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Albania: Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility, and Use of Fund Resources—Request for an Extended Arrangement—Staff Report; Staff Statement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Albania

In the context of the request for a three-year arrangement under the Poverty Reduction and Growth Facility, and use of Fund resources—request for an extended arrangement, the following documents have been released and are included in this package:

- the staff paper for the Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility, and Use of Fund Resources—Request for an Extended Arrangement, prepared by a staff team of the IMF, following discussions that ended on November 21, 2005, 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 12, 2006. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff statement of January 27, 2006 updating information on recent developments.

- a Press Release summarizing the views of the Executive Board as expressed during its January 27, 2006 discussion of the staff report that completed the requests.

- a statement by the Executive Director for Albania.

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

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

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INTERNATIONAL MONETARY FUND

ALBANIA

Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility, and Use of Fund Resources—Request for an Extended Arrangement

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

Approved by Ajai Chopra and Scott Brown

January 12, 2006

- Discussions on a new program took place in Tirana, November 8–21, 2005. The staff team comprised Messrs. Székely (head), Lazar, Oestreicher (all EUR), Ganelli (FAD), and Mansilla (PDR), and Ms. Westin (Resident Representative). The staff team met Prime Minister Berisha, Finance Minister Bode, Bank of Albania (BoA) Governor Fullani, Minister of Economy Ruli, Transportation Minister Basha, the public finance committee, senior BoA and government officials, opposition leader Rama, academics, and NGO and private sector representatives.

- The authorities are requesting financial assistance under three-year PRGF and EFF arrangements in a total amount of SDR 17.045 million or 35 percent of quota (SDR 8.523 million under each arrangement). The previous PRGF arrangement with Albania, which ended in November 2005, was successful overall. The authorities have agreed to the publication of all program documents.

- The annual report on the implementation of the poverty reduction strategy paper (PRSP) and a joint staff advisory note (JSAN) with the World Bank will be circulated to the Board before the meeting on the program request.

- The World Bank's new Country Assistance Strategy (CAS), which envisages a gradual phasing out of IDA support, is expected to be approved in January 2006.

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EXECUTIVE SUMMARY

This arrangement aims to prepare Albania for graduation from IMF-supported programs. If properly implemented, the policies it embodies will reduce vulnerabilities, enhance growth potential, strengthen government solvency, and protect priority spending. These policies will also contribute to improved governance—a precondition for attracting the high-quality investment needed to address the structural imbalances in the external accounts and to ensure the continuation of strong growth. Remaining vulnerabilities in the financial system are also addressed.

Policy discussions focused on measures to maintain macroeconomic stability in the wake of the electricity disruptions and other potential external shocks; and on the structural measures needed to achieve the program's objectives.

- **Despite a generally good macroeconomic performance in the past, near-term growth and external prospects have worsened due to disruptions to the electricity supply**. Supply disruptions and rising costs contributed to a decline in growth from about 6 percent in 2004 to 5½ percent in 2005, and to a projected further decline to 5 percent in 2006, compared with the 6 percent for both years projected in mid-2005. Nonetheless, following the democratic and peaceful transfer of power, confidence appears relatively strong. The exchange rate is stable, and reserves, monetization, and private credit are all rising—the latter very rapidly, albeit from a low base. Despite the electricity shock and high oil prices, the outlook is for inflation to remain at 3 percent—the midpoint of the BoA target band. However, the authorities will need to be vigilant and react quickly to any second round effects. In the wake of significantly higher electricity imports, the current account deficit is projected to deteriorate to 8 percent of GDP in 2006, but to improve in subsequent years as domestic production returns to normal levels.

- **The fiscal framework is designed to reduce both domestic credit to government and public debt relative to GDP**. The 2006 budget is based on realistic revenue and privatization projections, and utilizes large contingencies to further protect priority expenditure. The budget excludes possible gains from tax administration which, if they occur, will be allocated in a mid-2006 supplementary budget.

- Comprehensive **tax administration** reforms, based on IMF technical assistance, will be pursued to enhance efficiency, with special emphasis on servicing large tax payers and improving their tax compliance. Following an early 2006 IMF evaluation mission, a detailed action plan to improve **debt management** will be drawn up to guide reform over the program period. In the **Financial sector**, the authorities will develop an action plan to implement the FSAP recommendations, with selected items set as conditionality at the first review. In the meantime, previously-initiated reforms will be completed. Other measures include **civil service reform** and improvements in the **institutional framework for evaluating large projects**; reform of the macro-critical **electricity sector**; and **statistics**.

The accompanying Letter of Intent and Memorandum of Economic and Financial Policies contain policy commitments appropriate to maintain macroeconomic stability and to accelerate the pace of the reform agenda; and staff supports the request for a program.

I. Introduction

1. **In the attached LOI, the authorities request a new three-year program supported by a PRGF-EFF blend arrangement.** Given Albania's protracted external financing needs, the proposed access is SDR 17.045 million (35 percent of quota), equally distributed between the two facilities (Table 1). This would gradually lower the stock of outstanding obligations to the Fund and phase out, by the end of the program, access to the PRGF (Table 2).

2. **After more than a decade of IMF-supported programs, this arrangement aims to prepare Albania for graduation by promoting further decisive reforms and reducing vulnerabilities.** The recent ex post assessment of longer-term program engagement (EPA) concluded that remaining macroeconomic challenges and an unfinished reform agenda warranted a continued program-based engagement by the IMF. The key reform areas of the proposed program are revenue administration, public debt management, financial market development, civil service, and expenditure management. The EPA also noted that graduation would be facilitated by strong external anchors that could replace IMF-supported programs. In this respect, completing a Stabilization and Association Agreement with the European Union is critical. By improving governance and strengthening institutions in key areas, the program will also accelerate this process.

II. Background

3. **Though it suffered major setbacks in periods of political uncertainty, overall, Albania's macroeconomic performance has been strong in recent years (Table 3, Figure 1).** Following a recovery from a deep crisis in 1997, growth averaged about 5¾ percent in 2000–05, the highest in the region, supported by strong domestic demand. Inflation was rapidly reduced after 1997 and has remained generally within the BoA's 3 percent +/- 1 percent target range in recent years. Although growth and inflation deteriorated in 2001–02 following an electricity crisis, a drought, and financial sector turbulence, confidence began rebounding in mid-2002, and the lek has since

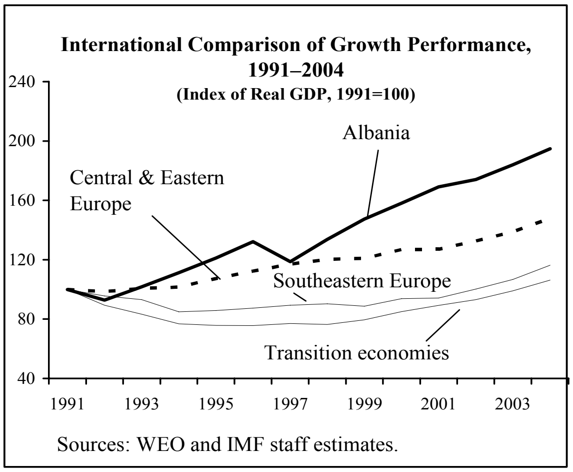
Albania: Key Macroeconomic Indicators

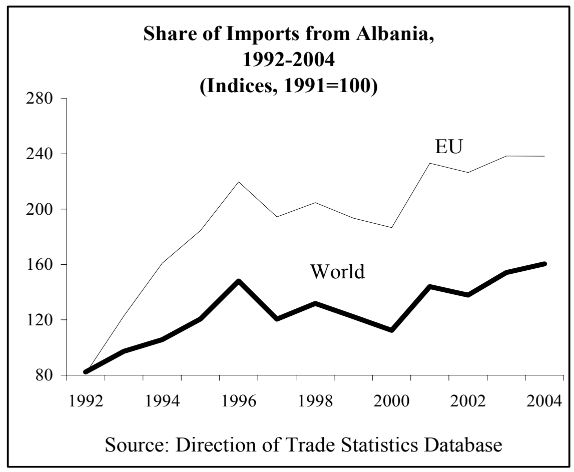
(Average 2000-2005)

	Real GDP growth	CPI inflation	General Government Balance 1/	Current Account 1/
Albania	**5.7**	**2.7**	**-6.1**	**-4.9**
Other SEE	4.3	12.2	-2.5	-9.4
Bosnia and Herzegovina	5.0	1.8	-3.6	-23.2
Bulgaria	5.0	6.1	0.0	-8.3
Croatia	4.0	3.3	-5.6	-5.0
Serbia and Montenegro	4.8	36.4	-1.5	-7.9
FYRMacedonia	1.8	2.7	-1.6	-5.9
Romania	5.2	23.1	-2.4	-6.3
Central Europe 2/	3.6	5.0	-5.1	-5.2
Baltic States 2/	7.1	2.8	-0.9	-8.0
European Union	2.1	2.3	-2.1	-0.2

Source: WEO and IMF staff reports.
1/ In percent of GDP
2/ Poland, Hungary, Slovak Republic and Czech Republic.
3/ Lithuania, Latvia and Estonia

experienced a modest trend real appreciation. The dominant retail bank was privatized in 2004, and private sector credit growth has picked up. Public debt declined significantly (from 76 percent of GDP in 1997 to 57 percent in 2004), helped by debt rescheduling. However, despite relatively strong export growth in recent years, Albania's market share has increased only slightly since 1996, reflecting the lack of export-oriented investment.



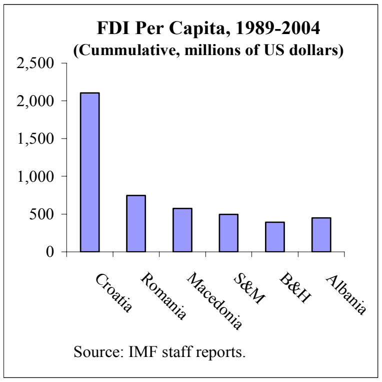


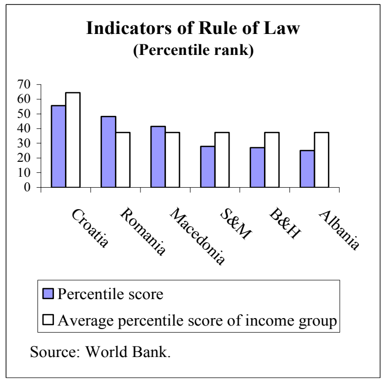
4. **Uneven progress with structural reforms has kept the business environment uninviting.** Poor infrastructure and weak governance and institutions have continued to hinder private business development and FDI. Albania is close to the regional average for many business climate indicators and per capita FDI. However, looking at broader indicators, it ranks at the bottom in the region and is significantly below average for lower-middle-income countries with respect to the rule of law and control of corruption. Moreover, maintaining the regional average is not enough, as Albania's neighboring western Balkan countries also need to become more successful in attracting FDI and significantly increasing their export market shares.

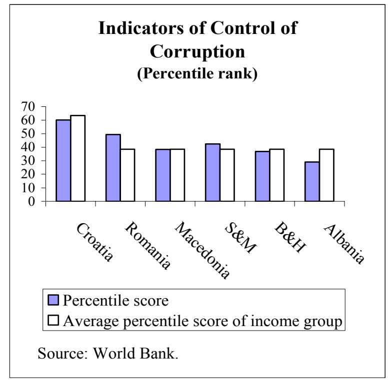
Business Climate Indicators (2004)

	Albania	Regional Average	OECD Average
Starting a business			
Number of procedures	11	10	7
Duration (days)	47	48	30
Cost (% GNI per capita)	32	15	8
Hiring and firing costs			
Difficulty of hiring 1/	11	31	26
Difficulty of firing 1/	20	42	27
Rigidity of employment index	30	42	27
Enforcing contracts			
Number of procedures	39	29	19
Duration (days)	390	412	229
Cost (% debt)	29	18	11
Getting credit			
Public credit registry coverage 2/	0	6	76
Private bureau coverage 2/	0	47	577
Closing a business			
Time (years)	4	3.3	1.7
Cost (% of estate)	38	13	7
Recovery rate (cents per $)	25	30	72

Source: World Bank, Doing Business, July 2005.
1/ Each index takes values between 0 and 100, with higher values representing more rigid regulations.
2/ Borrowers per 1000 adults.







5. **Despite major improvements, poverty remains widespread.** Rising incomes have underpinned the alleviation of some aspects of poverty, including absolute poverty and child mortality, but indicators have deteriorated in some other areas—most important, educational

Albania: Poverty Indicators 1/

	1998	2002	2003
Percentage of population with consumption below basic requirements 2/	...	25.4	...
Percentage of population with consumption below minimum calorie requirements 2/	...	4.7	...
Percentage of population with consumption below 60 percent of median 2/	29.6	13.5	...
Percentage of population with per capita income below US$2 a day 2/	46.6	10.8	...
Gini coefficient 3/	0.4	0.3	...
Headcount poverty level (in percent) 4/	...	20.0	17.0
Estimated per capita consumption (in leks) 4/	...	7,679	8,116
Percentage of population without running water inside their dwellings 4/	...	50.0	40.0
Mean number of hours per day without electricity 4/	...	8.6	4.8
Infant mortality rate (per 1,000 live births) 5/	27.6	22.0	18.0

1/ Data for 1998 are from the Living Condition Survey (LCS) carried out by INSTAT. The 2002 Living Standards Measurement Survey (LSMS) was carried out by the World Bank. Data for 2003 and 2004 are from the draft 2005 NSSED (the authorities' PRSP). Due to different methodologies, data are not necessarily comparable. A full LSMS is being implemented in 2005.
2/ For 2002, the source is the 2002 LSMS.
3/ Higher value indicates more inequality.
4/ Source: Draft 2005 NSSED. Not based on a full fledged consumption module using LSMS 2003.
5/ Source: World Development Indicators database.

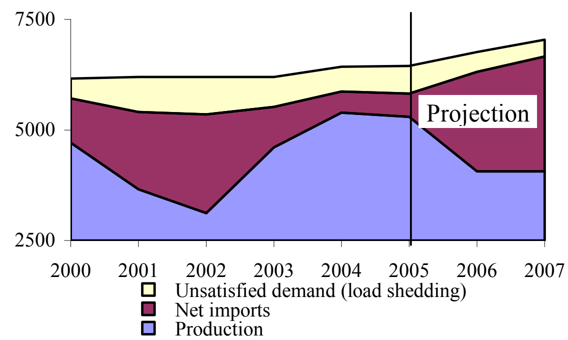
enrollment. Further major efforts are thus needed to make sufficient progress in meeting some of the Millennium Development Goals (Table 4). The weaknesses of the fiscal system—weak links between the medium-term budget framework and the annual budget process, the lack of strong contingencies to protect priority spending, and, until recently, unrealistic revenue projections—were also responsible for a mixed performance in this area. These shortcomings resulted in a disconnect between the National Strategy for Socio-Economic Development (NSSED) and annual budgets and typically led to ad hoc cuts at the end of the year, mostly in public investment and other priority spending.

6. **The elections in July 2005 led to the first peaceful transfer of power in Albania but still proved to be disruptive to the public sector.** After eight years in opposition, a Democratic Party-led coalition won a solid parliamentary majority. The new government's program calls for sweeping measures to root out corruption, improve the business environment, and reduce widespread poverty—indicating strong program ownership. In the two months that it took to release the official election results, however, budget revenue collection efforts were relaxed and the management of some of the state-owned companies deteriorated significantly. Moreover, the change in government has triggered yet another wave of replacement of managers in public institutions and state-owned companies, further weakening, at least temporarily, an already limited implementation capacity.

III. Recent Developments

7. **Though the electricity supply has improved recently, it remains a source of major risks.** There were widespread blackouts in the autumn as domestic hydropower generation had to be reduced due to rapidly falling water reserves. The state-owned electricity company (KESH) had largely depleted the water reserves by early-September, partly because it could not secure necessary imports. Moreover, KESH's collection and electricity distribution loss rates started to deteriorate in the second quarter of 2005 resulting in decline in its financial performance. The electricity supply situation improved markedly in December as imports resumed after the new government simplified procurement rules, and domestic production increased again. Nonetheless, given capacity constraints on imports, electricity rationing may well continue until rising water levels in the spring allow domestic production to return to normal. This will force businesses to continue to produce electricity with their own generators at a significantly higher cost than electricity tariffs, thereby squeezing their profit margins and creating pressures on consumer prices and the external current account.

Albania: Electricity Demand 2000-2007 (in GWH)

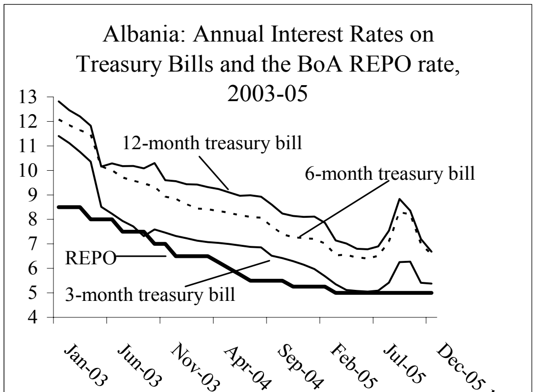


Sources: KESH; and World Bank.

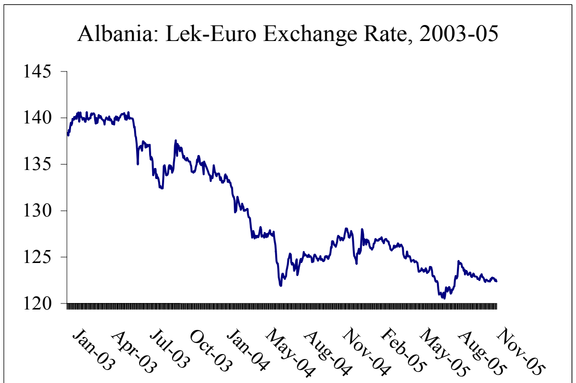
8. **Reflecting these developments, the near-term growth outlook has worsened since the last review.** The precarious situation in the energy sector, combined with a slowdown in textile exports, is expected to lead to a deceleration in economic activity. Staff thus projects GDP growth to decline to 5½ percent in 2005 and 5 percent in 2006, compared with the 6 percent for both years projected at the time of the last PRGF review. Moreover, downside risks have increased significantly for 2006 and could rise further if blackouts create growing public discontent. Strong demand for fuel, used by private power generators, high oil prices, and a slowdown in textile exports widened the trade deficit in 2005. This, combined with a

gradual decline in the income balance, pushed up the current account deficit from 5.5 percent of GDP in 2004 to an estimated 7 percent in 2005 (Tables 5a and 5b). Reflecting the costs of higher electricity imports, the current account deficit is projected to widen further in 2006, to 8 percent of GDP, but international reserves are also projected to rise.

9. **The delay in announcing the election results also put pressure on financial markets and contributed to the BoA's missing the end-September indicative targets on international reserves and net domestic assets.** Political uncertainty, combined with narrowing spreads between domestic and foreign currency deposits, reduced demand for lek in the third quarter. To avoid a sudden depreciation, the BoA purchased less than planned foreign exchange reserves during this period, effectively cutting off the main channel of liquidity supply—leading to declining demand for T-bills and sharply increasing market



Source: Bank of Albania.
1/ Value at December 6, 2005

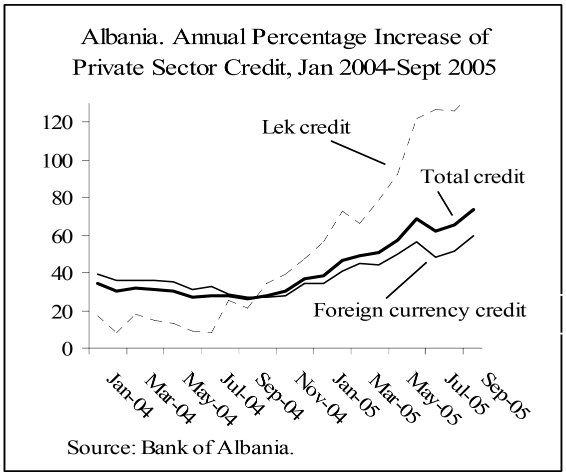


Source: Bank of Albania.

interest rates. The BoA reacted by temporarily extending direct credit to government and by injecting liquidity into the system, while the government drew down its deposits. These actions led to a rapid expansion of the BoA's net domestic assets. Markets began to return to normal in early September. With reserve purchases increasing, the BoA began withdrawing liquidity in October, but T-bill rates reverted to their previous levels only in November (Figure 2).

10. **Despite low inflation, the BoA faces new challenges.** At 3 percent (year-on-year) in November, inflation is at the midpoint of the BoA's 3 percent +/- 1 percent target range. Nonetheless, the potential second-round effects of the electricity shortage and high oil prices on consumer prices pose a challenge. Moreover, reflecting the rapid growth of foreign exchange deposits, broad money growth was faster than programmed (Table 6). On the banks' asset side, private credit accelerated rapidly throughout the year, well above the rates projected in the previous program. While this is a welcome development as financial intermediation is underdeveloped even by regional standards—private sector credit is projected to reach about 14½ of GDP by end-2005, still one of the lowest in the region—it also entails inherent risk to loan quality. The still high capitalization of the banking system, however, mitigates this risk (Table 7). Furthermore, given the ample supply of foreign

exchange deposits (due to remittances and possibly reduced foreign exchange cash holding by households), the historically strong net foreign asset position of banks has been preserved.



International Comparison of Private Sector Credit Levels 1/
(Percent of GDP at end-year)

	2002	2003	2004
Albania 2/	7.3	8.4	9.9
Kosovo	...	9.6	14.9
Romania	8.3	9.5	10.0
FYR of Macedonia	17.7	19.6	23.6
Slovak Republic	39.6	31.6	30.6
Bulgaria	19.6	27.4	36.7
Estonia	26.9	33.1	43.3
Czech Republic	29.8	30.7	32.2
Hungary	35.8	43.0	45.9
Croatia	50.7	54.2	57.5
Euro Area	108.8	112.0	114.8

Source: IFS database; Kosovo data from Kosovo authorities.
1/ Excludes credit to nonfinancial public enterprises and nonbank financial institutions.
2/ Includes credit held by Bank Assets Resolution Trust.

IV. Policy Discussions

A. Medium-Term Framework and Reform Strategy

11. **There was agreement that wide-ranging structural reforms were needed to maintain Albania's high growth potential (MEFP ¶6).** Staff estimates suggest that, without further structural reforms, the rate of potential growth will decline by about half a percentage point in the coming five years (Box 1). At the same time, if, over the next five years, Albania could close half of its gap vis-à-vis Croatia regarding the size of foreign trade relative to GDP (requiring an increase of 20 percentage points to reach 42 percent of GDP, compared with the 10 percentage points gained in the past five years), as well as reach Croatia's current level of institutional quality (requiring the same pace of improvement as in the past five years), it could counterbalance this decline. Based on this framework, staff considers that the structural measures of the proposed program could maintain growth in the medium term at about 6 percent.

12. **The authorities considered that continued Fund involvement was needed to address remaining vulnerabilities.** They agreed that, besides weak institutions and governance problems, the budget was ill-prepared to absorb the consequences of large economic shocks. Weak revenue administration and public debt management further added to fiscal vulnerabilities. Moreover, the authorities agreed that, though the financial system had been strengthened significantly, additional improvements were needed to ensure that it, too, could absorb potentially large shocks.

13. **The program therefore focuses on promoting sound financial policies, enhancing growth potential, reducing vulnerabilities, and strengthening government solvency while increasing and protecting priority spending (Box 2 and MEFP ¶6):**

Box 1. Albania's Growth Potential

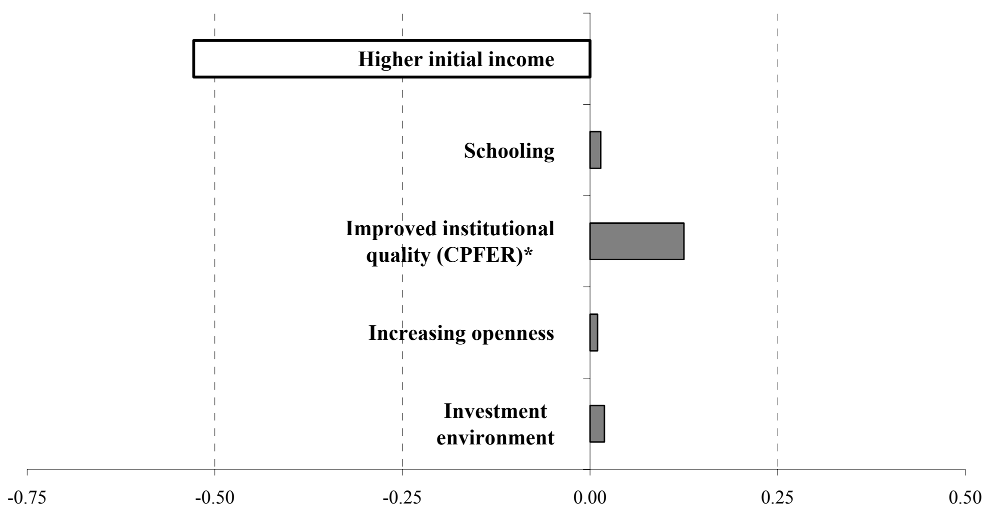
Growth accounting shows that total factor productivity growth declined gradually in Albania in the past five years. To identify the factors responsible for this trend and estimate potential growth for the program period, staff applied a model recently developed in the European Department to explain growth by two broad groups of variables: [1]

- factors outside the short-term control of policymakers, such as income level, population growth, and trade partner growth; and

- policy-influenced factors, such as schooling, relative price of investment, openness to trade, and institutional quality.

Results suggest that, without new structural reforms, Albania's potential growth rate is likely to decline by about half a percentage point in the coming five years—mostly because policy improvements would not be sufficient to counterbalance the gradual decline associated with its higher income level.

Albania: Changes in the Growth Potential between 1999 and 2004
(Contribution to per capita growth rate in percentage points)



* Composite Political, Financial and Economic Risk Rating by the PRS Group

Source: IMF staff calculations.
1/ A description of the model is given in S. Schadler et al. "Growth in the Central and Eastern European Countries of the European Union: A Regional Review", forthcoming.

Box 2. Albania—Structural Conditionality

Coverage of Structural Conditionality

Structural conditionality focuses on measures that are critical to enhance growth potential and reduce major vulnerabilities. Key reform areas are revenue administration, public debt management, public expenditure management, and the financial system. These reforms will also prepare Albania for graduation from IMF programs. To mitigate the significant fiscal risks created by the deterioration of KESH's performance in 2005, there is a structural performance criterion (PC) related to the implementation of the Power Sector Action Plan. Prior actions were set to jump-start tax administration reforms and reduce significant political and implementation risks. As salaries are now paid through the banking system to all those budgetary employees who live in regions served by commercial banks, this area is no longer covered by structural conditionality. Table 2 of the MEFP (Attachment I) lists the structural PC and structural benchmarks (SBs) for the first review.

Status of Structural Conditionality from Earlier Programs

The implementation of reforms has remained largely on track since the last review under the previous PRGF arrangement (Table 8). The computer-based system that was introduced with foreign technical assistance to select taxpayers for audits, however, turned out to be ill-designed and needs to be modified to fit local conditions in Albania. The measures necessary to make the large taxpayer office (LTO) fully functional were delayed due to the change in government, but they have subsequently been implemented as a prior action. Two quarterly reports (on external arrears and projects financed by non-concessional loans) were not produced on time, but the required information was provided during the mission and arrangements have been made to produce these reports regularly in the future.

Structural Areas Covered by World Bank Lending and Conditionality

The new CAS focuses on improving governance; supporting private sector development by strengthening financial intermediation, finalizing the privatization of strategic companies, enhancing the business climate, improving security of land tenure, establishing a functioning land market, and building the infrastructure, including electricity, necessary for growth; and improving public service delivery, particularly in the social sectors.

- Continued macroeconomic stability will be supported by fiscal consolidation—centered on a gradual reduction of domestic borrowing and improvement in the current and primary balances; and by strengthening the monetary policy framework and financial supervision capacity.

- Growth potential will be enhanced by making revenue and expenditure reforms that promote increases in both the quantity and quality of productive public investment; by pursuing growth-enhancing structural reforms, such as completing the privatization process; and by taking other measures to improve the business environment, such as modernizing the tax and customs administrations, and establishing a credit information bureau.

- Declining levels of public debt relative to GDP, together with improvements in revenue administration and public debt management, as well as reforms that limit contingent liabilities (e.g., in the electricity sector), should also strengthen government solvency and reduce fiscal vulnerabilities. Significantly lengthening the average maturity of domestic public debt will be a critical measure in this regard.

14. **While preparing action plans to identify and sequence new measures in these areas, the authorities will also focus, in the short run, on completing ongoing reforms.** Further deploying the Automated System for Customs Data (ASYCUDA) (MEFP ¶16), improving statistics (MEFP ¶24), and safeguarding the efficient use of nonconcessional external loans (MEFP ¶17) are the key measures the authorities will take in the short run. As a prior action, they have produced, in collaboration with staff, an action plan to implement the recommendations of a recent FAD tax administration technical assistance (TA) report (MEFP ¶15). They plan to formulate similar action plans based on the 2005 Financial Sector Stability Assessment (FSSA) report (MEFP ¶10) and the forthcoming report of a joint FAD-MFD public debt-management TA mission (MEFP ¶18) scheduled for early 2006. These plans will specify and prioritize future measures in these new areas.

15. **The proposed policies are consistent with the priorities of the NSSED**. The NSSED (the local version of the PRSP) was presented to the Boards of the Fund and the Bank in 2002 and has been updated every year since then. The new government has endorsed the 2004 NSSED progress report approved by the previous government last July. The authorities confirmed their intention to prepare a new NSSED for 2007–09 by the end of 2006 (MEFP ¶1, ¶25). The World Bank will continue to provide broad support in implementing structural reforms based on the recently approved CAS (Appendix II).

16. **Under the proposed program, Albania's external and public debts will remain sustainable in the medium term (Appendix IV)**. External debt, which is largely concessional (Table 9), is expected to stabilize at about 20 percent of GDP. Moreover, the country's strong net external position will be preserved, as evidenced by the fact that net foreign debt remains negative in the medium term. Given this and to promote graduation from IMF programs, a small amount of non-concessional borrowing, less than one percent of GDP, is permitted under the program. On the domestic front, public debt relative to GDP

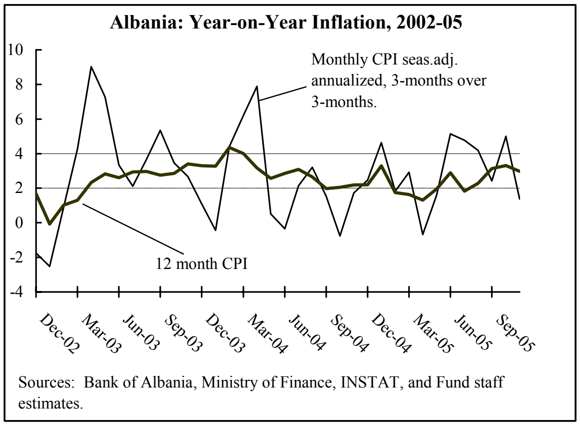
gradually declines over the program period. Nonetheless, the relatively large short-term domestic debt leaves public finances vulnerable to sudden changes in market sentiment. Regarding other risk factors, public debt is most sensitive to a negative shock to growth, and external debt to an adverse shock to exports.

