and commercial creditors are ongoing. The MoF has prepared a timetable for rescheduling remaining external arrears, subject to cooperation of the creditors. The MoF continues to report external arrears data to the IMF on a regular basis (SB; ongoing).

- In the **statistical area**, we published full documentation of the methodology and data sources for our new national accounts; and introduced a new law on statistics to Parliament designed to provide our statistics agency with better access to source data.
7. **However, some measures were not completed within the planned time frame.**
- Settlement of **the remaining claims of Albtelekom** (SB; end-September) was not finalized, notwithstanding our good faith efforts, due to a delay in negotiations with a major counterpart.
  - The scheduled auctioning of the **fiscal functions of the Savings Bank** in 5 cities (SB; end-December) was converted into the full liberalization of these services at the beginning of 2004. Regional treasury offices and government agencies are now empowered to select any bank offering such services to act as their fiscal agent.
  - Although we instituted the reporting of **VAT refunds** and opened the VAT account shortly after the deadline (SB end-June), related procedures are still being established.
  - We have not completed the process of redrafting the **VAT and customs laws and regulations to ensure consistency** (SB; end-December), but expect to do so in time for the presentation of the 2005 budget (revised SB; end-October 2004).
  - The computerization of the Tirana Treasury office was not completed on time, but will be finished by February 2004.
  - We did not introduce a **simplified registration procedure for the small business tax** as part of the 2004 fiscal package (SB: end-March 2004), but will do so in early 2005, in order to have an updated registry of small businesses at the time when social contribution collections from small businesses are transferred to the GDT.

### **III. POLICIES AND MEASURES FOR JANUARY–DECEMBER 2004**

#### **A. Overall Strategy**

8. **As we enter the second half of the 3-year PRGF arrangement, our overall program strategy is broadly unchanged.** Our macroeconomic and structural policies remain predicated on the belief that improvements in the business climate, leading to sustainable, high-quality, private sector-led growth, are essential for reducing poverty. At the same time, we are committed to pursuing greater efficiency and equity in the mobilization and use of resources so as to increase our capacity to provide essential poverty-reducing services such as health care, education, and social protection. Common to all our policies is a strong focus on fighting corruption, strengthening institutional capacity, improving governance, reducing informal activity, and enhancing dialogue with all stakeholders.



## B. Macroeconomic Framework

9. **A favorable, but realistic, macroeconomic framework is assumed for the remainder of the program period.** Supported by rising investment, and improvements in the business environment, real GDP growth is expected to continue at 6 percent, while monetary policy, supported by a flexible exchange rate regime, will focus on maintaining inflation in the 2–4 percent range. Ongoing reforms to enhance the efficiency of tax administration, combined with a concerted effort to reduce the size of the grey economy, will increase total revenue as a share of GDP and permit an expansion of priority expenditure within a framework of further fiscal consolidation. Following a 1¼ percentage point of GDP reduction in 2003, the overall budget deficit (including grants) will fall by a further ¾ percentage point of GDP to 4¼ percent by 2006, which will facilitate a decline in public debt from an estimated 61 percent of GDP in 2003 to 57½ percent in 2006. Aided by rising exports, the fiscal consolidation will support a 1¾ percentage point of GDP decline in the current account deficit to 6¾ percent by 2006. Reserve cover will remain above 4 months of imports of goods and services.

## C. Fiscal Policy

10. **The 2004 budget projects the overall deficit (including grants) to broadly stabilize at about 5 percent of GDP, and domestic borrowing to remain unchanged at 2¾ percent of GDP.** The overall deficit in 2004 is about 1 percentage point below the level foreseen in the 2002–05 MTEF, while domestic borrowing is set ½ percentage points above the MTEF level, in order to help protect road and other infrastructure expenditure, and to mitigate the effect of past and present shortfalls in foreign project financing. Quantitative performance criteria for March 2004, and indicative targets for June have been set as ceilings on net domestic credit to the government. Parliament has approved the 2004 budget as a prior action for completion of the third program review.

11. **Tax revenues are projected to be 20¾ percent of GDP in 2004, about ¾ percentage points of GDP higher than the 2003 estimated outturn.** The increase is predicated primarily on specific tax measures, in particular, the full-year effect of the introduction of the new excise law in July 2003, reform of the social security system, and the imposition of new environmental taxes at the beginning of 2003. The budget also includes offsetting tax measures to compensate for expected revenue losses arising from our WTO commitments to lower tariffs, and our agreement with the EU and the IMF to transform the components of the road tax into changes in the excises on diesel and gasoline, and an additional tax on vehicles, without increasing the tax burden.

12. **The 2004 budget does not assume any privatization receipts from the sale of Albtelekom or the Savings Bank.** Should such receipts materialize, we may spend part of it in 2004 on well-conceived investment projects in priority areas as identified in the NSSD

and the recently updated Medium-Term Budget Program (MTBP)<sup>1</sup>. The supplementary budget for this expenditure would be formed in close consultation with IMF staff.

