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

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

- The staff report for Fourth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, Review Under the Extended Arrangement, and Financing Assurances Review, prepared by a staff team of the IMF, following discussions that ended on November 13, 2007, 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 March 14, 2008. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A staff statement of March 28, 2008 updating information on recent developments.

- A Press Release summarizing the views of the Executive Board as expressed during its March 28, 2008 discussion of the staff report that completed the review.

- 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*
Poverty Reduction Strategy Paper
Joint Staff Advisory Note of the Poverty Reduction Strategy Paper
*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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INTERNATIONAL MONETARY FUND

ALBANIA

Fourth 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 G. Russell Kincaid

March 14, 2008

Executive Summary

All quantitative program targets and most of the structural conditionality for the fourth review have been met.

The Albanian economy underwent a demanding test in 2007. Growth improved and inflation expectations remained low in spite of large external shocks from a drought and rising food and energy prices. However, unfinished reform in the electricity sector has buffeted the budget and poses large risks.

Program modifications centered on the electricity sector and the appropriate fiscal stance. Upfront measures to usher in a sustainable improvement in the sector were introduced. Fiscal anchors were tightened to avoid creating demand stimulus.

An increasingly maturing financial sector requires supervisors to reform in step. Program priorities include improved risk management capabilities and collateral execution, and strengthened cooperation with the home supervisors of foreign banks.

On the basis of satisfactory program performance and the authorities' commitments, staff recommends completion of the Fourth Review and Financing Assurances Review.

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GLOSSARY

ARMO	State-owned oil company
BSD	Banking Supervision Department
BoA	Bank of Albania
CIRR	Commercial Interest Reference Rate
CIT	Corporate income tax
DMB	Deposit monetary bank
FSA	Financial Supervisory Authority
FSD	Financial Stability Department
GDC	General Directorate of Customs
GTD	General Directorate of Taxation
INSIG	State-owned insurance company
INSTAT	The state statistical agency
JSAN	Joint Staff Advisory Note
KESH	The state-owned electricity company
LTO	Large taxpayer office
MEFP	Memorandum of Economic and Financial Policies
NATO	North Atlantic Treaty Organization
NSDI	National Strategy for Development and Integration
PC	Performance criterion
PPP	Public Private Partnership
PRSP	Poverty Reduction Strategy Paper (denoted as the National Strategy for Development and Integration in Albania)
SB	Structural benchmark
SLI	Savings and loan institution

I. Introduction

1. **In a challenging environment, economic and policy performance have generally held up, except in the critical energy sector**. Growth remained rapid, underlying inflation was contained, and most program conditionality related to this review was met (Table 1, MEFP Table 1). However, a drought affecting all of Southeastern Europe had particularly adverse effects in Albania and exacerbated problems in the electricity sector—an issue that dominated the previous review.

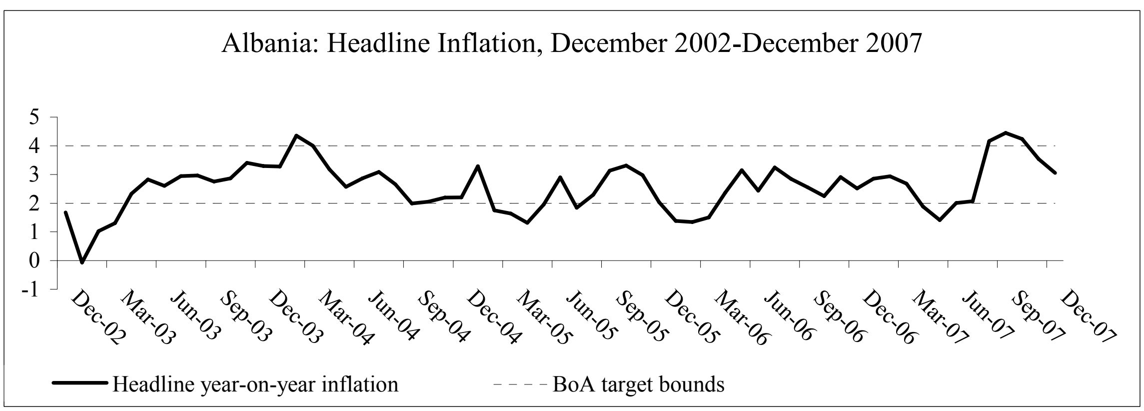
2. **The main challenges for this review were to further redress long-running problems in the energy sector, and to balance fiscal policy requirements for development spending with macroeconomic stability**.