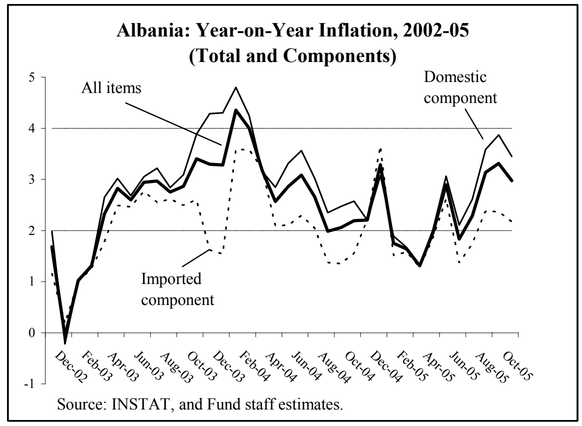
B. Monetary and Exchange Rate Policy

17. **There was agreement that the basic design of the monetary program should remain unchanged.** The relative stability of velocity and the money multiplier suggests that the programming framework of the previous program, including the quantitative PCs, remains appropriate. The quantitative targets are set with a view to keeping inflation in the BoA's 3 percent +/- 1 percent target range (MEFP Table 1). As in the past, foreign exchange market interventions (the major source of domestic liquidity) will be carried out to secure required international reserves and mitigate the impact of relatively large seasonal variation in currency supply. Private credit growth, which is concentrated in the corporate sector, is projected to slow down somewhat in 2006 as companies with high borrowing capacity gradually reach their desired levels of leverage. However, the policy rate currently has a limited impact on private credit demand. Consequently, similar to some other countries in the region, the use of additional instruments— including reserve requirements and, as a last resort, direct credit control—cannot be ruled out, particularly if rapid credit growth leads to a significant widening of the current account deficit (MEFP ¶8).

18. **Given the underdeveloped financial markets and limited institutional capacity, the authorities thought that further reforms were needed to create the conditions for introducing inflation targeting (IT).** With MFD assistance, they are identifying the necessary steps and formulating an action plan. Regarding timing, the authorities considered that, even with determined efforts, it would take several years to introduce IT. Nonetheless, there was agreement that many of the reforms involved in preparing for IT were necessary to improve the quality of policymaking irrespective of the policy regime and, thus, should be implemented in a timely fashion (MEFP ¶9).

19. **Supported by a tight budget, the current monetary policy stance remains adequate, but the BoA retains the option of a preemptive rate hike.** Inflation has remained in the BoA's target range, and there are no signs yet of inflationary pressure despite the recent pickup in food and transportation prices. Nonetheless, staff warned that headline inflation might accelerate in 2006, particularly if cost pressures created by electricity shortages and sustained high oil prices lead to second-round effects and no timely action is taken. The BoA agreed and, to anchor inflation expectations, informed the public that it would take swift action if there were indications of second-round effects, particularly a pickup in nominal wage demand.

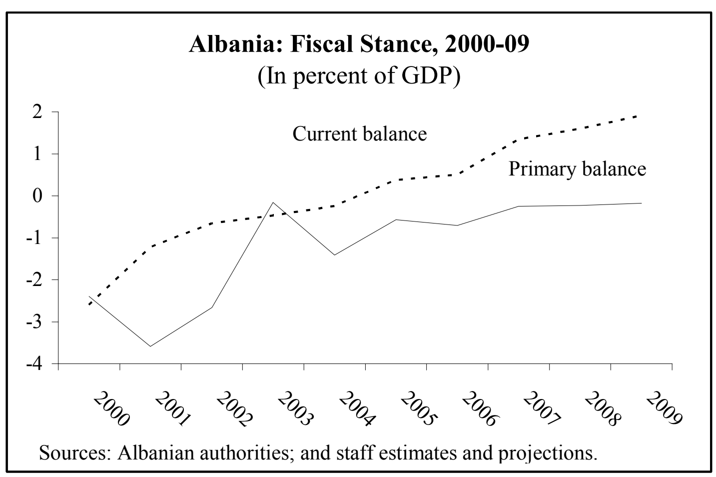




20. **There was agreement that a flexible exchange rate continued to serve Albania well (MEFP ¶9).** Exposure to potentially large idiosyncratic shocks also argued for retaining exchange rate flexibility. The authorities considered that the continued export growth in the past did not suggest the need for an exchange rate realignment, though they agreed with staff that a gradual market correction might take place if the apparent slowdown of textile exports proved to be a lasting trend. Regarding long-term trends, staff emphasized that significantly increasing exports relative to GDP—one of the most important ways of maintaining Albania's high growth potential—would require the implementation of macroeconomic and structural policies envisaged in the program to enhance competitiveness.

C. Fiscal Policy

21. **The authorities' medium-term fiscal program aims to gradually reduce public debt relative to GDP (Tables 10a and 10b, MEFP ¶2).** Despite a sizable decline since 1997, also helped by debt restructuring, public indebtedness has remained high. There was agreement that, given Albania's economic fundamentals, public indebtedness needed to be further reduced so as to limit vulnerabilities and enhance sustainability (Appendix IV, MEFP ¶12). The envisaged pace of reduction over the medium-term strikes a balance between this goal and allocating sufficient funds to public investment and other PRSP priority areas. In this framework, the current fiscal balance would continue to strengthen, with the current surplus projected to reach about 2 percent of GDP in 2009 (up from about ½ percent in 2005),



implying an increase in the government's net worth. In addition, as regards future revenue gains from tax administration reforms, the authorities plan to allocate a part to further reducing public debt, as well as to growth-enhancing and poverty-reducing public expenditure and tax reforms. Moreover, they reconfirmed their commitment to use half of the receipts from large privatizations to reduce public debt (MEFP ¶3, ¶7).

Albania: Medium-Term Fiscal Path 1/
(In percent of GDP)

	2004	2005	2006	2007	2008	2009
Overall balance	-5.1	-3.8	-4.1	-3.5	-3.4	-3.2
Domestic financing	4.2	3.1	3.0	2.8	2.6	2.5
Privatization receipts	1.9	0.3	0.3	0.2	0.2	0.2
Domestic net borrowing	2.3	2.8	2.6	2.5	2.4	2.3
Foreign financing	1.0	0.7	1.1	0.7	0.7	0.7
Current balance	-0.2	0.4	0.5	1.3	1.6	1.9
Public debt	56.5	54.9	55.0	54.5	53.6	52.6
Domestic	38.5	38.1	38.1	37.4	36.6	35.8
External	18.0	16.8	17.0	17.0	17.0	16.8
Debt service to revenue 2/	17.3	15.5	16.9	15.6	15.7	15.3

Source: Albanian authorities; and staff estimates and projections.
1/ Owing to remaining uncertainties, the projections in this table do not include the privatization of Albelecom and the Tirana-Durres railway project.
2/ Revenue excluding grants. Almost none of the domestic debt has a maturity of more than one year.

22. **The 2006 budget is in line with the authorities' medium-term fiscal program and contains significantly strengthened contingency mechanisms to protect priority spending.** The main priorities of the budget—education, health care, and domestically financed public investment—are in line with the NSSED. Net domestic borrowing, the key fiscal target in the program, will be reduced to 2.6 percent of GDP from an estimated 2.8 percent in 2005. The total size of the different contingencies (allocated contingent expenditure, reserves and contingency funds) will be significantly larger than in the 2005 budget, which is appropriate given the increased uncertainty surrounding growth in 2006 (MEFP ¶7, ¶13). Revenue estimates are realistic, based on Albania's track record and reflecting only identified tax policy measures. The authorities were hopeful that gains from tax administration improvements would materialize early on, which would allow them to submit a supplementary budget to parliament in the second half of 2006. To secure successful program implementation, they agreed that this decision would be based on a minimum of six-month revenue performance, and would follow consultation with staff, particularly regarding the assessment of revenue trends (MEFP ¶7).

23. **The authorities' reform agenda focuses on mitigating fiscal vulnerabilities that will remain significant because of a relatively large public debt, as well as on raising the quality and efficiency of public expenditure (MEFP ¶14).** The main areas of reform are thus

- strengthening revenue administration;
- improving public debt management;
- continuing the civil service reform; and
- improving expenditure management, including preparing a public investment program.

24. **The authorities are committed to implementing the ambitious tax administration reforms set out in their action plan (Table 11, MEFP ¶15).** As a prior action, they made the LTO fully functional and regard its modernization—a reform that will improve the business climate, promote FDI, and enhance revenue collection—as one of the highest priorities. They aim to improve compliance by large taxpayers, particularly regarding social security contributions, and to raise the share of total tax collected by the LTO to over 50 percent by mid-2006 (SB). To gather evidence on corruption in the revenue administration and the impact of reforms in this regard, the authorities will select a private company to conduct regular independent surveys among the clients of the LTO and the customs office. The results of these surveys will be published in a timely fashion.

25. **The authorities will pursue comprehensive reforms to build, by the end of the program, a modern debt-management unit (MEFP ¶18).** Given the pressing need to broaden the investor base and significantly lengthen maturity, they considered that the current framework was inadequate. The also felt that the lack of necessary improvements in public debt management following the privatization of the dominant retail bank had further increased the vulnerability of public finances. Following a discussion on this matter at the 2005 Annual Meetings, the authorities requested a joint FAD-MFD TA mission to help formulate a reform strategy. They agreed with staff that this strategy should aim to introduce new debt instruments; modernize debt-management practices; significantly expand risk management capacity; and build the necessary capacity, by the end of the program, to independently produce debt-sustainability reports. The authorities will formulate a detailed action plan based on the recommendations of the TA mission by end-June 2006 (SB). To facilitate direct access to international capital markets, the authorities plan to initiate soon the process of obtaining a sovereign credit rating.

26. **Expenditure reforms aim to raise the quality of public expenditure and increase public investment and other priority spending (MEFP ¶17).** The authorities will formulate their reform plans based on the findings of the ongoing public expenditure review conducted by the World Bank. Staff will work closely with the Bank to expedite this review, identify and prioritize reform measures, and assess their budgetary and macroeconomic implications. In this connection, the following points were emphasized during the discussions:

- Civil service reform, supported by the World Bank since 2001, will be further pursued with the goals of developing the capacity to hire and retain skilled personnel, increase accountability, apply transparent procedures for promotions, and, ultimately, improve the effectiveness of public administration and services (MEFP ¶17). As a first step, the authorities will complete a census of all public sector employees by end-June 2006 (SB). An ongoing review of the government's structure and functions will eliminate redundant units and is likely to lead to reductions in the overall costs of public administration.

- The authorities considered that the institutional framework for evaluating and prioritizing public investment projects needed to be strengthened (MEFP ¶17). As a first step, they agreed to create a public investment program department within the MoF and prepare and issue instructions for submitting public investment proposals (SB).

- Staff stressed the need for reviewing the design of the pension system, with a view to strengthening its long-term financial position based on the findings of the World Bank's ongoing Social Insurance Review by the (MEFP ¶10).

27. **Staff pressed for a cautious and comprehensive approach to tax reform.** The new government's election program included large tax rate cuts and envisaged considerable supply-side effects. Moreover, the authorities thought that large rate cuts would also lead to a sizable broadening of the tax base. While staff agreed that tax yields could be increased significantly, it stressed that achieving this would require sustained efforts to improve tax administration and reduce the informal economy. Regarding tax policy reforms, staff noted that a 2004 FAD TA report had found that the overall design of major taxes was basically sound and that tax rates were comparable to regional levels. Particularly, the report called for safeguarding the main features of the VAT system—most important, the single rate. It, however, also found that the high social security contribution rate was discouraging legal employment. The mission thus saw a case for using part of the permanent revenue gains from tax administration improvements, once these were fully entrenched, to narrow the tax wedge on labor. This could support job creation, which is among the authorities' top priorities. The authorities agreed to formulate, by mid-2006, in

Social Security Contribution Rates in Selected Countries, 2004 1/

	Contribution rate	Per capita GDP in PPP terms 2/
Albania	**41.9**	**3,350**
Algeria	17.0	4,984
Bosnia and Herzegovina 3/	24.0	...
China	27.5	3,477
Georgia	33.0	4,904
Laos	9.5	...
Macedonia	32.0	...
Moldova 4/	30.0	2,082
Morocco	11.9	3,720
Thailand 5/	6.0	6,857
Tunisia 6/	15.5	6,777
Vietnam	15.0	...

Sources: National authorities, U.S. Social Security Administration, and Penn World Table.
1/ Countries with income levels broadly similar to that of Albania.
2/ GDP in purchasing power parity terms in 2000 expressed in 1996 constant US dollars.
3/ As of June 2003, based on net wages.
4/ Contribution rate in industry.
5/ An additional 1 percent is paid by the government.
6/ Excluding certain in-kind payments or reimbursement.

consultation with staff, a medium-term tax policy reform strategy incorporating this approach (MEFP ¶19).

D. Financial System Stability and Development

28. **The FSSA report[1] concluded that the financial system was generally sound and that core legal and regulatory frameworks were in place**. The banking system's vulnerability to macroeconomic or financial sector shocks is relatively low, although this will inevitably grow over time with the continued growth of credit in the economy. The levels of monetization and financial intermediation are rising, albeit from low levels, and key financial markets remain underdeveloped.

29. **The authorities' plans for structural reform in the financial sector over the next three years will be guided by the FSSA**. The BoA and the MoF have formed a joint task force to develop an action plan by end-March 2006 (SB). The authorities and staff agreed that reforms should strengthen monetary policy management and financial market supervision; further develop financial markets, particularly secondary markets for government securities and interbank markets; improve the quality, breadth, and depth of financial intermediation—including through the further development of credit unions; and buttress the overall AML/CFT framework. The authorities felt that there was an immediate need to improve insurance and private pension supervisory capacities, and asked for technical assistance in this area (MEFP ¶10). The FSSA also identified this as an area where improvements were needed and recommended, as a first step, the merging of nonbanking supervisions. To jump-start the process, the World Bank, which has the necessary expertise in this area, plans to send an expert to Tirana in January to assist the authorities.

30. **While the action plan is being prepared, structural policy in the financial sector will remain focused on completing and expanding the reforms initiated under the previous program (MEFP ¶11)**. Commercial banks stressed the need for establishing a credit information bureau under the leadership of the BoA, with a view to increasing the availability of credit to small and medium-sized companies and helping price credit risk better. The FSSA also identified this as a key short-term measure to mitigate vulnerabilities arising from rapid credit growth. Staff agreed and urged the authorities to streamline the procedures for executing collateral, which are currently ineffective. The mission stressed the importance of retaining the T-bill window at the BoA and encouraging commercial banks to offer their clients direct access to government securities as a fee-based service. The BoA is planning new measures to eliminate cash payment at its T-bill window, as part of the strengthening of the AML/CFT framework. Regarding privatization, the authorities are determined to divest remaining minority interests in commercial banks, as evidenced by the recent sale of their holding in the Italian-Albanian Bank (MEFP ¶11).

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[1] IMF Country Report No. 05/274.

E. Other Structural Policies

31. **The authorities have taken several measures to improve the financial performance of KESH and enhance electricity supply over the medium term (MEFP ¶20).** They have updated their Power Sector Action Plan (PSAP), endorsed by the World Bank and other donors; and cleared the arrears accumulated by budgetary institutions in 2005. KESH will make further efforts to meet the PSAP targets for collection rates and losses for the first quarter of 2006 (structural PC). To support these efforts, the government has taken measures to ensure that budgetary institutions pay their electricity bills regularly. Given the burden of widespread blackouts, the new government felt that the upcoming adjustment in electricity tariffs (to cover cost increases due to higher electricity imports in 2006 and continue the gradual removal of cross subsidies) should be postponed until mid-2006. As electricity import subsidies have been phased out, the 2006 budget contains no provisions for such subsidies. KESH, thus, will have to borrow from the banking sector in the meantime if it needs additional funds to finance increased imports. As a last resort if KESH cannot secure commercial financing, the government is prepared to issue a short-term loan guarantee or advance a direct short-term loan to KESH using available budgetary reserves and contingency funds (amounting to 0.3 percent of GDP). The authorities will also adjust water tariffs to improve the financial positions of regional water companies. Despite receiving budget subsidies, these companies accumulated large arrears to KESH during 2005. Regarding electricity supply, the authorities will work with the World Bank and other donors to accelerate the implementation of essential investments in electricity generation and transmission capacities.

32. **The authorities have cancelled the Tirana-Durres-Rinas railway (TDR) project and intend to complete the investigation of the privatization tender for Albtelecom (MEFP ¶21).** The new government did not regard the TDR project, which was not included in the Albanian National Transport Plan (ANTP) or the NSSED, as a priority project and found the financial conditions of the project unfavorable. Regarding Albtelecom, staff urged the authorities to investigate the alleged irregularities of the tender process in a timely fashion and rely on reputable independent experts. The authorities have discussed with the foreign investor selected in the privatization tender the steps they will take to resolve this matter. The authorities' privatization plan for 2006 also includes the sale of some 16 small and medium-sized companies.

F. Other Issues

33. **The authorities have made further progress in clearing arrears with non-Paris Club creditors (MEFP ¶23).** Albania maintains outstanding debit balances, estimated at €70 million at end-2005, with Algeria, Cuba, Greece, Poland, Vietnam, and Serbia and Montenegro derived from inoperative bilateral payment agreements that were in place before Albania joined the Fund. During 2005, agreements for arrears clearance with Romania and the Czech and Slovak Republics have been reached for a total of €16.7 million. The reconciliation process with Poland has been concluded and the parties have initiated the negotiations for the terms of repayment. Regarding private sector creditors, the authorities

have proceeded in accordance with Fund policies on lending into arrears. They have engaged private sector creditors collectively in each country and reported some progress in reconciling outstanding balances with German, Swiss and Greek creditors. The authorities expect to clear all arrears with official creditors by mid-2007 and with private creditors by mid-2008. The implementation of Albania's WTO commitments to reduce tariff barriers progresses as scheduled.

34. **Statistics should remain a core area of structural reforms (MEFP ¶24).** Albania's Institute of Statistics (INSTAT) recently published preliminary 2003 national accounts and is finalizing flash estimates for 2004 and the first quarter of 2005 using a new methodology to estimate the contribution of the informal economy. Staff noted that the lack of high-frequency labor market and wage statistics hindered monetary policy formulation and called on INSTAT to strengthen its efforts in this area, in cooperation with the BoA. Regarding future reforms, the mission urged the government to submit to parliament the already-completed five-year statistical plan.

G. Program Issues

35. **The program is fully financed for 2006 (Table 12).** The financing gap is expected to be closed by donor assistance and arrears rescheduling. For 2007–08, most of the gap financing has been identified.

36. **Given its relatively small external debt and sound record of servicing debt to the Fund, Albania should be able to meet its obligations to the Fund under the proposed access (Table 13)**. Outstanding obligations and projected debt service to the Fund under the proposed program would remain minimal (peaking at 0.6 percent of exports).

37. **The program will be monitored by quantitative quarterly benchmarks and semiannual PC.** These are proposed to include net international reserves and net domestic assets of the BoA, net domestic government borrowing, and nonconcessional external public debt. The first test date will be set for March 31, 2006. The proposed structural PC and SBs focus on areas of the Fund's mandate that are critical for macroeconomic stability and are in accordance with the current guidelines on conditionality.

38. **The proposed program is subject to significant political and implementation risks but it contains several safeguards to mitigate these risks.** Owing to the peaceful transfer of power and solid majority of the new coalition, the current political environment is conducive to reforms. Nonetheless, a long-standing tradition of confrontational politics could undermine reform efforts. Moreover, given the weak implementation capacity, slippages in preparing and implementing measures may continue. The prior actions were selected with a view to reduce these risks. To further accelerate reforms, the IMF will provide additional technical assistance in key areas, starting with a FAD-MFD public debt-management TA mission in early 2006. Moreover, donors have been generally supportive of the program's reform agenda. To build a strong domestic reform constituency, staff has encouraged the

authorities to forge a political consensus on its main reform plans through a broad consultative process. Staff has also intensified its own outreach activities to help this process.

V. Staff Appraisal

39. **Despite setbacks, Albania's achievements in the past decade in establishing macroeconomic stability and reducing poverty are commendable.** Growth on average has been high, while price stability has been established and the external balance kept under control. Helped by rapidly rising incomes, most indicators of poverty have improved, though progress in meeting the Millennium Development Goals has been mixed.

40. **Nonetheless, notwithstanding progress in structural reforms, weak public and private institutions and corruption limit the growth potential and leave the country vulnerable to inherent high economic volatility.** Inadequate contract enforcement and property rights protection, as well as a poor infrastructure, continue to hinder private investment, particularly in tradable sectors. On the fiscal front, despite progress in modernizing customs, revenue administration has remained weak, threatening fiscal sustainability and reducing the government's capacity to finance priority expenditure. Moreover, the relatively large short-term domestic public debt, combined with limited public debt-management capacities, make the budget vulnerable to changes in market sentiment. The lack of necessary improvements in public debt management following the privatization of the dominant retail bank has added to this vulnerability.

41. **As the recent EPA found, continued program-based Fund involvement is warranted to promote reforms that can reduce these vulnerabilities.** Given the still widespread poverty, protracted external financing needs and limited capacity to borrow under commercial terms, but taking into account Albania's relatively high income level, an arrangement supported by a blend of PRGF and EFF resources is considered appropriate. A gradual exit from the PRGF would also be in line with the recently approved CAS of the World Bank, which envisages a gradual phasing out of IDA support.

42. **Building on previous efforts, the reform agenda appropriately concentrates on reducing remaining vulnerabilities and enhancing growth, and, thus, facilitates graduation from IMF-supported programs.** Revenue administration reforms are necessary to strengthen fiscal sustainability, improve the business environment, and help root out corruption. The government's action plan provides a good basis for implementation. Revenue gains from these reforms can create much-needed room for additional growth enhancing public investment and tax reforms that can promote job creation and private investment, as well as for reducing the fiscal deficit more ambitiously than in the present program. In formulating policies in this area, the authorities should find the right balance among these competing claims on additional resources and design a tax reform that focuses on job creation and private investment. The considerable risks associated with the relatively large and short-term domestic public debt need to be mitigated to make public finances more robust to market fluctuation, especially now that the banking sector is almost completely privatized. The planned reforms to strengthen public debt management, broaden the investor

base, and lengthen debt maturity are essential in this regard. On the financial sector front, with property titles still largely absent, creating a credit bureau and improving the process of executing collateral are crucial for increasing the availability and reducing the cost of bank loans for small businesses, which are the backbone of the economy.

43. **The fiscal program strikes a balance between reducing public indebtedness and increasing growth-enhancing and poverty-reducing public expenditure.** Public debt relative to GDP is gradually being reduced and can be lowered even more if the privatization of large companies proceeds further. The reallocation of expenditure to public investment should enhance the growth potential while improving the current fiscal surplus and, thus, increase public sector net wealth. Based on the recommendations of the ongoing public expenditure review, it will be important for the authorities to specify the measures necessary to achieve this expenditure reallocation and implement them with determination. The 2006 budget is in line with the medium-term fiscal program and incorporates considerably strengthened contingencies that can improve budget implementation and protect priority expenditure.

44. **The monetary policy stance is appropriate, but the BoA should stay vigilant to ward off potential second-round inflationary effects from high oil prices and the cost pressures created by electricity shortages.** The monetary program is appropriately tight to maintain price stability while providing for an adequate increase in international reserves. Nonetheless, the pressure on production costs stemming from electricity shortages and high international oil prices is a potential threat to price stability. Monetary policy, therefore, should carefully analyze trends in order to identify early signs of second-round effects, particularly a pickup in nominal wage demand.

45. **Despite some progress, the energy sector remains a major risk factor.** The significant deterioration in the financial performance of KESH needs to be reversed urgently, and renewed efforts are needed to complete its restructuring. Moreover, the implementation of investments necessary to increase the domestic generation of nonhydroelectric power and import capacities needs to be accelerated.

46. **The program includes sufficient safeguards to mitigate the significant implementation risks.** The authorities' prior actions have considerably reduced risks to macroeconomic stability and jump-started tax administration reforms. Moreover, technical assistance by the IMF and donors will support the authorities' actions in key reform areas. Nevertheless, continuous efforts on the part of the authorities and staff will be required over the program period to manage the program implementation risks. The authorities have continued making good faith efforts to reach agreement with official and private creditors on the clearance of external arrears.

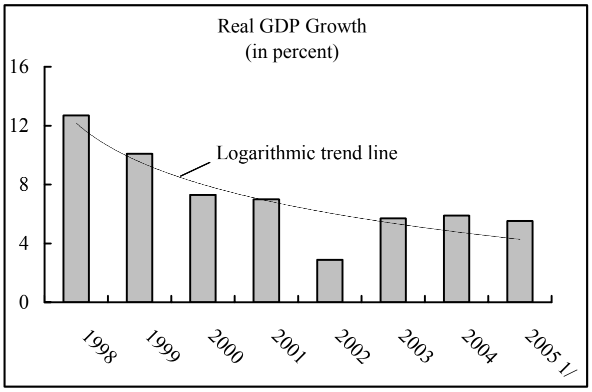
47. **Overall, the proposed program is appropriately ambitious, and the authorities have demonstrated sufficient political commitment to reform implementation.** Based on Albania's overall satisfactory track record and the strength of the program, staff recommends

approval of the authorities request for the use of Fund resources under the three-year PRGF and EFF arrangements.

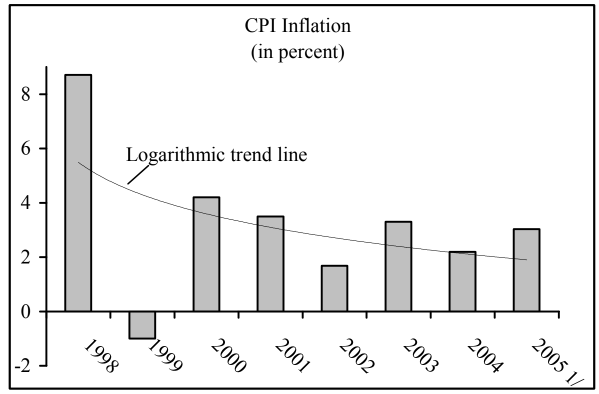
48. Staff proposes that the next Article IV consultation with Albania be held at the time of the first review, subject to the provisions of the decision on consultation cycles of July 15, 2002.

Figure 1. Albania: Economic Developments and Prospects, 1998-2005

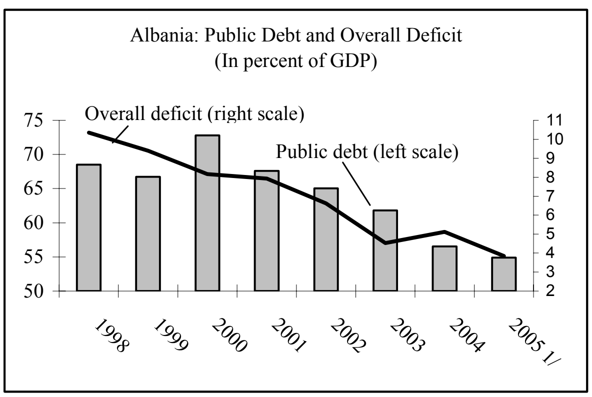
Growth has been rapid, though with occasional setbacks, and the growth potential has declined.



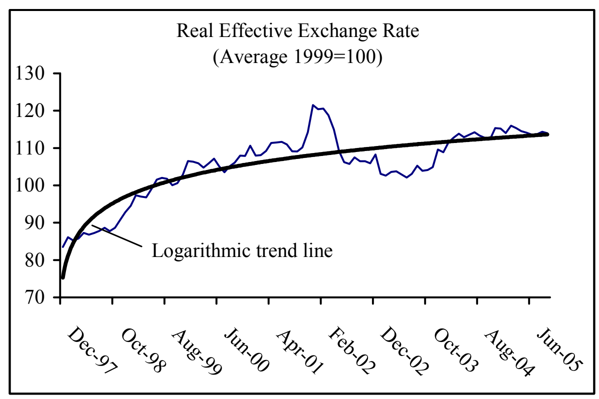
Inflation has been lowered...



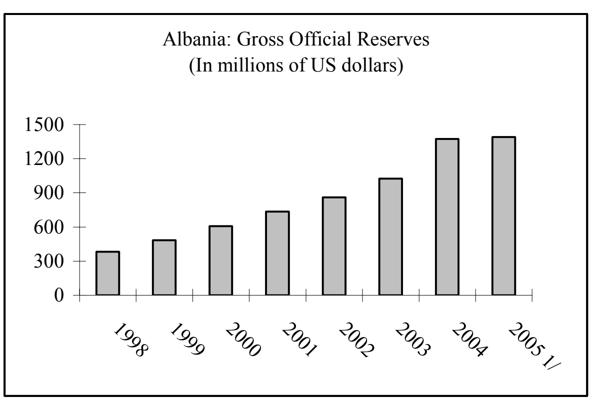
...helped by fiscal consolidation...



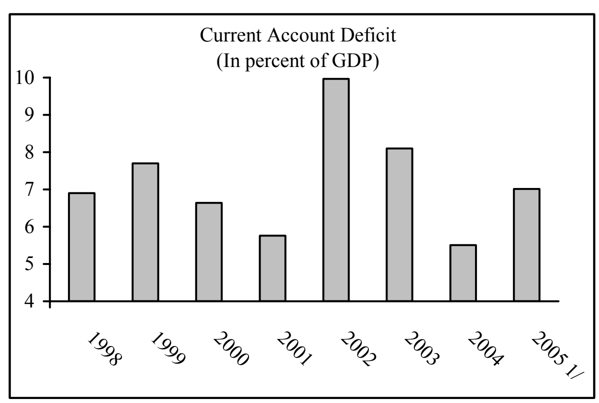
...and a trend real appreciation...



...and reserve levels have increased...



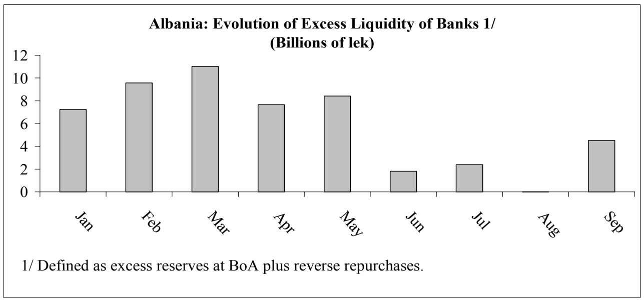
...but the current account deficit remains high.



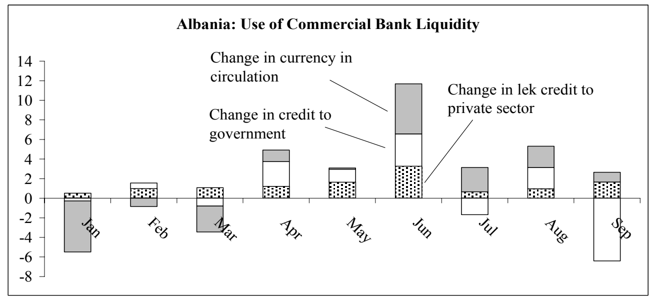
Sources: Albanian authorities and staff estimates and projections.
1/ IMF projection.

Figure 2. Albania: Recent Monetary Developments, January-September, 2005

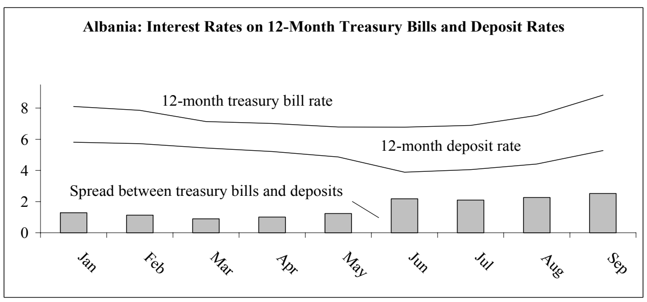
A large liquidity overhang built up in the first quarter, but was eliminated by end-August...



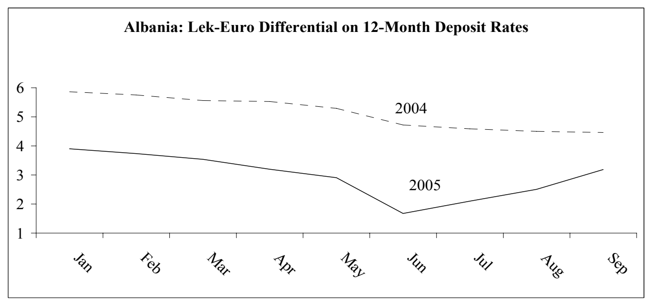
...as a result of accelerated lek lending and the seasonal increase of currency in circulation.



