February 2007
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Albania: Second Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, Review Under Extended Arrangement, and Financing Assurances Review—Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Albania

In the context of the second review under the three-year arrangement under the Poverty Reduction and Growth Facility, review under extended arrangement, and financing assurances review with Albania, the following documents have been released and are included in this package:

- the staff report for the Second Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, Review Under Extended Arrangement, and Financing Assurances Review, prepared by a staff team of the IMF, following discussions that ended on November 6, 2006, with the officials of Albania on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on January 17, 2007. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF;

- a Press Release summarizing the views of the Executive Board as expressed during its February 2, 2007 discussion of the staff report that completed the request and review; and

- 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*
*Also 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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ALBANIA

Second Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, Review Under Extended Arrangement, and Financing Assurances Review

Prepared by the European Department

(In consultation with other departments)

Approved by Juha Kähkönen and Scott Brown

January 17, 2007

Mission: October 25–November 6, 2006.

Staff: Messrs. Székely (head), Lazar, and Oestreicher (all EUR), Mr. Hussain and Ms. Stuart (both PDR), Mr. Ganelli (FAD), and Ms. Westin (Resident Representative).

Interlocutors: The President, the Prime Minister, the Minister of Finance, several other ministers, the Governor of the Bank of Albania, members of parliament, leaders of opposition parties, representatives of the international community, local businesses, academia, NGOs, and the media.

Arrangement: SDR 17.045 million (35 percent of quota), approved in January 2006; a total of SDR 4.87 million disbursed. First review completed in July 2006.

Contents Page

Attachments

Attachment I Tables

Attachment II Tables

EXECUTIVE SUMMARY

Albania's macroeconomic performance remains strong. Growth has picked up, inflation stayed low, and the current account deficit narrowed. The outlook for 2007 is positive, with growth projected at 6 percent. These developments owe much to good macroeconomic policies. All quantitative program targets were met. The 2007 budget is in line with the medium-term fiscal framework, which strikes a balance between reducing public debt and increasing priority expenditure. To contain inflationary pressures, the central bank started a tightening cycle in July 2006.

Progress in structural reform has been generally good. The program focuses on reducing fiscal vulnerabilities, improving budget management, and developing the financial system. Except for two brief delays in meeting structural benchmarks, all structural conditionality for this review was observed. Future fiscal reforms will focus on strengthening public debt-management capacity and tax administration. Key financial sector measures include creating a credit bureau and further strengthening prudential regulation. These achievements notwithstanding, major further efforts will be needed for Albania to reach European standards in institutions, infrastructure, and the business environment, as highlighted in the last Article IV consultation.

Policy discussions focused on two issues:

- **Fitting the authorities' road development program into the medium-term fiscal framework.** There was agreement that this program, estimated to cost up to 9 percent of GDP in 2006–09, can be accommodated within the existing framework while preserving other priority expenditure. Success will require better expenditure prioritization which is being developed, including through the creation of a public investment department in the Ministry of Finance. Some front-loading of nonconcessional borrowing, within the unchanged limit for 2006–09, will also be necessary to facilitate smooth implementation.

- **Anchoring inflation expectations to the 3 percent target.** Both sides agreed that a small policy rate hike was necessary to achieve this. Prudential measures are also helping cool rapid private credit growth—a major source of inflationary pressure—and lower banks' risk profiles. Following the mission, the central bank indeed raised the policy rate, and the macroeconomic policy mix is now broadly appropriate.

I. INTRODUCTION

1. **The review took place in a generally favorable setting.** Sound policies have contributed to strong macroeconomic performance. Growth has picked up, inflation stayed low, and the current account deficit narrowed. Action plans for structural reforms developed earlier have promoted smooth implementation in many areas. However, weaknesses in institutions, infrastructure, and the business environment continue to stand in the way of an even stronger performance.

2. **The biggest policy challenges for this review were to fit the authorities' major road development program into the medium-term fiscal framework and anchor inflation expectations.**

II. PERFORMANCE UNDER THE PROGRAM

3. **Economic developments in 2006 were broadly as anticipated in the latest Article IV consultation (Table 1):**

- An export recovery ended the slowdown that started in 2005.
- The current account deficit narrowed to about 6 percent of GDP (Table 2). The strong export recovery suggests that there is no major misalignment in the exchange rate.
- Inflation picked up but remained within the 3±1 percent target range (Figure 1).
- Helped by prudential measures, private credit growth declined from about 75 percent at end-2005 to about 50 percent by end-2006 (Table 3). At about 20 percent of GDP, private credit is still well below estimated equilibrium levels.

4. **These positive developments owe much to good macroeconomic policies.** All quantitative program targets have been met (MEFP Table 1). Net domestic credit to government was slightly below the target in 2006, but the overall budget deficit, at about 3 percent of GDP, was significantly less than budgeted because of delays in implementing donor-financed projects (Table 4). The Bank of Albania (BoA) started a tightening cycle in July 2006.

5. **Except for two minor delays with SBs, the authorities have met all structural conditionality for this review (Table 5).**[1] This reflects good progress in implementing reforms, particularly in tax administration and debt management.

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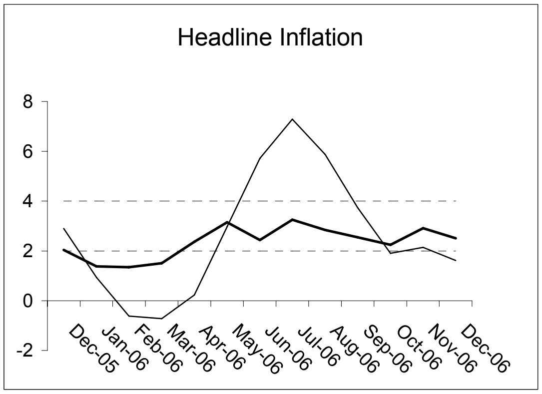
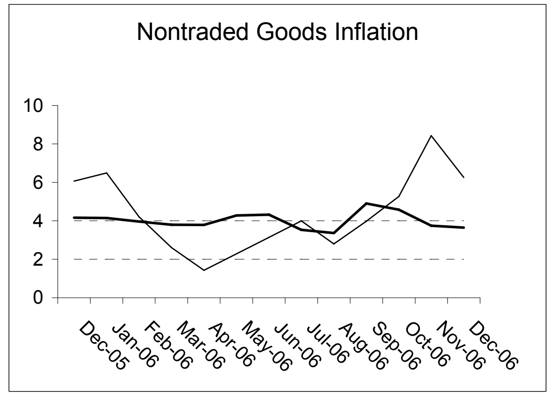
[1] While Albania did not complete the debt-management strategy by the end-September 2006 test-date, this does not constitute nonobservance because Albania had relied on understandings with Fund staff prior to the first review that the test-date would be end-October 2006. Due to an administrative error this understanding was not reflected in the Board decisions completing the first review, but was reflected in the staff report.

Figure 1. Albania: Price Developments, December 2005-December 2006

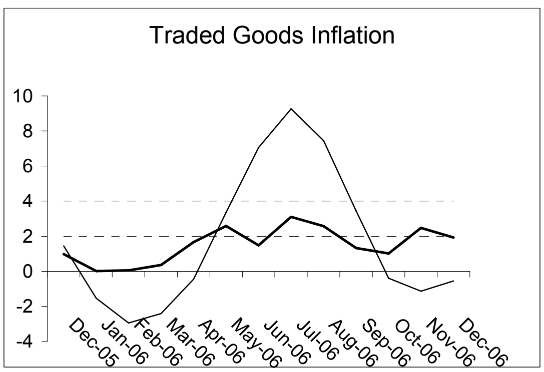
From very low levels in early 2006, headline inflation returned to the midpoint of the 2-4 percent target range...



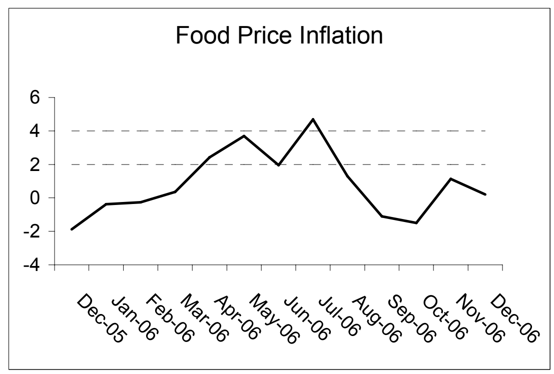
...as nontraded goods inflation remained relatively high...



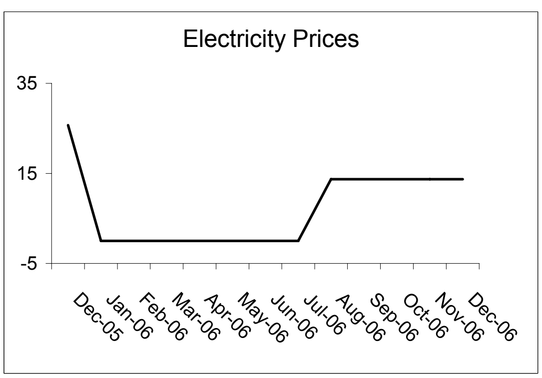
...and traded goods prices increased.



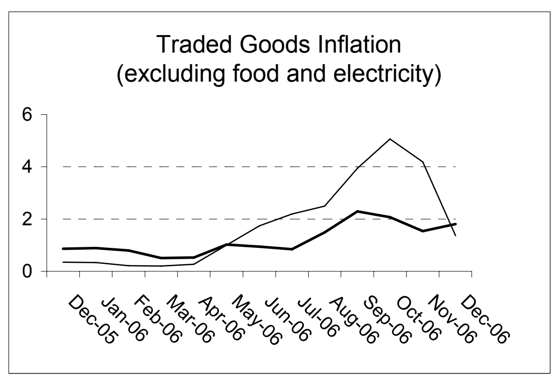
Traded goods prices were driven by rising food prices through July 2006...



...and then by the electricity tariff adjustment of August 2006...



...and by rising prices of other traded goods resulting from the imposition of higher excises on tobacco.



Source: Data provided by INSTAT.

Year-on-year inflation — Quarter-on-quarter, sa, annualized inflation — BoA target range

III. Program Discussions

A. Economic Outlook

6. **The Albanian economy is poised for a healthy expansion in 2007.** A continued export recovery is expected to raise growth to 6 percent and keep the external current account deficit largely unchanged at 6 percent of GDP. There was agreement that risks to these projections were broadly balanced

B. Fiscal Issues

7. **The 2007 budget is in line with the program's fiscal framework, which aims at a continued lowering of public debt while providing funds necessary to meet development goals (Table 6).** Net credit to government is capped at 2½ percent of GDP; given the authorities' commitment to use half of privatization receipts to lower domestic debt, the outcome will be significantly lower if the telecommunication company (Albtelecom) is sold in 2007 as planned. The small widening of the overall deficit mostly reflects an increase in infrastructure investment where implementation capacity is relatively strong. Expenditure priorities remain education, health care, and roads. The budget includes no new tax policy measures, but the authorities plan to cut taxes again in mid-2007 if there are further improvements in revenue collection.

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

	2004	2005	2006	2007	2008	2009	2010
Overall balance	-5.1	-3.6	-3.1	-3.8	-3.9	-3.7	-3.6
Total revenue	24.1	24.4	25.6	25.9	26.2	26.4	26.5
Total revenue (excluding grants)	23.8	23.7	24.9	25.2	25.6	25.8	26.0
Current expenditure	24.0	23.2	23.1	23.3	23.0	23.1	22.9
Capital expenditure	5.0	4.6	5.7	6.2	6.7	6.5	6.8
Current balance 1/	-0.2	0.5	1.8	1.8	2.3	2.5	2.9
Domestic financing	4.2	2.8	2.6	3.2	2.8	2.5	2.5
Privatization receipts	1.9	0.1	0.4	1.1	0.4	0.2	0.2
Domestic net borrowing	2.3	2.7	2.2	2.0	2.3	2.3	2.3
Foreign financing	1.0	0.8	0.7	0.7	1.2	1.1	1.1
Public debt	56.6	56.7	55.7	54.5	53.7	52.7	51.5
Domestic 2/	38.5	39.1	38.6	37.4	36.5	35.7	34.9
External 3/	18.0	17.5	17.1	17.1	17.2	17.0	16.6

1/ Revenue excluding grants minus current expenditure.
2/ Overwhelmingly lek-denominated and held by banks. Includes securities issued to the Bank of Albania in 2005 to compensate for its exchange valuation losses.
3/ Overwhelmingly official and concessional.

8. **There was agreement that the existing fiscal framework provides sufficient space for the authorities' road development program (Box 1).** This program is projected to cost up to 9 percent of GDP in 2006–09, with expenditure peaking in 2008. Staff concurred that,

with available budget resources allocated based on development priorities, the current fiscal framework could accommodate this without crowding out other poverty-reducing expenditure. The recently introduced integrated planning system and the newly created public investment department in the Ministry of Finance will help achieve better prioritization. The authorities also requested to bring forward some external nonconcessional borrowing within the unchanged overall program limit, if necessary to secure timely implementation. Given the authorities' commitment to introduce strong safeguards—which provide a sizable cushion against possible cost overruns and include increasing budget contingencies and allocating additional funds to road projects from large privatization receipts and mid-year budget reviews (MEFP, ¶23)—the mission supported this request. Staff urged the authorities to work closely with their development partners, particularly the World Bank, to keep spending on roads within limits and ensure that PRSP goals are met in other priority areas as well. Staff reiterated the recommendation to save not only half of privatizations receipts (a long-standing commitment), but also part of the gains from new tax administration measures. The authorities, however, expect to use tax administration gains to lower tax rates.

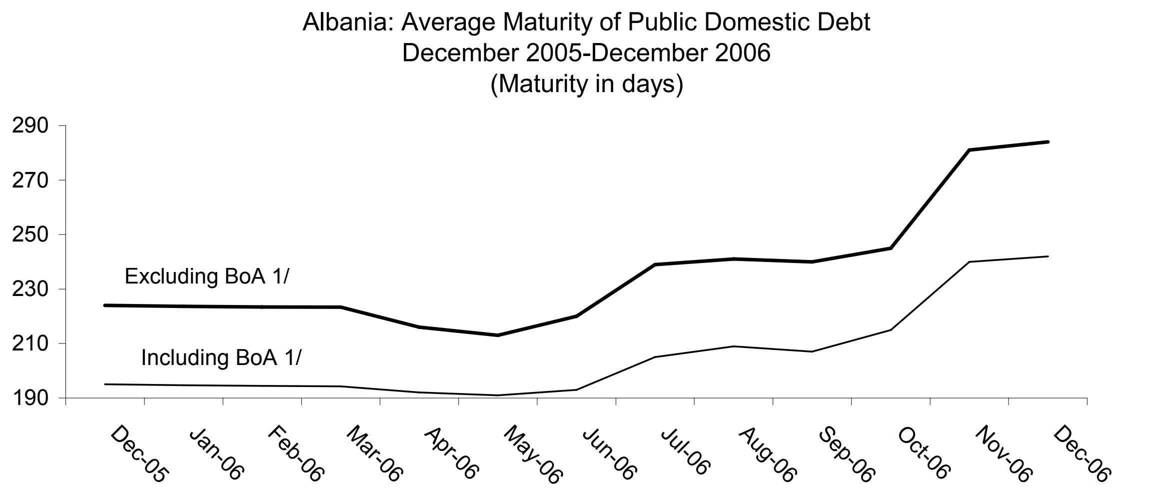
Box 1. Albania: Road Development Program

Poor transport infrastructure is a major factor hindering growth and poverty reduction in Albania. The World Bank concluded recently that Albania lags behind neighboring countries in terms of coverage and quality.

Addressing this problem is a top priority. The recently approved national transport plan (NTP)—a core element of the PRSP—provides a program for investments and institutional changes to move Albania toward European road standards.

Some nonconcessional external borrowing, within the program's cumulative ceilings, will be necessary to finance this program. A new national road corridor between Durres and the Kukes region—a main project in the NTP with a sizable rate of economic return, part of which the World Bank is considering to finance—is estimated to cost about 5½ percent of GDP. Current budget revenue can cover half of this cost without compromising other priority investments (MEFP, ¶20-21). While the government is seeking concessional financing, most of the external financing (2½–3 percent of GDP) is likely to be nonconcessional.

9. **While welcoming the authorities' new debt-management strategy, staff noted that implementation requires strengthened institutional capacities.** To increase the average maturity of domestic debt, the authorities will broaden the retail market and increase the liquidity of secondary markets for government debt. They are also developing new instruments to gain more flexibility (MEFP, ¶10). To strengthen institutional capacity, the authorities agreed to an independent review of the functions of the debt management unit to determine staffing needs and the conditions necessary to attract qualified staff (SB, June 2007) (Table 7).



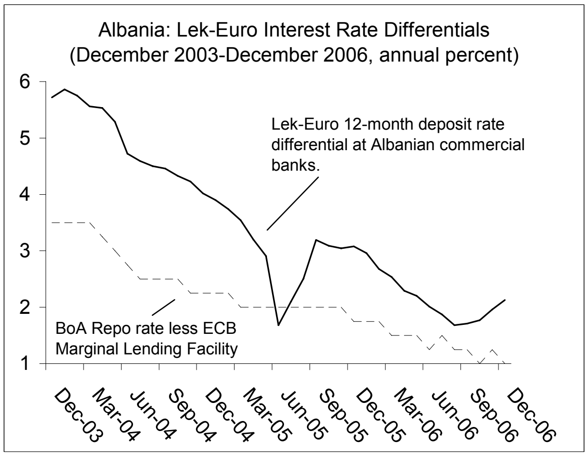
Source: Data provided by the Albanian authorities.

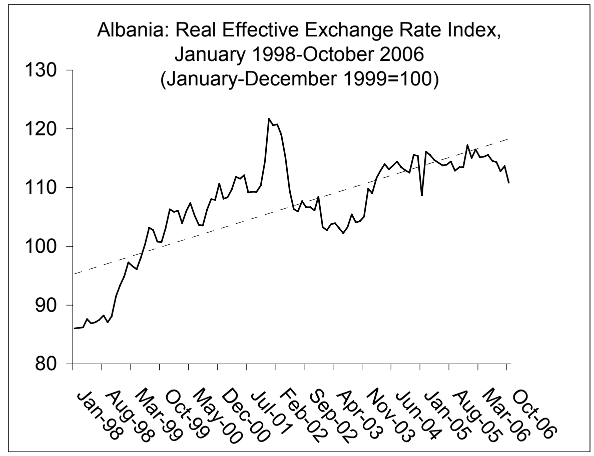
1/ Maximum maturity of public debt held by BoA is legally limited to 6 months.

10. **Revenue administration reforms will focus on consolidating improvements in the large taxpayer office and shifting resources to administrating high-yield taxes.** To achieve the latter, the authorities plan to review the functions of the Tax Police (PC for March 2007). Custom administration reform aims to promote a more effective use of the risk-management module of the ASYCUDA system (MEFP, ¶8).

C. Monetary Policy and Financial System Stability

11. **There was agreement that a small increase in the policy interest rate would help anchor inflation expectations to the 3 percent target.** At the time of the mission, the authorities and staff projected inflation to accelerate mostly due to supply-side factors—possibly breaching the upper edge of the target range in the second quarter of 2007 before moving back toward the target. It was therefore agreed that a small rate hike would help avoid potential second-round effects without posing significant risks to the economy. The rate increase was expected to work mainly through the exchange rate channel (given the floating exchange rate regime). The risks of overappreciation were seen as small, as the REER was slightly below its medium-term trend and the interest rate differential against the euro had narrowed since end-2005. Following the mission, the BoA raised the policy rate by 25 basis points in November 2006.





12. **Despite some deterioration in credit quality, the authorities were confident that the banking sector—fully private and predominantly foreign owned—was healthy**. Although rapid credit growth has lowered capital adequacy and liquidity ratios, banks appear on the whole to have remained well capitalized, liquid, and profitable (Table 8). Quarterly stress tests performed by the authorities indicate that the banking sector is fairly resilient to standard exchange rate, interest rate, and credit quality shocks.