13. **To help manage downward risks to the revenue projections and protect priority spending, the release of part of the reserve fund and contingency fund in 2004 will be made dependent on the revenue outturn for 2003.** In particular, up to Lek 1 billion of the reserve fund and up to Lek 1 billion of the contingency fund will not be available for expenditures to the extent that the final revenue collected in 2003 by the GDT, GDC, and SSI (including taxes collected on behalf of local governments) falls short of the current end-2003 projection of Lek 144.5 billion. Should such a shortfall occur, the government will adopt a formal decision to limit expenditure in this manner and to this extent (SB; end-June 2004). If the 2003 shortfall exceeds Lek 2 billion, we will execute further reductions in non-priority spending, in particular in administration costs. In addition, in the context of the fourth review, we will discuss the available 2004 revenue data with IMF staff and agree an appropriate response. This approach will serve to avoid haphazard reductions in expenditure and the corresponding adverse impact on priority spending.

14. **Reform of tax administration remains a cornerstone of our fiscal strategy.** The mobilization of additional resources through efficiency gains and through a broadening of the tax net is essential to reduce the burden on current taxpayers and expand the delivery of priority services. Over the remainder of the program period, reforms in this area will focus on strengthening information systems, auditing procedures, and incentive systems; enhancing cooperation among the GDT, the GDC, and the SSI; and improving taxpayers relations, including by further strengthening the appeals process, avoiding excessive audits, and providing more comprehensive information on regulations and procedures. We will not introduce any fiscal schemes that would undermine tax compliance or raise the potential for money laundering and other illegal activities. We will complete the specific measures described in Text Table 1.

15. **We are pushing ahead with the implementation of ASYCUDA.** We had originally intended that the system would be installed in the Tirana customs office and the Durrës port by end-January 2004. We still expect it to be fully operational in Tirana by this deadline, and propose an end-January 2004 performance criterion to this effect. However, technical and administrative difficulties will likely delay the process in the Durrës port. Accordingly, we propose an additional performance criterion, making the system fully operational in Durrës and initiating an integrity audit of the system in both Tirana and Durrës (as recommended by the EU CAM-A project) be set for end-March 2004. Transit procedures between Durrës and Tirana would then be completed by end-May 2004. The recommendations of the audit will be adopted by the Tirana customs office and the Durrës port (new SB; end-June 2004) before the final roll out phase begins.

---

<sup>1</sup> The ceiling on domestic borrowing will be increased (reduced) by half of any shortfall (excess) in privatization receipts from the budgeted amount.

16. **Ongoing expenditure measures, summarized in Text Table 2, focus on further increasing the efficiency and transparency of spending; and on further reorienting expenditures towards priority areas.** We will ensure that expenditure on health care and education will be increased in 2004, as planned in the budget and in line with the 2004–06 MTBF. The wage bill will rise no faster than nominal GDP. There will be no earmarking of revenues for specific capital expenditures (such as for the Durrës-Kukes road project) within the budget. We will use the reserve and contingency funds sparingly and only in case of emergencies.

Text Table 1: Tax Administration and Policy Reforms

<b>Measures introduced in the context of the 2004 budget</b>
Amend the law on tax procedures to obligate the tax administration to inform the public on tax changes.
Prepare and implement a tax form that requires firms to declare all social security contributions and personal income tax withheld.
Require all firms, including all firms benefiting from income tax exemptions, to have a tax registration number and to file an income tax report.
Eliminate estimated transportation costs from the VAT base.
<b>Other measures</b>
Improve fiscal reporting by completing the computerization of regional treasury offices (SB; End-September 2004).
Improve the VAT refunds process by reporting on the stock of VAT refunds claimed and refunds paid out every month (SB; End-March 2004, and ongoing).
Continue to increase the number of active, registered taxpayers from 48,000 at end-September 2003.
Continue the transfer of collection social security contributions to GDT in line with the July 2003 FAD technical assistance report (ongoing).
Ensure that the SSI will have a system providing individual level data on contributions paid and benefits received by end-December 2004.
Study the modalities of harmonizing the definition of gross employment income and the withholding mechanisms in the personal income tax law and the law on social security contributions in conjunction with the upcoming IMF technical assistance mission. Institute the change within 2004, in time for inclusion in the 2005 fiscal package.
Implement the new computer administration system for social insurance contributions by end-May 2004.
Define excise duties on alcohol in terms of liters of alcohol, rather than in liters of liquid, as part of the 2005 fiscal package.
Disseminate publicly the procedures for the initiation and conduct of enforced collection action; and for ensuring timely VAT refunds. Strengthen the appeals processes for the tax and customs administrations further by automatically granting the request to the taxpayer if the tax administration does not respond to the request within 30 days.
Implement strictly the requirements on the use of cash registers (ongoing).

17. **We will strictly implement the strategy for settling public sector inter-enterprise arrears and for preventing the emergence of new ones.** We will ensure both full and timely execution of the payments schedule for the stock of end-December 2001 arrears; and the rapid regularization of any arrears that occurred subsequent to this date or arise during the program period. A new unit at the Ministry of Economy (MoE) has been created to monitor scheduled payments as well as all subsequent overdue obligations, and this unit will report all instances of nonpayment in a public quarterly report. The MoE will be responsible for initiating prompt remedial action. We will complete a study on introducing incentives for responsible financial behavior by the water companies by end-June 2004.