II. Performance Under the Program

3. **The economy had to weather large exogenous shocks**. While still undeveloped links to world capital markets have so far buffered the impact of unsettled global financial market conditions, the drought and higher world food and energy prices have taken a toll:

- **Growth picked up to 6 percent.** Buoyant industrial production, the opening of new mines, rebounding construction activity, and strong export growth counterbalanced drought-related declines in domestic electricity generation and agricultural production (Table 2).

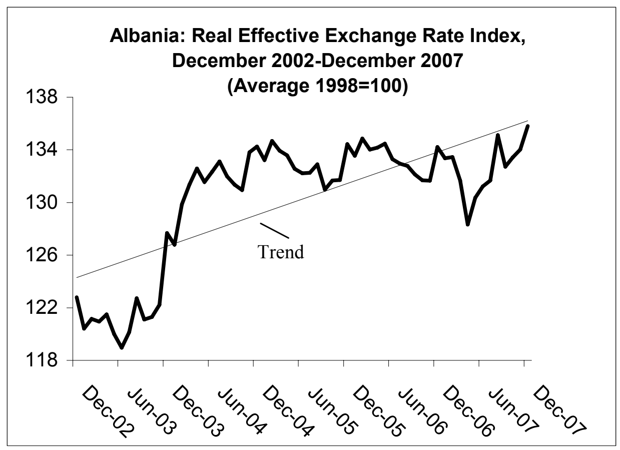
- **Headline inflation exceeded the 3±1 percent target band for several months in 2007.** Chronic power disruptions and sharply higher world prices for food were the main factors. The Bank of Albania (BoA) acted to stave off second-round effects by raising the policy rate to 6.25 percent in three ¼ percentage point increases in June, September, and November. Underlying inflation remained at 2½ percent and by December, headline inflation declined to 3.1 percent again.



- **Financial conditions continued to be supportive.** Rate increases and tighter prudential and regulatory frameworks helped rein in credit growth (Table 3). Nonetheless, the banking system has added about ⅔ percent of GDP in credit per month—overwhelmingly for housing and business purposes and funded from deposits.

- **The 2007 budget was executed broadly in line with the program.** Revenue gains financed higher social security expenses and an emergency transfer to the public electricity utility KESH. However, while problems in the execution of capital spending reappeared, the deficit reached 3.8 percent of GDP in line with the programmed 3.9 percent (Table 4), largely due to a budget reallocation that boosted spending on quick-disbursing projects. Proceeds from the privatization of the telecom company lowered the domestic financing requirement to 1.7 percent of GDP, compared to the programmed 2.5 percent.

- **The current account deficit widened to 9½ percent of GDP in 2007, largely due to higher and more costly imports of electricity, agricultural products, and capital goods** (Table 5). With structural reform having boosted productivity in the tradable sector, a competitive real exchange rate, and further expansion of mines, export growth strengthened further in 2007. Remittance flows remained strong at 14 percent of GDP.



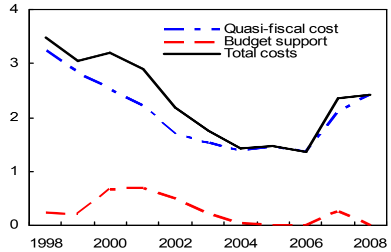
- **Structural conditionality in the fiscal and financial sectors was mostly met.** The Large Taxpayer Office became a full-service office (SB; end-October 2007), a cross-agency campaign to improve social security compliance was developed (SB; end-December 2007), and inactive taxpayers were removed from the tax registry (PC; mid-December 2007. In banking supervision, a credit bureau has been set up within the BoA (SB; end-December 2007), but legislation to transfer the supervision of leasing companies to the BoA has not yet been submitted to parliament (SB; end-October 2007).

4. **The financial position of KESH deteriorated significantly more than anticipated** (Box 1).

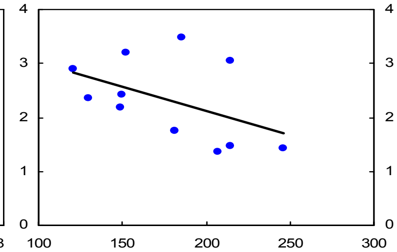
Box 1. Power Sector Restructuring and KESH Performance 1998–2008

- **KESH incurred large quasi-fiscal losses over the last decade.** While they gradually declined from 3.5 percent of GDP in 1998 to 1.4 percent of GDP in 2006, this largely reflected good rainfalls (and some increase in tariffs).