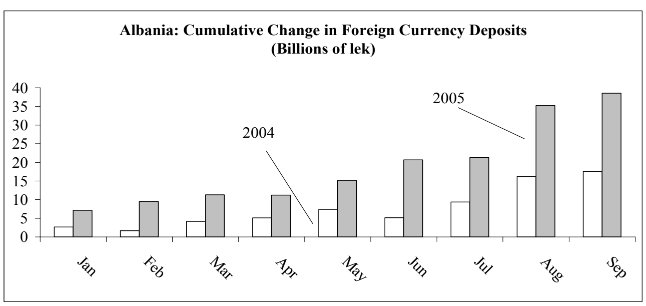
Interest rates followed liquidity developments, but spreads widened due to market imperfections.



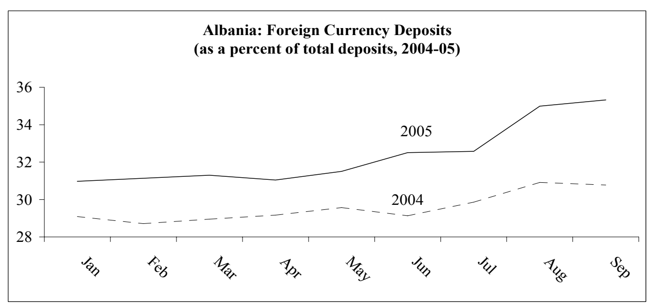
Interest differentials between lek and foreign currency deposits fell, while political uncertainty increased during the election period...



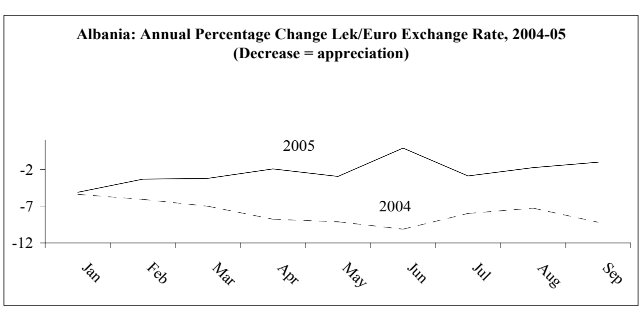
...reducing the incentive to convert foreign currency deposits into lek deposits...



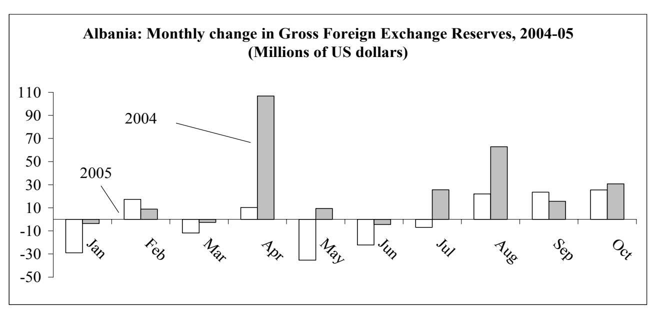
...increasing the degree of euroization....



...reducing the appreciation of the lek...



...and limiting reserve accumulation.



Sources: Albanian authorities; and staff estimates.

Table 1. Albania: Schedule of Disbursements Under PRGF/EFF Arrangement 1/

Date	Amounts in millions of SDRs	In percent of quota 2/	Conditions
February 2006	2.435	5.0	Board approval of PRGF arrangement
August 2006	2.435	5.0	Observance of end-March 2006 performance criteria and completion of first review.
February 2007	2.435	5.0	Observance of end-September 2006 performance criteria and completion of second review.
July 2007	2.435	5.0	Observance of end-March 2007 performance criteria and completion of third review.
January 2008	2.435	5.0	Observance of end-September 2007 performance criteria and completion of fourth review.
July 2008	2.435	5.0	Observance of end-March 2008 performance criteria and completion of fifth review.
January 2009	2.435	5.0	Observance of end-September 2008 performance criteria and completion of sixth review.
Total	17.045	35.0	

1/ The proposed distribution for the PRGF/EFF is 50 percent each.

2/ Albania's quota is SDR 48.7 million.

Table 2. Albania: Projected Payments to the Fund
(in millions of SDRs)

	2002	2003	2004	2005	2006	2007	2008	2009
				Projections				
Obligations from existing drawings								
1. Principal								
PRGF Repayments	6.2	6.8	6.4	6.2	7.6	9.4	9.6	9.1
GRA repurchases	4.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2. Charges and Interest 1/								
PRGF Interest	0.3	0.3	0.3	0.3	0.3	0.3	0.2	0.2
SDR Net Charges	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Obligations	11.0	7.1	6.7	6.5	7.9	9.7	9.8	9.2
(percent of quota)	23	15	14	13	16	20	20	19
Obligations from prospective drawings								
1. Principal								
PRGF Repayments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2. Charges and Interest 1/								
PRGF Interest	0.0	0.0	0.0	0.0	0.1	0.2	0.3	0.4
Total Obligations	0.0	0.0	0.0	0.0	0.1	0.2	0.3	0.4
(percent of quota)	0	0	0	0	0	0	1	1
Cumulative obligations (existing and prospective)								
1. Principal								
PRGF Repayments	10.6	6.8	6.4	6.2	7.6	9.4	9.6	9.1
2. Charges and Interest 2/								
PRGF Interest	0.3	0.3	0.3	0.3	0.4	0.4	0.5	0.5
SDR Net Charges	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Obligations	11.0	7.1	6.7	6.5	8.0	9.8	10.1	9.6
(percent of quota)	23	15	14	13	16	20	21	20
Outstanding Fund credit 3/	59.6	60.8	62.4	64.3	61.5	57.0	52.3	45.6
Memorandum items:								
Outstanding Fund credit								
In percent of:								
Exports of goods & services	8	7	6	5	5	4	3	2
GDP	2	1	1	1	1	1	1	1
Quota	122	125	128	132	126	117	107	94
Total Obligations								
In percent of:								
Exports of goods & services	1.6	0.9	0.6	0.5	0.6	0.6	0.6	0.5
GDP	0.3	0.2	0.1	0.1	0.1	0.2	0.1	0.1

1/ Based on actual data until October 31, 2005 and projected disbursements under the proposed program.
2/ Projections are based on current interest rates for PRGF. The current SDR interest rate is assumed for net use of SDRs.
3/ End of year value.

Table 3. Albania: Basic Indicators and Macroeconomic Framework, 2001–09

	2001	2002	2003	2004		2005		2006	2007	2008	2009
				6th Review 1/	Est.	6th Review 1/	Proj.	Proj.	Proj.	Proj.	Proj.
					(Growth rate in percent)						
Real GDP 2/	7.0	2.9	5.7	5.9	5.9	6.0	5.5	5.0	6.0	6.0	6.0
Retail prices (avg.)	3.1	5.2	2.4	2.9	2.9	2.2	2.5	3.0	3.0	3.0	3.0
Retail prices (end-period)	3.5	1.7	3.3	2.2	2.2	2.5	3.0	3.0	3.0	3.0	3.0
					(In percent of GDP)						
Saving-investment balance 3/											
Foreign savings 4/	2.8	7.2	5.5	4.5	3.8	5.7	5.5	6.7	5.9	5.7	5.8
Domestic savings	24.8	17.4	17.9	19.6	20.0	19.4	18.6	18.0	19.5	20.4	21.0
Public 5/	-0.6	0.0	-0.1	0.1	0.1	1.4	1.4	1.6	2.3	2.4	2.7
Private	25.4	17.4	18.0	19.5	19.9	18.0	17.2	16.4	17.3	18.0	18.2
Investment	27.6	24.5	23.4	24.1	23.8	25.1	24.2	24.7	25.4	26.1	26.8
Public	7.3	6.7	4.6	5.0	5.0	5.8	5.2	5.3	5.6	5.7	5.8
Private	20.2	17.8	18.8	19.1	18.8	19.3	19.0	19.4	19.8	20.4	21.0
Fiscal sector											
Revenues and grants	23.7	24.7	24.5	24.1	24.1	24.5	24.6	24.6	24.7	24.7	24.8
Tax revenue	19.8	20.6	21.3	21.7	21.7	21.8	21.7	21.8	21.9	22.0	22.1
Of which: social security contributions	3.8	4.1	4.2	4.3	4.3	4.4	4.3	4.4	4.5	4.5	4.5
Expenditures	31.6	31.4	29.0	29.2	29.2	29.1	28.3	28.7	28.2	28.0	27.9
Primary	27.3	27.4	24.6	25.5	25.5	25.7	25.1	25.3	24.9	24.9	24.9
Interest	4.3	4.0	4.4	3.7	3.7	3.4	3.2	3.4	3.2	3.1	3.0
Overall balance (including grants)	-7.9	-6.6	-4.5	-5.1	-5.1	-4.6	-3.8	-4.1	-3.5	-3.4	-3.2
Primary balance (excluding grants)	-4.2	-3.3	-0.5	-1.8	-1.8	-1.8	-1.6	-1.7	-1.2	-1.1	-1.0
Net domestic borrowing	3.1	3.3	2.9	2.3	2.3	2.8	2.8	2.6	2.5	2.4	2.3
Privatization receipts	2.2	0.1	0.1	1.9	1.9	0.2	0.3	0.3	0.2	0.2	0.2
Foreign financing	2.6	3.3	1.5	1.0	1.0	1.7	0.7	1.1	0.7	0.7	0.7
Public Debt	67.6	65.0	61.8	56.6	56.5	56.2	54.9	55.0	54.5	53.6	52.6
Domestic	41.0	41.7	41.1	38.5	38.5	38.1	38.1	38.1	37.4	36.6	35.8
External (including publicly guaranteed) 6/7/	26.6	23.3	20.7	18.1	18.0	18.1	16.8	17.0	17.0	17.0	16.8
Monetary indicators											
Broad money growth	20.2	5.7	8.7	13.5	13.5	11.0	13.9	12.0	12.0	12.7	12.8
Private credit growth	23.4	41.0	31.1	36.9	36.9	49.3	69.1	43.2	35.3	29.6	26.7
Velocity	1.5	1.5	1.5	1.6	1.5	1.5	1.5	1.4	1.4	1.3	1.3
Interest rate (3-mth T-bills, end-period) 8/	8.0	11.1	7.3	6.2	6.2	…	5.4	…	…	…	…
					(In percent of GDP unless otherwise indicated)						
External sector											
Trade balance (goods and services)	-22.5	-25.9	-25.1	-21.8	-21.7	-22.9	-23.2	-23.5	-22.5	-21.8	-21.6
Current account balance (excluding official transfers)	-5.8	-10.0	-8.1	-6.1	-5.5	-7.3	-7.0	-8.1	-7.3	-6.9	-6.9
Current account balance (including official transfers)	-2.8	-7.2	-5.5	-4.5	-3.8	-5.7	-5.5	-6.7	-5.9	-5.7	-5.8
Official transfers	3.0	2.8	2.6	1.7	1.7	1.5	1.5	1.4	1.3	1.2	1.1
Gross international reserves (in millions of Euros)	826	845	834	1025	1025	1089	1147	1225	1329	1483	1650
(in months of imports of goods and services)	4.6	4.4	3.9	4.1	4.1	4.0	4.1	4.1	4.1	4.1	4.2
(relative to external debt service)	19.1	13.2	18.8	18.8	23.6	13.2	19.8	13.4	12.1	10.0	9.3
(in percent of broad money)	25.5	28.2	24.6	25.3	25.3	25.8	24.8	23.8	23.3	23.3	23.2
Change in real effective exchange rate (e.o.p., in percent) 9/	9.8	-10.9	1.2	5.1	5.1	…	-1.1	…	…	…	…
Memorandum items											
Nominal GDP (in billions of lek) 2/	587.7	624.7	682.7	780.1	766.4	857.3	836.8	899.7	982.2	1075.7	1176.6

Social Indicators: GNI per capita, World Bank Atlas Method, US$ (2003): $1,740; **population** 3.2 million (2003; **life expectancy at birth** (2003): 74 years; **infant mortality rate** (2003, per thousand births): 18; **population living below the poverty line** (2002): 25.4 **population without running water inside their dwellings** (2003): 40 percent.

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

1/ Ratios to GDP have been adjusted to reflect revisions to nominal GDP.
2/ GDP data through 2003 are from the official national accounts. Real GDP growth is based on the observed economy only.
3/ The statistical discrepancy contained in the national accounts was allocated to private consumption and investment according to the ratio observed in the national accounts excluding the discrepancy. Unexplained oscillations in this discrepancy introduced additional statistical uncertainty into the historical data.
4/ Negative of current account including official transfers.
5/ Revenue including grants less current expenditure and net lending.
6/ Includes arrears, with the exception of pre-1978 arrears to China .
7/ Excludes IMF repurchase obligations.
8/ Value for 2005 is as of November 22.
9/ Estimate for 2005 based on September data.

Table 4. Albania: Millennium Development Goals

	1990	1995	2001	2002	2003	2015 Target
General Indicators						
Population (million)	3.3	3.2	3.1	3.1	3.2	
GNI per capita ($)	680	650	1400	1450	1740	
Adult literacy rate (% people ages 15 and over)	77	81.2	98.7	...	...	
Total fertility rate (births per woman)	3	2.6	2.1	2.2	...	
Life expectancy at birth (years)	72.3	71.3	74	74	74	
Aid (% of GNI)	0.5	7.3	6.1	6.4	...	
Goal 1. Eradicate extreme poverty and hunger						
Target 1. Halve, between 1990 and 2015, the proportion of people whose income is less that one dollar a day						
1. Population below 1 US$ a day (percent)	...	...	...	2.0	...	1.4
2. Poverty gap ratio at US$ 1 a day (percent)	...	...	...	0.5	...	...
3. Share of income consumption held by poorest 20 percent (percent)	...	...	...	9.1	...	...
Target 2: Halve, between 1990 and 2015, the proportion of people suffering from hunger						
4. Prevalence of child malnutrition (percent of children under 5)	...	...	14	...	...	5.4
5. Population below minimum level of dietary energy consumption (percent)	...	...	...	...	...	...
Goal 2. Achieve universal primary education						
Target 3: Ensure that, by 2015, children will be able to complete a full course of primary schooling						
6. Net primary enrollment ratio (percent of relevant age group)	...	98.7	97.2	...	...	100
7. Percentage of cohort reaching grade 5	...	...	82	...	...	100
8. Youth literacy rate (percent ages 15-24)	94.8	96.6	98	98.2	...	100
Goal 3. Promote gender equality and empower women						
Target 4: Eliminate gender disparity in primary and secondary education preferably by 2005 and to all levels of education in 2015						
9. Ratio of girls to boys in primary and secondary education (percent)	96.1	101.3	102	...	...	100
10. Ratio of young literate females to males (percent ages 15-24)	94.4	96.2	100.1	...	...	100
11. Share of women employed in the nonagricultural sector (percent)	39.6	...	41.1	...	40.2	...
12. Proportion of seats held by women in the national parliament (percent)	...	6.0	...	...	6.0	30
Goal 4. Reduce child mortality						
Target 5: Reduce by two-thirds, between 1990 and 2015, the under-five mortality rate						
13. Under-five mortality rate (per 1,000)	45	33	26	24	21	13.7
14. Infant mortality rate (per 1,000 live births)	36	29	24	22	18.0	...
15. Immunization against measles (percent of children under 12-months)	88	91	95	96	93	97.3
Goal 5. Improve maternal health						
Target 6: Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio						
16. Maternal mortality ratio (modeled estimate, per 100,000 live births)	...	31	55	...	...	9.5
17. Proportion of births attended by skilled health personnel	...	...	99.1	...	...	...
Goal 6. Combat HIV/AIDS, malaria and other diseases						
Target 7: Halt by 2015, and begin to reverse, the spread of HIV/AIDS						
18. HIV prevalence among females (percent ages 15-24)	...	...	...	...	...	0
19. Contraceptive prevalence rate (percent of women ages 15-49)	...	...	...	...	...	...
20. Number of children orphaned by HIV/AIDS	...	...	...	...	...	0

Table 4. Albania: Millennium Development Goals (concluded)

	1990	1995	2001	2002	2003	2015 Target
Target 8: Halt by 2015, and begin to reverse, the incidence of malaria and other major diseases						
21. Prevalence of death associated with malaria	...	...	...	...	...	0
22. Share of population in malaria risk areas using effective prevention treatment	...	...	...	...	...	
23. Incidence of tuberculosis (per 100,000 people)	26.7	28	29	27.5	22.9	<20
24. Tuberculosis cases detected under DOTS (percent)	...	...	20	24	29.5	...
Goal 7. Ensure environmental sustainability						
Target 9: Integrate the principles of sustainable development into policies and programs. Reverse the loss of environmental resources.						
25. Forest area (percent of total land area)	39	...	36.2	...	...	...
26. Nationally protected areas (percent of total land area)	...	2.9	3.1	3.8	...	...
27. GDP per unit of energy use (PPP $ per kg oil equivalent)	3.1	7.6	8.3	...	...	...
28. CO2 emissions (metric tons per capita)	2.2	0.6	0.9	...	...	...
29. Proportion of population using solid fuels	...	...	...	...	...	...
Target 10: Halve by 2015 the proportion of people without access to safe drinking water						
30. Access to improved water source (percent of population)	...	...	97	...		86.1
Target 11: Achieve by 2020 a significant improvement for at least 100 million slum dwellers						
31. Access to improved sanitation (percent of population)	...	...	91	...	...	94.7
32. Access to secure tenure (percent of population)	...	...	...	...	...	...
Goal 8. Develop a Global Partnership for Development 1/						
Target 16. Develop and implement strategies for productive work for youth						
45. Unemployment rate	9	13	16.8	...	...	...
Female	8	12	14.8	...	...	...
Male	11	15	19.3	...	...	...
Target 17: Provide access to affordable essential drugs						
46. Proportion of population with access to affordable drugs	...	...	...	...	...	...
Target 18: Make available new technologies especially information and communications						
47. Fixed line and mobile telephones (per 1,000 people)	12.6	13.4	191.2	347.7	...	...
48. Personal computers (per 1,000 people)	...	1.6	9.7	11.7	...	...

Source: World Bank and Fund staff estimates

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

Table 5a. Albania: Balance of Payments, 2001–09
(In millions of Euros)

	2001	2002	2003	2004	2005 Q1 Est.	2005 Q2 Est.	2005 Q3 Est.	2005 Q4 Proj.	2005 Proj.	2006 Projections	2007 Projections	2008 Projections	2009 Projections
Current account	-264	-468	-402	-331	-65	-112	-103	-192	-472	-584	-568	-583	-639
Balance of goods and services	-1,036	-1,214	-1,248	-1,307	-306	-387	-411	-448	-1,553	-1,699	-1,762	-1,851	-1,992
Exports	937	962	1,031	1,293	318	381	396	375	1,470	1,641	1,850	2,082	2,316
Goods	340	349	396	486	122	143	134	136	534	614	706	812	918
Services	597	613	635	808	197	237	262	240	936	1,027	1,143	1,269	1,398
Imports	1,973	2,176	2,279	2,600	624	768	807	823	3,022	3,340	3,611	3,933	4,307
Goods	1,476	1,555	1,572	1,752	398	507	516	609	2,030	2,275	2,452	2,657	2,883
Services	497	622	708	848	226	261	291	214	992	1,065	1,159	1,276	1,424
Income balance	166	134	152	146	30	32	39	32	133	134	135	135	141
of which : Interest due	16	22	21	18	4	7	5	10	27	48	58	68	76
Private transfers	605	612	693	830	210	243	270	224	947	981	1,059	1,133	1,212
Capital account	322	481	403	436	71	122	31	181	405	595	610	631	696
Official transfers	138	132	129	103	22	27	25	27	101	102	105	101	106
Direct investment	231	142	158	277	45	50	53	48	197	229	243	280	314
Other capital	-137	113	42	-13	-18	38	-57	95	58	140	184	196	234
Private loans (incl.net trade credits, net)	-1	12	21	78	3	47	12	5	66	53	55	58	73
Other financial flows	-136	102	21	-91	-21	-9	-68	90	-8	87	130	138	161
of which: Change in NFA of commercial banks (incr = -) 1/	-136	102	21	-91	-21	-9	-68	90	-8	87	130	138	149
Medium- and long-term loans (net)	91	95	75	68	22	7	9	11	49	124	78	55	42
New borrowing	99	123	101	100	27	18	15	25	85	178	141	156	173
Multilateral loans	61	84	75	72	17	13	11	20	60	140	105	105	107
World Bank	38	52	36	37	7	7	6	5	26	45	33	33	33
EBRD	2	8	13	13	3	4	2	5	13	35	26	25	25
Other	20	24	25	23	7	1	3	10	21	60	46	47	49
Bilateral loans	38	38	26	28	11	5	4	5	25	38	37	51	66
Amortization	-8	-28	-25	-33	-6	-10	-6	-14	-36	-54	-64	-101	-131
Errors and omissions 2/	87	-16	26	73	7	15	22	20	64	57	51	80	87
Net balance	145	-3	27	177	13	25	-50	8	-4	67	93	129	144
Financing requirement	-145	3	-27	-177	-13	-25	50	-8	4	-67	-93	-129	-144
Available financing	-145	3	-27	-177	4	-10	-3	13	4	-67	-93	-128	-144
Change in net reserves (increase = -) 1/	-154	-30	-46	-193	4	-10	-3	1	-8	-86	-116	-165	-178
Of which: Change in gross reserves, (increase = -) 1/	-149	-19	10	-191	1	-11	-6	3	-13	-77	-105	-153	-167
Use of Fund Resources (net)	-2	-9	2	2	4	-3	3	-2	2	-9	-11	-12	-11
Budget support	5	30	17	15	0	0	0	0	0	0	0	0	0
Changes in arrears (increase = +) 3/	-33	-301	2	-12	0	-4	0	-12	-17	-19	-51	0	0
Overdue debt forgiveness	11	225	0	0	0	0	0	0	0	0	0	0	0
Rescheduling 4/	26	79	0	12	0	4	0	0	4	0	0	0	0
Identified Financing	0	0	0	0	0	0	0	0	0	0	8	12	4
Of which: IMF PRGF	0	0	0	0	0	0	0	0	0	0	0	0	0
WB FSAC/PRSC	0	0	0	0	0	0	0	0	0	0	8	12	4
Financing gap	0	0	0	0	0	0	0	24	24	38	66	25	30
Expected EU Macro-Financial Assistance	...	...	...	...	0	0	0	12	12	13	0	0	0
Arrears Rescheduling	...	...	...	...	0	0	0	12	12	19	51	0	0
Other 5/	...	...	...	...	0	0	0	0	0	6	15	25	30
Memorandum items:													
Gross usable reserves	826	845	834	1,025	1,024	1,071	1,114	1,147	1,147	1,225	1,329	1,483	1,650
(months of imports of goods and services)	4.6	4.4	3.9	4.1	...	...	...	...	4.1	4.1	4.1	4.1	4.2
Balance of goods and services (percent of GDP)	-22.5	-25.9	-25.1	-21.7	...	...	...	...	-23.2	-23.5	-22.5	-21.8	-21.6
Current account (percent of GDP)	-5.8	-10.0	-8.1	-5.5	...	...	...	...	-7.0	-8.1	-7.3	-6.9	-6.9
Debt service (percent of exports of goods and services) 4/	4.1	6.3	5.0	4.1	...	...	...	...	4.2	5.9	5.5	6.6	7.1
Debt service (percent of central government revenues) 4/	3.7	5.5	4.5	3.9	...	...	...	...	4.2	6.0	5.8	7.1	7.8
Total external debt stock (percent of GDP) 6/	28.5	25.2	22.2	20.4	...	...	...	...	19.7	20.0	19.9	19.5	19.1
Volume of Exports of Goods and Services (percent change)	23.9	3.9	9.5	20.6	...	...	...	...	7.2	7.9	11.1	11.1	9.8
Volume of Imports of Goods and Services (percent change)	23.3	11.9	8.4	10.7	...	...	...	...	8.7	6.1	7.9	8.7	8.7

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

1/ Net of valuation changes.

2/ Includes unidentified capital inflows presumed, on the basis of their relative stability over time, to include remittances not captured through the current methodology as well as investment of funds acquired abroad by nonresident Albanians on their own behalf. These have been assumed to remain broadly stable relative to GDP over the projection period.

3/ In 2005-2007 assumes rescheduling of stock of outstanding arrears, both with official and private creditors.

4/ Public and publicly guaranteed debt only.

5/ Expected to be partially covered by Fund resources in 2006-2009

6/ Public and private external debt, including arrears. Debt stock converted into Lek at the e-o-p exchange rate.

Table 5b . Albania: Balance of Payments, 2001–09
(In percent of GDP)

	2001	2002	2003	2004	2005	2006	2007	2008	2009
Current account	-5.8	-10.0	-8.1	-5.5	-7.0	-8.1	-7.3	-6.9	-6.9
Balance of goods and services	-22.5	-25.9	-25.1	-21.7	-23.2	-23.5	-22.5	-21.8	-21.6
Exports	20.4	20.5	20.8	21.5	21.9	22.7	23.6	24.5	25.2
Goods	7.4	7.4	8.0	8.1	8.0	8.5	9.0	9.6	10.0
Services	13.0	13.1	12.8	13.4	14.0	14.2	14.6	14.9	15.2
Imports	42.9	46.3	45.9	43.2	45.1	46.2	46.2	46.3	46.8
Goods	32.1	33.1	31.6	29.1	30.3	31.5	31.3	31.3	31.3
Services	10.8	13.2	14.2	14.1	14.8	14.7	14.8	15.0	15.5
Income balance	3.6	2.8	3.1	2.4	2.0	1.9	1.7	1.6	1.5
of which : Interest due	0.3	0.5	0.4	0.3	0.4	0.7	0.7	0.8	0.8
Private transfers	13.2	13.0	14.0	13.8	14.1	13.6	13.5	13.3	13.2
Capital account	7.0	10.2	8.1	7.2	6.0	8.2	7.8	7.4	7.6
Official transfers	3.0	2.8	2.6	1.7	1.5	1.4	1.3	1.2	1.1
Direct investment	5.0	3.0	3.2	4.6	2.9	3.2	3.1	3.3	3.4
Other capital	-3.0	2.4	0.8	-0.2	0.9	1.9	2.4	2.3	2.5
Private loans (incl.net trade credits, net)	0.0	0.2	0.4	1.3	1.0	0.7	0.7	0.7	0.8
Other financial flows	-3.0	2.2	0.4	-1.5	-0.1	1.2	1.7	1.6	1.8
of which: Change in NFA of commercial banks (incr = -) 1/	-3.0	2.2	0.4	-1.5	-0.1	1.2	1.7	1.6	1.6
Official medium- and long-term loans (net)	2.0	2.0	1.5	1.1	0.7	1.7	1.0	0.6	0.5
New borrowing	2.1	2.6	2.0	1.7	1.3	2.5	1.8	1.8	1.9
Multilateral loans	1.3	1.8	1.5	1.2	0.9	1.9	1.3	1.2	1.2
World Bank	0.8	1.1	0.7	0.6	0.4	0.6	0.4	0.4	0.4
EBRD	0.1	0.2	0.3	0.2	0.2	0.5	0.3	0.3	0.3
Other	0.4	0.5	0.5	0.4	0.3	0.8	0.6	0.6	0.5
Bilateral loans	0.8	0.8	0.5	0.5	0.4	0.5	0.5	0.6	0.7
Amortization	-0.2	-0.6	-0.5	-0.5	-0.5	-0.7	-0.8	-1.2	-1.4
Errors and omissions 2/	1.9	-0.3	0.5	1.2	0.9	0.8	0.7	0.9	0.9
Net balance	3.2	-0.1	0.6	3.0	-0.1	0.9	1.2	1.5	1.6
Financing requirement	-3.2	0.1	-0.6	-3.0	0.1	-0.9	-1.2	-1.5	-1.6
Available financing	-3.2	0.1	-0.6	-3.0	0.1	-0.9	-1.2	-1.5	-1.6
Change in net reserves (increase = -) 1/	-3.3	-0.6	-0.9	-3.2	-0.1	-1.2	-1.5	-1.9	-1.9
BOP support	0.1	0.6	0.3	0.3	0.0	0.0	0.0	0.0	0.0
Changes in arrears (increase = +) 3/	-0.7	-6.4	0.0	-0.2	-0.2	-0.3	-0.7	0.0	0.0
Overdue debt forgiveness	0.2	4.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Rescheduling 4/	0.6	1.7	0.0	0.2	0.1	0.0	0.0	0.0	0.0
Identified Financing	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.0
Of which: IMF PRGF	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
WB ESAC/PRSC	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.0
Financing gap	0.0	0.0	0.0	0.0	0.4	0.5	0.8	0.3	0.3
Expected EU Macro-Financial Assistance	...	...	...	...	0.2	0.2	0.0	0.0	0.0
Arrears Rescheduling	...	...	...	...	0.2	0.3	0.7	0.0	0.0
Other 5/	...	...	...	...	0.0	0.1	0.2	0.3	0.3

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

1/ Net of valuation changes.

2/ Includes unidentified capital inflows presumed, on the basis of their relative stability over time, to include remittances not captured through the current methodology as well as investment of funds acquired abroad by nonresident Albanians on their own behalf. These have been assumed to remain broadly stable relative to GDP over the projection period.

3/ In 2005-2007 assumes rescheduling of stock of outstanding arrears, both with official and private creditors.

4/ Public and publicly guaranteed debt only.