Text Table 2: Expenditure Measures

---

**Measures introduced in the context of the 2004 budget**

---

Limit the maximum allowable transfer of one spending agency's appropriation to another without the consent of parliament to 7 percent.

Present the 2004 budget to Parliament with capital expenditure by project; and require approval by Parliament on a program basis.

Formulate guidelines on standards and norms for all budgetary institutions to enhance fiscal responsibility and accountability.

---

**Measures to be introduced in the context of the 2005 budget**

---

Increase the accountability and transparency of the budget process, including by provisions to gradually bring the budget process forward, beginning in 2005, to give Parliament more time for review; and to further expand the appropriations structure in the 2005 budget to include object/economic classification of recurrent expenditure (End-October 2004).

Limit the maximum allowable transfer of one spending agency's appropriation to another without the consent of parliament to 5 percent.

Expand the appropriation structure in the budget document to cover object/economic classifications of recurrent expenditure programs.

---

**D. Monetary Policy**

18. **Monetary policy will continue to aim at keeping inflation in a 2–4 percent target range.** We will investigate the possibility of focusing on average inflation in addition to, or instead of, end-year annual inflation, as this could allow us to concentrate more on underlying trends and reduce the influence of strong seasonal factors on policy. We will also continue to monitor complementary indicators such as core inflation and money growth, as the monetary transmission mechanism and inflation dynamics remain unclear. The repo rate will remain our key policy instrument, and we will seek to further improve its impact on market rates through supportive monetary management, including open market operations. These operations will also be guided by our monetary program to ensure consistency between monetary and inflation objectives and the agreed fiscal deficit target. We will conduct further

research on the determinants of inflation in the context of our preparations for moving to formal inflation targeting over the medium term with the help of MFD technical assistance. We will maintain a flexible exchange rate regime, with selective interventions aimed at smoothing short-term deviations from long-term trends and meeting NIR targets set within the monetary program. We will ensure that the legal and operational independence of the BoA is not compromised.

19. **The monetary program seeks to maintain continued monetary stability, inflation in line with the target, and a reserve-to-import ratio in 2004 of about 4 months.** Velocity is projected to remain broadly stable. Quantitative performance criteria for March 2004, and indicative targets for June have been set as a ceiling on net domestic assets of the Bank of Albania, and as a floor on net international reserves.

20. **The BoA will continue to strengthen banking supervision** in the context of the Supervisory Development Plan prepared in consultation with the World Bank. Technical assistance will be provided by the new MFD resident advisor.

21. **The BoA will strengthen its control, accounting, and auditing systems** in line with the July 2002 safeguards assessment report. It will continue to cooperate with the safeguards policy and provide updated documents and data as necessary.

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

22. **Improving governance in general, and fighting corruption in particular, remain key priorities within our broader strategy for supporting private sector activity and economic growth.** In this context, policies have been developed in consultations with the World Bank and the EU. These include: (i) efforts to enhance the professionalism and motivation of public sector personnel; (ii) measures to limit the scope for corruption by reducing discretion and ensuring clear and consistent regulations; (iii) the setting of high standards for public sector workers; and (iv) the application of credible and resolute action against abuse. In addition to the governance-related measures included in Text Tables 1 and 2, specific actions will include:

- **Complying strictly with existing conflict of interest legislation** contained in Chapter 2 of the new Law on Code of Ethics in Public Administration: and preparing a study of existing legislation by end-February 2004, in consultation with the World Bank, to decide whether a separate **law on conflict of interest of public officials** is necessary.
- Adopting a **new insurance law** with a transparent regulatory regime (end-March 2004).
- **Complying strictly with the Civil Service Law** and related legislation and the draft code of ethics in hiring and firing policies for high level government officials. In consultation with the World Bank, **extend the civil service law**, or its equivalent, to selected central government organizational units, with priority given to GDT, GDC, and INSTAT (SB; June 2004).

- Expanding the **operations of the High Inspectorate** charged with implementing the law on asset declarations by public officials. In particular, the staffing will be completed and effective procedures developed for processing and verifying declarations.
- Reinforcing our efforts to combat **money laundering**, in particular, by conducting a comprehensive self-assessment of our laws, regulations, institutions and practices in this area, in cooperation with the MFD resident advisor at the BoA (end-June 2004).

23. **The current initiative for removing administrative barriers to investment presents a unique opportunity to significantly improve the business climate, strengthen the export sector, and attract foreign and domestic investors.** Key barriers identified by FIAS include arduous licensing and tax procedures, lack of transparency in policy implementation, abuse of power by officials, and weak law enforcement. We developed an action plan in 2003 to implement remedial policies supported by corresponding, measurable indicators. Over the course of 2004, we will fully implement the action plan (SB; end-June 2004) in close consultation with the business community. To create better conditions in the agricultural sector, we will introduce a law to regulate land ownership and establish offices for land in every district. We will not introduce firm- or industry-specific financial or tax incentives to promote investment, and will improve credit provisioning through a new accounting law for enterprises and through improvements in the registry for collateral.