Fiscal and Quasi-Fiscal Costs of Electricity Sector, 1998-2008 (In percent of GDP)



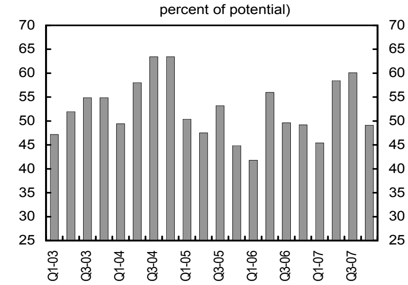
Total Fiscal Costs and Rainfalls



Source: Albanian authorities and staff estimates.

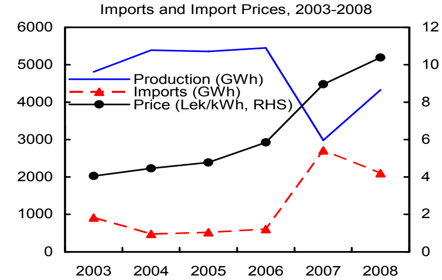
- **Unpaid electricity is the core problem.** Progress in raising the effective collection rates made over 2002–05 under Fund conditionality and World Bank programs was reversed between late 2005 and 2006 when technical losses and theft mounted. The deterioration peaked in January 2006, when payment was received on only a third of electricity supplied, compared to some 75 percent in the region.

KESH's Effective Collection Rates, 2003-07 (In percent of potential)



- **In 2007, financial difficulties were further aggravated by a regional drought**, driving up power prices in the region, and thus KESH's import prices, by more than half. At the same time, power imports jumped three fold to offset the drop in domestic production and poor water reserve management in 2006. Altogether electricity import costs increased by 2 percent of GDP in 2007.

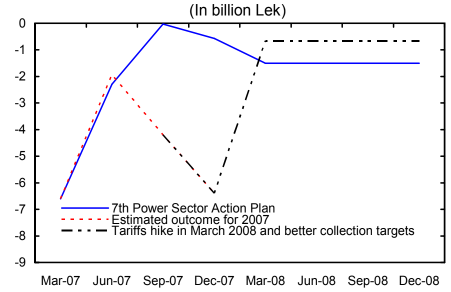
Domestic Production of Electricity, Net Imports and Import Prices, 2003-2008



Source: Albanian authorities and staff estimates.

- **In March 2007, the authorities made renewed efforts to restore KESH's financial performance in cooperation with the World Bank.** A new KESH management was installed, which cut off illegal connections and improved the effective collection rate by 2.5 percentage points by end-2007. Another 10 percentage point increase in the effective collection rate is planned for 2008. Together with an about 15 percent tariff hike in March 2008 and another one foreseen in summer, this is projected to improve KESH's cashflow and make up lost ground in 2007, despite a projected further 20 percent increase in import prices in 2008. To help achieve a more lasting solution to KESH's problems, the privatization of its distribution arm is slated for late 2008.

KESH: Net Financial Position, 2007-08 (In billion Lek)



Source: Albanian authorities and staff estimates.

III. Program Discussions

5. **Discussions focused on: updating the macroeconomic framework; sustainable reform of the electricity sector; the 2008 budget; and domestic financial market deepening.** The latter is key to prepare for accessing external debt markets, with the program set to expire in January 2009.

A. Economic Outlook

6. **Growth is expected to remain healthy and inflation to remain at target levels**. Rising agriculture and electricity production following a return of normal rainfalls is projected to offset a deceleration of industrial and mining growth to normal levels, supported by strong external demand. Rapid credit growth remains a challenge but the BoA should be able to contain inflationary pressures with continued timely monetary policy actions and regulatory tightening if, as expected, the fiscal stance remains broadly neutral (MEFP ¶22). The current account deficit is expected to drop to around 8½ percent of GDP in 2008 as significantly higher spending on capital goods imports is more than offset by lower fuel and electricity imports, and continued strong export growth. Renewed slippages in energy sector reform are the main risks to this scenario.