13. **Based on staff recommendations, the authorities took important steps to strengthen prudential regulation and bank supervision.** They formulated an action plan and informed banks of the measures considered. Within existing regulations, they used penalties more aggressively and imposed higher capital adequacy ratios (12½–13 percent) on three banks with rapid growth in NPLs. New measures to further improve credit risk management will soon come into force (Table 9). A key element is to allow bank supervision to lower ceilings on loans to related parties if a bank's internal control system is found inadequate (MEFP, ¶3). Staff welcomed the measures and emphasized the importance of closely monitoring credit quality, particularly in domestically owned banks.

14. **The next priorities in developing the financial system are to create a credit bureau and develop a delivery-versus-payment system for securities trading.** The implementation of the former (previously an SB, June 2007), however, needs to be postponed until end-2007 to provide sufficient time to establish a proper legal framework (MEFP, ¶15).

15. **A new integrated Financial Supervisory Authority (FSA) was created to supervise insurance companies, pension funds, and securities markets.** Its immediate focus is the insurance industry, but later it plans to review comprehensively the legislation for all nonbank financial sectors. Welcoming the creation of the FSA, staff stressed the importance of providing it with sufficient funding to recruit and retain qualified staff (MEFP, ¶16). Noting that the legal framework for pension funds is weak and that the FSA lacks adequate pension supervision capacities, the mission reiterated the recommendation to refrain from issuing new pension fund licenses until sufficient improvement is made in this area.

16. **Staff also noted that regulatory oversight over financial leasing remained weak**. Given close ownership links between banks and leasing companies, staff suggested allocating financial leasing supervision to the BoA (MEFP, ¶17).

D. Other Structural Reforms

17. **The authorities have started preparations to privatize the distribution arm of the electricity company (KESH).** They have selected the IFC as a privatization advisor and taken steps to incorporate distribution activities as a separate company. Staff welcomed this progress and recommended establishing a firm timetable for privatization, within the electricity sector strategy outlined during the 2006 Article IV consultation. It also encouraged the authorities to improve energy supply and strengthen KESH's financial performance.

18. **The mission advised the authorities to speed up privatization in other sectors.** Based on an independent review of the privatization tender for Albtelecom, the authorities have decided to renegotiate the contract with the originally selected foreign investor. Staff urged swift closure to dispel doubts about the authorities' commitment to privatization. The authorities have also started preparations to sell the state-owned insurance company (INSIG) by end-2007.

19. **A new scheme to attract FDI, "Albania – One Euro," will offer special leases on abandoned production sites for a token payment (MEFP, ¶27).** Staff encouraged the authorities to limit fiscal costs, work closely with the World Bank in finalizing the scheme, and accelerate complementary reforms to improve the business environment.

20. **The ongoing legalization of informal housing should promote growth and financial deepening.** Self-declaration of houses built without permission—in many cases on land owned by someone else—finished in November 2006. The authorities expect to begin issuing property titles in mid-2007. The process could unlock some US$4 billion (about 45 percent of GDP) in private wealth and make it available as loan collateral (MEFP, ¶24).

21. **Statistics need to be improved further.** The authorities prepared preliminary national accounts for 2005 and, with some delay, revised for 1996–2004 (SB November 2006), but information on the use of GDP is still largely absent. To improve data reliability, the authorities are conducting a household budget survey and will undertake a labor force survey in early-2007. They also revised the estimates of private transfers (SB, December 2006) but errors and omissions stayed relatively large, suggesting remaining problems with BoP statistics (MEFP, ¶31). Staff suggested developing an action plan to implement recommendations of the recent Data ROSC.

22. **Reforms have progressed also in areas where the World Bank is the lead development partner (MEFP, ¶27).** A new procurement law has been passed by Parliament, and a new concession law is being finalized. If sufficient progress is made in improving compliance with procedures associated with the civil service law, the new

concession and procurement laws meet international standards, and other core prior actions are completed, a Development Policy Loan could be approved in early-2007. With assistance from development partners, the authorities expect to complete their new PRSP (called NSDI) for 2007–09 by April 2007.

23. **Steady progress has been made in clearing external arrears to non-Paris Club creditors.** Albania's outstanding debit balances from inoperative bilateral payment agreements are estimated at €65.6 million at end-2006. Arrears to private companies in Germany, Italy, and Turkey have been cleared and arrears to Poland and Bulgaria are expected to be cleared by March 2007. The authorities aim to eliminate remaining arrears to official creditors by mid-2007 and to private creditors by end-2007, if at all possible. Staff encouraged the authorities to continue good-faith efforts to settle arrears based on intercreditor equity.

E. Program Issues

24. **Proposed conditionality for the third review (MEFP Tables 1–2) is generally consistent with** previously established program targets. However, the following revisions were considered necessary:

- Moving the deadline for establishing a credit bureau (SB) from June 2007 to December 2007 to allow sufficient time for necessary legislative amendments (MEFP, ¶15).

- Setting cumulative ceilings on contracting nonconcessional loans for March 2007 (PC) €57 million (0.7 percent of GDP) higher than the previously set indicative target, to facilitate implementation of infrastructure projects. As the cumulative program limit remains unchanged (the annual limit for 2008 will be reduced accordingly), this revision has no lasting implications for external debt sustainability.

25. **The program is fully financed in 2006–07 (Table 2).** In 2007, the financing gap is expected to be closed by arrears rescheduling. External debt remains sustainable (Table 10), and projected future debt service to the Fund remains minimal (Tables 11–12).

IV. Staff Appraisal

26. **Helped by good policies, Albania's macroeconomic performance has remained strong.** Growth is returning to potential, inflation has remained low, and the external current account deficit has narrowed. A marked slowdown in private credit growth has helped maintain price stability and improve the external balance. The policy rate hike in November was well timed, and the overall macroeconomic policy stance is now broadly appropriate. Prudent macroeconomic policies and central bank independence have been the foundation of Albania's economic success and should be preserved.

27. **The fiscal framework of the program remains adequate.** It reflects the authorities' development priorities—education, health care, and infrastructure—and keeps public debt on a declining path. Its steady implementation will reduce vulnerabilities and increase policy credibility. With proper prioritization, the authorities' road development program can be incorporated into this framework without crowding out expenditure in other important areas. However, it will be crucial to implement the planned safeguard measures, such as increasing budget contingencies, to mitigate inherent fiscal risks.

28. **The 2007 budget is in line with the fiscal framework.** The allocation of sufficient resources to development priorities, in combination with realistic revenue projections and adequate contingencies, should promote safe budget execution.

29. **Good progress has been made in implementing fiscal reforms, and future measures will help maintain momentum.** The enlargement of the Large Taxpayers' Office and customs reforms are helping to increase revenue, improve the business environment, and fight corruption. Future measures will broaden reforms to the rest of the revenue administration. The debt-management strategy rightly focuses on raising the average maturity of domestic public debt, but implementation requires strengthened institutional capacities.

30. **The authorities have taken necessary prudential measures to preserve the health of the banking system.** The focus on voluntary compliance and strengthened risk management in banks is appropriate, as is the close attention paid to domestically-owned banks and connected lending. Once implemented in early 2007, the planned new measures should further improve prudential regulation and supervision.

31. **The creation of the FSA was an important step to strengthen nonbank supervision.** Reforms should now concentrate on building the necessary institutional capacity. Until an appropriate legal framework and supervisory capacities for the pension industry can be developed, it would be advisable for the authorities to refrain from issuing new pension fund licenses. Given close ownership links between banks and leasing companies, the authorities should consider allocating financial leasing supervision to the BoA.

32. **Progress in privatizing the distribution arm of KESH, in the context of the energy sector strategy, is welcome.** Privatization should be accelerated in other sectors, particularly in telecommunication and insurance, as part of the effort to create a better business climate.

33. **Further efforts are needed to improve official statistics, including the timely completion of the household budget and the labor force surveys.**

34. **On the basis of the strong program performance and the authorities' commitments, staff recommends completion of the Second Review under the PRGF/EFF-supported program and the financing assurances review.**

Table 1. Albania: Basic Indicators and Macroeconomic Framework, 2002–10

	2002	2003	2004	2005	2006	2007	2008	2009	2010
				Est.	Proj.	Proj.	Proj.	Proj.	Proj.
				(Growth rate in percent)					
Real GDP 1/	2.9	5.7	5.9	5.5	5.0	6.0	6.0	6.0	6.0
Retail prices (avg.)	5.2	2.3	2.9	2.4	2.4	3.4	3.0	3.0	3.0
Retail prices (end-period)	1.7	3.3	2.2	2.0	2.5	3.3	3.0	3.0	3.0
				(In percent of GDP)					
Saving-investment balance 2/									
Foreign savings 3/	7.2	5.3	3.9	6.5	5.9	6.2	6.1	5.8	5.3
Domestic savings	17.4	18.2	19.9	17.1	19.2	19.9	21.0	21.7	23.0
Public 4/	0.0	-0.1	0.1	1.2	2.6	2.5	3.0	3.0	3.3
Private	17.4	18.3	19.8	15.9	16.7	17.4	18.0	18.6	19.6
Investment	24.5	23.4	23.8	23.6	25.1	26.0	27.1	27.5	28.3
Public	6.7	4.6	5.0	4.6	5.7	6.2	6.7	6.5	6.8
Private	17.8	18.8	18.8	19.0	19.4	19.8	20.4	21.0	21.5
Fiscal sector									
Revenues and grants	24.7	24.5	24.1	24.4	25.7	25.9	26.3	26.4	26.5
Tax revenue	20.6	21.3	21.7	22.0	23.1	23.5	23.9	24.2	24.4
Of which : social security contributions	4.1	4.2	4.3	4.3	4.2	4.4	4.6	4.6	4.6
Expenditures	31.4	29.0	29.2	28.0	28.9	29.8	30.3	30.1	30.2
Primary	27.4	24.6	25.5	24.9	25.8	26.8	27.0	27.0	27.2
Interest	4.0	4.4	3.7	3.1	3.1	3.0	3.2	3.1	3.0
Overall balance (including grants)	-6.6	-4.5	-5.1	-3.6	-3.1	-3.9	-3.9	-3.7	-3.6
Primary balance (excluding grants)	-3.3	-0.5	-1.8	-1.2	-0.8	-1.5	-1.4	-1.1	-1.1
Net domestic borrowing	3.3	2.9	2.3	2.7	2.2	2.0	2.3	2.4	2.4
Privatization receipts	0.1	0.1	1.9	0.1	0.4	1.1	0.4	0.2	0.2
Foreign financing	3.3	1.5	1.0	0.8	0.7	0.7	1.2	1.1	1.1
Public Debt	65.3	61.7	56.6	56.7	55.9	54.7	53.9	52.9	51.7
Domestic	41.7	41.1	38.5	39.1	38.8	37.6	36.6	35.9	35.0
External (including publicly guaranteed) 5/	23.5	20.6	18.0	17.5	17.2	17.1	17.3	17.1	16.7
Monetary indicators									
Broad money growth	5.7	8.7	13.5	13.9	14.9	11.8	12.7	12.6	12.1
Private credit growth	41.0	31.1	36.9	73.6	50.4	34.0	23.9	22.7	18.3
Velocity	1.5	1.5	1.5	1.5	1.4	1.3	1.3	1.3	1.2
Interest rate (3-mth T-bills, end-period)	11.1	7.3	6.2	5.4	5.9	…	…	…	…
				(In percent of GDP unless otherwise indicated)					
External sector									
Trade balance (goods and services)	-25.9	-25.1	-21.7	-24.0	-23.4	-23.4	-22.9	-22.0	-21.0
Current account balance (including official transfers)	-7.2	-5.3	-3.9	-6.5	-5.9	-6.2	-6.1	-5.8	-5.3
Current account balance (excluding official transfers)	-10.0	-7.9	-5.6	-7.7	-7.2	-7.5	-7.3	-6.8	-6.2
Official transfers	2.8	2.6	1.7	1.1	1.3	1.3	1.3	1.0	0.9
Gross international reserves (in millions of Euros)	845	834	1,025	1,202	1,290	1,367	1,508	1,645	1,836
(in months of imports of goods and services)	4.4	3.9	3.9	4.2	4.1	4.0	4.1	4.1	4.3
(relative to external debt service)	12.9	15.2	17.6	17.3	11.5	9.9	8.8	8.4	8.2
(in percent of broad money)	28.2	24.6	25.3	25.7	24.1	23.0	22.6	22.0	22.1
Change in real effective exchange rate (e.o.p., in percent)	-10.9	1.2	5.1	1.6	…	…	…	…	…
Memorandum items									
Nominal GDP (in billions of lek) 1/	624.7	682.7	766.1	836.6	896.3	978.9	1,072.1	1,172.6	1,288.8

Social Indicators: GNI per capita, World Bank Atlas Method, US$ (2005): $2,580; **life expectancy at birth** (2004): 74 years; infant mortality rate (2004, per thousand births): 16; population 3.2 million (2004); population living below the poverty line (2005): 18.5; population without running water inside their dwellings (2003): 40 percent.

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

1/ GDP data for 2002-03 are from the official national accounts; GDP data for 2004-10 are staff estimates.

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/ Revenue including grants less current expenditure and net lending.

5/ Includes arrears, with the exception of pre-1978 arrears to China, and excludes IMF repurchase obligations.

Table 2a. Albania: Balance of Payments, 2002–10
(In millions of Euros)

	2002	2003	2004	2005	2006			2007	2008	2009	2010
					Q1	Q2	2006	Projections			
					Est.	Est.	Proj.				
Current account	-336	-261	-235	-439	-125	-177	-429	-489	-525	-545	-548
Balance of goods and services	-1,214	-1,248	-1,307	-1,617	-398	-424	-1,707	-1,853	-1,978	-2,066	-2,157
Exports	962	1,031	1,293	1,498	421	447	1,726	1,937	2,158	2,362	2,620
Goods	349	396	486	530	144	166	633	728	823	930	1,051
Services	613	635	808	967	277	282	1,093	1,209	1,335	1,432	1,569
Imports	2,176	2,279	2,600	3,115	819	871	3,433	3,791	4,136	4,428	4,777
Goods	1,555	1,572	1,752	2,007	515	580	2,289	2,505	2,715	2,904	3,111
Services	622	708	848	1,108	304	292	1,145	1,286	1,421	1,524	1,666
Income balance	134	152	143	132	46	27	140	134	141	140	155
Of which : Interest due	22	21	18	25	5	13	40	56	65	74	83
Private transfers	612	706	826	969	207	199	1,045	1,124	1,204	1,283	1,366
Official transfers	132	129	103	77	20	21	93	106	108	98	88
Capital account	349	274	332	326	55	115	332	496	497	545	647
Direct investment	142	158	277	224	57	69	273	294	330	369	393
Other capital	113	42	-13	41	-13	40	33	122	82	111	198
Private loans (incl.net trade credits, net)	12	21	78	63	8	14	60	56	61	77	97
Other financial flows	102	21	-91	-22	-21	26	-27	66	21	35	101
Of which: Change in NFA of DMBs (incr = -) 1/	102	21	-91	-22	-21	26	-27	66	21	22	21
Medium- and long-term loans (net)	95	75	68	61	11	6	26	79	85	64	57
New borrowing	123	101	100	98	23	22	90	150	180	175	188
Multilateral loans	84	75	72	73	18	13	67	89	106	92	114
World Bank	52	36	37	32	5	9	31	35	35	19	37
EBRD	8	13	13	15	5	3	14	25	30	30	32
Other	24	25	23	25	8	1	22	29	41	43	45
Bilateral loans	38	26	28	26	4	9	22	61	74	83	74
Amortization	-28	-25	-33	-37	-12	-16	-63	-71	-95	-111	-131
Errors and omissions 2/	-12	14	80	183	94	105	206	68	163	141	97
Net balance	1	27	177	69	24	43	109	75	134	141	197
Financing requirement	-1	-27	-177	-69	-24	-43	-109	-75	-134	-141	-197
Available financing	0	-27	-177	-69	-24	-43	-110	-75	-134	-140	-197
Change in net reserves (increase = -) 1/	-30	-46	-193	-72	-33	-43	-132	-83	-146	-144	-201
Of which: Change in gross reserves, (increase = -) 1/	-19	10	-191	-77	-34	-41	-128	-77	-141	-137	-191
Use of Fund Resources (net)	-9	1	2	2	1	-2	-3	-5	-6	-8	-9
Budget support	30	17	15	3	9	0	9	0	0	0	0
Changes in arrears (increase = +) 3/	-300	3	-12	-17	0	-4	-7	-66	0	0	0
Overdue debt forgiveness	225	0	0	0	0	0	0	0	0	0	0
Rescheduling 4/	75	0	12	17	0	4	7	0	0	0	0
Identified Financing	0	0	0	0	0	0	13	8	12	4	4
of which : World Bank including DPL	0	0	0	0	0	0	0	8	12	4	4
Financing gap 5/	0	0	0	0	0	0	0	66	0	0	0
Expected EU Macro-Financial Assistance	...	...	...	0	0	0	0	0	0	0	0
Arrears Rescheduling	...	...	...	0	0	0	0	66	0	0	0
Other	...	...	...	0	0	0	0	0	0	0	0
Memorandum items:											
Gross usable reserves	845	834	1,025	1,202	1,219	1,223	1,290	1,367	1,508	1,645	1,836
(months of imports of goods and services)	4.4	3.9	3.9	4.2	...	...	4.1	4.0	4.1	4.1	4.3
Balance of goods and services (percent of GDP)	-25.9	-25.1	-21.7	-24.0	...	...	-23.4	-23.3	-22.8	-21.9	-20.9
Current account (percent of GDP)	-7.2	-5.3	-3.9	-6.5	...	...	-5.9	-6.2	-6.1	-5.8	-5.3
Debt service (percent of exports of goods and services) 4/	6.3	5.0	4.1	4.1	...	...	5.1	5.5	5.8	5.9	6.1
Debt service (percent of central government revenues) 4/	5.5	4.5	3.9	4.1	...	...	5.1	5.6	6.0	6.0	6.3
Total external debt stock (percent of GDP) 6/	25.3	22.2	20.4	20.4	...	...	20.1	19.9	19.8	19.5	19.0
Volume of Exports of Goods and Services (percent change)	3.9	9.5	20.6	6.3	...	...	10.1	13.1	12.0	12.0	11.8
Volume of Imports of Goods and Services (percent change)	11.9	8.4	10.7	8.4	...	...	4.3	8.9	9.1	8.2	8.1

Sources: Ministry of Finance; Bank of Albania; donors; and Fund staff estimates and projections.
1/ Net of valuation changes in 2005-2006. In projections for 2007-2010, valuation effects are assumed to be zero.
2/ Net errors and omissions include unidentified flows of private transfers.
3/ In 2006-2007 assumes rescheduling of stock of outstanding arrears, both with official and private creditors.
4/ Public and publicly guaranteed debt only.
5/ The financing gap is expected to be fully covered by arrears rescheduling and prospective privatization receipts.
6/ Public and private external debt, including arrears. Debt stock converted into Lek at the e-o-p exchange rate.