24. **The privatization process for large enterprises will be accelerated, concentrating mainly on Savings Bank, Altelekom, and INSIG.** We hope to finalize negotiations with a strategic investor in the Savings Bank by mid-2004. We will seek to ensure that the privatization of the Savings Bank does not endanger the continued provision of banking services throughout the country. We confirm that the bank will not embark on extending credit (other than to the government) before privatization except, possibly, on a pilot basis and with the prior approval of the BoA and World Bank and IMF staff. To help prepare Altelekom for privatization, we will make good faith efforts to finalize the settlement of the remaining financial claims before end-March 2004. As a pre-privatization action, 39 percent of INSIG has been sold to the EBRD and IFC. We expect the remaining government shares to be sold to a strategic investor sometime in 2004 or 2005.

25. **Improving the provision of electricity will be key to promoting private sector growth.** For this goal, and to help ensure that import subsidies can be held to Lek 1.5 billion in 2004 before being phased out completely in 2005, we will adhere to the performance targets of the sectoral action plan for 2004–05. In addition, we will:

- Not grant new lower prices as incentives to investors and will reduce differentiation of prices among different groups of customers. In particular, reduced electricity prices for public sector agencies (other than the water companies) will be eliminated by the end of 2005.
- Complete the installation of meters by end-2004.

- Maintain the MoF's responsibility for ensuring full payment of electricity fees for water companies.
- Prepare a proposal on whether, and if so, under what conditions, KESH should continue to collect the television license fee and the road cleaning fees (end-June 2004).
- Introduce a new targeted subsidy, in the context of the 2004 budget, fully paid for by government, to offset the impact of higher electricity prices on poor households.

26. **Financial sector reform will be aimed at improving the transparency and efficiency of financial markets.** We will promote the sale of treasury bills to the general public, including through Albapost, by exploring various options including the possibility of selling smaller denominations. We will further promote the use of the banking system for payments, particularly salaries, through a publicity campaign; and through the inauguration of the RTGS system before end-March 2004 and a bulk settlement system by end-September 2004. Furthermore, at least 10 percent of government employees will receive their salary through the banking system by September 2004. With respect to the stock exchange, while we will not assign it responsibility for the primary treasury bill market, the possibility of it serving as the main platform for secondary market sales will be explored. We will also examine the scope for it to trade in company shares, on the basis of a World Bank-sponsored study. The credit guarantee scheme and plan for providing soft loans to small and medium-sized enterprises will be presented to the World Bank and IMF staff for comments before adoption. We will request an official sovereign rating by the end of 2004.

#### F. External Policies

27. **We will continue negotiations on the Stabilization and Association Agreement, an important goal of which is to achieve an Albania-EU free trade area.** We are currently discussing the reduction of tariffs on industrial goods based on commitments negotiated with the WTO. In November 2003, we started discussions on further reducing tariffs on agricultural goods. We will carefully assess the revenue impact of future trade liberalization. As part of the negotiations with the EU, we have committed to combating corruption and organized crime and to giving this objective priority within the government agenda.

28. **We also continue to enhance regional cooperation.** We have already ratified free trade agreements with Macedonia, Croatia, Kosovo, Romania, Bulgaria, and Bosnia and Herzegovina. The agreements with Macedonia, Croatia, Kosovo, and Bulgaria are already effective. Free trade agreements with Serbia and Montenegro and Moldova have been agreed at the ministerial level.

29. **We have made progress in reducing external arrears to official creditors and remain committed to eliminating them completely by the end of 2005.** Following the rescheduling agreement on post-1978 arrears with China in 2002, we finalized rescheduling agreements with Hungary and Macedonia. The agreement with Hungary has been submitted to Parliament for ratification (SB; end-December 2003). Progress in settling official arrears in

nonconvertible currencies has been slower due to the difficulty in finding an agreement on the exchange rate, but negotiations with creditors to reconcile amounts due are continuing.

30. **We will strengthen the recording, monitoring, and projecting of donor financing activities.** We have established an interministerial working group chaired by the deputy prime minister. During 2004 we will complete the reorganization of these functions to avoid duplication of effort among ministries and to achieve better coordination. To ensure the success of this exercise we will seek the cooperation of the donor community, in particular to provide data on past disbursed grants and projected foreign aid.

31. **We will improve the evaluation and prioritization of non-concessional, foreign-financed investment projects.** They will be assessed within the context of the corresponding sectoral strategies as outlined in the NSSED and MTBP. We will establish and follow transparent, competitive procedures for negotiating and selecting favorable supply and lending agreements, pursuant to international practices and procedures and Albanian legislation. In this context, new large-scale projects will, in principle, be subject to international open tenders and will be executed only if (i) overall ceilings to non-concessional borrowing are respected; (ii) independent feasibility studies of international standards are prepared; and (iii) favorable financial terms are secured. We will inform the IMF on a quarterly basis on the list and status of projects being considered for non-concessional financing (SB, ongoing); and we will conduct an independent feasibility study for any new large project (SB, ongoing).