Albania: Real output growth by economic activities (in percent)

	2004	2005	2006	2007	2008
			Est.		Proj.
Agriculture, hunting and forestry	4.0	1.0	3.0	-1.9	2.5
Industry and mining	14.5	3.0	7.8	14.0	10.0
Construction	7.9	11.9	10.3	8.0	8.0
Trade, hotels and restaurants	3.7	8.6	5.0	9.0	7.5
Transport	9.6	3.1	5.0	8.0	8.0
Post and communication	6.3	10.0	2.1	5.0	4.0
Other services	2.5	5.0	2.5	5.0	4.0
Real GDP at market prices	5.9	5.8	5.0	6.0	6.0

Source: Albanian authorities and staff projections

B. Electricity Sector

7. **The authorities have adopted a two-pronged solution to the electricity crisis**. Their ultimate vision is for a private-sector dominated and diversified electricity sector that is fully integrated into the liberalized Southeastern European market (MEFP ¶21). A large thermal power plant and cross boarder transmission lines are planned to lessen dependence on rain, while licenses for private independent power producers have been awarded. Before the completion of these projects, and after long domestic consultations, the authorities aim to:

- **Take immediate measures to boost KESH's finances** (MEFP ¶19). A tariff increase of about 15 percent implemented in March and a subsequent one in summer to equilibrate KESH's cashflow is the lynchpin.[1] The authorities have committed to take additional measures to reduce the quasi-fiscal losses of KESH to 1.2 percent of GDP (SB; June 15, 2008); and a further 10 percentage point increase in effective collection rates—which would raise the effective collection rate to 62.5 percent—is also planned. Staff advised that cutting off nonpayers can make these measures mutually reinforcing in an environment where almost half the electricity provided goes unpaid.

- **Privatize the distribution arm of KESH** (MEFP ¶20). Improvements in cash flow and the regulatory regime in the electricity sector are critical to support the privatization process, which, the IFC believes, can be finalized by end-2008. Staff cautioned that this timeline required much improved coordination between donors. The Minister of Economy agreed to closely monitor and coordinate the process. The finalization of the market model and identification of eligible bidders are key and expected by June 2008.

C. Fiscal Policy

8. **Having put in place a major tax reform, the authorities want to focus on critical improvements in transport infrastructure in 2008**. The authorities' vision remains one of a small government providing an enabling environment for private sector-led growth. Key prerequisites are low nondistortionary taxation and upgraded transport infrastructure. After the adoption of a uniform 10 percent corporate income tax rate starting January 1, 2008—following a similar move in the personal income tax in 2007—direct taxes have become easier to administer and less distortionary. Higher excises and base-broadening measures made the reform revenue neutral while targeted improvements in tax administration continue (MEFP ¶13). However, public investment in transport infrastructure is only coming on stream in 2008, reflecting delays in design and procurement.

9. **Discussions centered on defining a fiscal stance in 2008 that allowed accelerated capital spending, while taking account of macroeconomic imperatives and risks from the energy sector**. The authorities considered that the program's fiscal anchors—ceilings on net domestic financing and the commitment on nonconcessionary debt—together with drastically shortened commitment-disbursement lags from a newly set-up commercial bank credit line allowed for a sharp increase in the deficit to some 8 percent GDP. This would help them finance cost overruns for the Rreshen-Kalimash road and complete the bulk of the project in 2008. Staff cautioned that in an already inflationary environment and with elevated current account deficits the budget should be mindful not to add stimulus. Moreover, the road

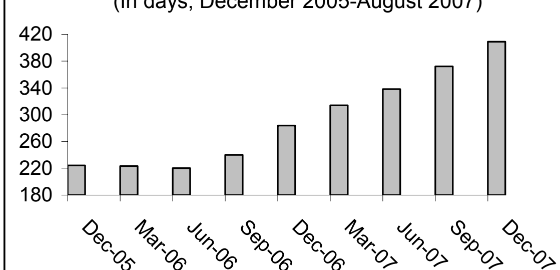
[1]A lifeline tariff for low consumption is reintroduced to protect the poorest households.

project had incurred significant cost overruns and, in line with past commitments under the program, these would need to be offset by cuts in other spending to maintain debt sustainability. Furthermore, it was not clear that smaller-scale road projects could be accelerated given past experience. Finally, ongoing uncertainties with KESH and—to a lesser extent—tax administration added further risks to budget execution.