Table 2b . Albania: Balance of Payments, 2002–2010
(In percent of GDP)

	2002	2003	2004	2005	2006	2007	2008	2009	2010
					Projections				
Current account	-7.2	-5.3	-3.9	-6.5	-5.9	-6.2	-6.1	-5.8	-5.3
Balance of goods and services	-25.9	-25.1	-21.7	-24.0	-23.4	-23.3	-22.8	-21.9	-20.9
Exports	20.5	20.8	21.5	22.2	23.6	24.4	24.9	25.1	25.4
Goods	7.4	8.0	8.1	7.9	8.7	9.2	9.5	9.9	10.2
Services	13.1	12.8	13.4	14.3	15.0	15.2	15.4	15.2	15.2
Imports	46.3	45.9	43.2	46.2	47.0	47.7	47.7	47.0	46.3
Goods	33.1	31.6	29.1	29.8	31.3	31.5	31.3	30.8	30.2
Services	13.2	14.2	14.1	16.4	15.7	16.2	16.4	16.2	16.2
Income balance	2.8	3.1	2.4	2.0	1.9	1.7	1.6	1.5	1.5
Of which : Interest due	0.5	0.4	0.3	0.4	0.6	0.7	0.7	0.8	0.8
Private transfers	13.0	14.2	13.7	14.4	14.3	14.1	13.9	13.6	13.2
Official transfers	2.8	2.6	1.7	1.1	1.3	1.3	1.2	1.0	0.9
Capital account	7.4	5.5	5.5	4.8	4.5	6.2	5.7	5.8	6.3
Direct investment	3.0	3.2	4.6	3.3	3.7	3.7	3.8	3.9	3.8
Other capital	2.4	0.8	-0.2	0.6	0.5	1.5	0.9	1.2	1.9
Private loans (incl.net trade credits, net)	0.2	0.4	1.3	0.9	0.8	0.7	0.7	0.8	0.9
Other financial flows	2.2	0.4	-1.5	-0.3	-0.4	0.8	0.2	0.4	1.0
Of which: Change in NFA of DMBs (incr = -) 1/	2.2	0.4	-1.5	-0.3	-0.4	0.8	0.2	0.2	0.2
Official medium- and long-term loans (net)	2.0	1.5	1.1	0.9	0.4	1.0	1.0	0.7	0.5
New borrowing	2.6	2.0	1.7	1.5	1.2	1.9	2.1	1.9	1.8
Multilateral loans	1.8	1.5	1.2	1.1	0.9	1.1	1.2	1.0	1.1
World Bank	1.1	0.7	0.6	0.5	0.4	0.4	0.4	0.2	0.4
EBRD	0.2	0.3	0.2	0.2	0.2	0.3	0.3	0.3	0.3
Other	0.5	0.5	0.4	0.4	0.3	0.4	0.5	0.5	0.4
Bilateral loans	0.8	0.5	0.5	0.4	0.3	0.8	0.9	0.9	0.7
Amortization	-0.6	-0.5	-0.5	-0.6	-0.9	-0.9	-1.1	-1.2	-1.3
Errors and omissions 2/	-0.3	0.3	1.3	2.7	2.8	0.9	1.9	1.5	0.9
Net balance	0.0	0.5	3.0	1.0	1.5	0.9	1.6	1.5	1.9
Financing requirement	0.0	-0.5	-3.0	-1.0	-1.5	-0.9	-1.6	-1.5	-1.9
Available financing	0.0	-0.5	-3.0	-1.0	-1.7	-0.9	-1.6	-1.5	-1.9
Change in net reserves (increase = -) 1/	-0.6	-0.9	-3.2	-1.1	-1.8	-1.0	-1.7	-1.5	-1.9
BOP support	0.6	0.3	0.3	0.0	0.1	0.0	0.0	0.0	0.0
Changes in arrears (increase = +) 3/	-6.4	0.1	-0.2	-0.2	-0.1	-0.8	0.0	0.0	0.0
Overdue debt forgiveness	4.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Rescheduling 4/	1.6	0.0	0.2	0.2	0.1	0.0	0.0	0.0	0.0
Identified Financing	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.0	0.0
of which: World Bank including DPL	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.0	0.0
Financing gap 5/	0.0	0.0	0.0	0.0	0.0	0.8	0.0	0.0	0.0
Expected EU Macro-Financial Assistance	...	...	...	0.0	0.0	0.0	0.0	0.0	0.0
Arrears Rescheduling	...	...	...	0.0	0.0	0.8	0.0	0.0	0.0
Other	...	...	...	0.0	0.0	0.0	0.0	0.0	0.0

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

1/ Net of valuation changes in 2005-2006. In projections for 2007-2010 onwards valuation effects are assumed to be zero.
2/ Net errors and omissions include unidentified flows of private transfers.
3/ In 2006-2007 assumes rescheduling of stock of outstanding arrears, both with official and private creditors.
4/ The financing gap is expected to be fully covered by arrears rescheduling and prospective privatization receipts.

Table 3a. Albania: Monetary Aggregates, 2002–10

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

	Actuals								IMF projections							
	2002	2003	2004	2005	2006					2007				2008	2009	2010
	Dec.	Dec.	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.	Dec. IMF Country Report No. 06/286	Mar.	Jun.	Sep.	Dec.	Dec.	Dec.	Dec.
Monetary survey																
Broad money	408.1	443.5	503.2	573.0	575.2	589.3	621.8	658.6	650.6	664.3	680.5	710.2	736.0	829.6	933.9	1046.9
Currency outside banks	130.8	125.2	138.1	149.7	137.2	141.0	146.2	164.6	166.6	153.9	158.2	161.7	176.6	195.8	205.5	217.5
Deposits	277.4	318.3	365.1	423.3	437.9	448.3	475.6	494.0	484.0	510.5	522.2	548.6	559.4	633.8	728.4	829.3
Domestic currency deposits	190.8	226.1	255.2	276.8	284.4	288.1	298.0	306.8	313.9	318.5	325.6	342.0	347.9	395.8	454.7	523.2
Foreign currency deposits	86.5	92.2	110.0	146.6	153.5	160.2	177.6	187.1	170.1	192.0	196.6	206.5	211.6	238.0	273.7	306.2
Net foreign assets	164.4	161.8	188.8	210.8	214.2	213.6	235.9	226.4	203.7	218.9	221.2	229.1	229.0	245.8	262.0	286.1
Bank of Albania	96.9	99.8	118.6	138.8	140.1	142.1	151.5	150.7	146.5	146.7	149.5	157.1	161.1	180.2	198.8	225.3
Commercial Banks	67.5	62.0	70.2	72.0	74.2	71.6	84.5	75.6	57.2	72.2	71.7	72.1	67.8	65.6	63.2	60.8
Net domestic assets	243.8	281.7	314.4	362.2	360.9	375.7	385.9	432.2	446.9	445.4	459.3	481.1	507.1	583.8	671.9	760.7
Claims on government (net of deposits)	245.3	260.1	271.0	277.0	264.7	263.7	266.4	296.1	292.8	298.2	297.5	301.8	308.2	325.9	344.4	364.2
BOA financing	71.0	64.6	57.2	58.6	52.4	54.8	53.6	58.2	62.9	56.2	54.2	56.2	58.2	57.6	55.6	53.6
Of which: gross credit	77.0	73.4	65.7	68.8	67.3	64.9	66.2	65.3	...	65.3	65.3	65.3	65.3	64.7	62.7	60.7
Other (including T-bills)	174.3	195.5	213.7	218.4	212.3	208.9	212.8	237.9	229.9	242.0	243.3	245.6	250.0	268.2	288.8	310.6
Claims on state enterprises and farms	0.0	0.0	0.1	0.1	0.1	0.2	0.1	0.0	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	124.4	137.4	155.7	169.8	187.1	187.7	198.6	213.6	231.6	250.7	310.7	381.2	450.9
In Leks	9.2	10.6	15.6	33.7	37.9	46.2	52.9	59.4	61.0	63.2	73.5	82.9	93.2	127.2	163.3	201.5
In foreign currency	30.7	41.7	56.0	90.6	99.5	109.6	116.8	127.7	126.7	135.5	140.2	148.7	157.5	183.4	217.9	249.4
Other items, net	-41.5	-30.8	-28.3	-39.2	-41.3	-44.0	-50.3	-51.1	-33.7	-51.5	-51.9	-52.3	-51.8	-52.7	-53.7	-54.4
Memorandum items:																
Reserve money (billions of Lek)	163.9	160.6	178.6	198.3	186.3	194.6	205.4	216.4	217.4	211.8	217.5	218.6	239.0	266.6	290.2	314.6
M1 (billions of Lek)	145.9	142.0	170.1	223.7	213.3	221.2	223.1	229.5	227.5	214.9	216.8	218.6	248.8	277.3	296.4	319.6
M2 (Billions of Lek)	321.6	351.3	393.3	426.4	421.6	429.2	444.2	471.4	480.5	472.3	483.9	503.7	524.5	591.6	660.2	740.7
Annual broad money growth	5.7	8.7	13.5	13.9	11.3	9.6	10.7	14.9	13.5	15.5	15.5	15.7	11.8	12.7	12.6	12.1
Annual reserve money growth	7.7	-2.0	11.2	11.0	8.9	7.8	5.8	9.1	10.2	13.7	11.8	3.5	10.5	11.5	8.9	8.4
Annual growth in private sector credit	41.0	31.1	36.9	73.6	68.6	59.2	57.1	50.4	50.9	44.6	37.2	37.1	34.0	23.9	22.7	18.3
Private sector credit as a percent of GDP	6.4	7.7	9.4	14.9	16.2	18.0	19.2	20.8	...	21.8	22.9	24.2	25.5	28.9	32.4	34.9
Annual M2 growth	6.4	9.2	11.9	8.4	6.6	5.4	7.4	10.6	12.7	12.0	12.7	12.8	11.2	12.8	11.6	12.2
Velocity (annual GDP/BM)	1.5	1.5	1.5	1.5	1.5	1.5	1.4	1.4	1.4	1.4	1.4	1.3	1.3	1.3	1.3	1.2
Money multiplier (absolute values)	2.5	2.8	2.8	2.9	3.1	3.0	3.0	3.0	3.0	3.1	3.1	3.2	3.1	3.1	3.2	3.3
Currency/Broad Money ratio	32.0	28.2	27.4	26.1	23.9	23.9	23.5	25.0	25.6	23.2	23.3	22.8	24.0	23.6	22.0	20.8
Foreign currency deposits/total deposits	31.2	29.0	30.1	34.6	35.1	35.7	37.3	37.9	35.1	37.6	37.6	37.6	37.8	37.6	37.6	36.9
Gross reserves (millions of euros)	845	834	1,025	1,202	1,219	1,223	1,293	1,290	1,260	1,253	1,274	1,331	1,367	1,508	1,645	1,836
Gross reserves (millions of U.S. dollars)	860	1,026	1,374	1,425	1,465	1,548	1,643	1,643	1,587	1,599	1,628	1,703	1,752	1,941	2,126	2,388
In percent of broad money	28.2	24.6	25.3	25.7	25.8	25.5	25.7	24.1	23.8	23.3	23.1	23.2	23.0	22.6	22.0	22.1
US Dollar Exchange Rate (end of period)	133.9	106.4	92.7	103.4	101.5	97.2	97.1	94.0	...	...	...	...	...	...	...	...
Euro Exchange Rate (end of period)	138.3	133.8	125.9	122.4	122.8	123.2	123.0	123.6	...	...	...	...	...	...	...	...
3-month T-bill rate (in percent)	11.08	7.32	6.15	5.42	5.23	5.23	5.96	6.25	…	…	…	…	…	…	…	…
BoA repo rate (in percent)	8.50	6.50	5.25	5.00	5.00	5.00	5.25	5.5	…	…	…	…	…	…	…	…

Sources: Bank of Albania; and Fund staff estimates.

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

Table 3b. Albania: Monetary Aggregates, 2002–10
(In percent of GDP; end-period)

	Actuals								IMF projections						
	2002	2003	2004	2005	2006				2007				2008	2009	2010
	Dec.	Dec.	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	Dec.	Dec.	Dec.
Monetary survey															
Broad money	65.3	65.0	65.7	68.5	67.9	68.1	70.2	73.2	72.8	72.9	74.2	74.9	77.1	79.4	81.0
Currency outside banks	20.9	18.3	18.0	17.9	16.2	16.3	16.5	18.3	16.9	16.9	16.9	18.0	18.2	17.5	16.8
Deposits	44.4	46.6	47.7	50.6	51.7	51.8	53.7	54.9	55.9	55.9	57.3	57.0	58.9	61.9	64.1
Domestic currency deposits	30.5	33.1	33.3	33.1	33.6	33.3	33.7	34.1	34.9	34.9	35.7	35.4	36.8	38.6	40.5
Foreign currency deposits	13.8	13.5	14.4	17.5	18.1	18.5	20.1	20.8	21.0	21.1	21.6	21.5	22.1	23.3	23.7
Net foreign assets	26.3	23.7	24.6	25.2	25.3	24.7	26.6	25.2	24.0	23.7	23.9	23.3	22.8	22.3	22.1
Bank of Albania	15.5	14.6	15.5	16.6	16.5	16.4	17.1	16.8	16.1	16.0	16.4	16.4	16.7	16.9	17.4
Commercial Banks	10.8	9.1	9.2	8.6	8.8	8.3	9.5	8.4	7.9	7.7	7.5	6.9	6.1	5.4	4.7
Net domestic assets	39.0	41.3	41.0	43.3	42.6	43.4	43.6	48.1	48.8	49.2	50.3	51.6	54.3	57.1	58.8
Claims on government (net of deposits)	39.3	38.1	35.4	33.1	31.2	30.5	30.1	32.9	32.7	31.9	31.5	31.4	30.3	29.3	28.2
BOA financing	11.4	9.5	7.5	7.0	6.2	6.3	6.1	6.5	6.2	5.8	5.9	5.9	5.4	4.7	4.1
Of which: gross credit	12.3	10.8	8.6	8.2	7.9	7.5	7.5	7.3	7.2	7.0	6.8	6.6	6.0	5.3	4.7
Other (including T-bills)	27.9	28.6	27.9	26.1	25.0	24.1	24.0	26.5	26.5	26.1	25.7	25.4	24.9	24.5	24.0
Claims on state enterprises and farms	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Claims on the private sector 1/	6.4	7.7	9.4	14.9	16.2	18.0	19.2	20.8	21.8	22.9	24.2	25.5	28.9	32.4	34.9
In Leks	1.5	1.6	2.0	4.0	4.5	5.3	6.0	6.6	6.9	7.9	8.7	9.5	11.8	13.9	15.6
In foreign currency	4.9	6.1	7.3	10.8	11.7	12.7	13.2	14.2	14.8	15.0	15.5	16.0	17.1	18.5	19.3
Other items, net	-6.6	-4.5	-3.7	-4.7	-4.9	-5.1	-5.7	-5.7	-5.6	-5.6	-5.5	-5.3	-4.9	-4.6	-4.2
Memorandum items:															
Reserve money	26.2	23.5	23.3	23.7	22.0	22.5	23.2	24.1	23.2	23.3	22.8	24.3	24.8	24.7	24.3
M1	23.4	20.8	22.2	26.7	25.2	25.6	25.2	25.5	23.5	23.2	22.8	25.3	25.8	25.2	24.7
M2	51.5	51.5	51.3	51.0	49.7	49.6	50.2	52.4	51.7	51.8	52.6	53.4	55.0	56.1	57.3

Sources: Bank of Albania; and Fund staff estimates.

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

Table 4a. Albania: General Government Operations, 2003-10
(In percent of GDP)

	2003	2004	2005	2006		2007	2008	2009	2010
				Supplementary Budget	Projections	Projections			
Total Revenue and Grants	24.5	24.1	24.4	25.6	25.6	25.9	26.2	26.4	26.5
Tax Revenue	21.3	21.7	22.0	23.1	23.1	23.4	23.9	24.1	24.4
VAT	7.4	7.6	7.7	8.4	8.4	8.7	8.7	8.7	8.7
Profit tax	1.9	2.1	2.3	2.3	2.3	2.3	2.4	2.5	2.4
Excise tax	1.8	2.1	2.2	2.7	2.7	2.8	2.8	2.8	2.8
Small business tax	0.4	0.5	0.5	0.3	0.3	0.3	0.3	0.3	0.3
Personal income tax	0.9	0.9	0.9	1.0	1.0	1.1	1.2	1.3	1.5
Customs duties	2.0	1.8	1.6	1.6	1.6	1.2	1.2	1.2	1.2
Other taxes	1.8	1.6	1.5	1.6	1.6	1.6	1.6	1.6	1.7
Property and local taxes	0.7	0.7	0.9	1.0	1.0	1.1	1.1	1.1	1.1
Social insurance contributions	4.2	4.3	4.3	4.1	4.1	4.4	4.6	4.6	4.6
Non-tax revenue	2.8	2.1	1.7	1.8	1.8	1.7	1.7	1.7	1.6
Grants	0.4	0.3	0.7	0.7	0.7	0.7	0.7	0.5	0.4
Of which Budget support	0.0	0.0	0.0	0.2	0.6	0.0	0.0	0.0	0.0
Total Expenditure	29.0	29.2	28.0	29.4	28.8	29.7	30.2	30.0	30.1
Current Expenditure	24.6	24.0	23.2	23.1	23.1	23.3	23.0	23.1	22.9
Personnel cost	6.6	6.4	6.4	6.6	6.6	6.5	6.3	6.1	6.1
of which contingency	…	…	…	0.1	0.1	0.4	…	…	…
Interest	4.4	3.7	3.1	3.1	3.1	3.0	3.2	3.1	3.0
Of which Domestic	4.1	3.5	2.9	2.7	2.7	2.6	2.7	2.5	2.4
Operations & maintenance	3.2	3.1	2.9	2.5	2.5	2.5	2.6	2.8	2.8
Subsidies	0.7	0.7	0.4	0.3	0.3	0.3	0.2	0.2	0.2
Social insurance outlays	6.6	6.6	6.7	6.7	6.7	6.9	6.5	6.4	6.4
Of which contingency	…	…	…	0.1	0.1	0.1	…	…	…
Local government expenditure	2.1	2.1	2.4	2.6	2.6	2.6	2.8	3.1	3.2
Social protection transfers	1.3	1.5	1.2	1.4	1.4	1.5	1.4	1.3	1.3
Other 1/	-0.3	0.0	…	0.0	0.0	0.0	0.0	0.0	0.0
Capital Expenditure	4.6	5.0	4.6	6.1	5.7	6.2	6.7	6.5	6.8
Domestically financed	2.7	3.6	2.9	3.9	3.8	4.4	4.6	4.4	4.8
Of which contingency	…	…	…	0.2	0.2	0.3	0.6	0.7	0.8
Foreign financed projects	1.9	1.4	1.7	2.2	1.9	1.8	2.1	2.0	2.0
Lending minus repayment	-0.2	0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Reserve and contingency funds 2/	...	...	…	0.2	…	0.2	0.5	0.4	0.4
Cash Balance	-4.5	-5.1	-3.6	-3.9	-3.1	-3.8	-3.9	-3.7	-3.6
Current Balance 3/	-0.5	-0.2	0.5	1.6	1.8	1.8	2.3	2.5	2.9
Financing	4.5	5.1	3.6	3.9	3.3	3.9	3.9	3.7	3.6
Domestic	3.1	4.2	2.8	2.8	2.6	3.2	2.8	2.5	2.5
Privatization receipts 4/	0.1	1.9	0.1	0.4	0.4	1.1	0.4	0.2	0.2
Net borrowing	2.9	2.3	2.7	2.3	2.2	2.0	2.3	2.3	2.3
Foreign	1.5	1.0	0.8	1.1	0.7	0.7	1.2	1.1	1.1
Memorandum Items:									
Primary balance	-0.2	-1.4	-0.5	-0.8	-0.1	-0.8	-0.7	-0.5	-0.6
Current balance including grants	-0.1	0.1	1.2	2.2	2.5	2.5	3.0	3.0	3.3
Total spending contingencies 2/	…	…	…	…	…	0.9	1.0	1.1	1.2
Expenditures in priority sectors 6/	7.3	8.2	8.0		8.0	8.9	9.6	10.1	10.1
Public Debt 5/	61.7	56.6	56.7	…	55.7	54.5	53.7	52.7	51.5
Domestic general government	41.1	38.5	39.1	…	38.6	37.4	36.5	35.7	34.9
External	20.6	18.0	17.5	…	17.1	17.1	17.2	17.0	16.6
GDP (in billions of leks)	683	766	837	899	899	982	1076	1177	1293

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

1/ Includes statistical discrepancy.
2/ Spending contingencies are reported according to their economic classification at outturn.
3/ Revenue excluding grants minus current expenditure.
4/ Includes privatization of Italian-Albanian Bank in 2006 and projected privatizations of Albtelekom in 2007 and INSIG in 2008.
5/ Includes securities issued to the Bank of Albania in 2005 to compensate for its foreign exchange valuation losses.
6/ Education, health, and road sectors.