#### G. Data Issues

32. **We recognize the need to redouble our efforts to address weaknesses in the quality and coverage of economic statistics, which continue to seriously hamper monitoring of developments and sound policy analysis.** In cooperation with our technical assistance providers, including a resident advisor facilitated by STA, we will improve the scope and collection of data on private remittances, real sector activity indicators and national accounts, with particular attention to the assessment of informal activity. We will employ surveys and other tools to improve our statistics on foreign direct investment through comprehensive coverage of at least the largest enterprises. We will also ensure the provision of adequate resources to INSTAT, as well as its inclusion under the Civil Service Law (or a comparable framework) during 2004.

#### H. Program Monitoring

33. The fourth review under the PRGF-supported program will be based on end-March 2004 quantitative PC's and end-June 2004 indicative targets (Table 1 and the TMU) and the end-January 2004, end-March 2004 and end-June 2004 structural conditionality (Table 2). PC's and indicative targets for end-September 2004 and end-December 2004 will be set at the time of the fourth review. During the program period, Albania will not impose or intensify restrictions on the making of payments and transfers for current international transactions, or introduce multiple currency practices, or conclude bilateral payments



agreements inconsistent with Article VIII, or impose or intensify import restrictions for balance of payments reasons. We will present a new progress report on the NSSD by April 2004, taking into account the recommendations of the joint staff assessment of the 2003 progress report.

Table 1. Albania: Quantitative Performance Criteria and Indicative Targets for 2003-04 1/

	End-Mar. 2003 2/			End-Jun 2003			End-Sep. 2003 2/			End-Dec. 2003	End-Mar. 2004 2/	End-Jun. 2004	End-Sep. 2004
	Actual	Prog.	Prog. (Adj.)	Actual	Prog.	Prog. (Adj.)	Actual	Prog.	Prog. (Adj.)	Prog.	Prog.	Prog.	Prog.
(In billions of lek)													
Ceiling on net domestic credit to the government	5	5	5	6	9	9	14	16	18	21	6	12	18
Ceiling on net domestic assets of the BOA 3/	-11	10	10	-18	11	11	-14	2	4	6	-7	-5	-3
Indicative target for revenues collected by Tax Department	13	14	14	26	29	29	40	43	43	59	...	...	...
Indicative target for revenues collected by Customs Department	12	13	13	27	27	27	41	43	43	59	...	...	...
Indicative targets for Social Insurance Revenues	7	7	7	14	15	15	21	22	22	31	...	...	...
Indicative total tax revenue targets 4/	...	...	...	...	...	...	...	...	...	...	36	76	116
(In millions of US dollars)													
Floor for net international reserves of the BOA 3/ 5/	53	-2	-5	44	20	17	52	14	-2	21	57	71	83
Ceiling on contracting or guaranteeing of public and publicly-guaranteed non-concessional external debt 3/ 6/ 7/ of which: 1-3 years	18	70	70	21	80	80	21	100	100	130	150	170	190
	0	0	0	0	0	0	0	0	0	0	0	0	0
Ceiling on public and publicly-guaranteed external debt with original maturities up to and including 1 year 3/ 6/ 7/	0	0	0	0	0	0	0	0	0	0	0	0	0
Nonaccumulation of new external payments arrears, excluding interest on pre-existing arrears 3/ 6/ 7/	0	0	0	0	0	0	0	0	0	0	0	0	0

1/ The performance criteria and indicative targets envisaged under the program, and their adjusters, are defined in the Technical Memorandum of Understanding (TMU). Targets are defined as cumulative changes as of the end of the previous year, except where noted.

2/ Performance criteria, except for revenue items. Data in all other columns are indicative targets.

3/ For end-March 2003 to end-September 2004: cumulative changes as of end-December 2002.

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

5/ Derived using the end-December 2001 exchange rates.

6/ This performance criterion applies to the contracting or guaranteeing by the central government or the Bank of Albania as specified in the TMU.

7/ These performance criteria apply on a continuous basis.