10. **The 2008 program accommodates a one-time increase in the deficit to 5.2 percent of GDP, but the fiscal stance is expected to be broadly unchanged from 2007 as the additional spending is highly import intensive.** The widening of the fiscal deficit stems from additional spending in 2008 on the Rreshen Kalimash road project, where cost overruns are expected to add 0.8 percent of GDP in 2008 and where the acceleration of spending from 2009 into 2008 is expected to add 1.3 percent of GDP. The authorities have agreed to offset the entire cost overrun by cutting expenditures elsewhere, including other investment projects, thus limiting the impact on the deficit. Since the project is highly import intensive—the import content is expected to be well over 80 percent—the fiscal impulse from accelerating road expenditures will therefore be small with the main effect an increase in capital goods imports in 2008, rather than a boost to domestic demand. Domestic financing is expected to remain within the 2.5 percent of GDP ceiling and the medium-term debt reduction objective will not be affected, as the accelerated road spending represents only a rephasing of already planned medium-term spending. The budget has been protected against heightened risks with a contingency reserve of some 1½ percent of GDP (MEFP ¶12). Moreover, the authorities have agreed that a midterm budget review will be used to make other cuts in expenditures should the deficit ceiling appear at risk (MEFP ¶14). In addition, any shortfalls in spending on the road project will not be made up by other, less import-intensive spending. Going beyond 2008, there was agreement to adopt an explicit deficit anchor through a ceiling of 4 percent of GDP (MEFP ¶11). Clarifying the definition and use of this anchor—alongside the existing anchors—will be raised by staff as a key issue in the Article IV mission tentatively scheduled for April 2008.

11. **With graduation from PRGF resources in sight, the authorities are aiming to access international capital markets**. There was agreement on the need to deepen and broaden domestic financial markets in tandem. Lengthened maturities—recently increased to seven years—have already helped to reduce rollover risks and trigger nonresident interest in the market for government securities. However, a secondary market is needed to further broaden the investor base, and, accordingly, the authorities will follow a preannounced auction calendar, reduce the frequency of primary auctions, and develop a delivery-versus-payment system (MEFP ¶27).

Albania: Average Maturity of Public Domestic Debt[1]
(In days, December 2005-August 2007)



Source: Data provided by the Albanian authorities.

1Excluding debt held by Bank of Albania which is legally limited to a maximum of 6 months maturity.

D. Monetary and Financial Sector Policy

12. **Credit growth and international and domestic cost-push factors constitute the main risk to price stability**. Successive rate hikes have helped to contain inflation expectations thus far, and the planned fiscal stance for 2008 is consistent with inflation in the target range (Figure 1). A sharp uptick in commodity prices, and ongoing problems in the electricity sector were the main cost push risks. The authorities expect to continue to rely on monetary policy as the first line of defense against inflationary pressures and threats to financial stability. There was agreement that monetary policy—in concert with regulatory and prudential actions—has contributed to slowing credit growth and that the stock of credit is now approaching levels observed in other countries in the region. Nonetheless, the orderly unwinding of fast credit growth was recognized as a significant challenge, particularly if the large-scale titling reform currently underway led to an expansion of available collateral, or, conversely, if there was a sudden stop in regional capital inflows. Continued vigilance and a timely monetary policy response to perceived threats was called for. However, given the still rudimentary interest-transmission channel, the policy response would again need to include comprehensive regulatory and prudential measures.

13. **The authorities are prioritizing the strengthening of regulation to assure financial stability in a rapidly maturing financial system** (Table 6)**.** As the banking system is predominantly foreign owned, the authorities have stepped up efforts to formalize the regular exchange of information and close cooperation with home country supervisors of foreign banks. They have also terminated the regulatory forbearance on some consumer protection aspects that they were practicing with foreign banks and began issuing sanctions. Also, cognizant that much of the credit portfolio was built up in an unprecedented period of economic expansion, and is thus untested, the BoA is putting priority on improving risk management practices in banks and the legal and institutional framework for collateral execution (MEFP ¶25–26).