Table 4b. Albania: General Government Operations, 2003-10
(In billions of leks)

	2003	2004	2005	2006		2007	2008	2009	2010
				Supplementary Budget	Projections	Projections			
Total Revenue and Grants	167.2	184.6	204.2	229.9	230.7	253.9	282.3	310.1	342.2
Tax Revenue	145.3	166.0	183.8	207.4	207.4	230.0	256.6	284.0	315.0
VAT	50.6	58.2	64.5	76.0	76.0	85.4	93.1	102.2	112.5
Profit tax	13.1	16.3	19.2	21.0	21.0	22.9	26.1	29.4	31.7
Excise tax	12.3	15.8	18.5	24.2	24.2	27.0	29.8	32.8	36.4
Small business tax	2.9	4.1	3.8	2.5	2.5	2.7	3.1	3.6	4.1
Personal income tax	6.4	6.9	7.4	9.0	9.0	10.8	13.0	15.7	18.9
Customs duties	13.9	13.9	13.6	14.2	14.2	11.8	12.9	14.1	16.1
Other taxes	12.5	12.1	12.7	14.6	14.6	16.0	17.6	19.2	21.3
Property and local taxes	4.5	5.0	7.5	9.4	9.4	10.5	11.8	13.1	14.9
Social insurance contributions	28.6	33.3	36.2	37.3	37.3	42.8	49.2	53.9	59.2
Non-tax revenue	19.2	16.0	14.2	16.5	16.5	17.1	18.6	19.9	21.3
Grants	2.6	2.6	6.2	6.0	6.7	6.8	7.0	6.3	5.8
Of which Budget support	0.2	0.2	0.4	1.4	5.1	0.0	0.0	0.0	0.0
Total Expenditure	198.1	223.8	234.2	264.8	258.9	291.7	324.5	353.1	389.1
Current Expenditure	167.7	183.8	194.0	207.8	207.8	229.0	247.7	272.0	296.5
Personnel cost	44.7	49.0	53.7	59.3	59.3	64.3	67.3	72.3	78.3
of which contingency	…	…	…	1.3	1.3	3.5	…	…	…
Interest	29.8	28.4	26.0	27.5	27.5	29.6	34.5	36.5	38.7
Of which Domestic	28.2	26.7	24.2	24.4	24.4	25.5	28.7	29.5	31.6
Operations & maintenance	22.2	24.0	24.5	22.2	22.2	24.1	27.5	33.0	36.2
Subsidies	5.1	5.1	3.7	2.6	2.6	2.6	2.5	2.5	2.5
Social insurance outlays	44.8	50.2	55.9	60.3	60.3	67.6	69.9	74.8	82.3
Of which contingency	…	…	…	0.8	0.8	0.6	…	…	…
Local government expenditure	14.2	15.9	20.0	23.1	23.1	25.8	30.5	36.7	41.0
Social protection transfers	8.8	11.5	10.2	12.5	12.5	14.4	14.9	15.7	17.0
Property compensation	…	…	…	0.3	0.0	0.5	0.5	0.5	0.5
Other 1/	-2.0	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital Expenditure	31.5	38.6	38.4	55.0	51.1	61.0	71.8	76.1	87.6
Domestically financed	18.3	27.6	24.3	34.8	34.4	43.2	49.2	52.2	62.1
Of which contingency	…	…	…	2.0	2.0	3.0	6.0	8.0	10.0
Foreign financed projects	13.2	11.0	14.1	20.1	16.8	17.8	22.7	23.9	25.5
Lending minus repayment	-1.1	1.4	1.9	0.0	0.0	0.0	0.0	0.0	0.0
Reserve and contingency funds 2/	...	...	…	2.0	…	1.7	5.0	5.0	5.0
Cash Balance	-30.9	-39.2	-30.1	-34.8	-28.2	-37.8	-42.2	-43.0	-46.9
Current Balance 3/	-3.2	-1.9	4.0	14.1	16.1	17.3	25.1	29.3	37.4
Financing	30.9	39.2	30.1	34.8	29.6	37.8	42.3	43.1	47.0
Domestic	20.9	31.9	23.3	24.8	23.7	31.0	29.8	30.0	32.7
Privatization receipts 4/	0.9	14.4	0.9	4.0	3.7	10.9	4.6	2.4	2.3
Net borrowing	20.0	17.6	22.4	20.8	20.0	20.1	25.2	27.6	30.4
Foreign	10.0	7.3	6.8	10.0	5.9	6.9	12.5	13.1	14.3
Memorandum Items:									
Primary balance	-1.1	-10.8	-4.0	-7.3	-0.7	-8.2	-7.7	-6.5	-8.2
Current balance including grants	-0.6	0.7	10.2	20.1	22.9	24.1	32.1	35.6	43.2
Total spending contingencies 2/	…	…	…	…	…	8.8	11.0	13.0	15.0
Expenditures in priority sectors 6/	50.1	62.6	66.7	…	71.7	87.5	102.9	118.8	130.6
Public Debt 5/	421.4	433.4	474.0	…	501.2	535.4	577.8	620.4	665.7
Domestic general government	280.8	295.2	327.4	…	347.4	367.7	392.9	420.5	450.8
External	140.6	138.2	146.6	…	153.8	167.7	185.0	199.9	214.9

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

1/ Includes statistical discrepancy.
2/ Spending contingencies are reported according to their economic classification at outturn.
3/ Revenue excluding grants minus current expenditure.
4/ Includes privatization of Italian-Albanian Bank in 2006 and projected privatizations of Albtelekom in 2007 and INSIG in 2008.
5/ Includes securities issued to the Bank of Albania in 2005 to compensate for its foreign exchange valuation losses.
6/ Education, Health and Road Sectors.

Table 5. Status of Performance Criteria and Structural Benchmarks under the PRGF and EFF Arrangements

	Test Date	Status
I. Performance Criteria		
1. Finalize and publish a debt management strategy defining the main goals of debt management, the targets for the main characteristics of public debt, including currency composition, average maturity and modified duration, and the main debt instruments; and a time frame for implementing the debt management strategy.	End-October 2006	Met 1/
II. Structural Benchmarks		
A. Improve public expenditure management		
2. 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	Ongoing	Met
(ii) Provide a semestrial listing and status report on all projects being considered for nonconcessional foreign financing.	Ongoing	Met
B. Reduce fiscal vulnerabilities		
Strengthen tax administration		
3. 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	Met
4. 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	Met
5. Prepare a feasibility study for merging small branches of the GDT and establishing bigger and more efficient branches.	End-October 2006	Met
Improve debt management capacity		
6. Prepare semi-annual reports (within one month of the end of each semester) on the stock of external arrears.	Ongoing	Met
7. Submit to parliament of new public debt law.	End-September 2006	Met
C. Strengthen the financial system and improve economic monitoring		
8. Submit to parliament of new banking law.	End-March 2007	Met
9. Submit to parliament of new legislation improving the efficiency and timeliness of the execution of collateral.	End-December 2006	Delayed 2/
10. Establish a credit bureau within the Bank of Albania.	End-June 2007	...
11. Strengthen statistical and economic monitoring capacity:		
(i) Complete the revision of national accounts for 1997-2004 and prepare preliminary national accounts for 2005.	End-November 2006	Met with minor delay
(ii) Prepare revised estimates of private transfers in the balance of payments.	End-December 2006	Met

1/ While Albania did not complete the debt-management strategy by the end-September 2006 test-date, this does not constitute nonobservance because Albania had relied on understandings with Fund staff prior to the first review that the test-date would be end-October 2006. Due to an administrative error this understanding was not reflected in the Board decisions completing the first review, but was reflected in the staff report.

2/ Draft legislation is prepared, but not yet submitted to Parliament due to delays in the process of inter-agency review.

Table 6. Albania: Public Sector Debt Sustainability Framework, Baseline Scenario, 1997-2010
(In percent of GDP, unless otherwise indicated)

	Actual											Projections					
	1997	1998	1999	2000	2001	2002	2003	2004	2005	Historical Average 4/	Standard Deviation 4/	2006	2007	2008	2009	2010	2006-10 Average
Public sector debt 1/	75.6	68.5	66.7	72.8	67.6	65.3	61.7	56.6	56.7			55.7	54.5	53.7	52.7	51.5	
Of which: foreign-currency denominated	38.1	32.3	29.3	30.2	26.6	23.5	20.6	18.0	17.5			17.1	17.1	17.2	17.0	16.6	
Change in public sector debt	22.1	-7.1	-1.8	6.1	-5.2	-2.3	-3.6	-5.1	0.1			-0.9	-1.2	-0.8	-1.0	-1.2	
Identified debt-creating flows	23.3	-12.8	-0.9	-1.5	-3.5	6.3	-1.9	-4.6	-1.7			-1.1	-1.9	-1.2	-1.1	-1.1	
Primary deficit	7.3	1.6	1.9	2.4	3.6	2.7	0.2	1.4	0.5	2.4	2.1	0.1	0.8	0.7	0.6	0.6	0.6
Revenue and grants	18.3	24.2	25.5	23.8	23.7	24.7	24.5	24.1	24.4			25.6	25.8	26.2	26.4	26.5	
Of which: grants	0.7	1.6	2.8	1.0	0.6	0.7	0.4	0.3	0.7			0.7	0.7	0.7	0.5	0.4	
Primary (noninterest) expenditure	25.5	25.8	27.5	26.1	27.3	27.4	24.6	25.5	24.9			25.7	26.7	27.0	26.9	27.1	
Automatic debt dynamics	16.3	-14.3	-2.6	-2.2	-4.9	3.7	-1.9	-4.1	-2.1			-0.8	-1.6	-1.4	-1.4	-1.6	
Contribution from interest rate/growth differential	7.5	-8.8	-0.6	-0.8	-2.4	0.3	-0.9	-2.4	-1.5			-1.0	-1.5	-1.3	-1.3	-1.4	
Of which: contribution from average real interest rate	2.9	4.4	5.6	3.7	2.3	2.3	2.6	1.0	1.4			1.7	1.6	1.8	1.7	1.6	
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			-2.7	-3.2	-3.1	-3.0	-3.0	
Contribution from real exchange rate depreciation	8.8	-5.5	-2.0	-1.4	-2.5	3.4	-1.0	-1.7	-0.6			0.2	-0.1	-0.1	-0.1	-0.2	
Other identified debt-creating flows	-0.3	0.0	-0.2	-1.7	-2.2	-0.1	-0.1	-1.9	-0.1			-0.4	-1.1	-0.4	-0.2	-0.2	
Privatization receipts (negative)	-0.3	0.0	-0.2	-1.7	-2.2	-0.1	-0.1	-1.9	-0.1			-0.4	-1.1	-0.4	-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	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	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	0.0	
Residual, including asset changes	-1.2	5.7	-0.9	7.6	-1.7	-8.7	-1.7	-0.5	1.9			0.2	0.6	0.4	0.1	-0.1	
NPV of public sector debt	...	...	...	...	...	...	...	...	...			52.7	51.5	50.7	50.0	49.0	
Of which: foreign-currency denominated	...	...	...	...	...	...	...	...	...			14.1	14.1	14.2	14.3	14.2	
Of which: external	...	...	...	...	...	...	...	...	...			14.1	14.1	14.2	14.3	14.2	
NPV of contingent liabilities (not included in public sector debt)	...	...	...	...	...	...	...	...	...			...	...	...	...	...	
NPV of public sector debt-to-revenue ratio	...	...	...	...	...	...	...	...	...			205.6	199.3	193.4	189.8	185.3	
Of which: external	...	...	...	...	...	...	...	...	...			55.1	54.5	54.2	54.2	53.5	
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	14.4			14.2	13.7	13.9	13.4	13.0	
Primary deficit that stabilizes the debt-to-GDP ratio				-3.7	8.8	5.0	3.8	6.5	0.3			1.0	2.1	1.5	1.5	1.9	
Key macroeconomic and fiscal assumptions																	
Real GDP growth	-10.2	12.7	10.1	7.3	7.0	2.9	5.7	5.9	5.5	6.2	6.1	5.0	6.0	6.0	6.0	6.0	5.8
Average nominal interest rate on forex debt	0.8	0.7	0.4	1.7	0.7	1.5	1.1	1.2	1.3	0.9	0.5	2.1	2.7	3.5	3.8	3.6	3.1
Average real interest rate on domestic currency debt	10.8	13.8	18.0	11.1	7.1	5.8	7.2	3.3	4.5	8.2	5.4	4.9	4.2	4.3	4.2	3.9	4.3
GDP Deflator (percent change)	9.8	13.6	4.5	4.3	3.5	3.3	3.4	6.0	3.5	9.4	9.8	2.4	3.0	3.3	3.2	3.5	3.1
Growth of real primary spending	-2.3	13.8	17.3	2.2	11.6	3.4	-5.0	9.6	3.0	4.6	8.7	8.6	10.0	7.1	5.8	6.9	7.7
Grant element of new external borrowing	...	...	...	...	...	...	...	...	...	...	...	20.6	19.6	8.0	8.0	6.7	12.6

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 7. Albania: Action Plan for Structural Reforms in Debt Management

Area	Activity	Deadline
Establishing and strengthening the framework for strategic debt management	Finalize and publish a debt management strategy defining the main goals of debt management, the targets for the main characteristics of public debt, including currency composition, average maturity and modified duration, and the main debt instruments; and a time frame for implementing the debt management strategy.	End-October 2006 (PC) 1/
	Submit the debt management strategy to the government for adoption by the government.	End-December 2006
Improvement of the public debt management system	Submit to the Parliament the new public debt law.	End-September 2006 (SB)
	Integrate the administration of the public debt database in the IT maintenance system.	End-October 2006
	Conduct an independent review of staffing requirements in the debt management unit of the Treasury and Public Debt Management Directorate, including a review of the conditions (e.g., competitive salary) necessary to recruit people with the appropriate skills in accordance with the civil service law.	End-June 2007 (SB)
	Review and improve the functions of public debt management and restructuring the Debt Department in compliance with its functional review.	End-June 2007
	Establish an integrated management system for external debt and domestic debt and migrate domestic debt into the computerized system.	End-June 2007
Developing government securities domestic market	Improve the database and the communication system to shorten time of development of the auctions and to enable decision-making within the day.	End-June 2006
	Review the regulatory framework to enable the participation of individuals and the Bank of Albania only in the non-competitive bids.	End-July 2006
Other	Publish auction results on the website of the MoF.	Ongoing after every auction
	Discontinue the practice of running the treasury single account to zero at the end of the year.	End-December 2006
	Obtain a credit rating.	End-March 2007

Source: Albanian authorities

1/ While Albania did not complete the debt-management strategy by the end-September 2006 test-date, this does not constitute nonobservance because Albania had relied on understandings with Fund staff prior to the first review that the test-date would be end-October 2006. Due to an administrative error this understanding was not reflected in the Board decisions completing the first review, but was reflected in the staff report.

Table 8. Albania: IMF Core Indicators of Financial Soundness, December 2003-November 2006

		Dec-03	Dec-04	Mar-05	Jun-05	Sep-05	Dec-05	Mar-06	Jun-06	Sep-06	Nov-06
I	**Capital-based**										
(i)	Regulatory capital as a percent of risk-weighted assets	28.5	21.6	21.0	19.8	18.3	18.6	19.3	18.4	18.3	na
(ii)	Regulatory Tier 1 capital as a percent of risk-weighted assets	29.0	21.5	20.4	19.3	17.9	18.1	18.9	17.4	17.2	na
(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	5.4	5.8	5.7	5.9	6.0
	Regulatory capital as a percent of total assets	4.7	4.8	5.1	5.3	5.3	5.6	5.9	6.0	6.3	6.3
	Shareholders' equity as a percent of total assets	5.9	6.1	5.8	6.4	6.6	6.6	6.5	6.7	7.0	6.9
(iv)	Nonperforming loans net of provisions as a percent of capital										
	Nonperforming loans net of provisions as a percent of regulatory Tier 1 capital	4.8	4.8	4.5	3.0	4.1	4.4	6.2	9.5	7.7	7.7
	Nonperforming loans net of provisions as a percent of regulatory capital	4.9	4.8	4.4	2.9	4.0	4.3	6.1	8.9	7.2	7.3
	Nonperforming loans net of provisions as a percent of shareholders' equity	3.9	3.8	3.9	2.4	3.2	3.6	5.6	8.1	6.5	6.6
(v)	Return on equity (ROE) (annual basis)	19.5	21.1	22.1	24.3	24.5	22.2	21.4	18.8	19.2	19.6
(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	9.5	6.7	0.1	6.4	7.8
	Net open position in foreign exchange as a percent of regulatory capital	7.3	7.4	3.5	8.5	7.1	9.3	6.6	0.1	6.0	7.4
	Net open position in foreign exchange as a percent of shareholders' equity	5.9	5.9	3.1	7.0	5.7	7.8	6.0	0.1	5.4	6.7
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	62.6	62.1	60.0	58.7	57.8
(viii)	Liquid assets as a percent of short-term liabilities	na	na	83.2	109.9	73.5	75.2	75.5	75.6	74.5	73.4
(ix)	Return on assets (ROA) (net income to average total assets) (annual basis)	1.2	1.3	1.3	1.5	1.5	1.4	1.4	1.2	1.3	1.3
(x)	Nonperforming loans (gross) as a percent of total loans	4.6	4.2	3.5	2.4	2.4	2.3	3.0	3.8	3.3	3.2
(xi)	Sectoral distribution of loans to total loans	na	na	na	na	na	na	na	na	na	na
III	**Income and expense-based**										
(xii)	Interest margin to gross income	89.6	80.3	83.2	80.5	82.0	84.0	93.4	98.5	95.6	94.5
(xiii)	Noninterest expenses to gross income	57.4	66.2	81.5	75.3	76.7	76.3	71.4	72.9	68.5	67.0
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	342.5	326.6	296.6	286.7	271.4
	Foreign currency-denominated loans to total loans	82.1	80.5	79.9	77.7	77.6	75.5	74.5	72.5	71.1	71.5
	Foreign currency-denominated liabilities as a percent of total liabilities	35.9	37.0	38.2	39.9	41.5	41.0	41.0	41.6	43.1	42.7
	Other indicators:										
	Risk weighted assets as a percent of total assets	16.7	22.2	24.4	26.8	28.7	30.0	30.8	32.8	34.4	na
	Total loans as a percent of total assets	13.6	16.4	17.6	20.8	22.8	25.7	26.5	28.9	30.4	31.5
	Total loans as a percent of shareholders' equity	231.2	270.3	302.6	326.5	348.7	387.0	408.7	434.4	432.5	454.8

Source: Data provided by Bank of Albania.

Table 9. Albania: Measures to Strengthen the Banking System Supervisory/Regulatory Regime

I. To improve credit risk management

1. Stricter requirements are placed on individual banks based on their (i) rate of credit growth; and (ii) non performing loan level. The individual bank bears the responsibility of monitoring continuously these indicators and reporting them to the BoA. As soon as problems are identified in maintaining these figures within certain levels, banks, according to the gravity of the situation and in a need-based approach, will be required on their own to:

(a) Strengthen monitoring processes. Additional monthly reporting to the BoA will be required to identify problem loans according to their characteristics (nature, maturity, currency, sector, geography).

(b) Slow their rate of credit provision by (i) adjusting interest rates and revising credit growth objectives; (ii) reducing internal guidelines for acceptable levels of customers' debt service to available income ratios to below 25 percent—especially for consumer loans; (iii) reduce internal guidelines for credit to collateral value ratios; and (iv) suspend promotional advertisements in the media.