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

Measures	Test-date
<b>A. Proposed Prior Actions for the Third Review</b>	
1. Parliament to approve the 2004 budget consistent with the Supplementary Memorandum of Economic and Financial Policies.	...
2. Execute the government-assisted netting and final settlement of public sector inter-enterprise arrears as of end-2001 1/.	...
<b>B. Performance Criteria for the Fourth Review</b>	
1. Make the ASYCUDA computer administration system operational in the Tirana custom house.	End-January 2004
2. Make the ASYCUDA computer administration system operational in the Durrës port; and initiate an integrity audit of the ASYCUDA system in both the Tirana customs house and the Durrës port.	End-March 2004
<b>C. Structural Benchmarks under the Fourth and Fifth Reviews 2/</b>	
1. Extend the Civil Service Law or its equivalent to selected central government organizational units, with priority given to INSTAT, GDT and GDC.	End-June 2004
2. Adopt a government decision not to release up to Lek 1 billion from each of the reserve fund and contingency fund by the amount that final tax revenue collected in 2003 by the GDT, GDC, and SSI (including taxes collected on behalf of local government) falls short of Lek 144.5 billion.	End-June 2004
3. Strengthen tax and customs administration through:	
(i) Improving the VAT refunds process by reporting on the stock of VAT refunds claimed and refunds paid out every month;	End-March 2004 and ongoing
(ii) Implementing the recommendations of the integrity audit of the ASYCUDA computer administration system in the Tirana customs office and the Durrës port;	End-June 2004
(iii) Improving fiscal reporting by completing the computerization of the regional treasury offices;	End-September 2004
(iv) Redrafting the VAT and customs laws and regulations to ensure consistency in time for the 2005 budget.	End-October 2004
4. Ensure implementation of the Action Plan for removing administrative barriers to investment.	End-June 2004
5. Prepare quarterly reports (within one month of the end of each quarter) on the stock of external arrears.	Throughout
6. Safeguard the efficient use of nonconcessional foreign project loans through:	
(i) Conducting an independent feasibility study for any large project (as defined in the TMU) financed through non-concessional borrowing.	Throughout
(ii) Provide a quarterly listing and status report on all projects being considered for nonconcessional foreign financing.	Throughout

1/ For all arrears among: Albaker; Albkrom Tirane; Albtelcom; Amro APC; the Krabe, Mborje-Drenove, Mushqeta, and Priske coal mines; Metalifere Construction; Elbasan Energy Plant; Tirana Furniture Company; Metalifere Tirane; Elbasan Steel Plant; GDT; GDT; SSI; KESH (excluding the pilot projects); and the water companies.

2/ Items 3. (iii) and 3. (iv) refer to the fifth review.

## ALBANIA

### TECHNICAL MEMORANDUM OF UNDERSTANDING

1. This memorandum defines the quantitative benchmarks and performance criteria established in the Memorandum of Economic and Financial Policies (MEFP) for December 2003–September 2004.

#### A. Net Domestic Credit to the Central Government

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

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

4. 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 at discounted value. 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.

---

<sup>1</sup> Nonbank domestic lenders comprise both firms (including insurance companies) and households. For small lenders, treasury bill windows are available at the central bank and at selected Albapost offices throughout the country.

5. According to the above definition, the level of **net domestic credit** to government was Lek 259.8 billion at end-December, 2002.<sup>2</sup> Gross loans were composed of (i) total outstanding T-bills at issue price in the amount of Lek 265.2 billion, of which Lek 74.5 billion was held by the Bank of Albania, Lek 175.9 billion by commercial banks, and Lek 14.8 billion by other domestic lenders; and (ii) other government lek securities, loans, and other claims on government in the amount of Lek 3.6 billion. From these gross loans, the following items were deducted: (i) central government deposits (excluding social security funds) in the amount of Lek 2.8 billion; and (ii) SSI and HII deposits and T-bill holdings in the amount of Lek 6.2 billion.

6. The limits on the change in net domestic credit to the government will be cumulative from end-December 2002.

### **B. Net Domestic Assets**

7. 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 87.1 billion as of end-December 2002. The NDA limits will be cumulative changes from end-December 2002 and will be monitored from the accounts of the Bank of Albania.

### **C. Net International Reserves**

8. **Net international reserves (NIR)** are defined as reserve assets minus reserve liabilities of the Bank of Albania. **Reserve assets** are readily available claims of the Bank of Albania on nonresidents denominated in foreign convertible currencies, and held for the purpose of meeting balance of payments financing needs, intervention in exchange markets, and other purposes. They include Bank of Albania holdings of monetary gold, SDRs, Albania's reserve position in the IMF, foreign currency cash, and deposits abroad. Excluded from reserve assets are any assets that are pledged, collateralized, or otherwise encumbered; claims on residents; precious metals other than monetary gold; assets in nonconvertible currencies; illiquid assets; and claims on foreign exchange arising from derivatives in foreign currencies vis-à-vis domestic currency (such as futures, forwards, swaps, and options). **Reserve liabilities** shall be defined as foreign exchange liabilities to residents and

---

<sup>2</sup> 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.

nonresidents of the Bank of Albania, irrespective of their maturity. They include: foreign currency reserves of commercial banks held at the Bank of Albania; all credit outstanding from the IMF; commitments to sell foreign exchange arising from derivatives (such as futures, forwards, swaps, and options); and all arrears on principal or interest payments to commercial banks, suppliers, or official export credit agencies. Excluded from reserve liabilities are the government's foreign currency deposits at the Bank of Albania.<sup>3</sup> Reserve assets and reserve liabilities will both be expressed in U.S. dollars.