Albania: Structure of the Banking System as at October 2007

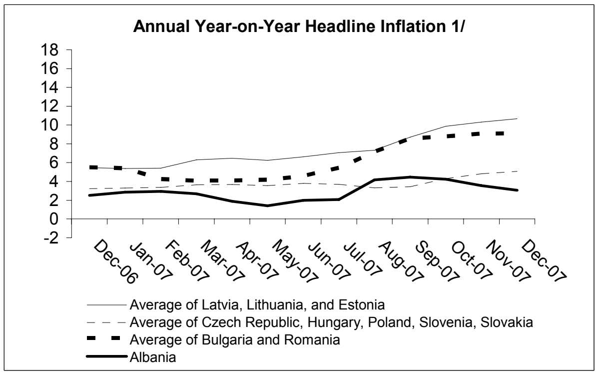
	Assets of banking system		Deposits in banking system		Loans to private sector		Net credit to government	
	Dec-03	Dec-07	Dec-03	Dec-07	Dec-03	Dec-07	Dec-03	Dec-07
Percent of total								
All banks	100	100	100	100	100	100	100	100
Foreign-owned banks	47	89	41	89	97	90	24	91
Domestic-owned banks	53	11	59	11	3	10	76	9
Largest bank 1/	52	32	58	35	1	19	76	49
Five largest banks 1/	85	72	88	76	61	65	96	84
Percent of GDP								
All banks	55	75	47	62	7	29	29	26
Foreign-owned banks (15)	26	67	19	55	7	26	7	24
Domestic-owned banks	29	8	28	7	0	3	22	2
Largest bank 1/	28	24	27	22	0	6	22	13
Five largest banks 1/	46	54	41	47	5	19	27	22

Source: Data provided by Bank of Albania.

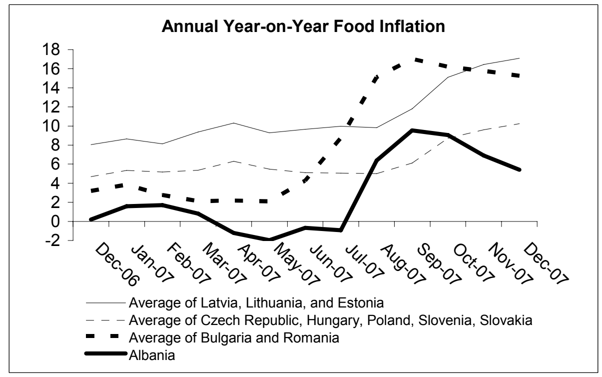
1/ Defined according to total assets at end-December 2007.

Figure 1. Albania: Inflation Developments, December 2006-December 2007

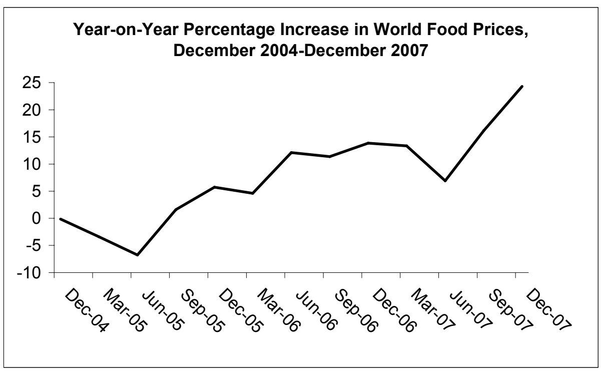
The recent acceleration of inflation in Albania is part of a regional development...



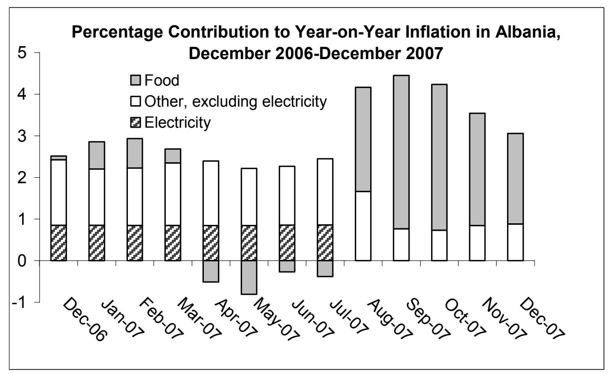
...driven largely by increases in food prices...