(c) Weight with a 150 percent risk factor, the greater of (i) the value of credit that exceeds the prudential requirements for single exposures, individually or in total; (ii) the value of nonperforming loans that exceeds the new ceiling level set by BoA; or (iii) the value of the loan portfolio that has increased above the limit set up by the BoA (either in absolute terms or as a ratio of loans to deposit).

(d) Increase their capital, or take other measures to achieve a higher minimum level of capital adequacy ratio.

(e) Initiate cost-cutting measures, including by suspending dividends and further expansion of branch networks.

(f) Set up an additional reserve fund from profit within the following six months.

2. The Supervision Department will have the authority to impose any of the measures mentioned above when they judge that the bank has delayed the required action or implemented them with insufficient rigor. If this is necessary, penalty measures will be automatic. If the BoA judges that such measures are not working, they will then have the authority to suspend all or part of the credit operations of the bank; or introduce credit ceilings for individual banks.

II. To improve transparency

3. The new regulations also contain requirements concerning the transparency the bank should have with its clients, particularly as regards the contracting of credit (e.g. warn the borrower about the risks entailed in foreign currency-denominated lending, calculate and indicate the effective interest rate of the loan etc).

III. To strengthen regulations governing lending to related persons

4. The aggregate prudential limit on lending by individual banks to related persons will be reduced if the bank is found to have insufficient systems in place to monitor related persons exposures.

Source: Bank of Albania.

Table 10. Albania: External Debt Sustainability Framework, Baseline Scenario, 1996-2026 1/
(In percent of GDP, unless otherwise indicated)

	Actual										Projections							
	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2015	2020	2026
External debt (nominal) 1/	28.6	40.1	34.3	31.2	31.6	28.5	25.2	22.1	20.3	20.5	20.1	19.9	19.8	19.5	19.0	17.5	17.0	18.5
Of which: public and publicly guaranteed (PPG) 2/	28.6	40.1	34.3	31.2	31.6	28.4	25.2	22.0	19.2	18.7	18.1	17.9	17.9	17.6	17.0	14.1	12.3	12.0
Of which: private	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.2	1.1	1.8	2.0	2.0	1.9	1.9	2.0	3.4	4.8	6.5
Change in external debt	-0.9	11.4	-5.7	-3.1	0.4	-3.1	-3.2	-3.1	-1.8	0.1	-0.4	-0.2	-0.1	-0.4	-0.4	-0.3	0.1	0.3
Identified net debt-creating flows	-1.3	14.5	-6.6	-12.0	-6.5	-6.4	3.5	1.0	-3.0	2.0	1.8	2.2	1.9	1.3	0.7	0.4	-0.4	-0.4
Non-interest current account deficit	7.8	12.8	6.0	1.4	6.3	5.4	9.5	7.7	5.2	7.1	6.6	6.8	6.6	6.0	5.4	4.1	3.0	2.6
Deficit in balance of goods and services	24.1	26.6	24.6	18.6	21.6	22.5	25.9	25.1	21.7	24.0	23.4	23.3	22.8	21.9	20.9	18.6	16.7	15.4
Exports	10.7	10.0	10.6	17.3	19.0	20.4	20.5	20.8	21.5	22.2	23.6	24.4	24.9	25.1	25.4	28.1	29.7	29.9
Imports	34.8	36.6	35.2	35.8	40.6	42.9	46.3	45.9	43.2	46.2	47.0	47.7	47.7	47.0	46.3	46.7	46.3	45.3
Net current transfers (negative = inflow)	-14.1	-11.4	-16.1	-9.5	-12.1	-13.2	-13.0	-14.0	-13.8	-14.4	-14.3	-14.1	-13.9	-13.6	-13.2	-12.4	-11.6	-10.7
Other current account flows (negative = net inflow)	-2.2	-2.3	-2.5	-7.6	-3.2	-4.0	-3.3	-3.5	-2.7	-2.5	-2.5	-2.4	-2.4	-2.3	-2.3	-2.1	-2.0	-2.0
Net FDI (negative = inflow)	-3.2	-1.9	-1.6	-1.5	-3.9	-5.0	-3.0	-3.2	-4.6	-3.3	-3.7	-3.7	-3.8	-3.9	-3.8	-3.3	-3.1	-2.8
Official tranfers (negative = inflow)	-2.6	-3.5	-3.3	-4.1	-3.0	-3.0	-2.8	-2.6	-1.7	-1.1	-1.3	-1.3	-1.2	-1.0	-0.9	-0.7	-0.5	-0.3
Endogenous debt dynamics 3/	-3.3	7.1	-7.7	-7.9	-5.9	-3.8	-0.2	-1.0	-3.6	-1.9	-1.0	-0.9	-0.9	-0.8	-0.9	-0.4	-0.3	-0.2
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	0.5	0.7	0.7	0.8	0.8	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	-1.0	-0.9	-1.0
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	-1.2	-0.6	-0.5	-0.5	-0.5	-0.6	-0.3	-0.3	-0.3
Residual 4/	0.4	-3.0	0.8	8.9	6.9	3.2	-6.7	-4.1	2.9	-0.7	-0.9	-1.0	-0.7	-0.6	-0.3	0.0	0.4	0.8
Of which: 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	0.0
Net external debt 5/	7.8	13.7	8.8	4.9	2.4	-2.5	-6.7	-5.9	-7.7	-7.7	-8.4	-6.4	-5.7	-5.2	-6.2	-6.9	-8.9	-9.2
Of which: public sector	19.3	25.8	21.0	17.2	14.9	11.5	6.5	5.6	2.4	1.1	0.5	0.7	0.4	0.1	-0.8	-3.2	-6.1	-7.6
Of which: private sector	-11.5	-12.1	-12.2	-12.3	-12.5	-14.0	-13.2	-11.5	-10.0	-8.8	-8.8	-7.1	-6.2	-5.3	-5.4	-3.8	-2.8	-1.6
NPV of external debt 6/	...	...	...	...	...	...	...	...	...	16.8	16.0	16.0	16.1	16.1	16.1	15.9	15.7	16.4
In percent of exports	...	...	...	...	...	...	...	..	...	76.5	67.8	65.7	64.5	64.3	63.2	56.6	52.9	54.9
NPV of PPG external debt	...	...	...	...	...	...	...	...	...	15.0	14.1	14.0	14.2	14.2	14.1	12.6	11.0	10.0
In percent of exports	...	...	...	...	...	...	...	...	...	68.4	59.5	57.4	56.7	56.6	55.4	44.7	36.9	33.3
Debt service-to-exports ratio (in percent)	8.1	12.8	8.9	4.2	4.0	4.0	6.4	5.2	4.5	4.6	6.5	7.1	7.9	8.2	8.5	8.3	8.5	9.6
PPG debt service-to-exports ratio (in percent)	8.1	12.8	8.9	4.2	4.0	4.0	6.0	4.9	4.1	4.1	5.1	5.5	5.8	5.9	6.1	5.6	4.9	4.6
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	0.3	0.4	0.5	0.5	0.5	0.6	0.9	1.5
Non-interest current account deficit that stabilizes debt ratio	8.7	1.4	11.7	4.5	5.9	8.5	12.7	10.8	7.0	7.0	7.0	6.9	6.7	6.4	5.8	4.4	2.9	2.3
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	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	6.3	3.2	2.6	2.8	2.7	3.2	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	2.0	2.9	3.8	4.1	4.3	4.5	5.3	6.1	6.6
Growth of exports of G&S (in terms of Euros, in percent)	10.3	-23.7	32.8	114.7	37.1	23.3	2.7	7.2	25.4	15.8	15.3	12.2	11.4	9.5	10.9	9.9	8.4	8.2
Growth of imports of G&S (in terms of Euros, in percent)	29.3	-14.2	20.9	34.1	41.1	21.6	10.3	4.7	14.1	19.8	10.2	10.4	9.1	7.1	7.9	8.1	7.8	7.4
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	...	...	...	...	22.3	20.6	19.6	8.0	8.0	6.7	5.8	6.2	6.6
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	7.3	8.0	8.7	9.4	10.3	15.1	22.3	35.3

Averages and Standard Deviations	Historical Average	Standard Deviation	Average 2006-11	Average 2012-26
Real GDP growth (in percent)	5.7	6.2	5.8	6.0
GDP deflator in terms of Euros (change in percent)	7.0	8.8	2.7	1.9
Effective interest rate (percent) 7/	1.6	0.2	4.1	5.9
Growth of exports of G&S (in terms of Euros, in percent)	24.6	36.1	11.6	9.0
Growth of imports of G&S (in terms of Euros, in percent)	18.2	15.7	8.9	7.8
Grant element of new public sector borrowing (in percent)	...	...	11.4	6.1
Non-interest current account deficit	6.9	3.0	6.1	3.5
Net current transfers (negative = inflow)	-13.2	1.8	-13.7	-11.8
Net FDI (negative = inflow)	-3.1	1.2	-3.8	-3.1

Source: Staff simulations.

1/ Includes both public and private sector external debt.
2/ Includes IMF.
3/ Derived as [r - g - r(1+g)]/(1+g+r+gr) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and r = 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 divided by previous period debt stock.

Table 11. Albania: Actual and Projected Payments to the Fund, 2002-10
(in millions of SDRs)

	2002	2003	2004	2005	2006	2007	2008	2009	2010
					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	8.0
GRA repurchases	4.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.2
2. Charges and Interest 1/									
PRGF Interest	0.3	0.3	0.3	0.3	0.4	0.27	0.22	0.17	0.13
SDR Net Charges	0.1	0.0	0.0	0.0	0.00	0.13	0.13	0.13	0.13
Total Obligations	11.0	7.1	6.7	6.5	8.0	9.8	10.0	9.4	8.4
(percent of quota)	23	15	14	13	16	20	20	19	17.3
Obligations from prospective drawings									
1. Principal									
PRGF Repayments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
GRA repurchases	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2. Charges and Interest									
PRGF Interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
SDR Net Charges	0.0	0.0	0.0	0.0	0.0	0.1	0.2	0.3	0.3
Total Obligations	0.0	0.0	0.0	0.0	0.0	0.1	0.2	0.4	0.4
(percent of quota)	0	0	0	0	0	0	0	1	1
Cumulative obligations (existing and prospective)									
1. Principal									
PRGF +EFF Repayments	10.6	6.8	6.4	6.2	7.6	9.4	9.6	9.1	8.2
2. Charges and Interest 1/									
PRGF Interest	0.3	0.3	0.3	0.3	0.4	0.3	0.2	0.2	0.2
SDR Net Charges	0.1	0.0	0.0	0.0	0.0	0.2	0.3	0.5	0.5
Total Obligations	11.0	7.1	6.7	6.5	8.0	9.9	10.2	9.7	8.8
(percent of quota)	23	15	14	13	16	20	21	20	18
Outstanding Fund credit 2/	59.6	60.8	62.4	64.3	61.6	57.0	52.3	45.6	37.6
Memorandum items:									
Outstanding Fund credit									
In percent of:									
Exports of goods & services	8.2	7.0	5.5	5.2	4.2	3.4	2.8	2.2	1.7
GDP	1.7	1.5	1.2	1.2	1.0	0.8	0.7	0.6	0.4
Quota	122	125	128	132	126	117	107	94	77
Total Obligations									
In percent of:									
Exports of goods & services	1.6	0.9	0.6	0.5	0.5	0.6	0.5	0.5	0.4
GDP	0.3	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1

1/ Projections are based on current interest rates for PRGF and the EFF. The current SDR interest rate is assumed for net use of SDRs.
2/ End of year value.

Table 12. Albania: Schedule of Remaining Disbursements Under PRGF/EFF Arrangement

Date	Amounts in millions of SDRs	In percent of quota 1/	Conditions
February 2007	2.435	5.0	Observance of the end-October 2006 structural performance criterion, end-September 2006 quantitative performance criteria and completion of second review.
July 2007	2.435	5.0	Observance of end-March 2007 quantitative and structural performance criteria and completion of third review.
January 2008	2.435	5.0	Observance of end-September 2007 quantitative performance criteria, structural performance criteria and completion of fourth review.
July 2008	2.435	5.0	Observance of end-March 2008 quantitative performance criteria, structural performance criteria and completion of fourth review.
January 2009	2.435	5.0	Observance of end-September 2008 quantitative performance criteria, structural performance criteria and completion of fourth review.
Total	**12.175**	**25.0**	

1/ Albania's quota is SDR 48.7 million.

ANNEX I: FUND RELATIONS
As of November 30, 2006

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	47.79	98.12
Reserve position in Fund	3.35	6.89

III. **SDR Department**:	SDR Million	Percent Allocation
Holdings	7.33	N/A

IV. **Outstanding Purchases and Loans**:	SDR Million	Percent Quota
Extended Arrangement	2.44	5.00
PRGF arrangements	60.30	123.81

V. **Financial Arrangements**:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
EFF	2/01/2006	1/31/2009	8.52	2.44
PRGF	2/01/2006	1/31/2009	8.52	2.44
PRGF	6/21/2002	11/20/2005	28.00	28.00

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

			Forthcoming		
	2006	2007	2008	2009	2010
Principal	1.19	9.41	9.62	9.08	8.15
Charges/Interest	0.15	0.40	0.36	0.31	0.26
Total	1.35	9.81	9.98	9.39	8.41

VII. **Safeguards Assessments**:

The Bank of Albania (BoA) was subject to a safeguards assessment with respect to current arrangements. The most recent assessment was completed on July 14, 2006 and found that some weaknesses exist in the central bank's safeguards framework. The main vulnerabilities identified by the assessment concern the quality of the external audit, oversight of the external and internal audit functions and the system of internal controls, and certain weaknesses in the controls over the Fund data reporting process. The assessment recommended measures to alleviate these weaknesses. The authorities have already taken steps to improve the external audit process, and staff will monitor their implementation of the remaining recommendations.

VIII. **Exchange Rate Arrangement**:

On July 1, 1992 the Albanian authorities adopted a floating exchange rate system (an independent float). Under the Fund's de facto exchange rate regime classification, Albania follows an independently floating exchange rate regime—although the monetary authorities occasionally intervene in the foreign exchange market with the objective of smoothing temporary fluctuations. Albania's exchange rate arrangement is free from exchange restrictions and multiple currency practices subject to Fund jurisdiction under Article VIII. However, the country still avails itself of the transitional arrangements under Article XIV and maintains exchange restrictions in the form of outstanding debit balances on inoperative bilateral payment agreements, which were in place before Albania became a Fund member. These relate primarily to debt in nonconvertible and formerly nonconvertible currencies, which the authorities are working to resolve by mid-2007 for official creditors, and by end-2007 for private sector creditors. Albania has not imposed new restrictions under Article VIII. The exchange rate stood at 94.12 lek per U.S. dollar at end-November 30, 2006.

IX. **Article IV Consultation**:

The conclusion of the 2006 Article IV consultation and the first review under the PRGF/EFF-supported program took place in July 2006 (IMF Country Report No. 06/286). 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. An action plan for implementing the FSAP recommendations has been prepared in consultation with the IMF and is currently being implemented. A data module ROSC 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). A data module ROSC reassessment using the Data Quality Assessment Framework was conducted in March 2006.

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.

ANNEX II: 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 65 loans mostly in IDA commitments totaling US$839.8 million, IFC commitments of US$100 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 discussed a new Country Assistance Strategy (CAS) for Albania for FY06-FY09 in January 2006. The new CAS builds on the experience of the World Bank Group (WBG) since the early 1990s (through three CASs).[2] 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, remains the main development strategy that aims to bring Albania's living standards and income levels closer to the levels of its neighboring European countries. The NSSED is based on three pillars: (i) improving governance, (ii) promoting private sector development, and (iii) fostering human resources development. It 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. A Joint Staff Advisory Note presented the Staffs assessment of the NSSED implementation as communicated in the Third Annual Progress Report for the NSSED prepared by GoA.

4. The government is currently finalizing the new National Strategy for Development and Integration (expected for April 2007) and is committed to better address the link between MTBP and NSDI processes. Based on the Integrated Planning System, the strategic planning methodology has been launched, which sets standards for the formulation, approval, implementation and monitoring of the new national strategy.

Bank Group Strategy

5. 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

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

made to address the challenge of poor governance in Albania, and introduces a 'Governance 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.

6. 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.

7. The active World Bank portfolio includes 17 investment projects with a total commitment of $261.5 million, of which about $176.3 million remain to be disbursed. The investment side of the Bank's portfolio has performed well. The following projects have been approved by the Board this year: (i) Albania Avian Flu (June, 27) (ii) BERIS (October, 26); (iii) Education Excellence and Equity Project (June 1). Two new projects, Transport Project and Land Administration and Management Project, were negotiated during the first half of December, 2006 and are expected to be approved by the Board in February 2007**.**

Bank-Fund Collaboration in Specific Areas

8. 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; and, (v) an improved policy environment for business.

9. **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 (PEIR) and the Country Fiduciary Assessment Update (CFAU-FY06). These have identified 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.

10. 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.

11. **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, c) 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 through the DPL continues to engage on civil service reform.

12. **Power sector reform**: The Bank and the Fund confirmed their support to the Government's efforts to overcome the recent 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.

13. 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 is 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). The authorities are also attempting to complete a long-delayed tender for a new thermal power station.

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 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 supervision and regulation; and, (iii) adoption and implementation of an EU-compatible legal and institutional framework for accounting and auditing.

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 Reform and Institutional Strengthening Project (approved in October 2006) and the Land Management and Urban Development project (expected board approval in February 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) establishment and operations of a Secretariat for Regulatory Reforms for the removal of administrative barriers to investment; and, (iii) adoption and implementation of a transparent land registration system.

Prepared by World Bank staff. Questions may be addressed to Ms. Alia Moubayed at 473-0250 or Ms. Nancy Cooke at 473-8727.

APPENDIX III: STATISTICAL ISSUES

Data provision is adequate overall for surveillance, although further improvements in some areas are needed. 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.[3] 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). In response, a ROSC data module mission took place during March 8–22, 2006. The mission assessed data quality in six areas of macroeconomic statistics (national accounts, consumer price index, producer price index, government finance, monetary, and balance of payments statistics) based on the DQAF (July 2003), and reassessed Albania's data dissemination practices against the GDDS. At the request of the authorities, the mission also conducted an assessment of dissemination practices against the SDDS and prepared a work program and timetable for meeting the requirements for SDDS subscription.

The mission found that Albania's statistical system has made significant progress in adopting international statistical standards despite acute resource constraints. Official statistical agencies demonstrate strong and sustained commitment to plans and programs to further upgrade statistics in response to greater challenges posed by: i) a rapidly evolving economy; ii) the desire of the Albanian authorities to subscribe to the SDDS; iii) the adoption of an inflation targeting regime; and iv) growing national aspirations to join the European Union. However, due to severe resource constraints at the Institute of Statistics (INSTAT), the improvement in the national accounts has been slower relative to other datasets.

The *Law on Official Statistics* (2004) strengthened the legal framework for INSTAT as an independent agency under the Council of Ministers, and articulated the role of the Statistics Council as INSTAT's governing body. In addition, Memoranda of Understandings between INSTAT and the Ministry of Finance (MoF) and the Bank of Albania (BoA), expected to be signed soon, will facilitate data sharing and coordination among these agencies.

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

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. However, given the limited coverage of the 2000 household budget survey (HBS) (only urban areas combined with a rapid change of the structure of the economy and consumption pattern), new CPI weights should be compiled. The recent ROSC mission recommended (i) introduction of checks on the prices reported by enumerators; (ii) replacement of nonrespondents to the HBS with similar households; and (iii) inclusion of new items into the CPI as they become significant.

A monthly producer price index (PPI) has been published quarterly since March 2002. Prices are collected for each month, but only once a quarter, due to financial constraints. The weights were derived from the 1998 annual Structural Business Survey. The ROSC mission recommended (i) monthly publication of the PPI; (ii) replacement of enterprises that go out of business; and (iii) validation of the PPI results against all other available price data.