9. 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

10. The NCG and NDA ceilings and the NIR floor are defined on the assumption that total privatization proceeds (privatization proceeds received in foreign currency)<sup>4</sup> will amount, on a cumulative basis, from January 1, 2004, to:

End-March 2004	Lek 1,355 million, (Lek 0.0 million, US\$0.0 million)
End-June 2004	Lek 3,215 million, (Lek 1,860 million, US\$15.5 million)

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

11. The ceilings on NCG and NDA, and the floor on NIR are defined based on the assumption that **foreign budgetary and/or balance of payments financing** (excluding IMF

---

<sup>3</sup> This exclusion is justified by current procedures in Albania, whereby the government's foreign currency receipts are deposited in a blocked account at the Bank of Albania and the funds are transferred to the government's lek account before being spent. A change in this procedure, would require revisiting the NIR definition.

<sup>4</sup> The domestic component of privatization revenue includes US\$10 million received for the partial privatization of INSIG in 2003. This amount is treated as a financing item in the 2004 budget.

financing and project and commodity loans or commodity grants, or other aid) will amount, on a cumulative basis, from January 1, 2004, to:

End-March 2004	US\$0.0 million (of which grants: US\$0.0 million)
End June 2004	US\$0.0 million (of which grants: US\$0.0 million)

In cases where total foreign loan financing exceeds this projection, the ceilings on NDC to the government and NDA of the Bank of Albania will be adjusted downward, and the floor on NIR will be adjusted upward. In cases where total foreign grant financing exceeds this projection, the ceiling on NDA of the Bank of Albania, the floor on NIR of the Bank of Albania, and the ceiling on NDC to the government will remain unchanged.<sup>5</sup>

12. 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**

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

---

<sup>5</sup> For the NCG adjuster, the lek equivalent of deviations from the programmed amounts in terms of dollars is converted at an exchange rate of Lek 120 per U.S. dollar, in order to ensure consistency with the budget projections.

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.

14. 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.

15. Large projects (as referred to in MEFP paragraph 31 and Table 2) financed by non-concessional foreign borrowing are defined as those projects involving total non-concessional foreign borrowing in excess of US\$25 million.

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

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



## F. Tax Revenues

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

## G. Monitoring and Reporting Requirements

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

20. **The Bank of Albania will supply to the Fund:**

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

21. **The Ministry of Finance will supply to the Fund:**

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

22. **The General Directorate of Customs will supply to the Fund:**

- (i) Detailed monthly data on customs revenues collected; and

- (ii) Quarterly reports on corrective measures taken to deal with problems identified by the internal audit function.

23. **The General Directorate of Taxation will supply to the Fund:**

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

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

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

**Statement by Pier Carlo Padoan, Executive Director for Albania  
and Alessandra Lanza, Advisor to Executive Director  
January 23, 2004**

Despite undergoing a politically difficult year, marked by local elections, the majority party convention, and, lately, some government reshuffling, Albania has made remarkable progress both in terms of macroeconomic stability and in advancing in the structural reform process. From a macroeconomic standpoint, growth has been robust, inflation subdued, the external position strengthened, reserves have increased, interest rates have declined and deposits have been restored to their pre-crisis level. The successful sale of the Savings Bank and remarkable improvements in the power sector indicate that Albania is tackling major structural impediments to growth. All in all, authorities do not fully share the staff view that performance has remained uneven.

### **Macroeconomic performance**

**Growth** has recovered to 6.0 percent, up from 4.7 in 2002, thanks in large part to the strength of domestic demand, which—coupled with the deposit increase—points to renewed confidence. Growth was also driven by a very favorable export performance that led the trade balance to improve by 1.5 percent of GDP in the first three quarters of 2003. The current account deficit, while still substantial (8.5 percent of GDP), has improved by half a percentage point compared to the previous year, while reserves now amount to about four and a half months of imports.

**Inflation** mitigated substantially during 2003, with retail price inflation averaging 2.3 percent. This allowed the Central Bank to lower its **repo rate** by 200 basis points between April and December 2003, thus creating a more favorable investment environment. The banking system has been strengthened considerably and deposits have returned to their 2002 levels. The overall panorama of the banking sector will also greatly benefit from the finalization of the privatization of the **Savings Bank**, which was sold to the Austrian Raiffeisen Bank for 126 million dollars on January 13.

### **Fiscal policy**

The process of **fiscal consolidation** remained on track in 2003 and the targets for the deficit were met. Improvements in tax administration, including the new excise tax law, led to an increase in tax revenues by 1 percentage point in 2003. However, as staff notes tax revenues have fallen short of budget targets. This, however, is largely the result—as staff clearly points out in paragraph 16 on page 8—of past overoptimistic projections. As the recent IEO report on fiscal policy points out, overoptimistic projections have been common practice in Fund programs. However, projections for the 2004 budget lie on the cautious side and will thus add to the scope of fiscal consolidation. In addition, the authorities have set aside a contingency expenditure plan so as to protect priority spending should unforeseen risks arise. Also, some new developments may decrease pressure on the budget as they materialize: the

proceeds of the privatization of the Saving Bank have not in fact been included in the budget, nor has a support disbursement by the EU amounting to 0.4 percent of GDP.