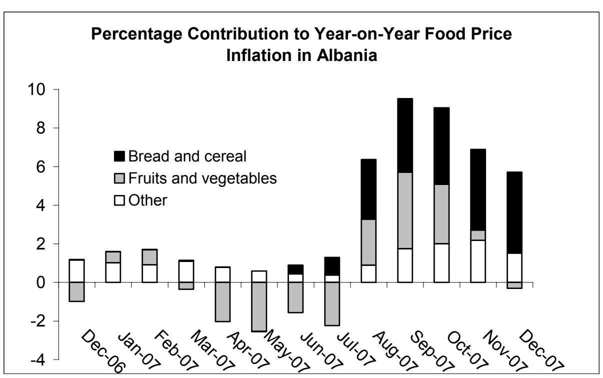
...which are themselves part of an ongoing global phenomenon.



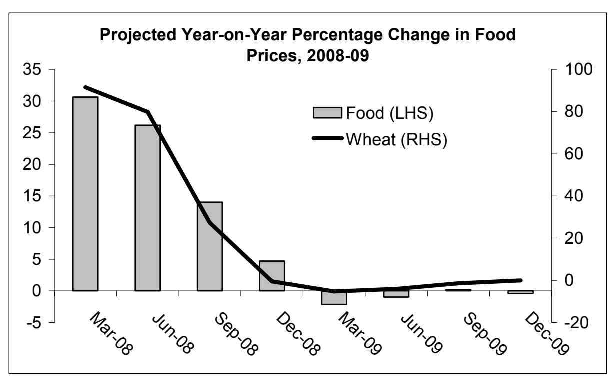
Abstracting from food price effects, underlying inflationary pressures in Albania are easing.



Within Albania, the food price increase is mainly due to the global increase in cereal costs, and to drought-induced increases in prices of fruits and vegetables.



Consequently, these price spikes will likely be temporary if normal weather patterns return, and if world food prices decline as expected.



Source: Eurostat HICP database, IMF WEO, and Macedonian, Serbian, and Albanian authorities.
1/ Annual change in national CPI for Albania. Annual change in Eurostat's Harmonized Indices of Consumer Prices for others.

14. **BoA's solvency was restored** by a transfer of gold in early 2008. Moreover, to avoid a recurrence of undercapitalization, which previously arose from valuation losses on reserves from lek appreciation, the authorities removed legal obstacles to BoA using retained earnings to augment its capital (MEFP ¶28).

E. Other Structural Reforms

15. **The privatization program is winding down**. The residual assets include a medium-sized insurance company, petroleum distribution assets, and government minority stakes, which are likely to be divested over 2008 and 2009.

16. **There is renewed momentum toward urgently needed improvements in statistics**. Preparatory surveys to permit the compilation of reliable national accounts are underway, and the authorities have secured Fund TA to help them in this area. Price statistics will also be refined following TA from the Fund.

F. Program Issues

17. **The authorities have prepared a new PRSP (National Strategy for Development and Integration) for 2007–13**.Their strategic priorities are European integration and NATO membership; a further focus on improving governance and the rule of law; and balanced and sustainable economic, and social and human development (a JSAN is attached and the NSDI has been circulated to the Board).

18. **The proposed conditionality for the Fifth Review is consistent with program goals, and the program is fully financed through 2008 (Table 7 and MEFP Table 1)**. Two modifications are proposed:

- The targeted increase in the number of social security taxpayers (SB; end-June 2008) needs to be scaled down to 410,000 from the initial target of 440,000, reflecting new data on employment that showed a lower-than-originally-estimated taxable base.

- A structural benchmark on limiting quasi fiscal losses in the electricity sector was introduced.

The 2008 financing gap is expected to be closed by arrears rescheduling and Fund financing, and projected future debt service to the Fund is minimal (Tables 8 and 9).

19. **Progress is being made on clearing remaining external arrears** (MEFP ¶33).

IV. Staff Appraisal

20. **Thanks to generally prudent policies, Albania's economy largely passed a demanding test in 2007**. Growth improved and inflation expectations remained low despite drought and higher food and energy prices. Prudent fiscal and monetary policies were key in

this regard, while ongoing structural reform is reaping rewards from improved competitiveness.

21. **However, the reform of the electricity sector must not falter this time around**. Unfinished reform efforts buffeted the 2007 budget and pose significant risks moving forward. In the short term, tariff increases and improvements in collections are imperative to contain fiscal risks and to lay the ground for a successful privatization, which should bring about a more sustainable improvement in electricity supply over the medium term.