National accounts

In January 2003, INSTAT published the first official GDP estimates for 1996-2000 and, later that year, preliminary estimates for 2001. Following the first release, revised GDP estimates have been disseminated but not on a regular basis. In November 2005, INSTAT released major revisions of the GDP estimates (for 1996-2003) and updates for 2004, reflecting methodological improvements.

STA missions visited Albania in November 2004 and March 2005 to assist the authorities in improving the timeliness of the annual national accounts data and in developing quarterly national accounts. INSTAT has benefited from technical assistance by the Fund and the European Union (EU), mainly to address weaknesses in methodology, basic data sources, and incomplete coverage of the private sector.

STA concluded a technical assistance project in March 2006 for which the Italian government agreed to commit $500,000 from its sub-account with the IMF over a period of two years. The project was aimed at further improving the national accounts estimates and basic source data. The Italian National Institute of Statistics (Istat) and the National Statistics Office of Finland (Statistics Finland) provided technical assistance to INSTAT following the project contract.

National accounts are compiled from numerous but insufficient source data that are hampered by poor questionnaire design (e.g., Structural Business Survey), limited area coverage (e.g., HBS), and insufficient frequency of surveys. Despite the technical assistance provided on methodological procedures, source data still do not supply sufficient information to compile reliable estimates on the nonobserved economy. The ROSC mission recommended (i) improvement of source data to adequately capture the nonobserved economy; (ii) expansion of the scope of annual national accounts to include the income account, the capital account, and the rest of the world accounts; and (iii) improvement of the timeliness of GDP data (currently 11 months) so as to meet the 9-month recommendation of the GDDS.

INSTAT needs additional staff and financial resources to fully carry out its statistical work program.

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.

Government Finance

Albanian government finance statistics (GFS) generally follow internationally accepted standards and guidelines on concepts and definitions, scope, classification and sectorization, and basis for recording vis-à-vis the *Government Finance Statistics Manual 1986* (*GFSM 1986*). A formal "migration path" to the *GFSM 2001* has not been articulated, but a series of coordinated technical actions at the MoF—including the design and implementation of an accrual-compatible database infrastructure—are well advanced. The scope of the general government sector is in line with the *GFSM 1986* and encompasses budgetary central government, (representing a total of about 1520 individual budget institutions), local government (representing a total of about 2160 units), and two extrabudgetary funds (the social security fund and the health insurance fund).

The *Organic Budget Law* and the *Guidelines on State Budget Performance* clearly mandate the responsibility of the MoF for compiling and disseminating government finance statistics. The main data sources, which are timely, are reports of i) District Treasury Offices; ii) the Debt Management and Financial Analysis System; iii) project implementation units for foreign financed project; and iv) the extrabudgetary funds. The significant weakness in source data is in the availability of data on certain external donor financed (grants) projects that do not pass through the treasury system. Albania recently submitted fiscal data to the Fund for publication in the *Government Finance Statistics Yearbook*. The authorities have expressed an interest in reporting high-frequency data for publication in the *International Financial Statistics* using the *GFSM 2001*-based monthly Statement of Sources and Uses of Cash.

The ROSC mission recommended that MoF accelerate work aimed at formally adopting the *GFSM 2001*-based reporting format and improve source data coverage for external donor financed projects.

Monetary Accounts

The monetary data compilation framework conforms to the methodology recommended in the *Monetary and Financial Statistics Manual (MFSM)*, and data are compiled and reported on a timely basis. The depository corporations survey covers the BoA and all the other deposit-taking institutions (17 commercial banks and 130 savings and loans associations (SLAs)). The accounts of the SLAs, with the exception of loans, are produced on a cash basis, which is not in accordance with the *MFSM*'s recommendations of accrual accounting. The accounts of the BoA and of the commercial banks are produced on an accrual basis. An exception is that their holdings of nontradable long-term securities are recorded at book value.

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.

To further improve Albania's monetary statistics, the recent ROSC mission recommended that the BoA (i) apply fully the *MFSM*'s recommendations on market valuation and accrual accounting; (ii) implement measures to improve the accuracy of the banks' reporting; (iii) implement an electronic (online) reporting system for banks and other financial institutions; and (iv) introduce a database driven compilation system for monetary statistics.

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 revised the methodology for the measurement of tourism services, principally through surveys of travelers. Problems remain in the areas of service transactions and remittances, and in the monitoring of financial account transactions, foreign assistance (grants from abroad to regional and local governments are underreported), 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 took place in February 2006. The mission focused on remittances, goods for processing, services (particularly travel services), official transfers, and direct investment.

To further improve compilation and dissemination of balance of payments statistics, the ROSC mission recommended that BoA (i) improve source data to adequately capture remittances; (ii) strengthen its law to provide for the sanctions—including fines—needed to mandate response to surveys by nonbank reporters, to inspect the financial accounts of firms, and to prohibit the provision of individual reporter's data to tax authorities; (iii) require quarterly reporting by significant firms of transactions in direct investment equity, debt, and reinvested earnings; in portfolio equity and debt; and in trade credit; and (iv) introduce a database driven compilation system for balance of payments statistics.

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 (Template). While the definition of data on official reserve assets is, in principle, consistent with that of the Template, the data may not be adequate for monitoring the economy because other foreign currency assets and currency drains are not included. The ROSC mission, in the context of SDDS-related issues, discussed with the authorities the various components of the Template and the data requirements for net predetermined drains and contingent drains.

External Debt and Grant Statistics

Good quality external debt statistics for public and publicly-guaranteed debt are compiled by the MoF. 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 MoF.

ALBANIA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE
AS OF JANUARY 17, 2006

	Date of latest observation	Date received	Frequency of data[6]	Frequency of reporting[6]	Frequency of publication[6]	Memo Items: Data Quality – Methodological Soundness[7]	Memo Items: Data Quality – Accuracy and Reliability[8]
Exchange Rates	01/17/07	01/17/07	D and M	D and M	D and M		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	11/30/06	12/15/06	M	M	M		
Reserve/Base Money	12/27/06	12/28/06	D and M	D and M	M and M	O,O,O,LO,	O
Broad Money	11/30/06	12/27/06	M	M	M		LO,LO O,O
Central Bank Balance Sheet	12/27/06	12/28/06	D and M	D and M	M and M		
Consolidated Balance Sheet of the Banking System	11/30/06	12/27/06	M	M	M		
Interest Rates[2]	01/16/07	01/17/07	D and M	D and M	D and M		
Consumer Price Index	12/2006	01/11/07	M	M	M	O,LO,O,LO	LO,LO,LO,O,O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	11/2006	01/2006	M	M	M	LO,O,O,O	LO,O,O,O,O
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	11/2006	01/2006	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	09/30/06	12/02/06	Q	Q	A		
External Current Account Balance	06/30/06	10/17/06	Q	I	I	O,O,O,LO	LNO,LO,O,LO,O
Exports and Imports of Goods and Services	06/30/06	10/17/06	M	Q	Q		
GDP/GNP	2004	03/2006	A	A	A	O,LNO,O,LNO	LNO,LNO,O,LO, LO
Gross External Debt	06/2006	10/2006	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).
[7] Reflects the assessment provided in the data ROSC in October 2006 ..., and based on the findings of the mission that took place in March 2006 for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).
[8] Same as footnote 7, except referring to international standards concerning source data, statistical techniques, assessment and validation of source data, assessment and validation of intermediate data and statistical outputs, and revision studies.

ATTACHMENT I

Tirana, January 11, 2007

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

Dear Mr. de Rato:

For over ten years, the International Monetary Fund has supported our efforts to develop and restructure the Albanian economy, and to achieve and maintain the stable macroeconomic environment needed for rapid growth and improved living standards. This support is ongoing, and our current arrangement with the Fund is on track. All quantitative and structural performance criteria have been observed and economic prospects remain favorable, both from the near- and medium-term perspectives. We therefore maintain the expectation that our need for the Fund's resources will end with the expiration of the current arrangements.

Since the first review of our latest program, economic developments have proceeded largely as expected and we maintain a firm foundation moving forward. Trend growth is strong, inflation is in the 3±1 percent target range, and confidence in the currency and the banking system remains solid. With significant structural adjustment carried out over the last three years, and with detailed action plans now prepared to implement the FSAP recommendations and to overhaul our debt management capacity, 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 Report of July 2005.

We therefore request completion of the Second Review under the three-year Poverty Reduction and Growth Facility arrangement together with concurrent approval of the Second Review under the three-year Extended Fund Facility arrangement; and also request the third disbursement under both these arrangements in a total amount of SDR 2.435 million.

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 remainder of the 2006-2009 program period, and provides a detailed description of our policy intentions up to the end of 2007. 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 will prepare a new NSSED—now called the National Strategy for Development and Integration (NSDI)—for 2007-09 by April 2007, formulated within the comprehensive Integrated Planning System introduced in 2005 and taking into account the recommendations of the joint staff assessment of the 2005 progress report.

II. Economic developments

2. **Macroeconomic developments proceeded largely as envisioned at the time of the last review**.

- Real GDP growth this year is expected to be in line with our previous projection of at least 5 percent. Although activity in construction slowed down—in part owing to a sharp reduction in the number of construction permits and delays in the execution of public investment—a faster-than-anticipated recovery in electricity production and an improvement of exports served as mitigating factors. Trade performance in fact strengthened significantly in 2006, as traditional exports such as footwear recovered and we began exploiting new export opportunities—in particular chrome where exports quadrupled in the first half of 2006 compared with the previous year. Consequently, the weakening of trade performance that began in late 2005—brought on by electricity shortages, rising energy costs, increased competition in export markets, and slower growth in partner countries—was largely reversed during the course of 2006.

- With the recovery of exports, our underlying external balance has improved considerably. The current account deficit is estimated to have narrowed by about 0.6 percentage point to 5.9 percent of GDP in 2006. However, we estimate the underlying trend to be about ½ percentage point of GDP lower, as the structural improvements made to our revenue administrations have also uncovered previously-uncaptured imports of roughly this magnitude.

- Fiscal developments this year were dominated by the success of revenue administrative reforms, which significantly increased our resource envelope. In recognition of the relatively strong demand pressures in the economy we saved ¼ percent of GDP of the revenue gains and allocated the remainder in a supplementary budget—in accordance with our program agreements—between additional investments and tax relief. Combined with half the receipts from the sale of

Italian Albanian Bank (0.1 percentage point of GDP), these revenue gains financed a budgeted increase in infrastructure investment and maintenance expenditures of about 0.8 percentage point of GDP; and a lowering of the employers' share of the social security tax from 29 percent of wages to 20 percent.

- Inflation exhibited a rising trend in 2006, but remained within the 3±1 percent target range. Price pressures originated with strengthening domestic demand, higher food prices, and an administered increase in the cost of electricity. They were mitigated somewhat, however, by two 25 basis point increases in the policy rate in July and November; by the fiscal correction in the supplementary budget, which reduced the impact of the 2006 fiscal impulse by ¼ percentage point of GDP; and by the tightening of the supervisory and regulatory regime implemented by the BoA that had the effect of both improving banks' risk profiles and of slowing the rate of private sector credit growth.

3. **Significant advances were also made in various areas of structural reform since the time of the last review**.

- **Our reform program in revenue administration—developed with the help of IMF TA—is on track**. The role of the Large Taxpayer Office (LTO) was considerably expanded. All large taxpayers are now incorporated into the LTO for assessment and audit purposes; and the assessment and audit of social security taxes have been fully integrated into its operations. The revenue share generated by the LTO is up sharply—about 60 percent at end 2006 instead of the 50 percent targeted at the time of program conception. To further increase the efficiency of tax administration, we completed a feasibility study for merging small branches of the General Taxation Directorate (SB; end October 2006) and intend to move ahead with its implementation. We have requested a follow-up technical assistance mission to chart progress and fine tune recommendations. In addition, we have maintained the impetus to improve VAT administration by clearing all the VAT arrears dating before 2006 and by preparing and providing to the Fund quarterly reports on the aggregate amounts of the VAT refunds requested, refunds paid and refunds rejected (SB; ongoing). In the customs administration we have introduced the ASYCUDA system and its risk assessment module in 12 custom houses; and have also improved customs performance by preparing and issuing quarterly reports on progress made in the actual use of the risk assessment module of the ASYCUDA system to perform inspections (SB; ongoing).

- **We made some progress in the area of debt management**. We submitted a new public debt law to Parliament defining the objectives and establishing the institutional structures for debt management (SB; end-September 2006); and we completed and published an explicit, time bound, debt-management strategy (PC; end-October 2006). The public debt law was adopted by Parliament at end-December 2006. We also improved our electronic data management capacity, and made tentative steps towards increasing the maturity of our domestic debt stock (from 195 days at end-2005 to 235 days at end-2006) by increasingly issuing multi-year government bonds for new borrowing and for the rollover of maturing treasury bills, including our first five-year floating rate bond. We are actively seeking additional technical assistance. In order to safeguard the use of nonconcessional project loans, we will continue our policy of conducting independent feasibility studies for any large project[4] financed in this manner (SB; ongoing), and will continue to provide the twice yearly listing and status report of all projects being considered for nonconcessional foreign financing (SB; ongoing). In addition, we will continue our practice of preparing semi-annual reports on the stock of external arrears (SB; ongoing).

- **We took steps to significantly strengthen the legal, regulatory, and supervisory regimes governing commercial bank activity**. We updated the overall legal framework in December 2006 with the passage of a new Banking Law (SB; end-March 2007)—prepared with IMF technical assistance—which will come into force in June 2007. In addition to strengthening supervision within existing regulations, new regulations were introduced to safeguard the banking sector's health in the face of rapid credit growth. These measures focus primarily on improving credit risk management—principally by mandating a more complete incorporation of actual risks into banks' pricing decisions—and by instilling greater transparency by insisting on a more complete disclosure by banks to their clients of the risks inherent in borrowing. It is indicative of the success of these measures that the quarter-on-quarter annualized rate of credit creation eased from over 80 percent in mid-2005 to about 46 percent by end-September 2006, in line with program projections. Draft legislation has also been prepared to significantly improve the efficiency and timeliness of the execution of collateral. While it was not tabled in time to meet the end-2006 structural benchmark, the delay will be short as we intend to send it to Parliament by end-January 2007.

- **In line with the FSAP recommendations, we unified nonbank financial sector supervision within the new Financial Supervisory Authority (FSA)**. To promote the independence of the new institution, the chairman and supervisory board of the new institution were appointed by Parliament, adequate funding has been secured for current operations, and technical assistance is being provided by the World Bank. Some movement has already been achieved regarding supervision and regulatory control over the insurance sector with the submission to Parliament of legislation aimed at raising capital requirements to European standards.

[4] As defined in the TMU.

- **We are moving ahead with the sale of our remaining strategic public enterprises**. Following the completion of an independent review of the privatization tender for the telecom company (Albtelecom), we reopened negotiations in November with the original investor, and we are optimistic that we can complete the privatization of the company this year. We presented our new electricity strategy to donors in September, and selected the International Finance Corporation (IFC) as our advisor for the privatization of the distribution arm of the power utility KESH, which we have already constituted as a separate company. We have also issued a tender for the privatization of the state-owned insurance company (INSIG). In the banking sector, we sold our minority stake in Italian Albanian Bank to San Paolo-INTESA of Italy, and are proceeding with preparations to sell our remaining equity in the system, which consists of a minority position in one small bank.

- **Progress in the statistical area was mixed**. We made progress in preparing the preliminary national accounts for 2005 and the quarterly GDP estimates for 2005, and completed—albeit with a slight delay—the revision of national accounts for 1997-2004 (SB; end-November 2006). These data will be released in May 2007, in accordance with INSTAT's official publication calendar. We revised our balance of payments estimates of private transfers (SB; end-2006); and took actions to strengthen the coordination between INSTAT, the Bank of Albania and the Ministry of Finance to expand data sources and improve data sharing between our institutions. We have been working closely with the staff of the IMF's Statistical department to finalize the recent draft Report on the Observance of Standards and Code (ROSC); and also adopted an action plan to meet the SDDS goals.

III. STRATEGY, OBJECTIVES, AND POLICIES

4. **We remain committed to the medium-term strategy outlined in our previous LOI/MEFP of July 14, 2006**. This strategy—predicated on the maintenance of both macroeconomic and financial sector stability—is designed to effectively address the institutional weaknesses and resulting lack of nonprice competitiveness that currently constitute the greatest threat to continued rapid private sector-led growth.

- Macroeconomic stability will be anchored through a continued adherence to the existing medium-term fiscal framework—while the BoA will continue to aim at keeping inflation within the 3±1 percent target range. We expect the resulting fiscal stability to engender market confidence, while affording greater stability and predictability to development spending. Our reluctance to employ fiscal policy for countercyclical operations also reflects the lack of timely savings and investment data.

- Financial sector stability will be promoted through a continued refinement of our regulatory and supervisory reforms. In the banking sector, though difficult to observe over a short time horizon, we believe the tightened supervisory and regulatory regime put in place over latter half of 2006 has already resulted in sounder lending practices, as evidenced by the slowing of the rate of credit growth. A clearer picture of the actual situation will emerge over the following months as our enhanced supervisory regime takes hold and improvements in required reporting practices increasingly bear fruit. However, sustained commitment will be necessary to maintain momentum and avoid erosion of gains made to date. Strengthening nonbank financial sector supervision is also an important goal which we will pursue vigorously over the program period.

- Over a longer time horizon, our program addresses institutional weaknesses and nonprice competitiveness, and encourages a broadening of the export base through wide-ranging reforms, including to the budget process, financial sector, and debt management capacity. We are also pursuing institutional change outside the program in areas impacting the investment climate, including measures to improve the commercial court system and the process of land title registration with the aim of creating conditions capable of attracting enough foreign and domestic investment to effect a rapid increase of our productive capacity. We also intend to significantly downsize government involvement in non-core areas, primarily by stepping up the pace of privatization, including in the electricity sector. Weak infrastructure is a serious constraint on growth and we are taking decisive action to improve the infrastructure, particularly in the transportation sector.

A. Macroeconomic Framework

5. **The macroeconomic framework outlined in our LOI/MEFP of July 14, 2006 remains realistic**. We expect economic growth to return to its trend rate of 6 percent in 2007, supported by continued strong performance of exports, an acceleration in the growth of services, and by a rise in public investment, including in the road sector. With the level of demand appropriately balanced by monetary policy—aided by lower credit growth and supported by a flexible exchange rate regime—we expect inflation to remain within the target range in 2007. Ongoing fiscal consolidation will allow a steady improvement in government solvency. Public savings will increase 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 rapidly rising income levels. With capital goods imports for public investment rising rapidly in 2007 and 2008, there will be a small but manageable increase in the current account deficit next year. However, we expect this to be temporary and the deficit will begin to narrow again from 2008. To secure safe budget execution, we will continue to protect this framework from unforeseen shocks through the use of budgetary contingencies; and also through the use of conservative estimates of absorptive capacity, tax revenue and privatization receipts, and by a policy of not expending the gains from tax administration reforms before their realization.

B. Fiscal Policy

6. **Our fiscal strategy is based on the premise that a small, but increasingly efficient, government would be most effective in promoting our economic development**. This strategy—which follows that of the more successful middle-income countries—involves a concentration of reform effort in reducing key vulnerabilities; improving efficiency of core activities; and, wherever possible, offloading noncore functions to the private sector. We anticipate that a successful implementation of our reform program will substantially improve the attractiveness of Albania as a destination for foreign investment.