5/ Expected to be partially covered by Fund resources in 2006-2009

Table 6. Albania: Monetary Aggregates, 2002–09

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

	Actuals						IMF projections							
	2002	2003	2004	2005				2006				2007	2008	2009
	Dec.	Dec.	Dec.	March	June	Sep	Dec.	March	June	Sep	Dec.	Dec.	Dec.	Dec.
Monetary survey														
Broad money	408.1	443.5	503.2	516.9	537.8	561.9	573.4	585.4	601.5	628.4	642.2	719.1	810.0	913.4
Currency outside banks	130.8	125.2	138.1	129.4	135.8	141.5	151.0	147.4	151.5	158.3	164.4	173.3	183.1	187.2
Deposits	277.4	318.3	365.1	387.5	402.0	420.4	422.4	438.0	450.0	470.1	477.8	545.8	627.0	726.2
Domestic currency deposits	190.8	226.1	255.2	266.2	271.3	271.9	273.9	283.3	290.3	296.5	304.2	347.9	404.3	482.9
Demand deposits	15.1	16.8	32.0	38.1	37.7	67.4	60.6	59.2	60.8	63.5	61.5	68.4	77.0	87.9
Time deposits	175.7	209.3	223.2	228.1	233.7	204.5	213.3	224.1	229.5	232.9	242.7	279.5	327.3	395.0
Foreign currency deposits	86.5	92.2	110.0	121.3	130.6	148.5	148.5	154.7	159.7	173.6	173.6	197.9	222.6	243.3
Demand deposits	22.7	21.2	25.0	27.9	30.8	33.7	...	...	...	...	...	...	...	...
Time deposits	63.8	71.0	85.0	93.3	99.8	114.8	...	...	...	...	...	...	...	...
Net foreign assets	164.4	161.8	188.8	197.3	199.2	213.8	205.1	202.5	196.0	212.1	206.6	206.7	212.1	217.8
Bank of Albania	96.9	99.8	118.6	122.2	124.9	128.4	131.6	130.8	130.0	140.4	143.4	159.4	181.9	206.4
Commercial Banks	67.5	62.0	70.2	75.1	74.3	85.3	73.5	71.7	66.0	71.7	63.1	47.3	30.2	11.4
Net domestic assets	243.8	281.7	314.4	319.6	338.6	348.1	368.3	382.9	405.6	416.3	435.7	512.4	597.9	695.6
Claims on government (net of deposits)	245.3	260.1	271.0	269.9	276.4	277.6	283.6	287.6	291.6	295.7	299.7	316.8	334.5	353.1
BOA financing	71.0	64.6	57.2	56.7	56.0	63.2	62.2	64.5	71.2	74.8	61.8	58.7	52.6	38.2
Other (including T-bills)	174.3	195.5	213.7	213.2	220.4	214.5	221.3	223.1	220.4	220.9	237.9	258.1	281.8	314.9
Claims on state enterprises and farms	0.0	0.0	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Claims on the private sector 1/	39.9	52.3	71.6	81.5	97.8	108.1	121.1	132.0	150.9	157.9	173.5	234.6	304.2	385.2
In Leks	9.2	10.6	15.6	18.1	24.3	27.6	30.1	33.7	42.4	42.5	49.5	73.0	103.3	147.1
In foreign currency	30.7	41.7	56.0	63.4	73.6	80.5	91.0	98.4	108.5	115.4	123.9	161.6	200.9	238.1
Other items, net	-41.5	-30.8	-28.3	-32.0	-35.7	-37.6	-36.4	-36.7	-37.0	-37.3	-37.6	-39.0	-40.7	-42.8
Memorandum items:														
Reserve money (billions of Lek)	163.9	160.6	178.6	171.2	180.4	194.1	197.3	198.9	203.5	212.6	216.8	233.1	251.8	262.8
M1 (billions of Lek)	145.9	142.0	170.1	167.5	173.5	208.9	211.7	206.6	212.3	221.8	225.9	241.6	260.1	275.1
M2 (Billions of Lek)	321.6	351.3	393.3	395.6	407.1	413.4	424.9	430.7	441.8	454.7	468.6	521.2	587.4	670.1
Annual broad money growth	5.7	8.7	13.5	14.8	18.8	16.3	13.9	14.4	14.2	12.2	12.0	12.0	12.7	12.8
Annual reserve money growth	7.7	-2.0	11.2	10.8	14.9	16.6	10.5	16.2	12.8	11.2	9.8	7.5	8.0	4.4
Annual growth in private sector credit	41.0	31.1	36.9	48.5	68.0	73.2	69.1	62.0	54.3	46.1	43.2	35.3	29.6	26.7
Annual M1 growth	6.9	-2.7	19.8	21.8	25.9	38.1	24.5	0.0	0.0	0.0	6.7	7.0	7.6	5.8
Annual M2 growth	6.4	9.2	11.9	11.8	14.6	10.8	8.1	0.0	0.0	0.0	10.3	11.2	12.7	14.1
Velocity (annual GDP/BM)	1.5	1.5	1.5	1.6	1.5	1.5	1.5	1.5	1.4	1.4	1.4	1.4	1.3	1.3
Money multiplier (absolute values)	2.5	2.8	2.8	3.0	3.0	2.9	2.9	2.9	3.0	3.0	3.0	3.1	3.2	3.5
Currency/Broad Money ratio	32.0	28.2	27.4	25.0	25.3	25.2	26.3	25.2	25.2	25.2	25.6	24.1	22.6	20.5
Foreign currency deposits/total deposits	31.2	29.0	30.1	31.3	32.5	35.3	35.2	35.3	35.5	36.9	36.3	36.3	35.5	33.5
Gross reserves (millions of euros)	845	834	1,025	1,024	1,071	1,114	1,147	1,138	1,129	1,211	1,225	1,329	1,483	1,650
Gross reserves (millions of U.S. dollars)	860	1,026	1,374	1,351	1,303	1,342	1,390	1,380	1,370	1,470	1,486	1,617	1,809	2,016
In percent of broad money	28.2	24.6	25.3	25.4	24.9	24.5	24.8	24.2	23.4	24.1	23.8	23.3	23.3	23.2
US Dollar Exchange Rate (end of period)	133.9	106.4	92.7	97.2	102.7	102.5	...	...	...	...	...	...	...	...
Euro Exchange Rate (end of period)	138.3	133.8	125.9	125.9	123.9	123.3	...	...	...	...	...	...	...	...
3-month T-bill rate (in percent)	11.1	7.3	6.2	5.3	5.0	6.3	…	…	…	…	…	…	…	…
BoA repo rate (in percent)	8.5	6.5	5.3	5.0	5.0	5.0	…	…	…	…	…	…	…	…

Sources: Bank of Albania; and staff estimates.

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

Table 7. Albania: IMF Core Indicators of Financial Soundness, December 2003-September 2005

		Dec-03	Dec-04	Mar-05	Jun-05	Sep-05
I	**Capital-based**					
(i)	Regulatory capital as a percent of risk-weighted assets 1/	28.5	21.6	21.0	19.8	18.3
(ii)	Regulatory Tier 1 capital as a percent of risk-weighted assets 1/	29.0	21.5	20.4	19.3	17.9
(iii)	Capital as a percent of total assets					
	Regulatory Tier 1 capital as a percent of total assets	4.8	4.8	5.0	5.2	5.1
	Regulatory capital as a percent of total assets	4.7	4.8	5.1	5.3	5.3
	Shareholders' equity as a percent of total assets	5.9	6.1	5.8	6.4	6.6
(iv)	Nonperforming loans net of provisions as a percent of capital					
	Nonperforming loans net of provisions as a percent of regulatory Tier 1 capital 2/	4.8	4.8	4.5	3.0	4.1
	Nonperforming loans net of provisions as a percent of regulatory capital 2/	4.9	4.8	4.4	2.9	4.0
	Nonperforming loans net of provisions as a percent of shareholders' equity 2/	3.9	3.8	3.9	2.4	3.2
(v)	Return on equity (ROE) (annual basis)	19.5	21.1	22.1	24.3	24.5
(vi)	Net open position in foreign exchange as a percent of capital					
	Net open position in foreign exchange as a percent of regulatory Tier 1 capital	7.2	7.5	3.6	8.7	7.3
	Net open position in foreign exchange as a percent of regulatory capital	7.3	7.4	3.5	8.5	7.1
	Net open position in foreign exchange as a percent of shareholders' equity	5.9	5.9	3.1	7.0	5.7
II	**Asset-based**					
(vii)	Liquid assets as a percent of total assets (Liquid-asset ratio)	73.6	71.1	70.3	67.1	65.3
(viii)	Liquid assets as a percent of short-term liabilities	na	na	83.2	109.9	73.5
(ix)	Return on assets (ROA) (net income to average total assets) (annual basis)	1.2	1.3	1.3	1.5	1.5
(x)	Sectoral distribution of loans to total loans	na	na	na	na	na
III	**Income and expense-based**					
(xi)	Interest margin to gross income	89.6	80.3	83.2	80.5	82.0
(xii)	Noninterest expenses to gross income	57.4	66.2	81.5	75.3	76.7
IV	**Memorandum items**					
	Other (noncore) indicators:					
	Customer deposits as a percent of total (non-interbank) loans	652.1	535.8	498.3	417.8	384.8
	Foreign currency-denominated loans to total loans	82.1	80.5	79.9	77.7	77.6
	Foreign currency-denominated liabilities as a percent of total liabilities	35.9	37.0	38.2	39.9	41.5
	Other indicators:					
	Risk weighted assets as a percent of total assets	16.7	22.2	24.4	26.8	28.7
	Total loans as a percent of total assets	13.6	16.4	17.6	20.8	22.8
	Total loans as a percent of shareholders' equity	231.2	270.3	302.6	326.5	348.7

Source: Data provided by Bank of Albania.

Table 8. Albania: Structural Policy Intentions for the Second Half of 2005 under the Previous PRGF Arrangement

	Test date	Status as of January 9, 2006
A. Key Policy Intentions		
1. Deployment of the ASYCUDA system in 10 customs houses.	End-December 2005	Installed in 9 houses
2. Implement the risk assessment module of the ASYCUDA system in 6 customs houses to perform inspections.	End-December 2005	Installed in 2 houses
3. The salaries of 70,000 employees of budgetary institutions to be paid through the banking system.	End-September 2005	Met
B. Other		
4. Establish and implement a set of clear and objective criteria for inclusion of taxpayers in the large taxpayers unit of the General Directorate for Taxes.	End-September 2005	Completed in November
5. Concentrate control of large taxpayers in the large taxpayers unit in Tirana.	End-September 2005	Met in November
6. Implement in the Durrës tax office a program for selecting taxpayers for 80 percent of all fiscal visits on the basis of an objective, computer-based risk	End-September 2005	Met in part
7. Prepare advance GDP estimates for the first quarter of 2005.	End-September 2005	Met
8. Complete the preliminary 2004 national accounts.	End-December 2005	Met 1/
9. Complete and make operational the inter-bank bulk clearing system at the Bank of Albania.	End-September 2005	Met
10. Prepare quarterly reports (within one month of the end of each quarter) on the stock of external arrears.	Ongoing	Not met on time, but provided to the mission team
11. Clear overdue VAT refunds originated prior to June 2004 by allocating to this end 1 percent of VAT gross revenue on a quarterly basis.	Ongoing	Met
12. Prepare quarterly reports on the aggregate amounts of the VAT refunds requested, refunds paid and refunds rejected.	Ongoing	Met
13. 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 commercial borrowing.	Ongoing	On track. No new large project since the 6th review.
(ii) Provide a quarterly listing and status report on all projects being considered for nonconcessional foreign financing.	Ongoing	Not met on time, but provided to the mission team

1/ Preliminary estimates have been discussed with staff and further refinements are being made on staff's request.

Table 9. Albania: External Public and Publicly Guaranteed Debt Stock by Creditors, 2000–2005
(In millions of Euros)

	2000	2001	2002	2003	2004	2005 1/
Total public and publicly guaranteed debt	1,321	1,391	1,140	1,122	1,169	1,274
Public and publicly guaranteed debt (excluding arrears)	803	925	1,010	1,021	1,090	1,192
Multilateral	531	590	633	659	714	787
CEB	0	0	0	1	3	4
EBRD	8	10	13	22	31	37
EIB	29	40	48	57	63	66
IDA	372	414	454	463	497	545
IDB	2	6	9	10	12	15
IFAD	14	17	20	23	24	27
IMF	97	94	78	73	72	79
OPEC	8	10	11	11	12	13
Bilateral	272	335	377	362	375	405
Rescheduled debt	64	90	112	91	88	95
Paris club members	64	64	53	41	35	37
Austria	2	2	1	1	0	0
France	6	5	3	2	1	0
Germany	6	5	6	5	3	3
Italy	6	6	5	4	4	3
Japan	0	0	0	0	0	0
Netherlands	0	0	0	0	0	0
Russia	45	47	37	30	27	30
Non Paris Club Members	0	26	59	49	53	58
China	0	0	38	31	27	29
FYR Macedonia	0	0	0	0	0	0
Hungary	0	0	0	0	9	10
Turkey	0	26	22	18	17	19
Post cut-off debt	208	245	265	271	287	310
Paris Club members	177	210	227	233	245	264
Austria	5	5	1	1	1	1
Germany	51	56	65	73	81	86
Italy	74	86	105	107	109	111
Japan	31	29	27	29	35	46
Norway	12	30	25	19	15	16
Sweden	4	5	4	3	3	3
Non-Paris Club	30	35	38	39	42	47
China	2	2	2	1	1	1
Greece	12	15	13	13	13	13
Korea	0	0	0	0	5	7
Kuwait	16	19	22	24	22	25
Arrears	519	466	131	101	79	82
Convertible currency	144	102	66	55	45	47
Non-convertible currency 2/	180	182	13	10	6	3
Commercial	42	38	32	17	15	17
Cumulative Overdue Interest 3/	153	144	19	18	13	16
Memorandum items:						
Total PPG debt (percent of GDP, incl. IMF)	33	28	25	22	19	...
Total arrears (percent of GDP)	13	10	3	2	1	...

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

1/ As of September 30, 2005.
2/ Consists of bilateral clearing accounts in rubles converted to U.S. dollars using the parameters agreed under the Paris Club rescheduling.
3/ Reflects overdue interests arising from outstanding arrears.

Table 10a. Albania: General Government Operations, 2003-09
(in percent of GDP)

	2003	2004	2005			2006	2007	2008	2009
			Budget	Prog.	Estimate	Staff Projections			
			2004 Art. IV	6th Review					
Total Revenue and Grants	24.5	24.1	24.7	24.5	24.6	24.6	24.7	24.7	24.8
Tax Revenue	21.3	21.7	21.8	21.8	21.7	21.8	21.9	22.0	22.1
Tax revenues from Tax and Customs Directorates	16.4	16.6	16.6	16.6	16.5	16.5	16.6	16.6	16.7
VAT	7.4	7.6	7.6	7.6	7.6	7.8	7.6	7.6	7.6
Profit tax	1.9	2.1	1.9	1.9	2.2	2.0	2.4	2.4	2.5
Excise tax	1.8	2.1	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Small business tax	0.4	0.5	0.5	0.5	0.5	0.3	0.3	0.3	0.3
Personal income tax	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Customs duties	2.0	1.8	1.9	1.9	1.6	1.6	1.5	1.5	1.5
Other taxes	1.8	1.6	1.7	1.7	1.5	1.6	1.7	1.7	1.8
Property and local taxes	0.7	0.7	0.7	0.7	0.9	1.0	0.9	0.9	0.9
Social insurance contributions	4.2	4.3	4.4	4.4	4.3	4.4	4.5	4.5	4.5
Non-tax revenue	2.8	2.1	2.1	2.1	1.8	1.8	1.8	1.8	1.8
Grants	0.4	0.3	0.8	0.6	1.0	1.0	0.9	0.8	0.8
of which Budget support	0.0	0.0	0.2	0.0	0.0	0.2	0.0	0.0	0.0
Total Expenditure	29.0	29.2	29.7	29.1	28.3	28.7	28.2	28.0	27.9
Current Expenditure	24.6	24.0	23.2	23.1	23.2	23.0	22.4	22.2	22.1
Personnel cost	6.6	6.4	6.6	6.6	6.5	6.7	6.2	6.1	6.0
of which contingency	…	……	…	…	…	0.1	…	…	…
Interest	4.4	3.7	3.6	3.4	3.2	3.4	3.2	3.1	3.0
of which Domestic	4.1	3.5	3.3	3.1	2.9	3.0	2.8	2.6	2.5
Operations & maintenance	3.2	3.1	2.6	2.6	2.9	2.4	2.9	2.9	2.8
Subsidies	0.7	0.7	0.3	0.3	0.4	0.3	0.2	0.2	0.2
Social insurance outlays	6.6	6.6	6.6	6.6	6.6	6.7	6.6	6.6	6.6
of which contingency	…	…	…	…	…	0.1	…	…	…
Local government expenditure	2.1	2.1	2.1	2.1	2.3	2.4	2.1	2.1	2.1
Social protection transfers	1.3	1.5	1.2	1.3	1.2	1.3	1.2	1.2	1.2
Other 1/	-0.3	0.0	…	…	…	0.0	0.0	0.0	0.0
Capital Expenditure	4.6	5.0	6.0	5.8	5.2	5.3	5.6	5.7	5.8
Domestically financed	2.7	3.6	3.3	3.1	3.2	2.8	3.6	3.7	3.7
of which contingency	…	……	…	…	…	0.2	…	…	…
Foreign financed projects	1.9	1.4	2.7	2.7	2.0	2.5	2.0	2.0	2.1
Lending minus repayment	-0.2	0.2	0.0	0.0	…	0.0	0.0	0.0	0.0
Reserve and contingency funds 2/	...	...	0.4	0.2	…	0.3	0.1	0.1	0.1
Cash Balance	-4.5	-5.1	-5.0	-4.6	-3.8	-4.1	-3.5	-3.4	-3.2
Current Balance 3/	-0.5	-0.2	0.5	0.8	0.4	0.5	1.3	1.6	1.9
Financing	4.5	5.1	5.0	4.6	3.8	4.1	3.5	3.4	3.2
Domestic	3.1	4.2	3.4	3.0	3.1	3.0	2.8	2.6	2.5
Privatization receipts	0.1	1.9	0.6	0.2	0.3	0.3	0.2	0.2	0.2
Net borrowing	2.9	2.3	2.8	2.8	2.8	2.6	2.5	2.4	2.3
Foreign	1.5	1.0	1.7	1.7	0.7	1.1	0.7	0.7	0.7
of which Budget support	0.3	0.2	0.1	0.1	0.1	0.0	0.1	0.1	0.0
Memorandum Items:									
Primary balance	-0.2	-1.4	-1.5	-1.2	-0.6	-0.7	-0.2	-0.2	-0.2
Public Debt (including guarantees)	61.8	56.5	55.8	56.2	54.9	55.0	54.5	53.6	52.6
Domestic general government	41.1	38.5	38.2	38.1	38.1	38.1	37.4	36.6	35.8
External	20.7	18.0	17.5	18.1	16.8	17.0	17.0	17.0	16.8
GDP (in billions of leks)	683	767	837	837	837	900	982	1076	1177

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

1/ Includes statistical discrepancy

2/ Spending out of reserve and contingency funds are reported according to their economic classification at outturn.

3/ Revenue excluding grants minus current expenditure.

Table 10b. Albania: General Government Operations, 2003-09
(in billions of leks)

	2003	2004		2005			2006	2007	2008	2009
		Prog. 2004 Art. IV	Actual	Budget 2004 Art. IV	Prog. 6th Review	Estimate	Staff Projections			
Total Revenue and Grants	167.2	184.5	184.6	206.5	205.0	205.6	221.3	242.5	265.4	291.4
Tax Revenue	145.3	165.8	166.0	182.2	182.2	181.7	196.2	215.6	236.7	260.4
Tax revenues from Tax and Customs Directorates	111.7	126.9	127.1	139.1	139.1	137.8	148.2	162.7	178.5	196.1
VAT	50.6	58.1	58.2	63.3	63.3	63.8	70.0	75.0	81.8	89.3
Profit tax	13.1	16.0	16.3	16.0	16.0	18.7	18.3	23.1	25.7	29.0
Excise tax	12.3	16.2	15.8	18.3	18.3	18.0	19.9	21.4	23.3	25.5
Small business tax	2.9	4.2	4.1	3.9	3.9	3.9	2.4	2.8	3.1	3.5
Personal income tax	6.4	6.8	6.9	7.6	7.6	7.4	8.3	8.8	9.5	10.4
Customs duties	13.9	13.6	13.9	15.6	15.6	13.4	14.1	15.0	16.2	17.5
Other taxes	12.5	12.0	12.1	14.4	14.4	12.7	14.2	16.8	18.7	21.0
Property and local taxes	4.5	5.4	5.0	5.8	5.8	7.5	8.8	8.9	10.0	11.1
Social insurance contributions	28.6	32.9	33.3	36.7	36.7	36.4	40.0	43.9	48.3	53.2
Non-tax revenue	19.2	15.8	16.0	17.4	17.4	15.3	16.5	18.0	19.8	21.6
Grants	2.6	3.0	2.6	6.9	5.4	8.6	8.6	8.9	8.9	9.4
of which Budget support	0.2	0.2	0.2	1.9	0.4	0.4	1.6	0.0	0.0	0.0
Total Expenditure	198.1	222.4	223.8	248.7	243.6	237.1	258.0	276.8	301.6	328.8
Current Expenditure	167.7	182.3	183.8	194.6	193.2	193.9	207.2	220.4	239.3	259.5
Personnel cost	44.7	50.8	49.0	55.2	55.2	54.6	59.9	60.4	65.6	71.2
of which contingency	…	…	……	…	…	…	1.3	…	…	…
Interest	29.8	28.9	28.4	29.9	28.5	26.8	30.3	31.9	33.7	35.4
of which Domestic	28.2	26.8	26.7	27.3	25.9	24.7	26.6	27.4	28.2	28.9
Operations & maintenance	22.2	21.6	24.0	22.0	22.0	24.2	21.5	28.4	30.8	33.4
Subsidies	5.1	3.7	5.1	2.7	2.7	3.7	2.5	2.3	2.3	2.3
Social insurance outlays	44.8	49.5	50.2	55.2	55.2	55.0	59.9	64.5	70.7	77.3
of which contingency	…	…	……	…	…	…	0.8	…	…	…
Local government expenditure	14.2	16.2	15.9	17.7	17.7	19.3	21.2	20.6	22.8	25.3
Social protection transfers	8.8	9.9	11.5	10.5	10.5	10.2	11.5	12.2	13.4	14.6
Other 1/	-2.0	0.0	-0.3	0.0	…	0.0	0.3	0.0	0.0	0.0
Capital Expenditure	31.5	40.8	38.6	50.5	48.8	43.3	47.8	55.4	61.3	68.3
Domestically financed	18.3	30.6	27.6	28.0	26.2	26.5	25.3	35.6	39.6	43.9
of which contingency	…	…	……	…	…	…	2.0	…	…	…
Foreign financed projects	13.2	10.2	11.0	22.6	22.6	16.7	22.5	19.7	21.6	24.4
Lending minus repayment	-1.1	-0.8	1.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Reserve and contingency funds 2/	...	...	...	3.6	1.6	…	3.0	1.0	1.0	1.0
Cash Balance	-30.9	-37.9	-39.2	-42.2	-38.6	-31.5	-36.6	-34.3	-36.2	-37.4
Current Balance 3/	-3.2	-0.7	-1.9	4.0	6.4	3.1	4.5	13.2	17.2	22.5
Cash Balance--below-the-line	-30.9	-37.9	-39.2	-42.2		-31.5	-36.6	-34.3	-36.2	-37.4
Financing	30.9	37.9	39.2	42.2	38.6	31.5	36.6	34.3	36.2	37.4
Domestic	20.9	31.6	31.9	28.3	24.7	25.6	26.8	27.0	28.4	29.6
Privatization receipts	0.9	15.7	14.4	5.0	1.4	2.3	3.0	2.0	2.0	2.0
Net borrowing	20.0	15.9	17.6	23.4	23.4	23.4	23.8	25.0	26.4	27.6
Foreign	10.0	6.2	7.3	13.8	13.9	5.9	9.8	7.2	7.8	7.8
Memorandum Items:										
Primary balance	-1.1	-8.9	-10.8	-12.3	-10.1	-4.8	-6.3	-2.4	-2.5	-2.0
Public Debt (including guarantees)	422.0	431.6	433.4	466.9	470.2	459.2	494.9	534.8	576.5	619.0
Domestic general government	280.8	296.7	295.2	320.1	318.6	318.6	342.4	367.4	393.8	421.4
External	141.2	134.9	138.2	146.8	151.6	140.6	152.5	167.4	182.7	197.6

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

1/ Includes statistical discrepancy
2/ Spending out of reserve and contingency funds are reported according to their economic classification at outturn.
3/ Revenue excluding grants minus current expenditure.

Table 11. Albania: Structural Reforms in Tax Administration

Area	Activity	Proposed Implementation Date
Control of large taxpayers	Incorporate all firms meeting set criteria into Large Taxpayers Office (LTO) and integrate audit of social security contributions into LTO's audit capacity	Short term
	Increase compliance by large taxpayers, particularly regarding social security contributions, and increase the share of total taxes collected by the LTO to above 50 percent	Medium term
Organization and management of tax administration	Establish a proper management informations system, including a performance measuring system	Medium term
	Merge the smaller local tax offices into a reduced number of larger, modernized facilities	Medium term
	Improve training of officials, with the view of increasing allocation of skilled resources to more productive activities (audit, enforcement)	Medium term
Tax administration operations	Take immediate steps to increase the number of registered taxpayers, including by cross-checking information with the court registers and simplifying the registration process	Short term
	Set and achieve an objective of reducing the VAT stop-filer rate to 5 percent	Medium term
	Shift the emphasis of the audit program from comprehensive audits to single issue audits and increased VAT audits and introduce risk-based audit techniques	Medium term
	Initiate the practice of issuing automatic notices to delinquent tax payers and set targets to reduce the stock of arrears	Short term
	Improve VAT refunds administration, including by introducing a risk-to-revenue based assessments of new VAT refund requests, simplifying the application procedure for low-risk claimants and ensure that funds are available to pay all approved claims immedi	Short term
	Establish a management information system to ensure tight GDT management-control of the VAT refund regime	Medium term
	Increase voluntary compliance by promoting the concept of taxpayer services and improving accessibility to taxpayer services	Medium term
Administration of social contribution collections	Improve cooperation and exchange of information between the GDT and SII	Medium term
	Develop audit strategies and non-compliance indicators that exploit the advantages of joint declaration of social contributions and PIT withholdings. Revise them based on results	Medium term
Information technology to support tax administration	Enhance the existing Information Technology System (ITS) as the basis for all automation of tax administration	Medium term
	Develop IT reporting tools to produce the information required to manage tax administration by performance indicators	Medium term
Customs administration	Extend the ASYCUDA computer system to all customs offices	Short term

Table 12. Albania: External Financing Requirement and Sources, 2002–09
(In millions of Euros)

	2002	2003	2004	2005	2006	2007	2008	2009
				Projections				
Current account	468	402	331	472	584	568	583	639
Amortization	43	34	40	43	63	75	112	141
o/w: IMF	15	8	8	7	9	11	12	11
Change in gross reserves (increase = +)	19	-10	191	13	77	105	153	167
Reduction in arrears	301	-2	12	17	19	51	0	0
Total financing requirement	830	424	574	545	743	799	849	947
Available financing	830	424	574	520	705	733	825	917
Official grants	132	129	103	101	102	105	101	106
Foreign direct investment	142	158	277	197	229	243	280	314
Other capital	113	42	-13	58	140	184	196	234
Official medium- and long-term loans	123	101	100	85	178	141	156	173
Multilateral (excluding IMF)	84	75	72	60	140	105	105	107
Bilateral	38	26	28	25	38	37	51	66
IMF disbursements	6	10	10	9	0	0	0	0
Other 1/	-18	-32	69	66	57	51	80	87
Debt rescheduling	304	0	12	4	0	0	0	0
Budget support	30	17	15	0	0	0	0	0
Identified financing	0	0	0	0	0	8	12	4
o/w: WB FSAC/PRSC	...	...	...	0	0	8	12	4
Financing gap	0	0	0	24	38	66	25	30
Expected EU macro-financial assistance	...	...	...	12	13	0	0	0
Debt rescheduling (mostly clearance of bilateral arrears)	...	...	...	12	19	51	0	0
Other	...	...	...	0	6	15	25	30

Sources: Ministry of Finance, Bank of Albania, donors, and Fund staff estimates.
1/ Includes errors and omissions

Table 13. Albania: Indicators of Fund Credit, 2000-2005
(SDR Million unless otherwise indicated)

	2000	2001	2002	2003	2004	2005 Proj.
Outstanding credit						
Stand-By Arrangement	8.8	4.4	0.0	0.0	0.0	0.0
PRGF	58.6	61.8	59.6	60.8	62.4	64.3
Total	67.5	66.3	59.6	60.8	62.4	64.3
In percent of quota	138.5	136.0	122.4	124.9	128.1	132.0
In percent of exports (GNFS)	12.7	10.0	8.5	7.3	5.7	5.2
In percent of public external debt	7.6	6.7	6.9	6.5	6.1	6.4
Disbursements						
PRGF	14.3	9.4	4.0	8.0	8.0	8.0
In percent of quota	29.3	19.3	8.2	16.4	16.4	16.4
In percent of exports (GNFS)	2.7	1.4	0.6	1.0	0.7	0.6
Debt Service						
Principal	5.5	10.6	10.6	6.8	6.4	6.2
Interest and charges	0.7	0.7	0.4	0.3	0.3	0.3
Total	6.2	11.3	11.0	7.1	6.7	6.5
In percent of exports (GNFS)	1.2	1.7	1.6	0.9	0.6	0.5
In percent of public external debt service	29.3	41.6	24.9	17.2	15.2	12.5
Net Fund Financing	8.0	-1.9	-7.0	0.9	1.3	1.5

Source: Albanian authorities, Fund staff estimates.

ALBANIA: FUND RELATIONS

As of November 30, 2005

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

II. **General Resources Account**:	SDR Million	Percent Quota
Quota	48.70	100.00
Fund Holdings of Currency	45.35	93.12
Reserve position in Fund	3.35	6.89

III. **SDR Department**:	SDR Million	Percent Allocation
Holdings	10.10	N/A

IV. **Outstanding Purchases and Loans**:	SDR Million	Percent Quota
PRGF arrangements	65.46	134.41

V. **Financial Arrangements**:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
PRGF	06/21/2002	11/20/2005	28.00	28.00
PRGF	05/13/1998	07/31/2001	45.04	45.04
PRGF	07/14/1993	07/13/1996	42.36	31.06

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

			Forthcoming		
	2005	2006	2007	2008	2009
Principal	1.19	7.60	9.41	9.62	9.08
Charges/Interest	0.16	0.30	0.26	0.21	0.16
Total	1.36	7.90	9.67	9.83	9.25

VII. **Safeguards Assessments**:

Under the Fund's safeguards assessment policy, the Bank of Albania (BoA) will be subject to a safeguards assessment with respect to the proposed arrangements, to be completed not later than the first program review. The most recent full safeguards assessment was carried out in connection with the expiring program and was finalized in June 2002. The assessment noted that the BoA has made significant progress in implementing the recommendations of the first safeguards assessment, and that, in general, the BoA 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 system 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. These relate primarily to debt in nonconvertible and formerly nonconvertible currencies of about €70 million at end-2005. The authorities are working to resolve these balances by mid-2007 for official creditors, and by mid-2008 for private sector creditors. Albania has not imposed new restrictions under Article VIII. The exchange rate stood at 104.29 lek per U.S. dollar on November 30, 2005.

IX. **Article IV Consultation**:

The conclusion of the 2004 Article IV consultation and the fifth review under the three-year PRGF arrangement took place in February 2005 (IMF Country Report No. 05/89). Albania moved from a 12-month cycle to a 24-month cycle, in line with the decision on consultation cycles approved on July 15, 2002. The last Article XIV consultation was concluded in December 2005.

X. **FSAP Participation and ROSCs**:

An FSAP was carried out in early 2005. The Financial System Stability Assessment was considered by the Executive Board on August 1, 2005 concurrently with the staff report for the sixth review of the PRGF-supported program and financing assurances review. A ROSC on data dissemination was published on the Fund's website in June 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. Ms. Ann-Margret Westin has filled this position since August 2005.

Albania: IMF-World Bank Relations

Partnership in Albania's Development Strategy

1. The Republic of Albania has been a member of the World Bank since 1991. Since then, the WBG has provided strong support to Albania, including 57 loans mostly in IDA commitments totaling US$820 million, IFC commitments of US$125 million, and MIGA guarantees totaling US$8.6 million. The quality of the active portfolio has continued to improve, with an increasing focus on long-term capacity development and implementation through Government structures.

2. The World Bank's Board will discuss a new Country Assistance Strategy (CAS) for Albania for FY06-FY09 in January 2006. The proposed CAS builds on the experience of the World Bank Group (WBG) since the early 1990s (through three CASs).[1] The CAS presents a program of support which seeks to build on the improved macro-economic management and progress in structural reforms that has occurred since 2002. It aims to support Albania's National Strategy for Social and Economic Development (NSSED) and the European Union (EU) Stabilization and Association process (SAP) with the ultimate objective of EU integration and the attainment of the Millennium Development Goals (MDGs).

3. The NSSED, adopted in 2001, is an inclusive development strategy and aims to bring Albania's living standards and income levels closer to the levels of its neighboring European countries. It represents Albania's serious effort to use a comprehensive medium-term national development strategy to move from short-term crisis management to creating the conditions that promote long-term growth and poverty reduction. The NSSED has strong government ownership and was prepared through an unprecedented participatory process. It is based on three pillars: (i) improving governance, (ii) promoting private sector development, and (iii) fostering human resources development. The NSSED recognizes that weak governance and institutions are at the root of Albania's developmental problems, and acknowledges that economic growth will be the main instrument to reduce poverty, raise standards of living, and accelerate the attainment of the MDGs. It also contains improved poverty diagnostics and an ambitious plan for monitoring and evaluation.