### **External relations**

Given the improvement in the current account Albania will have no difficulty in meeting its future **external debt** service obligations, while payment to the Fund has consistently been made on schedule. This provides a sound basis for longer-term investment plans and should provide a starting point for improved relations with donors and stimulate renewed interest in foreign investors. Albanian authorities look forward to stimulating new investment for the development of much needed infrastructure. They intend to exploit the geographical location of Albania in an enlarging Europe as a strategic link between northern and southern regions of the Mediterranean basin. Given the need to secure a sustainable private sector growth and deepen structural reforms, the authorities are making further efforts to facilitate and intensify the donors' involvement, enhance the coordination process, and improve the absorbing capacities. In this context, the Government feels the need to strengthen donor involvement through bilateral agreements and technical assistance in the areas of institutional reform, financial and capital markets, and infrastructure development.

### **Structural reforms and basic infrastructure**

On the **structural front**, two of the main long-pending issues have seen important positive developments: the **Savings Bank** has been privatized and the **power sector** has shown remarkable improvements. In particular, all the targets in terms of the reduction of technical and financial losses have been met, the reform agenda is on track and the KESH financial situation has significantly improved. Steps on the privatization of the distribution system are also under consideration. The privatization of the INSIG, the insurance company is also under way.

With regard to Tirana-Durres-Rinas railway project, where GE, ABN AmroBank, SACE, and US EXIM Bank could be involved, the Authorities share the concerns expressed by staff on the need for a more timely communication and on the need for an independent study. Following staff recommendations, a meeting was held last Sunday in Tirana, where the Authorities and the Bank agreed on the terms of reference and a time-frame for the study that would expedite the process and maintain the potential involvement of all parties. The Bank is also assisting in providing finance to the Government for such a feasibility study.

### **Governance**

Governance, which was one of the key issues under discussion during the previous review, has been strengthened as all but one of the related measures under the program have been met. And the performance criterion for which a waiver is requested has been transformed into a prior action for this review. The authorities therefore do not share staff's view that the overall progress has been limited; they feel they have complied with all the measures foreseen under the program. Rather, as they believe good governance is critical to the development of Albania and to the strengthening of the private sector role in the economy,

they look forward to identifying a better program framework in this respect so as to achieve more comprehensive results. This will obviously be a challenging task but the authorities are strongly committed to improve performance, in this as well as in other program areas, and they do believe they have showed a good faith effort in meeting the program targets for this review.



Press Release No. 04/14  
FOR IMMEDIATE RELEASE  
January 23, 2004

International Monetary Fund  
Washington, D.C. 20431 USA

### **IMF Completes Third Review Under PRGF with Albania, Approves US\$5.9 Million Disbursement, and Grants Waiver**

The Executive Board of the International Monetary Fund (IMF) today completed the third review of Albania's economic performance and the financing assurances review under Albania's Poverty Reduction and Growth Facility (PRGF) arrangement. In completing the review, the Board approved the disbursement of SDR 4 million (about US\$5.9 million) to Albania. The Board further granted Albania's request for waiving the non-observance of a September 30, 2003 structural performance criterion, regarding measures to regularize arrears between public sector enterprises. In the meantime, these measures were implemented as a prior action for the completion of this review.

The three-year PRGF arrangement was approved on June 21, 2002 (see [News Brief No. 02/52](#)) for a total of SDR 28 million (about US\$41.5 million). So far, Albania has drawn SDR12 million (about US\$17.8 million) under its current PRGF arrangement from the IMF.

The PRGF is the IMF's most concessional facility for low-income countries. PRGF-supported programs are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners, and articulated in a Poverty Reduction Strategy Paper (PRSP). This is intended to ensure that each PRGF-supported program is consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. PRGF loans carry an annual interest rate of 0.5 percent, and are repayable over 10 years with a 5 ½-year grace period on principal payments.

Following the Executive Board discussion, Agustín Carstens, Deputy Managing Director and Acting Chairman, said:

“Albania's performance during the first half of the three-year PRGF-supported program has been satisfactory overall, in spite of some delays on the structural side. Growth has recovered, inflation remains low, and the exchange rate has strengthened. However, revenue shortfalls persist, and could compromise the program's poverty reduction objectives.

“Improving revenue mobilization is therefore a policy priority, requiring not only improvements in tax administration and in tax policy design, but also actions to enhance governance and the business climate in order to reduce the size of the informal economy and widen the tax net.

The program includes significant tax administration measures which, taken collectively, are expected to improve the efficiency, equity, and volume of tax collections.

“Governance issues are being addressed through a series of measures, including civil service reform, improvement of the capacity to combat money laundering, and a concerted effort to remove administrative barriers to investment. Over the longer term, these reforms will be essential for higher levels of foreign and domestic investment, with positive effects on the sustainability of growth, revenue, and the balance of payments. However, success will also require the authorities to take strong action on other governance issues, such as judicial reform and improvements in the rule of law. Similarly, agreement with domestic and foreign creditors to regularize government financial obligations will be critical.

“In view of the authorities’ strong commitment to the program and ownership of the policy package, the Executive Board granted a waiver for the nonobservance of a structural performance criterion—which has since been implemented—and completed the third review under the arrangement and the Financing Assurances Review,” Mr. Carstens said.