7. **Our 2007 budget and our medium-term fiscal framework are both fully consistent with this strategy.**

- Net credit to government in 2007 is targeted at 2½ percent of GDP—a ¼ percent of GDP increase over the 2006 outturn due to the one-off nature of the adjustment employed last year to reduce demand pressure—but in line with the original fiscal program and targets so that we maintain the same ongoing trend decline. We have continued our practice of securing safe budget execution and protecting priority expenditure by using realistic revenue projections—which exclude uncertain gains from new tax administration measures—as well as through sizable budget contingencies that will be released after consultation with the Fund if revenues are in line with projections. On the expenditure side, priorities remain education, health care, and roads. With proven revenue gains allocated almost exclusively to investment and capital maintenance expenditures, full execution of budget plans will imply that investment spending increases and that the current surplus, including grants, will remain at the relatively-high level of 2½ percent of GDP. The budget includes no new tax policy measures but—as was the case in 2006—we will introduce such measures in a supplementary budget in mid-2007 if further permanent improvements in revenue collection are attained. Any unanticipated one-off privatization receipts will be allocated in this budget according to our long-established formula—half to investment and the maintenance of existing capital, with the remainder used to retire domestic public debt.

- With our fiscal strategy containing expenditure at the 30 percent of GDP range, and using our existing—conservative—revenue projections, we anticipate a reduction of public debt as a percent of GDP, and a lowering of annual domestic borrowing to 2¼ percent of GDP by 2010. Over this time period, and within the expenditure envelope, a further diversion of resources to capital uses will increase our current surplus (including grants) by ¾ percentage point of GDP. However, with ongoing reform of revenue administration, we consider additional revenue gains likely. After their permanent nature has been demonstrated they will be used to reduce the tax burden, which will further improve our business climate.

8. **Revenue administration reform remains a key component of our program**. In the year ahead, we will concentrate on further strengthening the LTO, including through staff training and better human resource management. With a view to significantly increasing the allocation of skilled human resources to more productive activities (such as audit and enforcement), we will prepare and approve an action plan to review the role of the Tax Police, including a description of the measures that will be taken to implement IMF technical assistance recommendations in this area (PC; end-March 2007). We will also press ahead with efforts to reduce corruption that have been supported by technical assistance from the Millennium Challenge Account in the tax administration and by the European Commission in the customs administration.

9. **Our debt management capacity requires improvement as a matter of priority**. The recent development of an overall strategy and a new public debt law represented important prerequisites. However, more tangible gains are needed if we are to significantly reduce the vulnerability inherent in our present debt structure, where domestic debt equivalent to 38 ½ percent of GDP rolls over every 235 days. Over the next year, we will continue to follow the action plan developed to implement the IMF TA advice, including by:

- Conducting an independent review of staffing requirements in the debt management unit of the Treasury and Public Debt Management Directorate, including a review of the conditions necessary to recruit people with the appropriate skills (SB; end-June 2007);
- Complete a functional review of public debt management and on that basis restructure the Debt Department;
- Further improve our IT capacity by establishing an integrated management system for external and domestic debt; and migrating domestic debt into the computerized system. Automation of the auction process through the utilization of the Reuters system is already being implemented.

10. **We intend to further reduce vulnerabilities by developing new debt instruments**. The narrow range of domestic debt instruments and the large stock of short-maturity lek-denominated public debt leaves us exposed to volatile liquidity movements and shifting market sentiment. Thus, while ensuring that our markets develop at a pace commensurate with our debt management capacity, we need to develop alternate debt instruments and financing options capable of satisfying government borrowing requirements while at the same time insulating us somewhat from adverse short-term disruptions in the market for lek-denominated debt. We have therefore begun investigating ways and means of tapping the large foreign currency-denominated savings of residents. As a first step, we issued our first foreign currency-denominated treasury bills in December 2006. The bills were sold to domestic residents in a competitive auction and fully hedged to protect the treasury from exchange rate risk. Looking ahead, in consultation with the Fund, we intend to explore the

possibility of issuing longer-term foreign currency-denominated domestic debt, where the improved maturity structure would reduce rollover risk sufficiently to compensate for the possibility of adverse exchange rate movements.

11. **Improvements to our government securities markets are also expected to help our debt management capacity**. Over the course of 2007, building on IMF technical assistance, we will complete the development of an electronic delivery-versus-payment system for government securities. Integration of this system with the securities auctions will enable improvements in the debt database, and also allow auctions to take place over a shorter time frame, with agents able to make purchase decisions and receive their securities simultaneously. In addition, we will work to speed up the publication of auction results on the Ministry of Finance web site.

12. **Budget process and financial management**. We will continue to improve the selection of public investment projects, including by strengthening the operations of the public investment unit, which was established within the Ministry of Finance in January 2006. We will also improve our capacity to execute capital spending by introducing a mid-year budgetary review of investment projects, with the aim of redirecting investment allocations to sectors that show higher implementation capacity. We will strengthen coordination between the selection of public investment projects and the Medium Term Budget Program (MTBP), and between the MTBP and the annual budget process. This will include the practice of using annual expenditure ceilings for line ministries established under the MTBP as basis for annual budget allocations. In addition, we will further improve our implementation capacity by increasing the average size of projects in our budget and significantly decreasing their number. A new organic budget law was drafted and sent to international organizations for comments in December 2006, and we intend to submit it to Parliament by March 2007.

C. Monetary, Exchange Rate, and Financial Sector Policies

13. **The BoA is being called upon to conduct monetary policy within a difficult and changing environment.** With the fiscal stance determined by the medium-term fiscal framework, monetary policy is shouldering an increased responsibility for price stability. This comes at a time when the existing monetary policy framework[5] is facing new challenges. While this framework has proved effective in the past—and will be retained along with the flexible exchange rate regime—the transmission mechanism operates primarily through controlling the pass through effect on the lek price of traded goods. Over the past year, however, our situation has been one in which a significant portion of the price pressures we experience arise from the rapid growth of credit—over which policy rate changes have less influence. As the acceleration of credit also directly impacts banking

[5] 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.

system soundness, policies to maintain price and financial sector stability have become closely intertwined.

14. **As a consequence, maintaining price and financial sector stability will continue to require that traditional monetary policy instruments be supplemented with prudential and regulatory measures**.

- We stand ready to make appropriate adjustments in the policy rate in response to observed changes in money demand, or to prevent the development of second round effects from the recent increases in food and electricity prices.

- With demand for bank loans relatively interest inelastic, credit growth remains a significant and potentially-volatile component of total demand. Our response over the course of 2006 has been to directly counter this pressure by tightening the regulatory and supervisory framework governing the banking sector, and this has resulted in significant success in lowering banks' risk profiles and slowing the rate of credit expansion. However, a considerable effort will be required over the next year to safeguard these gains, as international experience has demonstrated a considerable potential for backsliding.

15. **Over the course of 2007, we intend to supplement the measures already taken**. We remain committed to the establishment of a credit bureau within the BoA. In this latter regard, we have completed a detailed action plan for implementation. However, recent Fund-provided technical assistance determined that the magnitude of the legal preparation involved was significantly greater than we had earlier anticipated. In accordance with the TA recommendations, we have postponed the deadline for completion of the credit bureau from end-June 2007 and have set it as a structural benchmark for end-December 2007. We will continue to consult closely with members of the banking community to ensure that they fully understand the actions taken to safeguard the banking system.

16. **In contrast to the situation in the banking sector, nonbank financial sector supervision remains underdeveloped and in need of considerable improvement**. While the unification of the nonbank supervisory agencies under the FSA provides a sound framework for moving forward, significant work will be needed to raise the quality of supervision to acceptable standards. With World Bank assistance, we have begun upgrading capacity. Our immediate priorities are to develop a new supervisory strategy and operating procedures (including operations manuals and basic staffing structures); and to carry out an urgent assessment of the health of insurance sector that will identify the necessary corrective actions. Over the longer term we will review all laws and regulations to bring them up to date with world standards, conduct ongoing staff training, and develop appropriate information technology systems. Until an appropriate legal framework is developed in the private pension industry, and until supervisory capacity improves, we will continue to restrict participation in the pension industry to the three companies already licensed.

17. **Over a near-term horizon, we will examine the issue of which institution would best supervise the leasing sector**. While this sector is still small in Albania, the experience in neighboring countries has shown it is capable both of extremely rapid growth and of circumventing to a large degree the efforts of monetary authorities to control demand forces. In view of the close substitution of some bank loans for lease contracts, we will give serious consideration to moving the supervision of leasing companies back to the BoA.

18. **We will continue to refine and improve financial sector infrastructure and institutions**. The treasury bill window at BoA will be maintained until alternate means of ensuring nonbank access to government securities are in place; and the necessary steps will be taken to ensure non-bank participants have access to the government debt market on an equitable basis. We expect the forthcoming delivery versus payment system to raise volumes in the secondary market for government debt and to foster the development of the interbank market—both developments that will improve the efficiency of monetary policy and of the overall intermediation process. To protect our existing institutional quality, we 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; and will take no legislative or regulatory action that weakens the independence of the BoA, including the Supervisory Board of the BoA's control over the Bank's budget and its authority to decide on compensation levels.

D. Transportation Strategy

19. **The most important pillar of our NSDI is sustained high economic growth, which requires a sound and solid infrastructure**. Investment in infrastructure, particularly in the transport sector, will also reduce poverty by increasing economic efficiency, lowering costs, and enhancing opportunities for trade, transit traffic and tourism. The recent Stabilization and Association Agreement (SAA) with the EU and our membership in the World Trade Organization (WTO) will open better access to regional and EU markets and provide new opportunities to develop tourism in Albania. However, reaping the benefits from these new opportunities requires a solid road infrastructure. Our National Transport Plan (NTP) therefore includes a number of key projects, both to construct new national roads and to improve the condition of the existing national roads. This will help to secure an Albanian road network that fulfills this purpose and moves us closer towards European Standards.

20. **A critical component of the NTP is a new road corridor between Durres and Morine that connects our main port of Durres with Kosovo and the South Balkans**. The road corridor is divided into three segments. The first section (Milot to Rreshen) will cost about €32million and we expect it to be mainly financed by the World Bank. The last section (Kalimash to Morine) is expected to cost €38 million and will be fully financed by domestic budgetary resources. The cost of the complex middle section, for which a construction contract has been agreed with a consortium of international companies, is expected to be about €430 million (excluding VAT). The total cost of the project is estimated at about €500

million (about 5½ percent of GDP) over the 2006-09 period. About half of the project cost will be covered by domestic budgetary resources. The domestic component of the financing plan for this project is well within our medium-term budget framework, which provides annual fiscal space of at least 4 percent of GDP for domestically-financed public investment.

21. **However, given other priority investments, our domestic budget resources are not sufficient to fully cover the costs of the Durres-Morine corridor**. Therefore, part of this road will be financed through external loans. We hope to receive strong support and some participation from our international development partners. We are in the process of finalizing a financing agreement for the first section of the corridor with the World Bank ($25 million) and OPEC Fund ($15 million), which is expected to be reached by early 2007. We are also negotiating with the Islamic Development Bank for a loan of $35 million, part of which will be on concessional terms. Nevertheless, we still need to arrange external financing of about €200 million over the next three years for the remainder of the project, most of which will likely be on nonconcessional terms.

22. **We are committed to maintaining external debt at sustainable levels, and we reaffirm our intention to keep the overall cumulative program limit on nonconcessional borrowing unchanged at €680 million**. However, the nature of the Durres-Morine corridor project requires that we seek a re-phasing of these commitments in order to complete the project by mid-2009. Consequently, we are seeking to revise upwards the end-2007 cumulative nonconcessional borrowing limit under the program from the current level of €280 million to €380 million. We will, however, make efforts to reduce our recourse to non-concessional external borrowing if possible—by devoting any additional concessional financing for the transport sector to this project, as well as half of all privatization receipts—and reduce the ceiling for 2007 accordingly.

23. **Inevitably, a large project like Durres-Morine corridor road increases the risk to budget and medium-term fiscal framework**. We will therefore take a number of measures to create a buffer against the potential budgetary risks stemming from this project.

- First, we will increase budget contingencies to about 1 percent of GDP, in line with our organic budget law, starting in 2008 to secure additional resources for this project in case of unanticipated developments.

- Second, this project will be a high priority for additional budgetary resources if our mid-year review of the capital budget (paragraph 12) indicates room for reallocation of funds.

- Third, over the course of this project, the part of the proceeds from any privatization of strategic public enterprises that can be used for investment (one half) will be used to finance this road project and non-concessional external borrowing will be reduced accordingly.

- Finally, in case of unanticipated developments that cannot be accommodated by the above described measures, we will reallocate resources from lower priority road projects to this project.

In addition to these buffers, we are establishing, in consultation with the World Bank, an effective monitoring mechanism to minimize cost overruns and delays in implementation.

E. Other Structural Reforms

24. **We are undertaking an important initiative to address informality in the housing sector.** Currently, some 300,000 housing units, accounting for close to 70 percent of all new construction since 1990 and valued at some US$4 billion (about 45 percent of GDP), reside in the extralegal sector. As these buildings are not properly registered, they cannot be sold outside a narrow circle of people or be used as collateral against a formal bank credit. A new legalization law was approved in April 2006 aimed at bringing this wealth into the formal economy where it can better contribute to economic development. A new agency has been set up, and the process of legalization is well advanced—as evidenced by self-declarations which reached some 270,000 buildings between July 15 and November 24.

25. **We will take further actions to ensure a stable supply of electricity and to strengthen the financial performance of KESH.** While favorable conditions for domestic production and large electricity imports helped us meet demand for electricity during most of 2006, our continued dependence on power imports is a concern. In addition to expanding hydro-power capacity, we are, therefore, finalizing a contract for the construction of a thermal power plant, which will be financed largely by the World Bank, the European Bank for Reconstruction and Development and the European Investment Bank. While performance so far is mixed, we will ensure that KESH meets the 2007 objectives with regard to collection rates and electricity losses envisaged in Power Sector Action Plan for 2006-2008. To advance this aim, we used budget funds in 2006 to settle all arrears owed to KESH by public institutions and water supply companies dating back to 2005 and earlier and most of such arrears for 2006. We will make further efforts in 2007 to settle the remaining arrears and ensure that these institutions pay their bills in a timely manner. Moreover, in line with our new energy sector strategy—which aims to increase private sector involvement—we are preparing for the sale of the distribution arm of KESH and have selected the IFC as a privatization advisor.

26. **We are expecting good progress in privatization of other strategic public enterprises in 2007**. In particular, we plan to finalize the negotiations for the sale of Albtelecom by the end of 2007. We also aim to move rapidly towards the privatization of INSIG, ARMO, Albpetrol and Servcom, and Transnafta, and have already merged the latter three enterprises to make them more attractive to strategic investors.

27. **We are also taking significant actions to improve our business and investment climate in areas outside the IMF-supported program**. In particular, we have established a

Regulatory Reform Task Force chaired by the Prime Minister for the formulation and monitoring of regulatory reforms. The Regulatory Reform Action Plan developed by this task force—and endorsed by the Council of Ministers—contains four main pillars: (i) Developing a regulatory management system (institutions and procedures); (ii) Improving the quality of existing regulations (reducing administrative and regulatory barriers); (iii) Improving the quality of new regulation (for example through regulatory impact assessments); and (iv) Establishing a framework for systematic monitoring and evaluation of reforms. The World Bank has approved a $9.3 million credit to support a number of activities under this plan. In addition, Parliament has passed a new procurement law; we have finished drafting a new concession law; and we intend to establish a one-stop shop for business registration and licensing by June 2007. We are also finalizing preparations to introduce the "Albania 1 Euro Initiative", which is designed to reduce investment barriers caused by the difficulties currently experienced in gaining secure title to land. We envisage this as a temporary measure that will become increasingly unnecessary as land formalization proceeds. The scheme does not involve tax incentives, and so is likely to lead to higher tax revenues once it has the anticipated effect on business and investment activity.

F. External Policies

28. **The signing of the Stabilization and Association Agreement with the European Union is a historic milestone**. It provides a solid framework to address the many reform challenges on the path to EU accession. Steadfast implementation of the necessary reforms will reap large benefits by strengthening the business environment and generating substantial foreign direct investment.

29. **We will retain our liberal trade regime**. We have implemented all commitments made to the WTO regarding tariff policies. On a regional level we have concluded free trade agreements with all our regional neighbors—which is significantly boosting our trade with them, albeit from a low level. At the beginning of 2007, we plan to introduce further trade liberalization through the Central Europe Free Trade Agreement.

30. **We are continuing to make good faith efforts to conclude the rescheduling of our arrears on inoperative payment agreements**. We are engaged in negotiations that aim at concluding the clearance process with official creditors by mid-2007—negotiations with Poland and Bulgaria are successfully concluded and we intend to clear these arrears in the first quarter of 2007. During 2006, we cleared arrears with a number of private creditors in Germany, Italy, and Turkey; and we expect to eliminate all remaining external arrears with private creditors by end-2007. We will continue to provide semi-annual reports to the Fund on the outstanding stock of external arrears (SB; ongoing) within one month of the end of each quarter.

G. Data Issues

31. **We are aware that our revised national accounts estimates rely on very narrow labor input data and lack plausibility**. Improving labor source data will therefore be a matter of priority to ensure the reliability of our national accounts estimates. To that effect, INSTAT will complete a labor force survey by the end of 2007 and finish the household budget survey by October 2007. However, fully revised national accounts using improved labor data might not be ready before mid-2008. Consequently, we will be preparing revised national accounts for 2004 and preliminary national accounts for 2005 based on the methodology used until 2005 to estimate the non-observed economy. We will also prepare revised national accounts estimates based on the labor input methodology using streamlined labor data. Based on the new household survey we will update the weights of the CPI. We will also continue our efforts to produce quarterly GDP estimates. We will strengthen the collaboration of INSTAT and the BOA, with a view to improving the quality of our BOP statistics, notably with regards to data on workers remittances. We will continue to work with the Statistics Department of the IMF to implement the recommendations of the recent ROSC and implement our plan to move towards SDDS status.

H. Program Monitoring

32. The fourth disbursement under the PRGF/EFF-supported program will be based on the end-March 2007 quantitative performance criteria (Table 1 and the TMU); the end-March 2007 structural performance criteria (Table 2 and the TMU); and completion of the third review and financing assurances review. The third review under the PRGF and EFF arrangements is expected to be completed no later than August 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.

Table 1. Albania: Quantitative Performance Criteria and Indicative Targets, June 2006-December 2007 1/

	End-June 2006			End-September 2006			End-December 2006		End-March 2007	End-June 2007	End-September 2007	End-December 2007
	Actual	Prog.	Prog. (Adj.)	Actual	Prog.	Prog. (Adj.)	Est.	Prog.	Prog.	Prog.	Prog.	Prog.
(In billions of lek)												
Ceiling on net domestic credit to the government 2/	-10	12	12	-10	18	20	...	24	8.0	16.0	22.0	25.1
Ceiling on accumulation of net domestic assets of the BOA 3/	-13	8	7	-6	6	7	...	10	11.5	11.9	11.9	21.7
Indicative total tax revenue target 4/	93	87	87	143	134	134	...	188	45.0	97.0	154.0	219.0
(In millions of US dollars)												
Floor on accumulation of net international reserves of the BOA 3/	140	17	17	125	80	66	...	96	71.1	90.6	156.6	174.0
(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	2	30	30	17	50	50	45	70	180.0	380.0	380.0	380.0
Ceiling on public and publicly-guaranteed external debt with original maturities up to and including 1 year 5/	0	0	0	0	0	0	...	0	0.0	0.0	0.0	0.0
Ceiling on accumulation of new external payments arrears, excluding interest on pre-existing arrears 5/	0	0	0	0	0	0	...	0	0.0	0.0	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-September 2006 are performance criteria, except where marked. Data for and end-March 2007 are proposed performance criteria, except where marked. Data for end-June 2006, end-December 2006, end-June 2007, end-September 2007, and end-December 2007 are indicative targets.

2/ Cumulative change within the calendar year.

3/ For June 2006, cumulative change from end-September 2005. Thereafter cumulative change from end-December 2005.

4/ 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. Targets defined as cumulative changes within each calendar year.

5/ Applies on a continuous basis.