Bank Group Strategy

4. Reflecting Government priorities, the CAS (2006-2009) program seeks to support Albania's efforts in strengthening governance, sustaining a private sector-led growth and improving service delivery**.** The new CAS recognizes that more coherent efforts need to be made to address the challenge of poor governance in Albania, and introduces a 'Governance

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[1] The `Bank' refers to the IBRD and IDA and the 'World Bank Group' generally refer to the Bank, IFC, FIAS and MIGA.

Filter' compromising of four core principles which will be used to ensure that governance considerations are mainstreamed into all of the Bank's interventions. The CAS program is also more selective, focused on two pillars:

(I) ***Continued Economic Growth through Support to Private Sector Development,*** with expected outcomes including (a) macroeconomic stability; (b) improved business climate through better quality of business regulations and improved public-private sector dialogue; (c) improved public infrastructure; (d) increased operational efficiency of financial institutions; (e) improved functioning of the land market; (f) improved corporate governance; (g) increased transparency and efficiency in the management of public spending and stronger institutions for planning, tendering and providing infrastructure and services; (h) better accountability in public administration; and (i) better management and planning for Albanian coastal resources.

(II) ***Improving Public Service Delivery, particularly in the Social Sectors*****,** with expected outcomes including: (a) improved educational attainment and quality of basic education; (b) improved efficiency and equity of health financing; (c) better quality of health care; (d) improved fiscal sustainability of the social insurance system and increased access to well-targeted, sustainable, and effective assistance; and (e) improved access to safe rural water supply and sanitation.

5. The CAS proposes a lending range of US$ 75 – US$ 196 million, with actual lending to be determined by the pace of reform in key sectors. The proposed lending program would be financed by a blend of IDA and IBRD resources, with gradual transition from IDA to IBRD beginning in FY06. Up to 11 new IDA/IBRD lending operations are proposed in FY06-FY09, of which three would be a series of programmatic Development Policy Loan (DPL) building on the success of the PRSC series in the previous CAS. The CAS employs also targeted program of WBG Analytical and Advisory Activities (AAA) support.

6. The active World Bank portfolio includes 13 investment projects with a total commitment of $215.4 million, of which about $162 million remain to be disbursed. The investment side of the Bank's portfolio has performed well, and several new activities are scheduled to be presented to the Board before the end of FY06. Following the Board approval in June 2005 of three new projects : (i) the Natural Resources Development project (June 9); (ii) the Integrated Coastal Zone Management and Clean-Up project (June 21); and, (iii) the new power sector ECSEE-APL2-Albania project (June 29), the World Bank is preparing three operations that are expected to be presented to the Board before the end of June 2006. These include: a) Business Environment Enhancement and Institutional Reform (BEEIR),b) Education Excellence and Quality and Equity Project , c) Health System Modernization Project**.**

Bank-Fund Collaboration in Specific Areas

7. As in previous periods, the World Bank assistance for structural reform in Albania will

continue supporting the IMF's lead role on support for macro-economic policies aimed at facilitating sustainable growth. Continuing collaboration is likely to become even more critical given that most of the outstanding areas for reform remain on the structural side. In areas of direct interest to the IMF, the Bank is engaging in policy dialogue and providing financial and technical assistance to support (i) improved public expenditure management; (ii) public sector reform; (iii) pension, health and social assistance reform; (iv) financial sector reform and development; (v) an improved policy environment for business.

8. **Public expenditure management**: Albania's weak systems of Public Financial Management (PFM) and related fiscal institutions constitute a main risk for macroeconomic stability and high quality fiscal adjustment. Over the past years, the Bank has complemented IMF policy conditionality and technical assistance with a multi-pronged assistance program including lending operations and fiduciary and diagnostic work. Under the new CAS, the Bank will continue taking the lead in this area through the ongoing Programmatic Public Expenditure and Institutional Review and the upcoming Integrated Fiduciary Assessment (CFAA/CPAR-FY06). These will identify key weaknesses in the PFM system and provide the underlying analysis for defining further public expenditure management components and policy reform conditionality in the DPL.

9. To increase the effectiveness of public expenditure and public financial management system, the World Bank will support a number of measures to further improve the strategic allocation of resources mainly through the support to the implementation of the Integrated Planning System (IPS); improving the linkages between recurrent and investment spending and strengthening the rigorous review of public investment projects based on economic and financial criteria.

10. **Public sector reform**: The civil service and broader public sector employment structures require continued engagement and support. The Bank and IMF will need to work closely to ensure that an appropriate framework is in place to allow the Government to move ahead with efforts to a) restructure the government apparatus by reducing the size of government and rendering it more efficient, b) increase competitiveness of the salary structure and the ability of the civil service to attract skilled and competent professionals; and b) consolidate and deepen the measures aimed at the depoliticization of the civil service through the expansion of the Civil Service Law in a manner that is fiscally responsible. As deeper reform of public administration is currently anticipated through the CAS period, the Bank will also look, to use the DPL to continue to engage on civil service reform.

11. **Power sector reform**: Efforts are continuing to progressively mitigate the impact of the crisis that has existed in the electric power sector since mid-2000. The crisis resulted from several factors, chief among them being (i) excessive demand caused by a chronic failure to curb illegal use and nonpayment, (ii) vulnerability of the mainly hydropower domestic generation capacity to hydrological variations, and (iii) transmission capacity constraints limiting electricity imports. The crisis has often resulted in frequent and prolonged load-shedding, which has had serious social and economic consequences, and also necessitated significant allocation of budgetary resources for electricity imports, thereby

diverting funds from other critical growth and poverty alleviation needs. Progress has been made since the beginning of 2001 in addressing these issues as a result of the implementation of an annually-updated Action Plan agreed by the Government with the donors. Electricity losses have been reduced, tariffs increased and collections improved; household demand growth has slowed significantly. KESH is being restructured, the regulatory framework has been strengthened, and the tariff structure is being rationalized. Efforts are underway to add domestic generation capacity and increase the capacity of the transmission network to import electricity. However**,** there still remains much to be done and, during 2005, sector performance deteriorated due to the political uncertainties associated with the recent elections, changes in KESH's management, and the inability to arrange for timely import of electricity. These issues are being addressed and both the Government and KESH have expressed their determination to sustain improvements in sector performance.

12. Conditionality related to improving sector performance, sector restructuring, and strengthening the regulatory and legislative framework is included in successive Bank-financed projects. On-going projects include the Power Sector Rehabilitation and Restructuring Project (2002) that covers rehabilitation of the distribution network in three regions; the Power Sector Generation and Restructuring Project (2004) that will provide new thermal generation capacity and is co-financed by EBRD and EIB; and the ECSEE APL2-Albania Project (2005) that will be co-financed by EBRD and will finance the upgrading of the high-voltage transmission substations, thereby facilitating Albania's participation in the Energy Community of South East Europe (ECSEE).

13. The Bank and the Fund confirmed their support to the Government's efforts to overcome the crisis and agreed with the authorities that sustained implementation of the agreed measures to improve the performance in the power sector will be indispensable for growth and macroeconomic stability. While the Bank has taken the lead in developing the policy agenda, the sector's fiscal impact has also motivated conditionality in successive Fund arrangements.

14. **Social Insurance Reforms**: The financial stability of the social insurance system and the coverage and targeting of the social assistance system are key components of medium term fiscal consolidation. Both the Bank and the IMF have focused on pension reform under the PRSC and PRGF programs, including the increase of the retirement age for men and women. The short-term agenda will focus on strengthening the financial sustainability of the existing pension scheme while aiming for a reduction of the overall payroll tax burden in the medium term so as to help improve competitiveness of Albanian labor. The Bank is supporting SII in developing its capacity to model medium- and long-term impacts of policy changes on the fiscal sustainability of the social insurance system and to identify a sustainable path for future reforms to the social insurance system. The Bank and the IMF will support such reforms in a coordinated fashion. They will also work closely to ensure that essential pre-conditions for future structural reforms to the pension system will be put in place, including strengthening of the financial markets as a one of the preconditions for establishment of potential future funded benefits systems.

15. **Financial sector reform and development**. Albania has made significant progress towards the adoption of a market-based economy with the support of the World Bank and the IMF. The Financial Sector Adjustment Credit (FSAC), approved by the Board in June 2002, has helped to advance reforms in the banking sector, including the privatization of the Savings Bank, the development of a deposit insurance system, improvement of the bankruptcy framework and collateral enforcement, strengthening of bank regulation and supervision, and the development of a Real Time Gross Settlement (RTGS) system. The IMF has provided technical assistance to the Bank of Albania by funding a resident adviser to support the implementation of the institutional development program for banking supervision developed by the Bank of Albania with the assistance from the Bank.

16. The WBG in conjunction with the IMF will assist the Government in the completion of the financial sector reform agenda and support the implementation of the recommendations of the recently concluded Joint IMF-World Bank Financial Sector Assessment Program (FSAP). The Business Environment Enhancement and Institutional Reform Project (expected board approval in June 2006) in conjunction with the DPL will support policy measures associated with financial sector development, including (i) adoption of a legal, institutional and supervisory framework enabling sound development of the non-banking financial sector, including the insurance sector; (ii) strengthening insurance and banking supervision and regulation and exit mechanisms for financial institutions; (iii) adoption and implementation of an EU-compatible legal and institutional framework for accounting and auditing; (iv) strengthening enforcement of the collateral regime; and (v) efficient and transparent completion of the privatization program.

17. This reform agenda will be coordinated closely with European Commission institutions, especially in those elements of the reform agenda, such as accounting and auditing, for which the *acquis communautaire* is relevant.

18. **Improving the business environment.** A weak business environment plagued with considerable administrative barriers, weak governance, corruption, ambiguities in property and land rights, poor quality and high cost of infrastructure and utilities, is undermining future growth prospects and job creation. Improving the business environment will be crucial to overcome high levels of unemployment, attract the badly needed investment flows, and boost exports. Complementing the IMF dialogue on macro-economic stability and its technical and advisory assistance to strengthening tax administration, the Bank will use a combination of instruments, namely the Business Environment Enhancement and Institutional Reform Project (expected board approval in June 2006) and the Land Management and Urban Development project (expected board approval in January 2007) in conjunction with the DPL to support improvements in the business climate, through (i) the adoption and implementation of regulatory governance rules and tools aimed at improving the quality of business-sector related regulations, (ii) further strengthening of the capacity to

implement a EU-compliant competition policy regime; and (iii) adoption and implementation of a transparent land registration system.

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ALBANIA: STATISTICAL ISSUES

Albania was a pilot country for the data dissemination module of the Report on the Observance of Standards and Codes (ROSC), and a data ROSC was published on the IMF's external website in May 2000.[1] Albania participates in the General Data Dissemination System (GDDS) and metadata for the external, financial, fiscal, and real sectors, as well as socio-demographic indicators were initially posted on the Fund's Dissemination Standards Bulletin Board (DSBB) in May 2000 and last updated in July 2005. Plans for improving data compilation and dissemination across all statistical sectors are also posted on the DSBB Recently, the authorities expressed an interest in a ROSC data module using the Data Quality Assessment Framework (DQAF) and subscription to the Special Data Dissemination Standard (SDDS).

Over the past few years Albania has made significant progress in improving its statistical database with extensive technical assistance, including from the Fund. Recently, a Council of Statistics has been established and its constitution and functions have been ratified. However, much still remains to be done, particularly in the with regard to the national accounts. To this end, a five-year master plan for statistical development has been prepared for consideration by Parliament

The new government plans to place the Institute of Statistics (INSTAT) under the Ministry of Interior (MI). The authorities see this is as part of the ongoing reform of all ministries, aiming at enhancing efficiency by the closer placement of the INSTAT to the population and property registration that are under the MI.

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 *International Financial Statistics (IFS)*. In 2001, a revision of CPI weights was initiated by INSTAT based on a new household budget survey and a revised CPI was finalized in February 2002. The compilation of the CPI generally follows international standards, and the estimation of imputed rent within the CPI was improved in 2003. A monthly producer price index (PPI) has been published quarterly since March 2002.

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

National accounts

In January 2003, INSTAT published the first official GDP estimates for 1996-2000 and, later that year, preliminary estimates for 2001. Preliminary GDP estimates for 2002 and revised estimates for 2001 were published in September 2004. Preliminary GDP estimates for 2003 and revised estimates for 2002 were published in August 2003. Fund technical assistance in this area continues (November 2003–November 2005) to address weaknesses in basic data sources and incomplete coverage of the private sector. The Italian National Institute of Statistics (Istat) and the National Statistics Office of Finland (Statistics Finland) will be providing technical assistance to INSTAT following the Fund project.

STA missions visited Albania in November 2004 and in March 2005 to assist the authorities in improving the timeliness of the national accounts data. The authorities agreed with the proposed approaches for compiling and disseminating early annual estimates and experimental quarterly estimates.

External trade

The compilation and dissemination of foreign trade data has improved in recent years, following disruptions in the late 1990s. One important factor is the implementation of the Automated System of Customs Data (ASYCUDA), supported by the EU. Further progress is expected in the area of trade in services as a result of the implementation of surveys, with the support of STA.

B. Government Finance

Albania began reporting fiscal data to the Fund for publication in the 1996 *Government Finance Statistics Yearbook* and *IFS*. However, only data for 1997, 1998, and 2002, consistent with *GFSM 1986* standards, have been reported for inclusion in the *GFS Yearbook*. These data are based on a cash accounting system and have been converted to the *GFSM 2001* framework by Fund staff. Albania does not currently report fiscal data for publication in the *IFS*. Some improvement in the collection of data on disbursement of foreign loans and grants has been achieved following 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 required regarding the accuracy and timeliness of information on foreign-financed capital expenditures, and fiscal data in general.

C. Monetary Accounts

The monetary data compilation framework conforms to the methodology recommended in the *Monetary and Financial Statistics Manual*, and data are compiled and reported on a timely basis. The authorities revised the accounts of the BoA, commercial banks, and the monetary survey from February 2001 onward to properly record repurchase and reverse repurchase agreements; revised monetary data were first published in the October 2002 issue of *IFS*. The authorities are also making efforts to revise the historical data.

In January 2005, the BoA reported its monetary data to STA using Standardized Report Forms. This will facilitate the implementation of an integrated monetary database to be used for both publication in *IFS* and for operational needs of EUR.

D. Balance of Payments

The data compiled by the BoA are methodologically sound, although some of the estimates, particularly for international transactions made outside the banking system 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. It has most recently revised the methodology for the measurement of tourism services, principally through the introduction of surveys of travelers. 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.

A November 2004 technical assistance mission noted that the coverage and accuracy of the data should be improved through the strengthening of the legal framework and the use of the banks reporting system to verify data from enterprises surveys. It also recommended incorporating the results of the direct investment survey as well as investigation and follow-up of the net errors and omissions observed at the level of individual reporting banks. A follow-up technical assistance mission by STA is scheduled for FY06. 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 is, in principle, 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 and Grant Statistics

Good quality external debt statistics for public and publicly-guaranteed debt are compiled by the Ministry of Finance. The 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, there have been some irregularities in the recording and presentation of old external arrears. The External Debt Committee needs to improve inter-agency coordination to ensure the timely and accurate reporting of the stock of external arrears and changes resulting from rescheduling agreements. The collection of data on external grants is not timely, with lags of several months frequently encountered. In consultation with donors, the authorities are preparing a new framework to improve data collection and reporting, to be led by the Ministry of Finance.

Albania: Table of Common Indicators Required for Surveillance

As of December 19, 2005

	Date of latest observation	Date received	Frequency of data[6]	Frequency of reporting6	Frequency of publication[6]
Exchange Rates	12/18/2005	10/18/2005	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	11/30/2005	12/16/2005	D	D	M
Reserve/Base Money	11/30/2005	12/16/2005	M	M	M
Broad Money	Oct-05	Dec-05	M	M	M
Central Bank Balance Sheet	11/30/2005	12/16/2005	M	M	M
Consolidated Balance Sheet of the Banking System	Oct-05	Dec-05	M	M	M
Interest Rates[2]	12/8/2005	12/8/2005	W	W	W
Consumer Price Index	Nov-05	Dec-05	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Oct-05	Nov-05	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	Oct-05	Nov-05	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	9/30/2005	11/15/2005	Q	Q	A
External Current Account Balance	9/30/2005	12/12/2005	Q	I	I
Exports and Imports of Goods and Services	9/30/2005	12/8/2005	M	Q	Q
GDP/GNP	2003	Aug-05	A	A	A
Gross External Debt	Mar-05	May-05	Q	I	NA

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).

Albania: External and Public Debt Sustainability Analysis (DSA)

Albania's ability to sustain its debt burden has strengthened significantly in the past ten years*. Debt restructuring with its main creditors, rapid growth and cautious public indebtedness has allowed a continuous decrease in the external debt-to-GDP ratios and external debt-to-exports ratios (both on NPV and in nominal terms), these are expected to stabilize in the medium term at about 20 percent of the GDP. At the same time projected public debt service-to-exports ratios will remain at very manageable levels between 5-7 percent. Public debt is projected to decline below 53 percent of GDP in 2009. This reflects further fiscal consolidation and sustained real growth. This outcome appears fairly robust to stress scenarios, however it is sensitive to adverse current account and growth shocks, suggesting that Albania should aim at diversifying its exports as a way to reduce its external vulnerability and to improve its economic growth potential.*

Main Assumptions

The baseline scenario is projected for the period 2005-24. The macroeconomic framework for the period 2005-09 is detailed in the staff report tables. The main assumptions for the long-term projections are:

- Average annual real GDP growth: 6 percent
- Inflation: 3 percent (central projection of the 2-4 percent target)
- Export growth: will significantly slow down compared to the historical average of 25 percent (in terms of Euros). For the rest of this decade the annual growth projected is 12 percent and 9 percent for the rest of the projection period.
- The average concessionality of the public sector borrowing is expected to decrease gradually.
- The real effective exchange rate will remain constant.
- Private debt is expected to grow substantially albeit from a very low base at present, gradually replacing the share of public and publicly guaranteed external debt on the total external debt.
- Domestic public debt is projected to increase in each year by the nominal amount consistent with meeting the domestic borrowing targets of the new program under the average real growth assumptions.

External Debt Sustainability

Albania is expected to maintain its external solvency throughout the period. The stock of total external debt-to-GDP ratio is expected to stabilize at about 20 percent. However it is expected that the composition of debt will gradually shift to less concessional sources and the importance of private sector borrowing from external sources is also projected to increase during the projection period. This change in the financing structure will be reflected in a slow long run increase of the NPV of total debt as a percent of GDP and in debt service ratios as a percent of exports. Nevertheless these indicators will remain at very manageable levels throughout the baseline period.

Albania has a low risk of debt distress as indicated by its relatively low external debt combined with the quality of its policies and institutions. According to the World Bank's Country Policy and Institutional Assessment (CPIA), Albania is classified as a medium performer and the corresponding indicative debt sustainability thresholds for the ratios of NPV of debt-to-GDP and debt-to-exports are 40 percent and 150 percent, respectively. These thresholds are comfortably met by the baseline projections and by the outcomes under most of the stress tests.

Moreover, at present Albania is a net creditor to the world (Table 1a). Although the public sector has a small positive stock of net external debt at present, it is expected to turn negative before the end of this decade under the baseline scenario. In contrast as the role of the private sector becomes more important in the economy, its net indebtedness is expected to turn positive during the projection period.

The standardized stress tests show that Albania's external debt would remain sustainable under several shocks. Table 1b shows that Albania's external debt indicators would stay below the indicative benchmarks under most stress tests. The simulations also show that Albania's debt ratios tend to revert to the baseline path over time, but they are particularly sensitive to negative shocks to exports (bound test B2), which would be the only test where Albania would exceed temporarily the thresholds for its CPIA category. This highlights the need for the country to diversify its exports and improve its competitiveness in the medium term.

The results of the standard alternative scenario based on historical averages for current account deficit and nominal GDP growth bear little relation to expected future developments in Albania's case. Specifically, Albania's high past external current account deficits have been driven by the need for large infrastructure investments mostly financed by official grants and concessional loans. With the process of catching up approaching an end, however, the need for such investments and the availability of official grants and concessional loans are assumed to gradually decline in the long run.

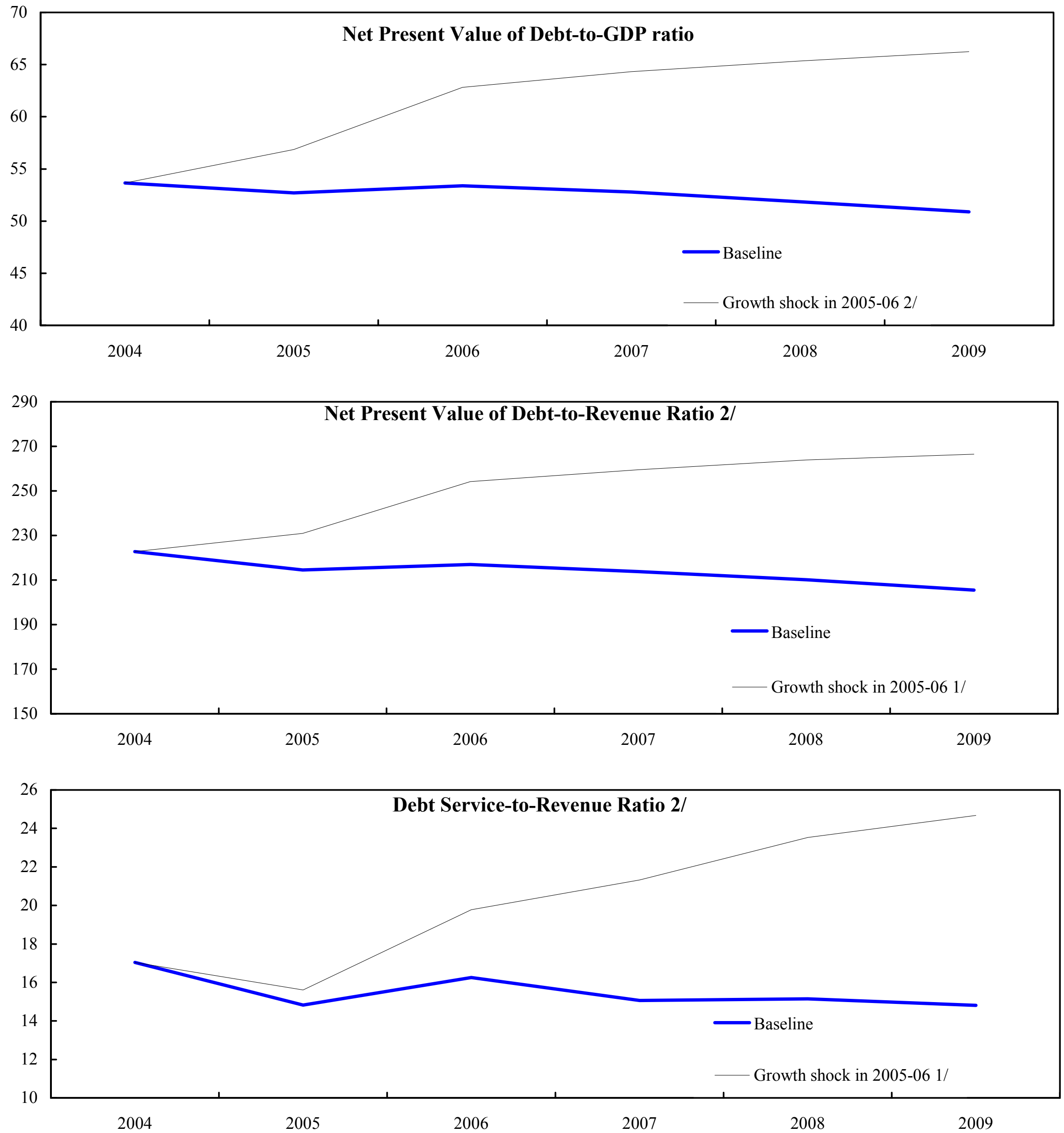
Public debt sustainability

The ratio of public debt to GDP declined significantly in recent years. Public debt is estimated to be at 54.9 percent of GDP at end 2005, compared to 75.6 percent of GDP in 1997. The reduction of the debt-to-GDP ratio reflected a number of factors, including sustained average growth rates (at around 6 percent), and the accounting effects of the lek appreciation.

Consistent with the authorities' medium term fiscal program, the baseline scenario projects a further decline of the debt-to-GDP ratio. The authorities' fiscal program implies a decline of the domestic borrowing target from an estimated 2005 level of 2.8 percent of GDP to 2.3 percent of GDP in 2009. On the basis of this fiscal program and of a rebound in real growth from 2007, public debt is projected to decline below 53 percent of GDP by 2009. The NPV of public sector debt is also projected to decline from 52.7 percent of GDP in 2005 to 50.9 percent of GDP in 2009.

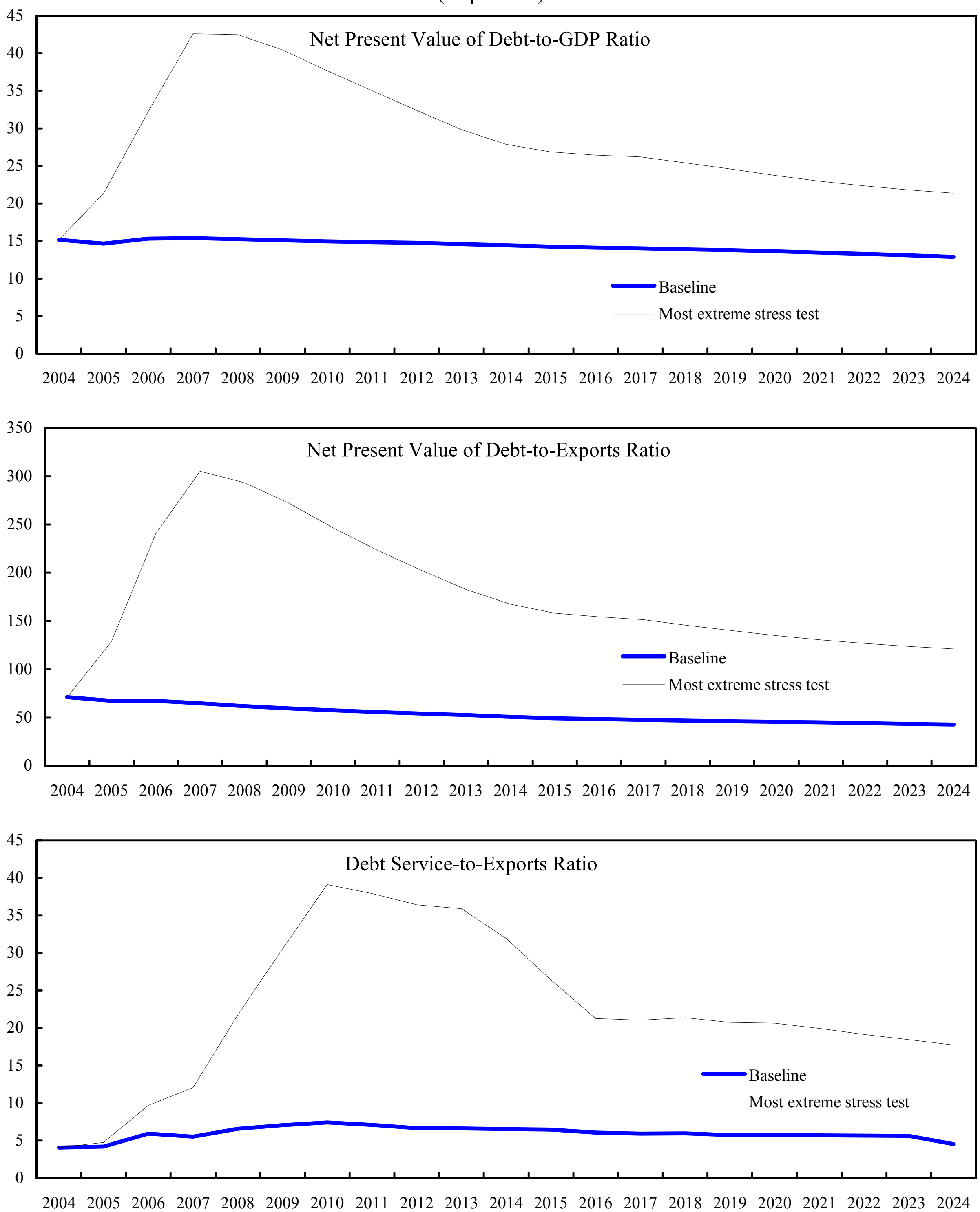
Stress tests show that public debt will remain sustainable under various shocks. The standard stress tests show that Albania's public debt position is relatively resilient to shocks. The NPV of the debt-to-GDP ratio remains below 60 percent under most of the tests. However, a real growth shortfall of one standard deviation (compared to historical average) in 2005-2006 would imply a debt-to-GDP ratio equal to 66 percent (in NPV) in 2009.

Figure 1. Albania: Indicators of Public Debt Under Alternative Scenarios, 2004-2009 1/
(In percent)



Source: Staff projections and simulations.
1/ The stress test that yields highest ratio in 2009: Real GDP growth at one standard deviation below the baseline in 2005 and 2006.
2/ Revenue including grants.

Figure 2. Albania: Indicators of Public and Publicly Guaranteed External Debt
Under Alternative Scenarios, 2004-2024
(In percent)



Source: Staff projections and simulations.

Table 1a. Albania: External Debt Sustainability Framework, Baseline Scenario, 1996-2024 1/
(In percent of GDP, unless otherwise indicated)

	Actual									Projections							
	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2009	2010	2015	2020	2024
External debt (nominal) 1/	28.6	40.1	34.3	31.2	31.6	28.5	25.2	22.2	20.4	19.7	20.0	19.9	19.1	19.1	19.8	19.9	20.2
o/w public and publicly guaranteed (PPG) 2/	28.6	40.1	34.3	31.2	31.6	28.4	25.2	22.0	19.2	17.9	17.9	17.8	17.2	17.0	16.6	15.5	14.8
o/w private	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.2	1.2	1.7	2.1	2.1	2.0	2.0	3.2	4.4	5.4
Change in external debt	-0.9	11.4	-5.7	-3.1	0.4	-3.1	-3.2	-3.1	-1.8	-0.7	0.3	-0.1	-0.4	-0.1	0.0	0.1	0.0
Identified net debt-creating flows	-0.9	14.8	-6.2	-12.1	-6.5	-6.4	3.5	1.0	-3.0	2.0	3.5	2.6	2.0	1.8	0.3	-0.3	-0.4
Non-interest current account deficit	8.2	13.2	6.3	1.4	6.3	5.4	9.5	7.7	5.2	6.6	7.4	6.5	6.1	5.7	3.8	2.9	2.6
Deficit in balance of goods and services	24.4	26.9	24.9	18.5	21.6	22.5	25.9	25.1	21.7	23.2	23.5	22.5	21.6	21.2	18.4	16.6	15.7
Exports	11.6	10.4	10.9	17.9	19.0	20.4	20.5	20.8	21.5	21.9	22.7	23.6	25.2	25.9	28.8	29.8	29.9
Imports	36.0	37.3	35.8	36.4	40.6	42.9	46.3	45.9	43.2	45.1	46.2	46.2	46.8	47.1	47.1	46.3	45.6
Net current transfers (negative = inflow)	-14.1	-11.4	-16.1	-9.5	-12.1	-13.2	-13.0	-14.0	-13.8	-14.1	-13.6	-13.5	-13.2	-13.0	-12.1	-11.3	-10.7
Other current account flows (negative = net inflow)	-2.1	-2.3	-2.4	-7.6	-3.2	-4.0	-3.3	-3.5	-2.7	-2.4	-2.5	-2.5	-2.4	-2.5	-2.4	-2.4	-2.4
Net FDI (negative = inflow)	-3.2	-1.9	-1.6	-1.5	-3.9	-5.0	-3.0	-3.2	-4.6	-2.9	-3.2	-3.1	-3.4	-3.4	-2.9	-2.7	-2.6
Official tranfers (negative = inflow)	-2.6	-3.5	-3.3	-4.1	-3.0	-3.0	-2.8	-2.6	-1.7	-1.5	-1.4	-1.3	-1.1	-1.1	-0.7	-0.5	-0.4
Endogenous debt dynamics 3/	-3.3	7.1	-7.7	-7.9	-5.9	-3.8	-0.2	-1.0	-3.6	-1.7	-0.8	-0.8	-0.7	-0.5	-0.5	-0.4	-0.4
Contribution from nominal interest rate	0.4	0.6	0.6	0.4	0.3	0.3	0.4	0.4	0.3	0.4	0.7	0.7	0.8	0.9	0.9	1.0	1.1
Contribution from real GDP growth	-2.3	3.6	-4.0	-2.6	-1.8	-2.0	-0.9	-1.4	-1.1	-1.0	-0.9	-1.1	-1.1	-1.1	-1.1	-1.1	-1.1
Contribution from price and exchange rate changes	-1.4	2.9	-4.2	-5.6	-4.3	-2.1	0.3	0.0	-2.8	-1.1	-0.5	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4
Residual 4/	0.0	-3.4	0.5	8.9	6.9	3.2	-6.7	-4.1	2.9	-1.2	-1.8	-1.4	-1.3	-0.8	0.4	0.4	0.5
o/w exceptional financing	-0.2	-0.2	-0.2	-0.3	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net external debt 5/	7.8	13.7	8.8	4.9	2.4	-2.5	-6.7	-5.9	-7.6	-8.0	-5.8	-3.6	-1.2	-1.2	-2.1	-3.7	-5.0
o/w public sector	19.3	25.8	21.0	17.2	14.9	11.5	6.5	5.6	2.4	0.9	0.9	0.7	-0.8	-0.9	-2.8	-5.4	-7.4
o/w private sector	-11.5	-12.1	-12.2	-12.3	-12.5	-14.0	-13.2	-11.5	-10.0	-9.0	-6.7	-4.3	-0.4	-0.3	0.7	1.7	2.5
NPV of external debt 6/	...	...	...	...	...	...	...	...	16.3	16.4	17.4	17.5	17.0	17.0	17.4	18.1	18.2
In percent of exports	...	...	...	...	...	...	...	..	76.7	75.1	76.3	73.7	67.4	65.3	60.4	60.4	60.7
NPV of PPG external debt	...	...	...	...	...	...	...	...	15.1	14.6	15.3	15.4	15.1	15.0	14.2	13.6	12.9
In percent of exports	...	...	...	...	...	...	...	...	71.3	67.2	67.2	64.8	59.7	57.5	49.3	45.5	42.8
Debt service-to-exports ratio (in percent)	7.5	12.3	8.7	4.0	4.0	4.1	6.8	5.3	4.5	4.8	6.7	7.2	9.4	9.8	8.9	9.0	8.7
PPG debt service-to-exports ratio (in percent)	7.5	12.3	8.7	4.0	4.0	4.1	6.3	5.0	4.1	4.2	5.9	5.5	7.1	7.4	6.5	5.7	4.5
Total gross financing need (billions of Euros)	0.1	0.2	0.1	0.0	0.2	0.1	0.3	0.1	0.2	0.4	0.4	0.4	0.5	0.5	0.7	0.9	1.3
Non-interest current account deficit that stabilizes debt ratio	9.0	1.8	12.0	4.5	5.9	8.5	12.7	10.8	7.0	7.3	7.1	6.6	6.5	5.8	3.8	2.8	2.5
Key macroeconomic assumptions																	
Real GDP growth (in percent)	9.1	-10.3	12.7	10.1	7.3	7.2	3.4	6.0	5.9	5.5	5.0	6.0	6.0	6.0	6.0	6.0	6.0
GDP deflator in terms of Euros (change in percent)	4.9	-9.1	11.6	19.7	16.1	7.2	-1.2	-0.2	14.3	5.6	2.6	2.2	2.2	1.9	1.9	1.9	1.9
Effective interest rate (percent) 6/	1.7	1.7	1.7	1.5	1.2	1.2	1.6	1.8	1.6	2.2	3.6	4.0	4.6	4.9	5.1	5.6	5.8
Growth of exports of G&S (in terms of Euros, in percent)	19.0	-26.4	31.3	116.2	32.3	23.3	2.7	7.2	25.4	13.7	11.7	12.7	11.2	11.1	10.2	8.1	8.1
Growth of imports of G&S (in terms of Euros, in percent)	33.6	-15.3	20.6	34.0	38.8	21.6	10.3	4.7	14.1	16.3	10.5	8.1	9.5	8.6	7.9	7.5	7.6
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	...	...	...	...	17.3	14.0	16.0	14.5	12.8	10.1	9.9	9.2
Memorandum item:																	
Nominal GDP (billions of Euros)	2.4	1.9	2.4	3.2	4.0	4.6	4.7	5.0	6.0	6.7	7.2	7.8	9.2	9.9	14.6	21.5	29.2

Averages and Standard Deviations	Historical Average	Standard Deviation	Average 2005-09	Average 2010-24
Real GDP growth (in percent)	5.7	6.6	5.7	6.0
GDP deflator in terms of Euros (change in percent)	7.0	9.4	3.0	1.9
Effective interest rate (percent) 7/	1.6	0.2	3.8	5.3
Growth of exports of G&S (in terms of Euros, in percent)	25.7	38.6	12.4	9.3
Growth of imports of G&S (in terms of Euros, in percent)	18.1	17.0	10.7	7.8
Grant element of new public sector borrowing (in percent)	...	...	15.7	10.3
Non-interest current account deficit	7.0	3.3	6.6	3.7
Net current transfers (negative = inflow)	-13.0	1.9	-13.5	-11.8
Net FDI (negative = inflow)	-3.1	1.3	-3.2	-2.9

Source: Staff simulations.

1/ Includes both public and private sector external debt.
2/ Includes IMF.
3/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in terms of Euros.
4/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.
5/ Defined as the stock of debt less international reserves of the banking system. Net debt of the public sector is defined as PPG external debt minus GIR of the Bank of Albania, and net debt of the private sector is estimated as private external debt minus foreign assets of commercial banks.
6/ Assumes that NPV of private sector debt is equivalent to its face value.
7/ Current-year interest payments devided by previous period debt stock.

Table 1b. Albania: Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2004-24
(In percent)

	Actual	Projections														
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2017	2019	2021	2024
NPV of debt-to-GDP ratio																
Baseline	15	15	15	15	15	15	15	15	15	15	14	14	14	14	13	13
A. Alternative Scenarios																
A1. Key variables at their historical averages in 2004-23 1/	15	20	22	22	22	22	22	22	22	23	24	25	27	29	30	32
A2. New public sector loans on less favorable terms in 2004-23 2/	15	15	16	16	17	17	18	18	18	19	19	19	19	20	20	21
B. Bound Tests																
B1. Real GDP growth at historical average minus one standard deviation in 2005-06	15	17	20	21	22	22	22	22	22	22	21	21	20	19	18	16
B2. Export value growth at historical average minus one standard deviation in 2005-06 3/	15	21	32	43	42	40	38	35	32	30	28	27	26	25	23	21
B3. GDP deflator in Euros at historical average minus one standard deviation in 2005-06	15	17	20	22	23	23	23	23	23	22	22	21	20	19	17	15
B4. Net non-debt creating flows at historical average minus one standard deviation in 2005-06 4/	15	23	31	32	31	30	29	27	26	24	23	23	22	21	20	18
B5. Combination of B1-B4 using one-half standard deviation shocks	15	21	28	28	29	28	27	27	26	25	24	24	23	21	20	19
B6. One-time 30 percent nominal depreciation relative to the baseline in 2006 5/	15	16	25	27	28	29	29	29	29	28	27	27	26	23	21	18
NPV of debt-to-exports ratio																
Baseline	71	67	67	65	62	60	58	56	54	53	51	49	48	46	45	43
A. Alternative Scenarios																
A1. Key variables at their historical averages in 2004-23 1/	71	95	102	104	105	107	108	111	115	122	131	141	166	191	217	261
A2. New public sector loans on less favorable terms in 2004-23 2/	71	67	70	70	69	69	69	69	68	68	67	67	67	68	69	69
B. Bound Tests																
B1. Real GDP growth at historical average minus one standard deviation in 2005-06	71	73	78	80	79	79	77	76	73	71	68	66	63	57	53	49
B2. Export value growth at historical average minus one standard deviation in 2005-06 3/	71	129	241	305	293	272	246	223	202	183	167	158	151	140	131	121
B3. GDP deflator in Euros at historical average minus one standard deviation in 2005-06	71	75	81	83	83	82	81	79	76	73	70	67	63	57	51	45
B4. Net non-debt creating flows at historical average minus one standard deviation in 2005-06 4/	71	105	136	135	129	120	111	104	96	89	84	81	78	71	67	62
B5. Combination of B1-B4 using one-half standard deviation shocks	71	98	128	126	122	117	111	105	100	94	89	86	82	75	71	66
B6. One-time 30 percent nominal depreciation relative to the baseline in 2006 5/	71	74	80	82	82	82	80	78	76	73	70	67	63	55	50	44
Debt service ratio																
Baseline	4	4	6	6	7	7	7	7	7	7	7	6	6	6	6	5
A. Alternative Scenarios																
A1. Key variables at their historical averages in 2005-24 1/	4	4	6	5	9	10	11	12	13	14	14	16	20	25	31	38
A2. New public sector loans on less favorable terms in 2005-24 2/	4	4	4	4	5	5	5	5	5	5	5	6	6	6	7	7
B. Bound Tests																
B1. Real GDP growth at historical average minus one standard deviation in 2005-06	4	4	5	4	6	6	7	7	8	8	8	8	7	7	7	6
B2. Export value growth at historical average minus one standard deviation in 2005-06 3/	4	5	10	12	22	31	39	38	36	36	32	26	21	21	20	18
B3. GDP deflator in Euros at historical average minus one standard deviation in 2005-06	4	4	5	4	6	7	8	8	8	9	8	8	8	7	7	6
B4. Net non-debt creating flows at historical average minus one standard deviation in 2005-06 4/	4	4	6	7	12	15	16	15	15	15	13	11	10	10	10	9
B5. Combination of B1-B4 using one-half standard deviation shocks	4	4	6	7	10	13	14	14	14	14	12	11	11	10	10	9
B6. One-time 30 percent nominal depreciation relative to the baseline in 2006 5/	4	4	5	4	6	7	8	8	8	8	8	8	8	7	7	5
Memorandum item:																
Grant element assumed on residual financing (i.e., financing required above baseline)	...	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1

Source: Staff projections and simulations.

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

Table 2a. Albania: Public Sector Debt Sustainability Framework, Baseline Scenario, 1997-2009

(In percent of GDP, unless otherwise indicated)

	Actual										Projections					
	1997	1998	1999	2000	2001	2002	2003	2004	Historical Average 4/	Standard Deviation 4/	2005	2006	2007	2008	2009	2005-09 Average
Public sector debt 1/	75.6	68.5	66.7	72.8	67.6	65.0	61.8	56.5			54.9	55.0	54.5	53.6	52.6	
o/w foreign-currency denominated	38.1	32.3	29.3	30.2	26.6	23.3	20.7	18.0			16.8	17.0	17.0	17.0	16.8	
Change in public sector debt	22.1	-7.1	-1.8	6.1	-5.2	-2.5	-3.2	-5.3			-1.7	0.1	-0.5	-0.9	-1.0	
Identified debt-creating flows	20.9	-12.4	-0.9	-1.5	-3.5	6.3	-1.8	-4.6			-1.5	0.0	-1.2	-1.4	-1.4	
Primary deficit	7.3	1.6	1.9	2.4	3.6	2.7	0.2	1.4	2.8	2.2	0.6	0.7	0.2	0.2	0.2	0.4
Revenue and grants	18.3	24.2	25.5	23.8	23.7	24.7	24.5	24.1			24.6	24.6	24.7	24.7	24.8	
of which : grants	0.7	1.6	2.8	1.0	0.6	0.7	0.4	0.3			1.0	1.0	0.9	0.8	0.8	
Primary (noninterest) expenditure	25.5	25.8	27.5	26.1	27.3	27.4	24.6	25.5			25.1	25.3	24.9	24.9	24.9	
Automatic debt dynamics	13.9	-14.0	-2.6	-2.2	-4.9	3.7	-1.9	-4.1			-1.8	-0.3	-1.2	-1.5	-1.4	
Contribution from interest rate/growth differential	7.5	-8.8	-0.8	-0.7	-2.2	0.5	-0.7	-2.3			-1.4	-0.3	-1.2	-1.4	-1.5	
of which : contribution from average real interest rate	5.3	4.1	5.5	3.8	2.6	2.4	2.8	1.1			1.6	2.3	1.9	1.6	1.5	
of which : contribution from real GDP growth	6.1	-8.5	-6.3	-4.5	-4.8	-1.9	-3.5	-3.4			-2.9	-2.6	-3.1	-3.1	-3.0	
Contribution from real exchange rate depreciation	6.4	-5.2	-1.8	-1.5	-2.7	3.2	-1.1	-1.8			-0.4	0.0	0.0	0.0	0.1	
Other identified debt-creating flows	-0.3	0.0	-0.2	-1.7	-2.2	-0.1	-0.1	-1.9			-0.3	-0.3	-0.2	-0.2	-0.2	
Privatization receipts (negative)	-0.3	0.0	-0.2	-1.7	-2.2	-0.1	-0.1	-1.9			-0.3	-0.3	-0.2	-0.2	-0.2	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes	1.2	5.4	-0.9	7.6	-1.7	-8.9	-1.4	-0.7			-0.2	0.1	0.6	0.5	0.5	
NPV of public sector debt	...	...	...	...	...	...	...	53.6			52.7	53.4	52.8	51.9	50.9	
o/w foreign-currency denominated	...	...	...	...	...	...	...	15.1			14.6	15.3	15.4	15.2	15.1	
o/w external	...	...	...	...	...	...	...	15.1			14.6	15.3	15.4	15.2	15.1	
NPV of contingent liabilities (not included in public sector debt)	...	...	...	...	...	...	...	...			...	...	...	...	...	
NPV of public sector debt-to-revenue ratio	...	...	...	...	...	...	...	222.8			214.5	217.0	213.8	210.2	205.5	
o/w external	...	...	...	...	...	...	...	62.9			59.6	62.3	62.3	61.8	60.9	
Debt service-to-revenue ratio (in percent) 2/ 3/	33.8	37.6	30.1	25.1	18.9	17.7	19.3	17.0			14.8	16.3	15.1	15.1	14.8	
Primary deficit that stabilizes the debt-to-GDP ratio				-3.7	8.8	5.2	3.4	6.7			2.2	0.6	0.8	1.1	1.2	
Key macroeconomic and fiscal assumptions																
Real GDP growth	-10.2	12.7	10.1	7.3	7.0	2.9	5.7	5.9	6.3	6.1	5.5	5.0	6.0	6.0	6.0	5.7
Average nominal interest rate on forex debt	0.8	0.7	0.4	1.7	0.7	1.5	1.1	1.2	0.9	0.5	1.5	2.6	2.9	3.3	3.5	2.8
Average real interest rate on domestic currency debt	10.8	13.8	18.0	11.1	7.1	5.8	7.2	3.3	8.6	5.4	4.7	5.8	4.9	4.2	4.0	4.7
GDP Deflator (percent change)	9.8	13.6	4.5	4.3	3.5	3.3	3.4	6.0	9.9	9.8	3.5	2.4	3.0	3.3	3.2	3.1
Growth of real primary spending	-2.3	13.8	17.3	2.2	11.6	3.4	-5.0	9.6	4.8	8.7	4.0	5.7	4.4	5.9	6.2	5.2
Grant element of new external borrowing	...	...	...	...	...	...	...	...	...	...	17.3	14.0	16.0	16.8	14.5	15.7

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

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

2/ Revenues including grants.

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

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

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

	Actual		Projections				
	2003	2004	2005	2006	2007	2008	2009
NPV of Debt-to-GDP Ratio							
Baseline	...	54	53	53	53	52	51
A. Alternative scenarios							
A1. Real GDP growth and primary balance are at historical averages	…	54	54	56	58	58	59
A2. Primary balance is unchanged from 2004	…	54	53	55	55	55	55
A3. Permanently lower GDP growth 1/	…	54	54	56	57	58	59
B. Bound tests							
B1. Real GDP growth is at historical average minus one standard deviations in 2005-2006	…	54	57	63	64	65	66
B2. Primary balance is at historical average minus one standard deviations in 2005-2006	…	54	57	61	60	59	58
B3. Combination of B1-B2 using one half standard deviation shocks	…	54	57	62	60	59	58
B4. One time 30 percent real depreciation in 2005	…	54	59	59	59	57	56
B5. 10 percent of GDP increase in other debt-creating flows in 2005	…	54	62	62	61	60	58
NPV of Debt-to-Revenue Ratio 2/							
Baseline	…	223	215	217	214	210	206
A. Alternative scenarios							
A1. Real GDP growth and primary balance are at historical averages	…	223	221	229	233	237	240
A2. Primary balance is unchanged from 2004	…	223	218	223	224	224	223
A3. Permanently lower GDP growth 1/	…	223	219	226	230	234	237
B. Bound tests							
B1. Real GDP growth is at historical average minus one standard deviations in 2005-2006	…	223	231	254	260	264	266
B2. Primary balance is at historical average minus one standard deviations in 2005-2006	…	223	232	249	244	239	232
B3. Combination of B1-B2 using one half standard deviation shocks	…	223	232	250	245	239	233
B4. One time 30 percent real depreciation in 2005	…	223	239	242	237	232	226
B5. 10 percent of GDP increase in other debt-creating flows in 2005	…	223	253	253	247	242	235
Debt Service-to-Revenue Ratio 2/							
Baseline	19	17	15	16	15	15	15
A. Alternative scenarios							
A1. Real GDP growth and primary balance are at historical averages	19	17	15	19	20	22	23
A2. Primary balance is unchanged from 2004	19	17	15	17	17	18	18
A3. Permanently lower GDP growth 1/	19	17	15	17	17	18	19
B. Bound tests							
B1. Real GDP growth is at historical average minus one standard deviations in 2005-2006	19	17	16	20	21	24	25
B2. Primary balance is at historical average minus one standard deviations in 2005-2006	19	17	15	22	25	22	20
B3. Combination of B1-B2 using one half standard deviation shocks	19	17	15	21	23	21	19
B4. One time 30 percent real depreciation in 2005	19	17	15	17	16	16	16
B5. 10 percent of GDP increase in other debt-creating flows in 2005	19	17	15	30	25	22	20

Sources: Albanian authorities; and Fund staff estimates and projections.
1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of 20 (i.e., the length of the projection period).
2/ Revenues are defined inclusive of grants.

ALBANIA

**Three-Year Arrangement Under the
Poverty Reduction and Growth Facility**

Attached hereto is a letter ("the Letter")* dated January 11, 2006, with its annexed Memorandum on Economic and Financial Policies for 2006 (the "Memorandum") and Technical Memorandum of Understanding (the "TMU"), from the Prime Minister, Minister of Finance, and Governor of the Bank of Albania requesting from the International Monetary Fund, as Trustee of the Poverty Reduction and Growth Facility Trust ("the Trustee"), a three-year arrangement under the Poverty Reduction and Growth Facility ("PRGF"), and setting forth:

(a) the objectives and policies of the program that the authorities of Albania intend to pursue during the three-year period of the arrangement;

(b) the objectives, policies and measures that the authorities of Albania intend to pursue during the first year of the arrangement; and

(c) understandings of Albania with the Trustee regarding reviews that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of Albania will pursue for the second and third years of the arrangement.

To support these objectives and policies, the Trustee grants the requested three-year arrangement in accordance with the following provisions, and subject to the provisions applying to assistance under the PRGF Trust.

1. (a) For a period of three years from February 1, 2006, Albania will have the right to obtain disbursements from the Trustee in a total amount equivalent to SDR 8.5225 million, subject to the availability of resources in the PRGF Trust.

(b) Disbursements under this arrangement shall not exceed the equivalent of SDR 3.6525 million until February 1, 2007 and the equivalent of SDR 6.0875 million until February 1, 2008.

2. During the arrangement:

(a) the first disbursement, in an amount equivalent to SDR 1.2175 million, will be available on or after February 1, 2006, at the request of Albania;

* See page 74.

(b) the second disbursement, in an amount equivalent to SDR 1.2175 million, will be available on or after August 1, 2006, at the request of Albania and subject to paragraphs 4 and 5 below;

(c) the third disbursement, in an amount equivalent to SDR 1.2175 million, will be available on or after February 1, 2007, at the request of Albania, and subject to paragraphs 3, 4 and 5 below.

3. The remaining conditions for the third disbursement referred to in paragraph 2(c) shall be determined in the context of the first review under Albania's PRGF arrangement. The right of Albania to request further disbursements during the second and third years of this arrangement shall be subject to such phasing and conditions as shall be determined in the context of reviews under Albania's PRGF arrangement.

4. Albania will not request the second and third disbursements under this arrangement respectively specified in paragraphs 2(b) and 2(c) above:

(a) if the Managing Director of the Trustee finds that with respect to the second disbursement, the data as of March 31, 2006, and with respect to the third disbursement, the data as of September 30, 2006 indicate that:

(i) the ceiling on net domestic credit to the government, or

(ii) the ceiling on net domestic assets of the Bank of Albania, or

(iii) the floor on net international reserves of the Bank of Albania, or

(iv) the ceiling on contracting or guaranteeing of public and publicly-guaranteed non-concessional external debt with original maturities greater than one year,

as specified in Table 1 of the Memorandum and further specified in the TMU, was not observed; or

(b) if Albania has not carried out its intentions with respect to the following structural performance criteria:

(i) by March 31, 2006 to further extend the use of ASYCUDA in customs administration by: deploying the ASYCUDA system in 10 customs houses; and implementing the risk assessment module of the ASYCUDA system in 10 customs houses to perform inspections as specified in Table 2 and paragraph 20 of the Memorandum; or

(ii) by March 31, 2006, KESH to meet the targets with respect to collection rates and losses, as set out in the Power Sector Action Plan dated January 13, 2006 as specified in Table 2 and paragraph 20 of the Memorandum; or

(c) until the Trustee has determined that, with respect to the second disbursement, the first program review referred to in paragraph 25 of the Memorandum, and with respect to the third disbursement, the second program review referred to in paragraph 25 of the Memorandum, has been completed; or

(d) until the Trustee has determined that, with respect to the second and third disbursements, so long as Albania has outstanding sovereign external payments arrears to private creditors, or by virtue of Albania's imposition of exchange controls there are outstanding non-sovereign external payments arrears, a financing assurance review is completed.

5. Albania will not request any disbursement under this arrangement:

(a) if at any time during this arrangement, the government of Albania contracts or guarantees public and publicly-guaranteed external debt with original maturities up to and including one year as specified in Table 1 of the Memorandum and further specified in the TMU; or

(b) if at any time during this arrangement, the government of Albania accumulates any new external payment arrears, excluding interest on pre-existing arrears as specified in Table 1 of the Memorandum and further specified in the TMU; or

(c) if Albania:

(i) imposes or intensifies restrictions on payments and transfers for current international transactions; or

(ii) introduces or modifies multiple currency practices; or

(iii) concludes bilateral payments agreements that are inconsistent with Article VIII; or

(iv) imposes or intensifies import restrictions for balance of payments reasons.

6. When Albania is prevented from requesting any disbursement under this arrangement because of paragraphs 4 and 5 above, such disbursements may be made available only after consultation has taken place between the Trustee and Albania and understandings have been reached regarding the circumstances in which Albania may request that and any further disbursements.

7. In accordance with paragraph 4 of the Letter, Albania will provide the Trustee with such information as the Trustee requests in connection with the progress of Albania in implementing the policies and reaching the objectives of the program supported by this arrangement.

8. During the period of this arrangement, Albania shall remain in close consultation with the Trustee in accordance with paragraph 4 of the Letter, Albania shall consult with the Trustee on the adoption of any measures that may be appropriate at the initiative of the government or whenever the Managing Director of the Trustee requests such a consultation. Moreover, after the period of this arrangement and while Albania has outstanding financial obligations to the Trustee arising from loan disbursements under this arrangement, Albania will consult with the Trustee from time to time, at the initiative of the government or whenever the Managing Director of the Trustee requests consultation on Albania's economic and financial policies. These consultations may include correspondence and visits of officials of the Trustee to Albania or of representatives of Albania to the Trustee.

ALBANIA

Extended Arrangement

Attached hereto is a letter ("the Letter")* dated January 11, 2006, with its annexed Memorandum on Economic and Financial Policies for 2006 (the "Memorandum") and Technical Memorandum of Understanding (the "TMU"), from the Prime Minister, Minister of Finance, and Governor of the Bank of Albania requesting an extended arrangement and setting forth:

(a) the objectives and policies that the authorities of Albania intend to pursue for the period of this extended arrangement;

(b) the policies and measures that the authorities of Albania intend to pursue during the first year of this extended arrangement; and

(c) understandings of Albania with the Fund regarding reviews that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of Albania will pursue for the second and third years of this extended arrangement.

To support these objectives and policies the International Monetary Fund grants this extended arrangement in accordance with the following provisions:

1. For a period of three years from February 1, 2006 Albania will have the right to make purchases from the Fund in an amount equivalent to SDR 8.5225 million, subject to paragraphs 2, 3, 4, and 5 below, without further review by the Fund.

2. Purchases under this extended arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 1. 2175 until August 1, 2006, the equivalent of SDR 2.435 million until February 1, 2007, the equivalent of SDR 3.6525 million until July 1, 2007, the equivalent of SDR 4.87 million until January 1, 2008, the equivalent of SDR 6.0875 million until July 1, 2008, and the equivalent of SDR 7.305 million until January 1, 2009.

3. Albania will not make purchases under this extended arrangement:

(a) during any period in which the data at the end of the preceding period indicate that:

(i) the ceiling on net domestic credit to the government, or

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* See page 74.

(ii) the ceiling on net domestic assets of the Bank of Albania, or

(iii) the floor on net international reserves of the Bank of Albania, or

(iv) the ceiling on contracting or guaranteeing of public and publicly-guaranteed non-concessional external debt with original maturities great than one year,

as specified in Table 1 of the Memorandum and further specified in the TMU, was not observed; or

(b) if by March 31, 2006, the use of ASYCUDA has not been further extended in customs administration by: deploying the ASYCUDA system in 10 customs houses; and implementing the risk assessment module of the ASYCUDA system in 10 customs houses to perform inspections as specified in Table 2 and paragraph 16 of the Memorandum; or

(c) if by March 31, 2006, KESH has not met the targets with respect to collection rates and losses, as set out in the Power Sector Action Plan dated January 13, 2006 as specified in Table 2 and paragraph 20 of the Memorandum; or

(d) if at any time during the period of the arrangement, Albania contracts or guarantees public and publicly-guaranteed external debt with original maturities up to and including one year as specified in Table 1 of the Memorandum and further specified in the TMU, or

(e) if at any time during the period of the arrangement, the government of Albania accumulates any new external payment arrears, excluding interest on pre-existing arrears as specified in Table 1 of the Memorandum and further specified in the TMU, or

(f) after August 1, 2006 and February 1, 2007 until the reviews contemplated in paragraph 25 of the Memorandum are completed, or

(g) after August 1, 2006 and February 1, 2007, until the respective financing assurances reviews referred to in paragraph 25 f the Memorandum are completed, or

(h) if at any time during the period of the extended arrangement, Albania

(i) imposes or intensifies restrictions on the making of payments and transfers for current international transactions, or

(ii) introduces or modifies multiple currency practices; or

(iii) concludes bilateral payments agreements which are inconsistent with Article VIII, or

(iv) imposes or intensifies import restrictions for balance of payments reasons.

When Albania is prevented from purchasing under this extended arrangement because of this paragraph 3, purchases will be resumed only after consultation has taken place between the Fund and Albania and understandings have been reached regarding the circumstances in which such purchases can be resumed.

4. Albania will not make purchases under this extended arrangement during any period in which Albania: (i) has an overdue financial obligation to the Fund or is failing to meet a repurchase expectation (a) in respect of a noncomplying purchase pursuant to Decision No. 7842-(84/165) on the Guidelines on Corrective Action, or (b) in respect of a purchase in support of debt and debt service reduction operation pursuant to Decision No. 9331-(89/167), or (c) pursuant to paragraphs 17 and 31 of Decision No. 8955-(88/126), on the Compensatory Financing Facility, or (d) in respect of a purchase under Decision No. 11627-(97/123) SRF on the Supplemental Reserve Facility and Contingent Credit Lines, or (e) pursuant to paragraph 1(b) of Decision No. 5703-(78/39) or paragraph 10(a) of Decision No. 4377-(74/114); or (ii) is failing to meet a repayment obligation to the PRGF Trust established by Decision No. 8759-(87/176) PRGF, or a repayment expectation to that Trust pursuant to the provisions of Appendix I to the PRGF Trust Instrument.

5. Albania's right to engage in the transactions covered by this extended arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Albania. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 5, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Albania and understandings have been reached regarding the circumstances in which such purchases can be resumed.

6. Purchases under this extended arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, unless, at the request of Albania, the Fund agrees to provide SDRs at the time of the purchase.

7. Albania shall pay a charge for this extended arrangement in accordance with the decisions of the Fund.

8. (a) Albania shall repurchase the amount of its currency that results from a purchase under this extended arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchase as Albania's balance of payments and reserve position improves.

(b) Any reductions in Albania's currency held by the Fund shall reduce the amounts subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

9. During the period of the extended arrangement Albania shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Albania or of representatives of Albania to the Fund. Albania shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Albania in achieving the objectives and policies set forth in the attached Letter and Memorandum.

10. In accordance with paragraph 4 of the Letter, Albania will consult with the Fund on the adoption of any measures that may be appropriate at the initiative of the government or whenever the Managing Director requests consultation because any of the criteria in paragraph 3 above have not been observed or because the Managing Director considers that consultation on the program is desirable. In addition, after the period of the arrangement and while Albania has outstanding purchases under this arrangement, the government will consult with the Fund from time to time, at the initiative of the government or at the request of the Managing Director, concerning Albania's balance of payments policies.

Tirana, January 11, 2006

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

Dear Mr. de Rato:

Since 1993, the International Monetary Fund has supported our efforts to achieve and maintain macroeconomic stability and to develop and restructure our economy. Our progress has been solid, but a considerable reform agenda lies ahead of us, and we continue to see significant benefit in further program-based engagement with the Fund.

The successful completion of the third PRGF-supported program in November 2005 provides us with a firm foundation for new arrangements. Trend growth is strong, inflation is in the 2-4 percent range, and confidence in the currency and the banking system is on the rise. Moreover, with significant structural adjustment carried out over the last three years, we are well placed to fully implement the ambitious reform agenda described in the attached Memorandum of Economic and Financial Policies (MEFP). These policies are consistent with our November 2001 National Strategy for Socio-Economic Development (NSSED) and the Annual Progress Reports of May 2003, May 2004, and July 2005.

We therefore request a new three-year Poverty Reduction and Growth Facility arrangement in an amount equivalent to SDR 8.5225 million (17.5 percent of quota) together with a concurrent three-year Extended Fund Facility arrangement in the same amount. Our request for a blend of these two facilities reflect Albania's rapid income growth over the last decade. We have already completed the prior actions agreed with Fund staff, including passage of a 2006 budget consistent with the negotiated program.

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

Following this arrangement, and as long as Albania has outstanding financial obligations to the IMF arising from loan disbursements under the present arrangement, Albania will consult with the IMF from time to time on economic and financial policies, at the initiative of the government or the Bank of Albania, or if 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/	/s/	/s/
Sali Berisha	Ridvan Bode	Ardian Fullani
Prime Minister	Minister of Finance	Governor, Bank of Albania

Memorandum on Economic and Financial Policies (MEFP) for Albania

I. Background

1. This memorandum lays out the broad thrust of our policies over the proposed 2006-2009 program period, and provides a detailed description of our policy intentions for 2006. It is consistent with the November 2001 National Strategy for Socio-Economic Development (NSSED) and the May 2003, May 2004, and July 2005 NSSED Progress Reports. We have started preparing an updated NSSED for 2007-09, to be completed by end-2006, which will be formulated within the comprehensive Integrated Planning System introduced in 2005.