Table 2. Proposed Performance Criteria and Structural Benchmarks under the PRGF and EFF Arrangements 1/

	Proposed Test Date
I. Performance Criteria	
1. *Prepare and approve by the Minister of Finance an action plan to review the role of the Tax Police, including a description of the measures that will be taken to implement IMF technical assistance recommendations in this area (as specified in the FAD report "Albania-Challenges to Reforming Tax Administration" of June 2005, page. 63)".*	*End-March 2007*
II. Structural Benchmarks	
A. Improve public expenditure management	
2. 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	
3. 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
4. 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	
5. Conduct an independent review of staffing requirements in the debt management unit of the Treasury and Public Debt Management Directorate, including a review of the conditions (e.g., competitive salary) necessary to recruit people with the appropriate skills.	*End-June 2007*
6. Prepare semi-annual 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	
7. Establish a credit bureau within the Bank of Albania.	*End-December 2007*

1/ Text in italics refers to new conditionality not carried over from the first review under the program (IMF Country Report No. 06/286).

ATTACHMENT II

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 end-March 2007; 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[6] 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; (c) negative balances in government deposits with BoA, DMBs and SLIs; (d) any securities or debt instrument of any kind issued by government (as defined above) to the Bank of Albania to compensate the Bank of Albania for its net valuation losses on its assets and liabilities in, or denominated in, gold, special drawing rights or foreign currencies, and which the Bank of Albania keeps in its (off-balance sheet) Valuation Reserve Securities Account of the Bank of Albania, as required in Article 64 of the Law on the Bank of Albania (No. 8269, dated December 12, 1997)[7]; and (e) any other form of financial obligation of the government the issuance of which resulted in borrowing funds by the government or a payment for an existing payment obligation of the government.

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[6] Other domestic lenders comprise firms, nonbank institutions, and households, or any other resident legal or natural person, or institution.

[7] This was equivalent to Lek 11.5 billion at end-December 2005 and Lek 12.2 billion at end-September 2006.

(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 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[8].

(iv) For the purposes of program monitoring, gross domestic credit to the government 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 147.8/SDR.

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 358.9 per ounce)[9].

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[8] 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.

[9] 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 358.9 per ounce); and (d) then converted to Lek at the program Lek/SDR exchange rate of Lek 147.8/SDR.

(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 147.8/SDR.

6. Under these definitions, the stock of net domestic credit to the government was Lek 307.9 billion at end-September 2006. The breakdown of the categories of net domestic credit to the government as defined above is given in Attachment Table 1.

7. The limits on the change in net domestic credit to the government will be cumulative within each calendar year.

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-December 2005. Under this definition, the level of NDA was Lek 77.1 billion as of end-December 2005. The NDA limits will be cumulative changes from end-December 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.[10] Reserve assets and reserve liabilities will both be expressed in U.S. dollars. The NIR limits will be cumulative changes from end-December 2005, and will be monitored from data supplied by the Bank of Albania.

10. During this program, for monitoring purposes, the exchange rates of the SDR and non-dollar currencies will be kept at their end-December 2005 levels and holdings of monetary gold will be valued at SDR 358.9 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$1,171.7 million at end-December 2005.

D. Adjusters for NCG, NDA, and NIR

11. The NCG and NDA ceilings and the NIR floor are defined on the assumption that cumulative privatization proceeds from January 1, 2007 will be as follows:

End-March 2007	Lek 250 mn.	(Of which US$0.0 mn. in foreign currency);
End-June 2007	Lek 500 mn.	(Of which US$0.0 mn. in foreign currency);
End-September 2007	Lek 750 mn.	(Of which US$0.0 mn. in foreign currency);
End-December 2007	Lek 1,000 mn.	(Of which US$0.0 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)

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[10] 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.

by half the amount of any excess (shortfall) in the receipt of total privatization proceeds from these assumed values[11].

12. The NCG ceiling will be adjusted upward (downward) by the increase (decrease) in debt instruments of any kind (valued at issue price if possible) that the government (as defined above) transfers to the Bank of Albania to compensate the Bank of Albania for its net valuation losses on its assets and liabilities in, or denominated in, gold, special drawing rights or foreign currencies, and which the Bank of Albania keeps in its (off-balance sheet) Valuation Reserve Securities Account of the Bank of Albania, as required in Article 64 of the Law on the Bank of Albania (No. 8269, dated December 12, 1997).

13. 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, loans from the International Development Association of the World Bank Group, and macro-financial assistance from the EU) will amount, on a cumulative basis, from January 1, 2007, to:

End-March 2007	US$0.0 mn.
End-June 2007	US$0.0 mn.
End-September 2007	US$0.0 mn.
End-December 2007	US$0.0 mn.

The ceilings on NDA of the Bank of Albania will be adjusted downward, and the floor on NIR will be adjusted upward by the amount total foreign loan financing (excluding IMF financing, project and commodity loans, loans from the International Development Association of the World Bank Group, and macro-financial assistance from the EU) exceeds these projections. The NCG ceiling will be adjusted downward by the amount total foreign loan financing (excluding IMF financing, project and commodity loans, loans from the International Development Association of the World Bank Group, and macro-financial assistance from the EU) exceeds these projections.[12]

14. 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.

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[11] For the NCG adjuster, the lek equivalent of deviations from the programmed amounts received in foreign currency will be converted to lek at the exchange rates prevailing on the value date of the transaction.

[12] For the NCG adjuster, the lek equivalent of deviations from the programmed amounts received in foreign currency will be converted to lek at the exchange rates prevailing on the value date of the transaction.

E. External Debt and Arrears

15. 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.

16. 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 15 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.

17. 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 15 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.

18. 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, 2006 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, 2006; and (ii) external arrears that are subject to debt rescheduling agreements or negotiations.

19. **Large projects** (as referred to in MEFP paragraph 3 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.

F. Release of Contingencies in the 2007 Fiscal Budget

20. The first 20 percent of the budget commitments embodied in the 2007 budget that represent contingencies for investment spending will be released after the following conditions are satisfied:

- At end-March 2007, 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;
- The decision to release the budget commitments related to the contingencies is taken in consultation with the Fund.

21. The remaining 80 percent of the budget commitments embodied in the 2007 budget that represent contingencies for investment spending, and all the budget commitments embodied in the 2007 budget that represent contingencies for current spending, and all non-allocated contingencies, will be released after the following conditions are satisfied:

- At end-June 2007, 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;

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

G. Tax Revenues

22. 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.

H. 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;
(xii) Detailed information on the stock and flow of any securities or debt instrument of any kind issued by government (as defined above) to the Bank of Albania to compensate the Bank of Albania for its net valuation losses on its assets and liabilities in, or denominated in, gold, special drawing rights or foreign currencies, and which the Bank of Albania keeps in its (off-balance sheet) Valuation Reserve Securities Account of the Bank of Albania, as required in Article 64 of the Law on the Bank of Albania (No. 8269, dated December 12, 1997).

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 quarter will be supplied within one month of the end of the quarter.
(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.
(iii) Quarterly reports on the progress made in the actual use of the ASYCUDA risk-assessment module to perform custom inspections;

The General Directorate of Taxation will supply to the Fund:

(i) Detailed monthly data on tax revenues collected.
(ii) Detailed monthly data on the share of taxes collected by the Large Taxpayer Office (LTO).

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 2006–December 2007
(In millions of lek)

		Sep-06	Dec-06	Mar-07	Jun-07	Sep-07	Dec-07
1.	**Treasury bills held outside central government**	254,792					
1. (i)	Held by Bank of Albania 1/	65,533					
1. (ii)	Held by deposit money banks 1/	156,853					
1. (iii)	Held by savings and loan institutions 2/	0					
1. (iv)	Held by other domestic lenders (excluding holdings of HHI and SSI) 2/	32,406					
	Of which:						
1. (iv) (i)	INSIG	2,064					
1. (iv) (ii)	Individuals and firms	30,342					
1. (iv) (ii) (i)	Of which: BoA window	20,313					
2.	**Plus: Other central government debt held outside central government (millions of lek)**	69,584					
2. (i)	Held by Bank of Albania 3/	12,164					
2. (i) (i)	Other securities 3/	12,164					
2. (i) (i) (i)	Of which: for BoA valuation losses 3/	12,164					
2. (i) (ii)	Short-term direct loans to government 3/	0					
2. (ii)	Held by deposit money banks 4/	57,420					
2. (ii) (i)	Fixed income securities 4/	57,420					
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:		324,376					
3.	**Less: Assets of central government (excluding HHI and SSI)**	14,151					
3. (i)	Deposits held at Bank of Albania 6/	6,930					
3. (i) (i)	In domestic currency	4,847					
3. (i) (i) (i)	Transferable deposits in lek	4,422					
3. (i) (i) (ii)	Deposits in lek for projects	424					
3. (i) (ii)	In foreign currency at program exchange rates and program price of gold 7/ 8/	2,084					
3. (i) (ii) (i)	In foreign currency evaluated at current exchange rates	2,280					
3. (i) (ii) (i) (i)	Transferable deposits in foreign currency evaluated at program exchange rate 7/ 9/	107					
3. (i) (ii) (i) (i) (i)	Transferable deposits in foreign currency evaluated at current exchange rate 9/	103					
3. (i) (ii) (i) (ii)	Standard gold deposits of government evaluated at program exchange rate and gold price (Lek mns.) 8/	1,977					
3. (i) (ii) (i) (ii) (i)	Standard gold deposits of government at current exchange rate and gold price (Lek mns.) 8/	2,176					
3. (i) (ii) (i) (ii) (i) (i)	Number of ounces of gold equivalent	37,269					
3. (ii)	Assets held at deposit money banks	7,221					
3. (ii) (i)	Deposits 10/	1,408					
3. (ii) (i) (i)	Deposits in domestic currency	259					
3. (ii) (i) (i) (i)	Transferable deposits in domestic currency	259					
3. (ii) (i) (i) (ii)	Other deposits in domestic currency	0					
3. (ii) (i) (ii)	Deposits in foreign currency evaluated at program exchange rates	1,149					
3. (ii) (i) (ii) (i)	In foreign currency evaluated at current exchange rates 7/	1,114					
3. (ii) (i) (ii) (i) (i)	Transferable deposits in foreign currency evaluated at current exchange rates	1,114					
3. (ii) (i) (ii) (i) (ii)	Other deposits in foreign currency evaluated at current exchange rates	0					
3. (ii) (ii)	DMB payables to government	1,411					
3. (ii) (iii)	Ministry of finance short-term lending to commercial banks	4,402					
3. (iii)	Held at savings and loan institutions 10/	0					
4.	**Less: Deposits of HHI and SSI**	2,358					
5.	**Equals: Stock of Net domestic credit to central government (1+2-3-4)**	307,866					
5. (iii)	Change since December 2006	...					
6.	Memorandum items:						
6. (i)	Current exchange rate (Lek/SDR, eop)	143.4					
6. (ii)	Current exchange rate (Lek/US dollar, eop)	97.1					
6. (ii)	Program exchange rate (Lek/SDR, eop)	147.8	147.8	147.8	147.8	147.8	147.8
6. (iv)	Program price of gold (price in SDRs dollars per ounce as at end-December 2003)	358.9	358.9	358.9	358.9	358.9	358.9
6. (v)	Market price of gold (price in US dollars per ounce)	601.4					
6. (vi)	Current exchange rate (US dollar per SDR, eop)	1.4764					

1/ Evaluated at issue price.
2/ Evaluated at face value (data on treasury bill holdings of SLAs and other domestic lenders are currently available only at face value).
3/ Excludes accrued interest.
4/ Valued at face value (data on fixed and variable income securities held by DMBs are currently available only at face value).
5/ Includes accrued interest.
6/ Includes transferable deposits of government in domestic and foreign currency, lek deposits of central government for projects; and standard gold deposits of government (footnote # 8). Excludes all non-standard gold deposits; and excludes all nongold precious metal deposits of government; and excludes government deposits in foreign currency for projects.
7/ The reported lek value of foreign currency denominated assets of government will be converted to SDRs using the current end-of-period lek/SDR exchange rate; and then converted back to lek using the program Lek/SDR exchange rate of Lek 147.8/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 358.9 per ounce; and then (d) converted to lek at the program Lek/SDR exchange rate of Lek 147.8/SDR.
9/ Including account set up to hold the Savings Bank privatization revenue (Account No: 11.2.2.1.4)
10/ Includes all deposits of central government.

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February 2, 2007

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Second Review Under PRGF Arrangement and Second Review Under EFF Arrangement with Albania and Approves US$3.6 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the second review of Albania's performance and financing assurances under the three-year Poverty Reduction and Growth Facility (PRGF) arrangement and the Extended Fund Facility (EFF) arrangement. The completion of the reviews enables the release of an amount equivalent to SDR 2.4 million (about US$3.6 million), which will bring the total disbursement under both arrangements to SDR 7.3 million (about US$10.9 million).

The 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$25.5 million) were approved effective from February 1, 2006 (see Press Release No. 06/17).

Following the Executive Board's discussion of Albania, Mr. Murilo Portugal, Deputy Managing Director and Acting Chair, stated:

“Albania’s macroeconomic performance has remained strong. Inflation is low, the external position has improved, and economic growth has picked up. These favorable developments owe much to sound macroeconomic policies and continued strong commitment to program implementation. Looking forward, maintaining these gains alongside further reduction in poverty will require additional growth-enhancing structural reforms.

“The authorities are committed to fiscal discipline, and are implementing a fiscal program that aims to reduce public debt while providing adequate funding for priority projects in infrastructure, health, and education. The planned safeguard measures to contain the fiscal risks related to large-project execution are appropriate. It will be crucial to implement these measures fully to protect other priority expenditures in case of cost overruns in large road projects.

“The existing monetary policy framework, including an independent central bank and a floating exchange rate, remain appropriate, and the authorities stand ready to adjust policies to maintain low inflation—as evidenced by the increase in the policy rate last November. The recent measures taken by the Bank of Albania to strengthen the regulatory and prudential frameworks will further reduce the risks posed by rapid credit growth. In the nonbank financial sector, the establishment of a unified and independent supervisory authority is an important step to improve the quality of supervision and prudential oversight. Continued efforts are needed to quickly increase capacity at the new authority, including through the allocation of sufficient resources.

“Structural reforms are progressing, particularly in tax administration. As a next step, the authorities will review the functions of the Tax Police. In the energy sector, the International Finance Corporation has been selected as an advisor for the privatization of the distribution arm of the national electricity company (KESH). Concerted efforts are needed to ensure stable energy supply and further improve the financial performance of KESH. Accelerating privatization in other sectors, such as telecommunication and insurance, would also be important. The authorities are encouraged to work toward eliminating the weaknesses in official statistics,” Mr. Portugal said.

Statement by Arrigo Sadun, Executive Director for Albania and Carlo Gola, Senior Advisor to Exeuctive Director February 2, 2007

On the behalf of the Albanian authorities, we wish to express our appreciation to the staff for a well-written report, which reflects the remarkable cooperation and very constructive dialogue with the authorities. Since the first review of the latest program, economic performance has proceeded largely as expected, with all quantitative and structural performance criteria observed, apart from minor delays. The authorities have demonstrated their willingness to implement, in a consistent way, all of staff's recommendations, and they are determined to continue on this path. The current PRGF and the Extended Fund Facility arrangement would offer the opportunity to implement the ambitious reform agenda described in the Memorandum of Economic and Financial Policies (MEFP).

1. Macroeconomic developments

Albania's macroeconomic performance remains solid. In 2006, despite the pronounced slowdown in the construction sector and postponements in public investment, both due to the new course of rigorous permits and procurement policies, the economy recovered faster than expected from the electricity supply-induced disruptions suffered at the end of the previous year. Trade performance strengthened significantly in 2006, thanks to the recovery of the traditional sectors, helping to contain the trade deficit and reducing the current account imbalance to 5.9 percent of GDP. Inflation exhibited a rising trend in 2006, but remained within the 3 ± 1 percent target range. Inflationary pressure has been curbed by two 25-basis point increases (in July and November); by the fiscal correction in the supplementary budget, which reduced the fiscal stimulus by ¼ percentage point of GDP; and by the tightening of the supervisory and regulatory regimes. In December 2006 inflation was 2.5 percent, compared to 2 percent in the same period of the previous year.

On the fiscal side, relevant administrative efforts, aimed at increasing the tax base, are yielding tangible results: for 2006 tax revenues should be above 23 percent of GDP. The responsible conduct of fiscal policy has allowed the authorities to reach a primary balance (excluding grants) of only -0.8 percent of GDP, further reducing the total public debt to 55.7 percent (it was 65 percent only five years ago). As in the past the supplementary budget allocated unexpected revenues to high-quality capital spending, tax relief, and debt reduction.

The banking system is liquid, profitable, and well capitalized, while the level of non-performing loans is low. Nonperforming loans (net of provisions) as a percentage of regulatory capital stood at 7.3 percent in November 2006. The presence of foreign banks is high (more than 90 percent of total assets) and the banking sector is highly concentrated (the market share of the first three banks is 60.5 percent of total assets, but the entry of new foreign entities has increased competition).

The authorities are determined to preserve the current, prudent macroeconomic policy stance and further enhance the quality of the budget, the credibility of the monetary framework, and the resiliency of the financial market. In particular, the independence of the central bank will be maintained and its capabilities further increased. The authorities are also committed to proceeding expeditiously with the remaining privatizations.

2. Structural reforms

On structural reforms, significant and tangible results have been achieved since the time of the last review, thanks also to the valuable support of the Fund and donors.

- The Large Taxpayer Office is fully operative, assessing and auditing now all large taxpayers (including for social security taxes). All VAT arrears before 2006 have been cleared. A quarterly report on VAT refund requirements and on customs administration risk assessments, under the ASYCUDA system, is being produced regularly; the feasibility study for merging small branches of the General Taxation Directorate has been concluded.

- On the crucial issue of debt management, the authorities have recently adopted a new public debt law and completed an explicit timetable to implement a new management strategy. The average maturity of the domestic debt stock increased by over 20 percent in the last year, although it remains very short (242 days).

- In the area of financial supervision, fundamental progress has been made: a new banking law was approved in December 2007; and an independent Financial Supervisory Authority, for the surveillance of the securities markets, insurance companies, and pension funds, has been created. In order to monitor all credit positions held by regulated entities, the authorities are determined to complete and make operational a credit bureau by the end of this year, and draft legislation has been prepared to improve the efficiency of the payment system. Transparency, risk management, and regulation on related parties have been greatly improved.

- Progress in privatizations has been relatively slow, due to the difficulties of the electricity company KESH and the renegotiation of the sale of the telecommunication company (Albtelecom). However, the privatization of a minority stake in a small bank has been concluded.

- The authorities are aware that the national account estimates rely on very narrow labor input data and lack plausibility, as underscored in the MEFP and noted in the recent ROSC assessment. Household and labor market surveys need to be expanded and improved. A more extensive cross-checking and timeliness of data is needed. The weights of the consumer and producer price indices have to be updated as soon as possible. The data coverage for external donor financial projects should be enhanced, as should several balance of payments statistics.

3. Program design

There is strong agreement between staff and the authorities on the design and prioritization of the program. The current fiscal framework provides a good balance between development spending and fiscal consolidation. The request for some front-loading of external nonconcessional borrowing within the limits described by the program seems acceptable. The main pillars of the program are: 1) maintaining current responsible and prudent policies; 2) reserving and reinforcing the institutional framework and enhancing administration capacity and governance; 3) further improving the business climate, the rule of law, and the attractiveness of Albania as a destination for foreign investments; 4) downsizing government involvement in non-core areas and stepping-up the pace of privatization; 5) enhancing basic infrastructures such as the transportation and electricity networks; and 6) re-establishing high educational standards and improving the health system. The authorities are convinced that the current three-year arrangement under the PRGF/EFF-supported program will provide not only a valid strategy to re-address the aforementioned problems, but also a successful exit strategy from the Fund-supported program, which will in turn pave the way for convergence with European standards.