2. **Albania's macroeconomic performance has been solid since 1998.** With the exception of the supply-induced disruptions of 2002, we have enjoyed a prolonged period of rapid, non-inflationary growth. Over the last three years in particular, confidence in the monetary framework has been enhanced and inflation expectations anchored to the 2-4 percent target range of the Bank of Albania (BoA). This has strengthened the lek and allowed the BoA to continue a prudent easing of the monetary policy stance while maintaining reserves at comfortable levels. On the fiscal front, current expenditure, the deficit, and domestic borrowing have been curtailed, and the 2005 budget delivered the first surplus on current operations since the beginning of the transition process. The public debt burden has been considerably reduced, reflecting foreign debt restructuring, fiscal consolidation, rapid economic growth, and the allocation of half the proceeds of large privatizations to redeem domestic debt. The debt to GDP ratio declined to an estimated 55 percent of GDP at end-2005—a reduction of 9½ percentage points since end-2002.

3. **We have also made progress in structural reform**. In the banking sector, following the privatization of the Savings Bank in 2004, all commercial banks are now under private management and the banking system is displaying significantly increased levels of dynamism and competitiveness. With rapidly rising credit volumes and greater provision of services, the system is now poised to play a more pivotal role in economic development. Complementing these developments, the completion of the real-time gross settlement system, bulk settlements system, and significant progress in switching public sector salary payments from cash to the banking system are encouraging the use of banks for a variety of economic transactions. In the fiscal area, adoption of realistic revenue projections—accurately reflecting the limited capacity of tax and customs administration—and other reforms to the budget process—including greater parliamentary oversight—have enhanced the transparency of our fiscal expenditure and budget processes. The privatization process is by now quite advanced, pending the finalization of the sale of Albtelecom expected in early 2006 and given the advanced state of preparations for the sale of the Italian-Albanian Bank. Should these privatizations occur, half of the receipts will be used to reduce public debt and the other half expended in priority areas. In the statistical area, we have made progress towards producing more comprehensive and reliable national accounts and other economic and social indicators; we have also adopted our first Statistical Master Plan that sets out our priorities

for the coming years. External arrears left over from before the transition have been greatly reduced.

4. **Reform of our revenue agencies has also been generally positive, although much more remains to be done**. The ASYCUDA system has been extended to 9 customs houses, together with related procedural reform in customs administration, including the implementation of the ASYCUDA system risk assessment module for conducting inspections in 2 customs houses. We have implemented a quick VAT refund system for exporters and progressed as planned towards eliminating the stock of VAT refund arrears—both measures aimed at providing much-needed improvement to the efficiency and equity of the tax system.

5. **Progress in some key areas, however, has been less than satisfactory.** Deficiencies in our business climate due to poor infrastructure and weaknesses in governance and institutions continue to deny our economy the investment—particularly foreign investment—needed to boost productivity and expand exports. The recent disruptions in electricity supply, due to poor water reserves management until early September and ill-designed procurement rules, call attention to the need for further large investments and structural reform in the energy sector. Despite the steps taken in recent years, including a FIAS supported review of administrative barriers to investment, the business environment remains uninviting. On the fiscal front, continued weaknesses in revenue administration and public debt management leave our economy vulnerable to economic shocks. Moreover, the quality of public expenditure requires improvement so that we may better utilize scarce resources for economic development and poverty reduction. Albeit to a lesser degree, further reform and modernization are also needed in the financial sector. Regarding poverty, though some key indicators have improved in recent years, advances are not uniform and a few indicators, such as enrollment ratios in education, need improvement.

II. Objectives and Policies

6. **Our program for the next three years will therefore concentrate on maintaining macroeconomic stability, enhancing growth potential, reducing vulnerabilities and strengthening government solvency**.

- Macroeconomic stability will be ensured through further fiscal consolidation—centered on a steady reduction of domestic borrowing and improvement in the current and primary balances; and through strengthening the monetary policy framework and financial supervision capacity.

- Growth potential will be enhanced through revenue and expenditure reforms that promote high quality public and private investment; by pursuing further structural reforms, such as completing the privatization process, improving the commercial court system and the process of land title registration; and by improving the business environment. Moreover, investments in alternative energy sources and the restructuring of KESH should help reduce the inherent volatility of electricity supply, which remains one of the economy's main sources of vulnerability.

- Declining levels of public debt relative to GDP, together with improvements in revenue administration and public debt management, as well as reforms that limit contingent liabilities (e.g., in the electricity sector), should strengthen government solvency and reduce fiscal vulnerabilities. Significantly lengthening the average maturity of domestic public debt will be a critical measure in this regard.

A. Macroeconomic Framework

7. **The program is built on a realistic macroeconomic framework**. Real GDP growth is projected to fall to 5 percent in 2006, from an estimated 5½ percent in 2005, as a result of the difficult situation in the electricity sector. However, as the issues in this sector are gradually resolved and import and production capacity improve, we anticipate a return to the historical 6 percent trend, reinforced by rising investment due to improvements in our business climate. An appropriate monetary policy stance, supported by a flexible exchange rate regime, should hold inflation to 3 percent—with a tolerance range for deviations of plus or minus one percent—while ongoing fiscal consolidation will allow a steady improvement in government solvency. Public savings will rise over the program period as we improve our revenue administration and reduce the share of current expenditure in total spending—including through lower interest costs resulting from better debt management. We also anticipate a rise in private—mainly corporate—savings in response to ongoing structural reform and rapid economic growth. With public and private investment rising at a lower pace, the current account will gradually improve and the growth contribution of net exports will rise. In recognition of our continued fiscal vulnerability, we have protected this framework from unforeseen shocks through the use of budgetary contingencies, conservative estimates of tax revenue and privatization receipts, and by a policy of not expending the gains from tax administration reforms before their realization. In the event additional receipts from the latter or privatization materialize, we will consult with the Fund on an appropriate division between additional priority expenditure, tax cuts, and debt reduction; and will submit to parliament a supplementary budget.

B. Monetary, Exchange Rate, and Financial Sector Policies

8. **We will direct monetary policy towards keeping inflation at 3 percent—with a tolerance range for deviations of plus or minus one percent**. Our current monetary policy framework—a reserve money program with quantitative targets set in consultation with the Fund and with changes to the repurchase rate as the main policy instrument—will be retained over the program period so long as it remains effective in controlling inflation. We expect over the medium term that velocity and the money multiplier will remain relatively stable, and that our existing framework will be sufficient to hold inflation within the target band. Nonetheless, we recognize that our past success in this regard took place largely in the context of a relatively underdeveloped banking system providing very low volumes of private sector credit. This environment is changing rapidly—credit growth exceeded 70 percent in October 2005, and both demand and supply of credit are expected to remain strong into the medium term. While our overwhelming preference is that monetary policy instruments remain market based, given the limited effect of policy rate changes on credit

demand—particularly on foreign currency denominated credit demand—the temporary use of direct instruments for controlling credit provision—in consultation with the Fund—cannot be ruled out at this stage.

9. **We will retain a flexible exchange rate regime, with foreign exchange interventions limited to smoothing seasonality and short term shocks, and maintaining an adequate reserve level**. The flexible rate provides a cushion to potential macroeconomic shocks, thereby reducing overall vulnerability. Our medium-term goal of moving to an inflation targeting regime also argues for the preservation of a flexible exchange rate. In this regard, with assistance from the Fund, we are in the process of identifying the necessary steps and formulating an action plan, which we hope to be able to begin implementing soon.

10. **Our efforts at structural reform in the financial sector over the program period will be guided by the recently completed Financial Sector Stability Assessment (FSSA) report**. We will set up a joint government-BoA task force to work with Fund staff to develop an action plan to implement the recommendations of this report (SB; end-March 2006). Measures will aim at improving financial intermediation and supervisory capacity, reducing the use of cash in the economy, and promoting greater efficiency in the financial sector. Within the action plan, strengthening supervisory capacity in the insurance and private pension industries, and the establishment of effective and independent regulatory authority will be a priority.

11. **While the action plan is being prepared, we intend to complete the reforms initiated under the previous program**. The payment of public sector wages through the banking system is now in place for over 75,000 employees, which may be a practical limit as the remaining employees are located far from bank offices. However, to the extent possible, we will endeavor to extend this system further, by including additional employees of state-owned enterprises and by encouraging the payment of taxes and utility bills in this fashion. Given the rapid growth of credit, we are taking steps to prevent deterioration of the quality of commercial bank loan portfolios. In this regard, we are in discussion with the World Bank and the Albanian Bankers' Association for assistance in setting up a credit bureau, initially inside BoA and will move ahead on this front as quickly as possible. We are also working with the Ministry of Justice to streamline the procedures for the execution of collateral, which are currently ineffective. In the insurance sector, we will seek technical assistance—including the appointment of an advisor—to strengthen prudential supervision in the short term. In addition, given the imminent launch of private pension funds, we will, as a matter of priority, seek technical assistance to modernize the legal framework for this industry. The treasury bill window at BoA will be maintained, but, in line with our goal of decreasing the use of cash for economic transactions, we will insist on the use of the new bulk settlement system as a means of payment. We will accelerate preparations to divest government's minority interest in the remaining commercial bank; and will refrain from creating any public financial institution or from taking an equity stake or issuing any explicit or implicit government guarantee to any financial institution. We will take no legislative or regulatory action that weakens the independence of the BoA, including the full control over the Bank's

budget—including staff compensation levels—currently exercised by the BoA's Supervisory Board.

C. Fiscal Policy

12. **The 2006 budget and medium term fiscal framework have been designed to strike a balance between debt reduction and the need for growth-enhancing and poverty reducing expenditure**. Over the program period, we expect a further 1 percentage point decline in public debt relative to GDP, and a fall in recourse to domestic financing from 2.8 percent of GDP in 2005 to 2.4 percent in 2008. Total expenditure relative to GDP is programmed to rise by only ¼ percentage point. This is in part a reflection of conservative revenue projections that make no allowance for revenue gains from tax administration measures, and will rise if the expected gains from revenue administration reforms materialize. Within the programmed envelope we intend to refocus expenditure towards more productive uses. Thus, over 2005-08, we project an improvement in the current balance relative to GDP of about 1½ percentage points and an improvement in the primary balance of about ½ percentage point of GDP.

13. **The 2006 budget was approved by Parliament in December 2005, satisfying a prior action for approval of this program**. It represents a conservative budgeting strategy that we intend to adopt throughout the program period. The budget incorporates tax measures to raise revenue by ¼ percent of GDP, but makes no allowance for immediate gains from tax administration measures. Contingencies, at about ¾ percent of GDP, are twice as large as in 2005, including allocated contingencies that will only be released, after consultation with the Fund, conditional on meeting the indicative total tax revenue target for end-June 2006 in the program. We have utilized conservative estimates for interest costs**,** privatization receipts, and assumptions concerning the macroeconomic framework. However, if there is a sustainable over performance—specifically if the expected gains from tax administration efficiencies materialize and/or higher privatization receipts are achieved in the first half of the year—we will, following a discussion with the Fund, submit to parliament a supplementary budget. In 2006, we will expend in full any extra revenue accruing through tax administration gains, but for privatization receipts will maintain the same formula developed during the previous program—half the revenues will be used to reduce domestic debt, and half will be spent on well-designed infrastructure projects. However, we will consider the use of a relatively small portion of this latter share to compensate former owners of property. In subsequent years, we will, in consultation with the Fund, consider applying the privatization formula to both sources of additional revenue.

14. **Structural measures in the fiscal area will concentrate on reforming the revenue administrations, raising the quality and efficiency of expenditure, and improving debt management capacity**. A major objective of the new program will be to reshape the revenue collection agencies into modern organizations relying on self-assessment and voluntary compliance through simple and transparent procedures, as well as vigorous enforcement. A cornerstone of this will be our full compliance with existing legislation and regulation regarding human resource issues and procedures. Having cleared almost all of the overdue

VAT refund claims in 2005, we intend to deal with all current claims on a timely basis and within the terms stipulated in the law. We will strengthen the payment discipline of budgetary units—particularly with respect to the payment of electricity and water bills, and facilitate this process by ensuring the installation of electricity meters in all budgetary institutions by mid-2006. Looking ahead, we intend to approve a new organic budget law aimed at enhancing the efficiency of public expenditure management, including by improving budget classification standards and by increasing parliamentary oversight and the accountability of the public administration.

15. **Measures to reform the tax administration will be guided by recommendations of a recent Fund technical assistance mission, which we developed into an action plan as a prior action for approval of this program**. The action plan addresses, over the course of the program, key governance concerns and operational and administrative deficiencies that currently engender vulnerability and substandard tax compliance.

- Collection efforts will be refocused on large taxpayers. Reflecting this, as prior actions for approval of this program, we included all firms meeting set criteria within the large taxpayer unit (LTU); and integrated the audit of social security contributions into the LTU's audit capacity.

- Subsequent actions outlined in the action plan are designed to further strengthen firms' compliance with tax laws once inside the LTU. The share of tax revenue collected by the LTU—currently low by regional standards—will be increased to 50 percent of all tax collected by end-June 2006 (SB)[4]. Measures adopted in this area will include continued refinement of inclusion criteria for the LTU; as well as actions to address the large under-reporting of the numbers of employees that currently depress receipts from social security and personal income tax.

- We have cleared almost all VAT arrears originating prior to June 2004—the remainder will be cleared in 2006. To further improve VAT administration, we will prepare and provide quarterly reports to the Fund on the aggregate amounts of VAT refunds requested, paid, and rejected (SB; ongoing).

- Other reforms will be aimed at promoting the efficient utilization of General Department of Taxation (GDT) resources and improving governance. In this regard, IT systems and reporting will be improved; and higher standards of quality among employees will be developed, including through increased use of civil service examinations. Greater use will be made of risk-assessment software in the selection of audits; while the design of audits will shift from a comprehensive to a more narrow or single-issue focus. The GDT office structure will be rationalized; the role of the tax

[4] As defined in the Technical Memorandum of Understanding (TMU).

police will be reviewed; and better reporting capabilities and practices will be instituted.

- The Ministry of Finance will contract an NGO specializing in anti-corruption activities to operate tax and customs hotlines to better enable the public to report cases of corruption. In addition, we will initiate confidential questionnaire-based surveys in the customs office and the LTU, administered by an independent private firm, to collect information on corruption in these institutions and to chart improvement over time.

16. **Reforms within the customs administration will be focused in the short term on completing the implementation of the ASYCUDA computer system**. The ASYCUDA system—including the risk assessment-based inspection selection module—will be deployed in 10 customs houses by end-March 2006 (PC). A report on progress in the utilization of the risk module will be issued on a quarterly basis (SB; ongoing).

17. **With assistance from the World Bank, measures will be pursued to raise the quality, efficiency, and productivity of expenditure and create room for additional public investment and priority spending**. Civil service reform will be pursued with the goals of developing capacity to hire and retain skilled personnel, increase accountability, apply transparent procedures for promotions, and ultimately improve the effectiveness of public administration and services. In preparation for this a census of all budgetary sector employees, including their salary levels and other compensation, will be completed by end-June 2006 (SB). The institutional framework for evaluating and prioritizing public investment projects will be strengthened, including through the preparation of a public investment program as part of our Medium-Term Budget Framework (MTBF) to be reviewed by the World Bank. The MTBF will then contain all the investments already contracted by government and planned for the next three years including projected disbursements, amortization, and rate of return. In preparation for this, we will (i) establish and staff a public investment program department within the General Directorate of the Ministry of Finance (SB; end-June 2006); and (ii) prepare and issue instructions for submitting public investment proposals consistent with the budget and the medium-term budgetary plan (SB; end-June 2006). In order to safeguard the use of nonconcessional project loans, we will conduct an independent feasibility study for any large project[5] financed in this manner (SB;ongoing), and provide to the Fund a biannual listing and status report of all projects being considered for nonconcessional foreign financing (SB;ongoing).

18. **Improving public debt management is a central goal of the new program**. The institutional capacity for public debt management is currently limited, while the short maturity of public debt raises vulnerability. A comprehensive action plan for improvement will be developed (SB;June 2006) following a Fund diagnostic mission tentatively scheduled

[5] As defined in the TMU.

for early 2006. The objectives would, in principle, include a significant increase in the maturity structure of public debt, improvement of terms, significantly expanded capacity in analysis and risk management, better management of data, and the ability, by the end of the program period, to independently produce debt sustainability reports. As part of the reform effort, we will also develop a public debt law that clearly defines responsibilities of different units; begin the preparation and publication of an annual debt strategy; and take steps to attract and retain qualified staff. As a first step to gaining direct access to international capital markets, the process of obtaining a country credit rating will be initiated as soon as possible.

19. **We shall develop a tax reform strategy in line with our overall priorities for the coming four years and base future tax policy measures on this strategy and our medium-term fiscal framework.** The most important goal for tax policy reforms is to promote employment and investment in the formal economy. Given that the tax wedge is high by international standards, we might consider using part of the revenue gains from tax administration reform, if and when they materialize, to reduce it. When deciding on tax reform measures, in order to preserve fiscal discipline, we shall pay particular attention to assessing the likely impact of different options based on quantitative analyses of tax collection data and the relevant experience of other transition economies.

D. Other Structural Reform

20. **We have taken measures to restore the supply of electricity and will take further action to reverse the deterioration in the performance of KESH**. We have also introduced new procurement rules that have already facilitated electricity imports and transmission from neighboring countries. We are preparing, in collaboration with the World Bank and other donors, an updated Power Sector Action Plan for 2006-2008. Meeting the targets for collection rates and losses set out in this plan will be a structural performance criterion for end-March 2006. We have reconciled the arrears between KESH and its budgetary and non-budgetary public consumers, including water supply companies, and paid the outstanding 2005 amounts. We will continue our policy, introduced in 2005, not to provide subsidies for imports of electricity. Given the high level of electricity imports expected in 2006 and the time it might take for domestic production to return to normal, we will use alternative means to support KESH during its financial recovery. These will include loans that could be contracted from the private banking sector, preferably without government guarantee, and government support for the ongoing rationalization of the electricity tariff structure to ensure cost recovery. In addition, we will re-evaluate the interpretation of the necessary collection efforts required by KESH to reclaim VAT on uncollectible invoices. We will continue the budgetary transfer to low income households and ensure that budgetary and non-budgetary public institutions honor their electricity bills in a timely manner. We will continue to work with the World Bank and other donors to restructure the water supply companies and to adjust water tariffs to properly reflect increased operating costs.

21. **We aim to upgrade Albania's transportation infrastructure to European standards.** Given Albania's limited financial resources, however, it is important that all large public investment projects are made within well-planned and prioritized national and

sectoral investment strategies, consistent with the available fiscal envelope. The NSSED and Albanian National Transport Plan (ANTP), financed by the European Union, provide such a framework. Therefore, new large projects, such as the Tirana-Durrës train rehabilitation project, should first be incorporated into these strategies before advancing them further. The ANTP suggests that measures are needed to restructure the Albanian railways (HSH), improve services, support cost recovery and enhance the sustainability of railway operations. Once such restructuring is underway, some limited investments may thus be justified on the Tirana-Durres line within the context of a sound business plan for HSH.

E. External Policies

22. **We will retain our liberal trade regime and continue to implement the remaining commitments made to the WTO regarding tariff policies, with an ultimate goal of concluding a Stabilization and Association Agreement and a free trade agreement with the EU**. The technical negotiations with the EU in relation to the free trade agreement are at an advanced stage. On a regional level, Albania has concluded free trade agreements with its neighboring countries, which has significantly boosted its exchange with them, albeit from a low base.

23. **We will continue to make good faith efforts to conclude the rescheduling of our arrears on inoperative payments agreements**. We are engaged in negotiations that aim at concluding the clearance process with official creditors by mid-2007; and with private creditors by mid-2008. We will provide biannual reports to the Fund on the outstanding stock of external arrears (SB; ongoing) within one month of the end of each quarter.

F. Data Issues

24. **We will improve our coverage of economic statistics over the program period as a precondition for improving economic policy formulation**. In 2006, we will prepare advance GDP estimates for the first half of 2005 and prepare and publish preliminary 2004 national accounts (both SB; March 2006). With donor support we will carry out a household budget survey and publish the results of the Living Standards Measurement Survey (LSMS), which will improve our assessment of poverty. We will also implement new methods to improve GDP calculations, statistics concerning the economic activity of enterprises, and the national accounts for the agricultural sector.

G. Program Monitoring

25. The second disbursement under the PRGF/EFF-supported program will be based on the end-March 2006 quantitative performance criteria (Table 1 and the TMU); the end-March 2006 structural performance criteria (Table 2 and the TMU); and completion of the first review and financing assurances review. The first review under the PRGF and EFF arrangements is expected to be completed no later than August 1, 2006 and the second review no later than February 1, 2007. During the program period, Albania will not impose or intensify restrictions on the making of payments and transfers for current international transactions; or introduce multiple currency practices, or conclude bilateral payments

agreements inconsistent with Article VIII, or impose or intensify import restrictions for balance of payments reasons. We will provide a fourth progress report on the NSSED by June 2006, taking into account the recommendations of the joint staff assessment of the 2005 progress report; and prepare a new NSSED for the 2007-09 period by end-2006.

Table 1. Albania: Quantitative Performance Criteria and Indicative targets, March-December 2006 1/

	End-March 2006	End-June 2006	End-September 2006	End-December 2006
	Prog.	Prog.	Prog.	Prog.
	(In billions of lek)			
Ceiling on net domestic credit to the government	7	12	18	24
Ceiling on accumulation of net domestic assets of the BOA 2/	3	8	7	9
Indicative total tax revenue target 3/	41	87	134	188
	(In millions of US dollars)			
Floor on accumulation of net international reserves of the BOA 2/	22	17	111	138
	(In millions of euros)			
Ceiling on contracting or guaranteeing of public and publicly-guaranteed non-concessional external debt with original maturities of more than one year	15	30	50	70
Ceiling on public and publicly-guaranteed external debt with original maturities up to and including 1 year 4/	0	0	0	0
Ceiling on accumulation of new external payments arrears, excluding interest on pre-existing arrears 4/	0	0	0	0

1/ The performance criteria and indicative targets outlined in this table, and their adjustors, are defined in the Technical Memorandum of Understanding (TMU). Targets are defined as cumulative changes from end-2005 except where marked. Data for end-March and end-September 2006 are performance criteria, except where marked. Data for end-June and end-December 2006 are indicative targets.

2/ Cumulative change from end-September 2005.

3/ Indicative target. Defined as 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.

4/ Applies on a continuous basis.

Table 2. Performance Criteria and Structural Benchmarks under the PRGF and EFF Arrangements

	Proposed Test Date
I. Prior Actions	
1. Parliament to approve 2006 budget in line with program targets.	Completed
2. Strengthen the Large Taxpayers Office (LTO) by:	
(i) Incorporating all firms meeting set criteria into the LTO.	Completed
(ii) Integrating the audit of social security contributions into LTO's audit	Completed
3. Develop and discuss with IMF staff an action plan for implementing the recommendations of the IMF technical assistance mission on tax administration.	Completed
II. Performance Criteria	
4. Further extend the use of ASYCUDA systems in customs administration:	
(i) Deploy the ASYCUDA system in 10 customs houses.	End-March 2006
(ii) Implement the risk assessment module of the ASYCUDA system in 10 customs houses to perform inspections.	End-March 2006
5. KESH to meet the targets under the 2006-2008 Power Sector Action Plan for end-March 2006 with regards to collection rates and losses.	End-March 2006
III. Structural Benchmarks	
A. Improve public expenditure management	
6. Complete a census of the wage bill for all budgetary sector employees.	End-June 2006
7. Strengthen public investment programming:	
(i) Establish and staff a public investment program department within the General Directorate of the Ministry of Finance.	End-June 2006
(ii) Prepare and issue instructions for submitting public investment proposals consistent with the budget and the Medium-Term Budgetary Plan.	End-June 2006
8. Safeguard the efficient use of nonconcessional foreign project loans:	
(i) Conduct an independent feasibility study for any large project (as defined in the TMU) financed through non-concessional commercial borrowing.	Ongoing
(ii) Provide a semestrial listing and status report on all projects being considered for nonconcessional foreign financing.	Ongoing
B. Reduce fiscal vulnerabilities	
Strengthen tax administration	
9. Improve VAT administration by preparing and providing to the Fund quarterly reports on the aggregate amounts of the VAT refunds requested, refunds paid and refunds rejected (within one month of the end of each quarter).	Ongoing
10. Increase the share of tax revenue collected by the Large Taxpayer's Office to 50 percent of all tax collected by end- June 2006.	End-June 2006
11. Prepare and issue quarterly reports on progress made in the actual use of the risk assessment module of the ASYCUDA system to perform inspections in the customs.	Ongoing
Improve debt management capacity	
12. Develop and discuss with IMF staff an Action Plan for implementing the recommendations of the IMF TA mission on debt management.	End-June 2006
13. Prepare biannual reports (within one month of the end of each semester) on the stock of external arrears.	Ongoing
C. Strengthen the financial system and improve economic monitoring capability	
14. Develop and discuss with IMF staff an Action Plan for implementing the recommendations of the Financial Sector Stability Assessment Report.	End-March 2006
15. Strengthen statistical and economic monitoring capacity:	
(i) Prepare advance GDP estimates for the first half of 2005.	End-March 2006
(ii) Prepare and publish preliminary national accounts for 2004.	End-March 2006

ALBANIA

TECHNICAL MEMORANDUM OF UNDERSTANDING

This memorandum defines the quantitative benchmarks and performance criteria established in the Memorandum of Economic and Financial Policies (MEFP) up until December 2006; and associated reporting requirements.

A. Net Domestic Credit to the Government

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

2. **Net domestic credit to the government** (NCG) is defined as gross domestic credit in lek and in foreign currency extended to the government (as defined above) by the banking system, savings and loan institutions (SLIs), and other domestic lenders;[1] less the sum of government financial assets held in the banking system and in the SLIs.

3. The following definitions apply to **gross domestic credit to the government**:

(i) Gross domestic credit in lek and in foreign currency extended to the government includes: (a) securities (including treasury bills and bonds) issued by the government and held by the Bank of Albania (BoA), deposit money banks (DMBs), SLIs, and other domestic lenders; (b) loans and advances extended to the government by BoA, DMBs, SLIs, and other domestic lenders; and (c) negative balances in government deposits with BoA, DMBs and SLIs.

(ii) Gross domestic credit in lek and in foreign currency extended to the government excludes (a) the onlending of foreign project loans to all parts of government; and (b) advances on profit transfers by the BoA. The value of the stock of gross domestic credit to government will also exclude the claims held by the units of government as defined above (in particular, the SSI and the HII).

(iii) The stock of gross domestic credit extended to the government and held by the BoA and DMBs in the form of treasury bills will be valued at issue price. The stock of gross domestic credit extended to the government and held by the BoA in the form of other securities and direct loans to government will be valued excluding accrued interest. The stock of gross domestic credit extended to the government and held by the DMBs in the form of variable and

[1] Other domestic lenders comprise firms, nonbank institutions, and households.

fixed income securities (excluding treasury bills) will be valued at face value. The stock of all gross domestic credit extended to the government and held by SLIs and other domestic lenders will be valued at face value[2].

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

(i) Government financial assets held at the Bank of Albania include: (a) transferable deposits in domestic and foreign currency; (b) lek deposits held in BoA for projects; and (c) standard gold deposits of the government. For the purposes of program monitoring, standard gold deposits will be valued at the program price of gold (SDR 326.6 per ounce)[3].

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

(iii) Government financial assets held at the DMBs include: (a) all deposits of government in domestic and foreign currency; and (b) payable amounts owed by the DMB to government.

(iv) Government financial assets held at the SLIs include all deposits of government held at the SLIs.

5. For the purposes of program monitoring, government financial assets in foreign currency will be converted from Lek to SDRs at the end-of period Lek/SDR exchange rate prevailing on the test date; and then converted to Lek at the program Lek/SDR exchange rate of Lek 148.5/SDR.

6. The breakdown of the categories of net domestic credit to the government as defined above is given in Attachment Table 1.

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

[3] The lek value of standard gold deposits will be (a) converted to US dollars using the current end-of-period lek/US dollar exchange rate; (b) then converted to ounces of gold using the current US dollar market price of gold; (c) then converted to SDRs at the program price of gold (SDR 326.6 per ounce); and (d) then converted to Lek at the program Lek/SDR exchange rate of Lek 148.5/SDR.

7. The limits on the change in net domestic credit to the government will be cumulative from end-December 2005.

B. Net Domestic Assets

8. The stock of **net domestic assets (NDA) of the Bank of Albania** is defined as reserve money—defined as the sum of currency issue (less lek notes and coins held by the Bank of Albania) and commercial bank reserves held at the BoA—less the net international reserves of the Bank of Albania (Section C). For program monitoring purposes, all foreign currency assets and liabilities making up NIR will be valued in local currency at the exchange rates of end-September 2005. Under this definition, the level of NDA was Lek 82.0 billion as of end-September 2005. The NDA limits will be cumulative changes from end-September 2005 and will be monitored from the accounts of the Bank of Albania.

C. Net International Reserves

9. **Net international reserves (NIR)** are defined as reserve assets minus reserve liabilities of the Bank of Albania. **Reserve assets** are readily available claims of the Bank of Albania on nonresidents denominated in foreign convertible currencies, and held for the purpose of meeting balance of payments financing needs, intervention in exchange markets, and other purposes. They include Bank of Albania holdings of monetary gold, SDRs, Albania's reserve position in the IMF, foreign currency cash, securities, and deposits abroad. Excluded from reserve assets are any assets that are pledged, collateralized, or otherwise encumbered; claims on residents; precious metals other than monetary gold; assets in nonconvertible currencies; illiquid assets; and claims on foreign exchange arising from derivatives in foreign currencies vis-à-vis domestic currency (such as futures, forwards, swaps, and options). **Reserve liabilities** shall be defined as foreign exchange liabilities to residents and nonresidents of the Bank of Albania, irrespective of their maturity. They include: foreign currency reserves of commercial banks held at the Bank of Albania; all credit outstanding from the IMF; commitments to sell foreign exchange arising from derivatives (such as futures, forwards, swaps, and options); and all arrears on principal or interest payments to commercial banks, suppliers, or official export credit agencies. Excluded from reserve liabilities are the government's foreign currency deposits at the Bank of Albania.[4] Reserve assets and reserve liabilities will both be expressed in U.S. dollars. The NIR limits will be cumulative changes from end-September 2005, and will be monitored from data supplied by the Bank of Albania.

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

10. During this program, for monitoring purposes, the exchange rates of the SDR and non-dollar currencies will be kept at their end-September 2005 levels and holdings of monetary gold will be valued at SDR 326.6 per ounce. Excluded from net international reserves are holdings of nonconvertible currencies, claims on nonresident financial institutions denominated in nonconvertible currencies, and other claims which are not readily available. Under this definition, the level of NIR was US$1,094.6 million at end-September 2005.

D. Adjusters for NCG, NDA, and NIR

11. The NCG and NDA ceilings and the NIR floor are defined on the assumption that total privatization proceeds will amount, on a cumulative basis, from January 1, 2006, to:

End-March 2006	Lek 750 mn. (Of which: US$0.0 mn. in foreign currency);
End-June 2006	Lek 970 mn. (Of which: US$0.0 mn. in foreign currency).
End-September 2006	Lek 3,000 mn (Of which: US$19.8 mn. in foreign currency).
End-December 2006	Lek 3,000 million, (Of which: US$19.8 mn. in foreign currency).

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

12. The ceilings on NCG and NDA, and the floor on NIR are defined based on the assumption that foreign budgetary and/or balance of payments loan financing (excluding IMF financing, project and commodity loans, and macro-financial assistance from the EU) will amount, on a cumulative basis, from January 1, 2006, to:

End-March 2006	US$ 0.0 million
End-June 2006	US$ 0.0 million
End-September 2006	US$ 0.0 million
End-December 2006	US$ 0.0 million

In cases where total foreign loan financing exceeds this projection, the ceilings on NCG to the government and NDA of the Bank of Albania will be adjusted downward, and the floor on NIR will be adjusted upward by the amount of the excess[5].

[5] 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 102.5 per U.S. dollar.

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

E. External Debt and Arrears

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

15. The limit on medium- and long-term external debt applies to the contracting or guaranteeing by the government or the Bank of Albania, of new nonconcessional external debt with an original maturity of more than one year. It applies not only to debt as defined in paragraph 14 of this memorandum, but also to commitments contracted or guaranteed for which value has not been received. External debt will be considered to have been contracted at the point the loan agreement or guarantee is ratified by the Albanian parliament. Excluded from the limits are refinancing credits and rescheduling operations (including the deferral of interest on commercial debt), credits extended by the IMF, and credits on concessional terms defined as those with a grant element of at least 35 percent. The grant element is to be calculated using the OECD Commercial Interest Reference Rates (CIRRs): for maturities of less than 15 years, the grant element will be calculated based on six-month averages of CIRRs; and for maturities longer than 15 years, the grant element will be calculated based on ten-year averages. Debt falling within the limit shall be valued in euros at the exchange rate prevailing at the time the contract or guarantee becomes effective.

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

17. A continuous performance criterion applies on the accumulation of new **external payments arrears** on external debt contracted or guaranteed by the government or the Bank of Albania. External payment arrears consist of external debt service obligations (principal and interest) falling due after September 30, 2005 and that have not been paid at the time they are due, taking into account the grace periods 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 September 30, 2005; and (ii) external arrears that are subject to debt rescheduling agreements or negotiations.

18. **Large projects** (as referred to in MEFP paragraph 17 and MEFP Table 2) financed by nonconcessional foreign borrowing are defined as those projects involving total nonconcessional foreign borrowing in excess of Euro 20 million.

19. **The budget commitments related to the contingencies embodied in the 2006 budget** will be released after the following conditions are satisfied:

(i) At end-June 2006, actual revenue collection, defined as all revenues collected by the GDT, GDC and SII (including all revenues collected on behalf of local governments but excluding revenues collected by local governments directly) is in line with the indicative total tax revenue target specified under the program;

(ii) The decision to release the budget commitments related to the contingencies is taken in consultation with the Fund.

20. A census of the wage bill will be carried out for all employees paid through the government budget. The information collected will include salary and bonuses, grade, and position.

F. Tax Revenues

21. 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.

22. For the purpose of meeting the structural benchmark referred to in MEFP paragraph 15 (that the share of taxes collected by the Large Taxpayer Office (LTO) will increase to 50

percent by end- June 2006), the following definition will apply. The share of taxes collected by the LTO will be calculated as the ratio of all taxes collected by the LTO to the total collection of all taxes administered by the GDT (VAT, excises, corporate income taxes, personal income taxes, social security contributions, national taxes, taxes on packages, and gambling taxes). In calculating this ratio, social security contributions paid by budgetary institutions will be excluded from the denominator. The structural benchmark will be deemed to have been met if this ratio—defined as above— is equal to or larger than 50 percent for revenue collected between April 1 and June 30 2006, inclusive.

G. Monitoring and Reporting Requirements

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

The Bank of Albania will supply to the Fund:

(i) The balance sheets of the Bank of Albania;
(ii) The consolidated accounts of the commercial banks and (separately) the SLIs;
(iii) The monetary survey;
(iv) Banking sector prudential indicators;
(v) Net domestic credit to the government (in the form outlined in Appendix Table 1);
(vi) The net foreign assets of the Bank of Albania and their components;
(vii) Comprehensive information on reserve assets that are pledged, collateralized, or otherwise encumbered.
(viii) The foreign exchange cashflow of the Bank of Albania, including the level of NIR;
(ix) Daily average exchange rates;
(x) Trade flows;
(xi) Periodic updates of balance of payments estimates;

The Ministry of Finance will supply to the Fund:

(i) The summary fiscal table, including the overall budget deficit, on a cash basis;
(ii) Issuance of treasury bills by the MOF, including gross value and cash received;
(iii) Privatization receipts;
(iv) Information on the contracting and guaranteeing of new debt;
(v) Information on the stock of short-, medium- and long-term debt;
(vi) Information on all overdue payments on short-, medium- and long-term debt (with assistance from the Bank of Albania).
(vii) Information on the stock of VAT refunds claimed and refunds paid out every month will be supplied within one month of the end of the reporting period.
(viii) Information on official grants for projects or budget support purposes.

(ix) Biannual reports on the stock and clearance of outstanding debit balances of inoperative bilateral payment agreements will be supplied within one month of the end of the semester.
(x) Information on expenditure arrears;
(xi) A biannual listing and status report of all projects being considered for nonconcessional foreign financing.

The General Directorate of Customs will supply to the Fund:

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

The General Directorate of Taxation will supply to the Fund:

(i) Detailed monthly data on tax revenues collected.
(ii) Monthly data on the ratio of tax revenue collected by the LTO, as defined in paragraph 21 of this TMU.

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 government arrears. It will communicate to the Fund progress in clearing the inter-enterprise government arrears accumulated in the years 2002 to 2005.
(ii) A description of remedial actions undertaken by the ministry in the event of non-payment on the agreed MOUs for the repayment of the stock of end-December 2001 inter-enterprise arrears.

The Albanian Statistical Agency (INSTAT) will supply the Fund:

(i) The consumer price index (CPI index) at the aggregated level and at the level of each individual item making up the basket.
(ii) The producer price index.
(iii) The construction cost index
(iv) All short term indicators as they become available as defined in INSTAT's quarterly publication "Conjoncture".
(v) In addition INSTAT will communicate to the Fund on a regular basis the preliminary estimates for Quarterly GDP. It will also communicate as early as possible the preliminary estimates for annual GDP disaggregated by 22 sectors and distinguishing between the observed and non-observed economy.

Table 1. Albania: Calculation of Net Domestic Credit to Central Government for Program Monitoring Purposes, September 2005–June 2006
(In millions of lek)

		Sep-05	Dec-05	Mar-06	Jun-06	Sep-06	Dec-06
1.	**Treasury bills held outside central government**	274,926					
Of which:							
1. (i)	Held by Bank of Albania 1/	66,499					
1. (ii)	Held by deposit money banks 1/	178,677					
1. (iii)	Held by savings and loan institutions 2/	0					
1. (iv)	Held by other domestic lenders (excluding holdings of HHI and SSI) 2/	29,750					
	Of which:						
1. (iv) (i)	INSIG	1,562					
1. (iv) (ii)	Individuals and firms	28,188					
1. (iv) (ii) (i)	Of which: BoA window	17,083					
Plus:							
2.	**Other central government debt held outside central government (millions of lek)**	34,374					
Of which:							
2. (i)	Held by Bank of Albania 3/	2,964					
2. (i) (i)	Other securities 3/	964					
2. (i) (ii)	Short-term direct loans to government 3/	2,000					
2. (ii)	Held by deposit money banks 4/	31,410					
2. (ii) (i)	Fixed income securities 4/	31,410					
2. (ii) (ii)	Variable income securities 4/	0					
2. (iii)	Held by savings and loan institutions 5/	0					
2. (iv)	Held by other domestic lenders 5/	0					
Equals gross domestic credit to government:		309,300					
Less:							
3.	**Assets of central government (excluding HHI and SSI)**	5,443					
3. (i)	Deposits held at Bank of Albania 6/	3,736					
3. (i) (i)	In domestic currency	1,964					
3. (i) (i) (i)	Transferable deposits in lek	1,378					
3. (i) (i) (ii)	Deposits in lek for projects	586					
3. (i) (ii)	In foreign currency at program exchange rates and program price of gold 7/ 8/	1,772					
3. (i) (ii) (i)	In foreign currency evaluated at current exchange rates	1,920					
3. (i) (ii) (i) (i)	Transferable deposits in foreign currency evaluated at program exchange rate 7/	117					
3. (i) (ii) (i) (i) (i)	Transferable deposits in foreign currency evaluated at current exchange rate 9/	110					
3. (i) (ii) (i) (ii)	Standard gold deposits of government evaluated at fixed exchange rate and gold price (Lek mns.) 8/	1,655					
3. (i) (ii) (i) (ii) (i)	Standard gold deposits of government at current exchange rate and gold price (Lek mns.) 8/	1,809					
3. (i) (ii) (i) (ii) (i) (i)	Number of ounces of gold equivalent	37,297					
3. (ii)	Assets held at deposit money banks	1,707					
3. (ii) (i)	Deposits 10/	1,111					
3. (ii) (i) (i)	Deposits in domestic currency	207					
3. (ii) (i) (i) (i)	Transferable deposits in domestic currency	207					
3. (ii) (i) (i) (ii)	Other deposits in domestic currency	0					
3. (ii) (i) (ii)	Deposits in foreign currency evaluated at program exchange rates	904					
3. (ii) (i) (ii) (i)	In foreign currency evaluated at current exchange rates 7/	853					
3. (ii) (i) (ii) (i) (i)	Transferable deposits in foreign currency evaluated at current exchange rates	853					
3. (ii) (i) (ii) (i) (ii)	Other deposits in foreign currency evaluated at current exchange rates	0					
3. (ii) (ii)	DMB payables to government	597					
3. (iii)	Held at savings and loan institutions 10/	0					
Less:							
4.	**Deposits of HHI and SSI**	2,000					
Equals:							
5.	**Stock of Net domestic credit to central government (1+2-3-4)**	301,857					
5. (i)	Change since September 2005	0					
6.	Memorandum items:						
6. (i)	Current exchange rate (Lek/SDR, eop)	149.2					
6. (ii)	Current exchange rate (Lek/US dollar, eop)	102.5					
6. (ii)	Program exchange rate (Lek/SDR, eop)	148.5	148.5	148.5	148.5		
6. (iv)	Program price of gold	326.6	326.6	326.6	326.6		
6. (v)	Market price of gold (price in US dollars per ounce)	473.4					
6. (vi)	Current exchange rate (US dollar per SDR, eop)	1.4566					

1/ Evaluated at issue price.
2/ Evaluated at face value (data on treasury bill holdings of SLAs and other domestic lenders are currently available only at face value).
3/ Excludes accrued interest.
4/ Valued at face value (data on fixed and variable income securities held by DMBs are currently available only at face value).
5/ Includes accrued interest.
6/ Includes transferable deposits of government in domestic and foreign currency, lek deposits of government for projects; and standard gold deposits of government. Excludes all non-standard gold deposits; and excludes all nongold precious metal deposits of government; and excludes government deposits in foreign currency for projects.
7/ The reported lek value of foreign currency denominated assets of government will be converted to SDRs using the current end-of-period lek/SDR exchange rate; and then converted back to lek using the program Lek/SDR exchange rate of Lek 148.5/SDR.
8/ Standard gold deposits are usable by government and therefore included in the definition of government assets. The lek value of standard gold deposits will be (a) converted to US dollars using the current end-of-period lek/US dollar exchange rate; (b) then converted to ounces of gold using the current market price of gold; then (c) converted to SDRs at the program price of gold of SDR 326.6 per ounce; and then (d) converted to lek at the program Lek/SDR exchange rate of Lek 148.5/SDR.
9/ Including account set up to hold the Savings Bank privatization revenue (Account No: 11.2.2.1.4)
10/ Includes all deposits of government.

Statement by the IMF Staff Representative
January 27, 2006

1. **This statement summarizes developments in Albania since the issuance of the staff report for the request for a three-year arrangement under the PRGF and for the use of Fund resources under an Extended Arrangement.** The additional information does not change the thrust of the staff appraisal.

2. **Recent developments have been broadly in line with previous projections.** Year on year CPI inflation dropped to 2 percent in December, compared with a projected 3 percent, mainly due to lower-than-expected seasonal increases in the price of imported vegetables. Though data are still incomplete, the evolution of monetary aggregates up to end-December appears to have been broadly in line with projections. Demand for lek, however, was stronger than expected. This allowed the central bank to purchase more foreign currency, raising end-year holdings of gross international reserves to US$1,425 million, US$35 million higher than projected. On the fiscal front, preliminary data suggest that net government borrowing in 2005 was somewhat below the program target.

3. **Developments in the energy sector have been relatively favorable, but major risks to electricity supply remain.** Abundant rainfall in December raised the water level in the reservoir significantly, allowing the electricity company to temporarily eliminate power cuts in Tirana during the holidays. The situation, however, is less favorable in the countryside where economic activity has also been affected by floods. The government approved the 2006-2008 Power Sector Action Plan on January 13, 2006, including the targets for collection and loss rates which are performance criteria in the proposed program. Electricity imports have been secured for the first quarter of 2006. However, increasingly difficult energy market conditions in Southern European make the outlook for electricity imports in the rest of 2006 uncertain.

4. **All prior actions have been implemented.** The 2006 budget passed by parliament is in line with program targets. All firms meeting the set criteria have been incorporated into the Large Taxpayer Office (LTO) and the audit of social security contributions has been integrated into the LTO's audit function. Finally, an action plan to implement the recommendations of the IMF TA mission on tax administration, incorporating comments from IMF staff, has been developed.

INTERNATIONAL MONETARY FUND EXTERNAL RELATIONS DEPARTMENT

Press Release No. 06/17
FOR IMMEDIATE RELEASE
January 27, 2006

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves US$24.7 Million under the PRGF and EFF for Albania

The Executive Board of the international Monetary Fund (IMF) today approved concurrent three-year arrangements under the Poverty Reduction and Growth Facility (PRGF) and the Extended Fund Facility (EFF) amounting to the equivalent of SDR 17.045 million (about US$24.7 million) for Albania to support the government's program of economic reform and poverty reduction. Of this amount, the equivalent of SDR 8.5225 million (about US$12.3 million) will be available under each of the PRGF and EFF arrangements. The approval of the arrangements enables Albania to draw the equivalent of SDR 2.435 million (about US$3.5 million) immediately.

The last PRGF arrangement for Albania, amounting to SDR 28 million, was approved on June 21, 2002 and expired on November 20, 2005 (See Press Release N0 02/30).

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

"Over the three-year span of the previous PRGF-supported program, Albania's macroeconomic performance was strong. Growth averaged close to 6 percent—the highest in the region—and monetary and fiscal policies successfully anchored inflationary expectations at low levels. As private sector confidence improved, the lek experienced a modest trend real appreciation, reserve holdings increased, and public debt relative to GDP was reduced. Progress in structural reform included strengthening customs administration, starting to use the banking system to pay public sector salaries, and the privatizing of the last state-controlled bank—the latter measure significantly raising the degree of competition and credit provision in the system.

"Near-term growth and external prospects worsened somewhat in late 2005 due to disruptions in the electricity supply, but the medium-term outlook remains relatively favorable. With full implementation of the policies contained in the new program—including the comprehensive Power Sector Action Plan for 2006-08—the economy is expected to return to its potential growth rate of 6 percent by 2007. Similarly, the current account deficit—after a projected deterioration in 2006 due to higher electricity imports—should also improve in subsequent years as domestic production returns to normal levels. The outlook is for inflation to remain at about 3 percent throughout the period, although downside risks have increased and policy makers will need to remain vigilant and react quickly to any second-round price pressures that may materialize.

”The new three-year arrangement has been designed to reduce economic vulnerabilities, enhance growth potential, strengthen government solvency, protect priority spending, improve governance, and further develop the financial system. Marking a change from previous financing arrangements, only half of this program will be supported through the concessional Poverty Reduction and Growth Facility, with the balance sourced from the Extended Fund Facility. Such a blend of concessional and nonconcessional financing reflects the strong progress made by Albania since the approval of the previous program—including in rapidly rising per capita income and overall institutional development.

”Reflecting the increased uncertainty surrounding near-term growth, the 2006 budget contains strengthened contingency mechanisms. Combined with realistic revenue projections, these provide considerable protection for planned priority expenditures on education, health care, and public investment. Over the medium term, the fiscal framework strikes an appropriate balance between spending in these areas and the need for continued fiscal consolidation. Net domestic borrowing—the key fiscal target—will decline gradually over the program period, but an increasing current fiscal surplus will ensure the concentration of expenditure on productive uses, while limiting borrowing to the financing of capital expenditure. In the event privatization revenues and gains from improvements in tax administration materialize, these will be either expended in priority areas or used for additional debt reduction.

“The program also envisages an acceleration of structural reform in key areas. Comprehensive tax administration measures, based on IMF technical assistance, will be pursued to enhance efficiency, with special emphasis on servicing large tax payers and improving tax compliance. Following an IMF evaluation mission, a detailed action plan to improve public debt management will be drawn up to guide reform over the program period. In the financial sector, the authorities intend to develop an action plan to implement the recommendations of the 2005 Financial Sector Stability Assessment report. Other structural measures will include civil service reform and improvements in the institutional framework for evaluating large projects; reform of the macro-critical electricity sector; and statistics,” Ms. Kruger said.

Albania: Selected Economic Indicators, 2001–09

	2001	2002	2003	2004	2005	2006	2007	2008	2009
				Est.	Proj.	Proj.	Proj.	Proj.	Proj.
				(Growth rate in percent)					
Real GDP 1/	7.0	2.9	5.7	5.9	5.5	5.0	6.0	6.0	6.0
Retail prices (avg.)	3.1	5.2	2.4	2.9	2.5	3.0	3.0	3.0	3.0
Retail prices (end-period)	3.5	1.7	3.3	2.2	3.0	3.0	3.0	3.0	3.0
				(In percent of GDP unless otherwise indicated)					
Saving-investment balance 2/									
Foreign savings 3/	2.8	7.2	5.5	3.8	5.5	6.7	5.9	5.7	5.8
Domestic savings	24.8	17.4	17.9	20.0	18.6	18.0	19.5	20.4	21.0
Investment	27.6	24.5	23.4	23.8	24.2	24.7	25.4	26.1	26.8
Fiscal sector									
Revenues and grants	23.7	24.7	24.5	24.1	24.6	24.6	24.7	24.7	24.8
Tax revenue	19.8	20.6	21.3	21.7	21.7	21.8	21.9	22.0	22.1
Of which: social security contributions	3.8	4.1	4.2	4.3	4.3	4.4	4.5	4.5	4.5
Expenditures	31.6	31.4	29.0	29.2	28.3	28.7	28.2	28.0	27.9
Primary	27.3	27.4	24.6	25.5	25.1	25.3	24.9	24.9	24.9
Interest	4.3	4.0	4.4	3.7	3.2	3.4	3.2	3.1	3.0
Overall balance (including grants)	-7.9	-6.6	-4.5	-5.1	-3.8	-4.1	-3.5	-3.4	-3.2
Primary balance (excluding grants)	-4.2	-3.3	-0.5	-1.8	-1.6	-1.7	-1.2	-1.1	-1.0
Net domestic borrowing	3.1	3.3	2.9	2.3	2.8	2.6	2.5	2.4	2.3
Privatization receipts	2.2	0.1	0.1	1.9	0.3	0.3	0.2	0.2	0.2
Foreign financing	2.6	3.3	1.5	1.0	0.7	1.1	0.7	0.7	0.7
Public Debt	67.6	65.0	61.8	56.5	54.9	55.0	54.5	53.6	52.6
Domestic	41.0	41.7	41.1	38.5	38.1	38.1	37.4	36.6	35.8
External (including publicly guaranteed) 4/5/	26.6	23.3	20.7	18.0	16.8	17.0	17.0	17.0	16.8
Monetary indicators									
Broad money growth	20.2	5.7	8.7	13.5	13.9	12.0	12.0	12.7	12.8
Private credit growth	23.4	41.0	31.1	36.9	69.1	43.2	35.3	29.6	26.7
Velocity	1.5	1.5	1.5	1.5	1.5	1.4	1.4	1.3	1.3
Interest rate (3-mth T-bills, end-period) 6/	8.0	11.1	7.3	6.2	5.4	…	…	…	…
External sector									
Trade balance (goods and services)	-22.5	-25.9	-25.1	-21.7	-23.2	-23.5	-22.5	-21.8	-21.6
Current account balance (excluding official transfers)	-5.8	-10.0	-8.1	-5.5	-7.0	-8.1	-7.3	-6.9	-6.9
Current account balance (including official transfers)	-2.8	-7.2	-5.5	-3.8	-5.5	-6.7	-5.9	-5.7	-5.8
Official transfers	3.0	2.8	2.6	1.7	1.5	1.4	1.3	1.2	1.1
Gross international reserves (in millions of Euros)	826	845	834	1,025	1,147	1,225	1,329	1,483	1,650
(in months of imports of goods and services)	4.6	4.4	3.9	4.1	4.1	4.1	4.1	4.1	4.2
(relative to external debt service)	19.1	13.2	18.8	23.6	19.8	13.4	12.1	10.0	9.3
(in percent of broad money)	25.5	28.2	24.6	25.3	24.8	23.8	23.3	23.3	23.2
Change in real effective exchange rate (e.o.p., percent) 7/	9.8	-10.9	1.2	5.1	-1.1	…	…	…	…
Memorandum items									
Nominal GDP (in billions of lek) 1/	588	625	683	766	837	900	982	1,076	1,177

Social Indicators: GNI per capita, World Bank Atlas Method, US$ (2003): $1,740; **population** 3.2 million (2003; **life expectancy at birth** (2003): 74 years;
infant mortality rate (2003, per thousand births): 18; **population living below the poverty line** (2002): 25.4 **population without running water inside their dwellings** (2003): 40 percent.

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

1/ GDP data through 2003 are from the official national accounts. Real GDP growth is based on the observed economy only.

2/ The statistical discrepancy contained in the national accounts was allocated to private consumption and investment according to the ratio observed in the national accounts excluding the discrepancy. Unexplained oscillations in this discrepancy introduced additional statistical uncertainty into the historical data.

3/ Negative of current account including official transfers.

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

5/ Excludes IMF repurchase obligations.

6/ Value for 2005 is as of November 22.

7/ Estimate for 2005 based on September data.

ANNEX

Recent Economic Developments

Albania's macroeconomic performance has been strong in recent years and medium-term prospects remain relatively favorable. However, near-term growth and external prospects worsened in late 2005, as disruptions to the electricity supply contributed to a decline in growth to 5 ½ percent in 2005 from about 6 percent in 2004; and to a worsening of the current account deficit. Despite progress to date, macroeconomic challenges and an unfinished reform agenda remain to be addressed, particularly in the areas of revenue administration, public debt management, financial market development, civil service, and expenditure management.

Program Summary

After more than a decade of IMF-supported programs, this arrangement aims at preparing Albania for graduation from Fund-supported programs. The program focuses on maintaining sound financial policies, while promoting reforms aimed at enhancing growth potential, strengthening government solvency, reducing vulnerabilities, protecting priority expenditure, and improving governance and the business climate.

Under the program, real GDP is projected to return to its trend growth rate of 6 percent by 2007, while macroeconomic stability—with inflation remaining in the Bank of Albania's 3 percent +/- 1 percent range—will be maintained by additional fiscal consolidation and by a strengthening of the monetary policy framework. Reforms in tax administration and expenditure management will permit the quantity and quality of public investment to increase alongside a declining debt to GDP ratio; while domestic borrowing will be gradually reduced over the program period, and the current and primary fiscal balances will improve. Measures to reform public debt management and the electricity sector will be pursued to further reduce economic vulnerabilities.

The PRGF is the IMF's 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 PRGF-supported programs are 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.

The EFF is an IMF financing facility that supports medium-term programs that seek to overcome balance of payments difficulties stemming from macroeconomic imbalances and structural problems.
The repayment terms are 10 years with a 4 ½-year grace period, and the interest rate, adjusted weekly, is currently about 4.30 a year.

Statement by Arrigo Sadun, Executive Director for Albania and Carlo Gola, Senior Advisor to Executive Director
January 27, 2006

On the behalf of the Albanian authorities, we would like to express our appreciation to the staff for the comprehensive report, which reflects the very frank and constructive discussions held in Tirana in preparation of this new program. Our authorities are convinced that a three-year program supported by a PRGF-EFF arrangement will provide a good base for a timely and successful exit strategy.

The authorities intend to maintain the current, positive, track record with the Fund and are committed to implement key structural reforms aimed at enhanced growth, proceed with the fiscal consolidation, continue in the institution building process, and eradicate poverty.

1. Despite the recent slowdown, the macroeconomic performance remains strong

From the macroeconomic standpoint the country has maintained a strong and consistent performance. The estimated GDP growth in 2005 (5.5 percent) is only slightly below the average of the last few years. In the last quarter of 2005 the economy experienced serious power shortages due to the exceptional drought season and problems related to the distribution network. The power shortages could also affect this year's growth performance, which is expected to be about 5 percent.

In 2005 the inflation remained below 2.5 percent. The effects of oil price increases on the CPI were modest, due in part to the structure of the economy, characterized by low-energy activities, such as agriculture and services (24 and 58 percent of GDP, respectively). However, should the electricity crisis persist, a potential second-round effect cannot be ruled out, given the necessity for many shopkeepers and small firms to use alternative, and more expensive, sources of energy.

The current account deficit remains high (7 percent of GDP in 2005), despite strong remittance inflows (about 950 million euros, 14 percent of the GDP in 2005), but the net inflow of FDI is consistent (3.7 percent of GDP on average in the last five years), although not particularly high if compared to similar countries in the region.

The debt-to-GDP ratio is steadily declining: between 1997 and 2005 it was reduced from 75.6 to 54.9 percent. In 2005 the deficit was 3.8 percent, well below the 5.1 percent of 2004. The current balance (revenues excluding grants minus current expenditure) was 0.4 percent. Thanks to the restructuring with its main creditors, the external debt shrank substantially and is estimated to be 16.8 percent of GDP in 2005. At the end of September 2005 the stock of external public debt was 1.274 billion euros; the arrears, all accumulated before the transition period, are only 82 million (as compared to 519 million in 2000).

2. The new Government is committed to maintain sound macroeconomic policies

The authorities are determined to preserve the current, prudent macroeconomic policies and further enhance the quality of the budget and the credibility of the monetary framework.

Fiscal policy

With a solid parliamentary majority, the new Government is committed to pursue prudent and growth-supportive, financial policies. To this aim, the authorities concur with staff on implementing a medium-term fiscal framework to gradually reduce the public debt-to-GDP ratio, through a mix of policies that increase the tax base and preserve the level of public investment so as to enhance the countries' physical infrastructures.

One of the key targets of the program is to reduce recourse to net domestic borrowing from the current 2.8 percent of GDP to 2.3 percent by 2009. The budget should be based on realistic assumptions in order to avoid, as occasionally occurred in the past, undesirable under-expenditure of the capital account, due to revenue performances below expectations. As described in the Memorandum on Economic and Financial Policies (MEFP, par. 13, p. 82), the program has a "contingent expenditures" mechanism: should by mid year the revenues be in line with the revenue target set in the budget (see table 1, p. 88), the authorities – after consultation with the Fund - can start releasing the "contingent expenditure" which, for the 2006 budget, equals about 7 billions leks (0.75 percent of GDP). Moreover, as in the past, half of the privatization receipts will be used to reduce domestic debt and half will be spent on well-designed infrastructure projects.

Further fiscal measures included in the program are the reform of the revenue administration, so as to increase the tax base and improve its composition (personal income and social securities contributions amount to only 5.2 percent of GDP, while the total revenues is 24.6 percent of GDP). The implementation of the recently established Large Taxpayer Unit should reduce the under-reporting of employees by large companies. The General Department of Taxation will be reorganized with the aim to create a modern tax administration. In the area of consumer administration, the implementation of the ASYCUDA computer system is almost completed. The authorities are also increasing their efforts to reduce the informal economy, which is estimated at about 30 percent of GDP and is particularly high in the services sector and small companies. A reduction of the tax wedge should facilitate the process.

The authorities are also aware that the increase in government revenues cannot simply be met with administrative measures, but also require a cultural change, as noted in the Poverty Reduction Strategy report. The strategy to raise government revenues should hinge on broadly based support and compliance.

Finally, the authorities recognize that improving the budget debt management is crucial, given the current very short maturity of the debt (on average about 6.5 months). Beside the technical aspects of enhancing debt management, the authorities intend to proceed in an expeditious manner to obtain a country rating with the aim of gaining direct access to international capital.

The banking sector and the monetary policy

Despite significant progress over the last few years, including the privatization of the large Saving Bank in 2004, the Albanian banking system remains relatively underdeveloped. The intermediation rate remains low (of about 52 percent of GDP held by banks as deposits, only 13 percent of GDP is extended as credit to the private sector). The sector is, however, changing rapidly, and the demand for credit is expanding at a strong pace. While the use of cash in transactions remains significant, the situation is rapidly improving: in the public sector almost all wages are now paid though current accounts; 70 percent of companies use banks; in general, the payment system is shifting from a cash-based economy to a system in which electronic payments play a prominent role. Establishing a "credit information bureau," under the lead of the Bank of Albania, aimed at improving the monitoring of the credit risk by commercial banks is another priority.

Although the degree of dollarization in Albania is below the average of other transition countries (foreign currency deposits are about 36 percent of total deposits), it can partially impair the efficiency of the monetary transmission mechanism, already restricted by the above-mentioned low level of intermediation. The Bank of Albania (BoA) has successfully coped with the structural weakness through a very rigorous and transparent policy. The credibility of the monetary policy allowed the BoA to contain inflation expectations relatively well as soon as prices started to accelerate. The authorities are determined to preserve the independence of the Bank and to enhance its technical capabilities. They are aware that it is imperative to conduct macroeconomic policy in a transparent and credible manner and to maintain a relatively high level of reserve cover.

The foreign exchange market interventions -- kept at a minimum so as not to interfere with the informal inflation target -- are finalized to smooth-out excessive exchange rate volatility and to preserve an adequate level of foreign reserves. The authorities, with the assistance of the Fund, intend to move gradually toward a formal inflation target. However, they are fully aware that this delicate passage needs several pre-conditions and should be carefully designed. They are also conscious that the strong inflows of remittances can be a potential source of real appreciation of the currency. It is therefore important to increase the productivity and contain labor costs to preserve competitiveness.

3. Structural reforms

To improve the infrastructure, enhance the institution building process, and substantially reduce poverty are the three economic priorities.

The recent power shortage showed that the Power Sector Action Plan must be a top priority. The authorities have already introduced new procurement rules that facilitate electricity imports and transmission from neighboring countries. They are also taking further action to improve the performance of the state owned electricity company KESH and are working with the World Bank and other donors to restructure the water supply company. Albania’s transportation infrastructure needs substantial improvements. The authorities intend to proceed according to a well-planned and prioritized investment strategy. In this perspective, new large projects should be considered only within this framework. The privatization of the main telephone company (Albetelekom) remains a priority.

Strengthening the rule of law is a key factor for achieving stability and economic growth. The mid-term priorities of the government are: improving the implementation and monitoring of policies and laws, strengthening institutional interaction, enhancing accountability, adopting instruments to motivate public functionaries, and improving available means of technology. It is also important to fight corruption at all levels of administration and complete the reform of government decentralization. The institution building process also includes the necessity to improve substantially the quality, extent, and timeliness of the statistics.

As far as the poverty reduction policies are concerned, we want to underscore the remarkable improvement obtained in just a few years: the percentage of population with per capita income below two dollars a day is now only 10.8 percent (it was 46.6 percent in 1998); the infant mortality rate (per 1000 live births) is 18 (it was 27.6 in 1998). However, as reported in the Poverty Reduction Strategy Report, in order to reach the MDG by 2015, substantial improvement needs to be obtained in the absolute poverty headcount rate, the rule of law, and control of corruption.

3. Future Fund engagement

Given Albania’s protracted external financing needs, the proposed access is SDR 17.045 million (35 percent of quota) equally distributed between the PRGF and EFF. The request for a blend of these two facilities reflects Albania's rapid income growth over the last decade. As noted above, the key reforms are in the areas of the revenue administration, public debt management, financial market development, expenditure management and civil service.