22. **The planned 2008 fiscal program is consistent with the program strategy, which focuses on keeping government small and creating an enabling environment for private sector-led growth**. The new income tax structure, centered on a uniform 10 percent rate, has lowered taxes on investment and reduced distortions. Over time, it should also yield benefits from easier administration and higher yields. The ambitious road building program should foster market integration and long-term growth.

23. **The fiscal stance needs to be more tailored to macroeconomic requirements**. As large development-related projects are winding down, and with graduation from PRGF financing on the horizon, the authorities are appropriately amending the fiscal anchor. For 2008, limiting the deficit to 5.2 percent limits the fiscal impulse, without sacrificing accelerated infrastructure construction. Any underexecution of the large road project should not be reallocated to less import-intensive spending, but be reflected in a lower deficit. Beyond the program period, the authorities' decision to anchor policies on a deficit target is welcome.

24. **Targeting a greater role for private financing upon graduation from PRGF resources is appropriate**. However, to fully realize the benefits of these funds and reduce risks, stepped-up domestic financial market development and significantly strengthened debt management are essential. Current limited debt management capacity, exposure to domestic debt rollover risk, and volatility in international financial markets also call for caution in accessing markets and in contracting additional nonconcessionary debt. Moreover, the availability of finance must not trigger a deviation from the planned medium-term reduction in public debt.

25. **Monetary policy has so far kept inflationary expectations anchored, but the authorities need to remain vigilant, especially to the risks from rapid credit growth**. Despite the recent run of headline inflation in excess of the target band, underlying inflation and expectations remain contained. With a still weak interest-rate transmission channel, and at least until fiscal policy can shoulder a greater role in stabilizing aggregate demand, the authorities also need to continue supplementing monetary policy with regulatory and prudential measures.

26. **Supervisory and regulatory capacities must develop in step with the rapidly-maturing financial system**. A high degree of foreign ownership puts a premium on close

and effective collaboration with home-country supervisors. Similarly, the untested quality of much of recently extended credit demands enhanced risk management in banks, as well as better targeting in supervisory activity.

27. **The authorities are appropriately placing heightened emphasis on improving statistics**. In the near term, these efforts should focus on national income accounts, building on Fund technical assistance.

28. **Given the strong program performance and the authorities' commitments, staff recommends completion of the Fourth Review under the PRGF/EFF-supported program and the financing assurances review**.

Table 1. Status of Performance Criteria and Structural Benchmarks under the PRGF and EFF Arrangements

	Test Date	Status March 6, 2007
I. Performance Criteria		
1. Remove all inactive taxpayers from the register of active taxpayers maintained by the General Directorate of Taxation.	Mid-December, 2007	Met
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	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. Make the Large Taxpayer Office (LTO) a full service office for all large taxpayers in Albania.	End-October 2007	Met
6. Develop a comprehensive cross agency campaign aimed at improving compliance in relation to social security contributions, including appointing a sufficiently-mandated person to coordinate the efforts.	End-December 2007	Met
7. Increase the number of taxpayers paying social security contributions (excluding agricultural workers and voluntary contributors) to 440 thousands.	End-July 2008	Proposed change in target number to 410,000 in light of new information
Improve debt management capacity		
8. Prepare semi-annual reports (within one month of the end of each semester) on the stock of external arrears.	Ongoing	Met
C. Strengthen the financial system and improve economic monitoring capability		
9. Allow nonbank foreign and domestic institutional investors full access to primary auctions—on a competitive basis—for all government securities.	End-September 2007	Met
10. Submit the necessary legislation to Parliament for transferring supervisory authority over the remaining leasing companies to the Bank of Albania.	End-October 2007	Not met
11. Complete the establishment of a credit bureau within the Bank of Albania.	End-December 2007	Met

Table 2. Albania: Basic Indicators and Macroeconomic Framework, 2003–12

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
				Est.	Est.	Proj.	Proj.	Proj.	Proj.	Proj.
	(Growth rate in percent)									
Real GDP 1/	5.8	5.7	5.5	5.0	6.0	6.0	6.1	6.1	6.2	6.3
Retail prices (avg.)	2.3	2.9	2.4	2.4	2.9	4.0	3.1	3.0	2.9	2.8
Retail prices (end-period)	3.3	2.2	2.0	2.5	3.1	3.7	3.0	2.9	2.8	2.8
	(In percent of GDP)									
Saving-investment balance 2/										
Foreign savings 3/	5.2	4.0	6.6	5.9	9.5	8.8	5.6	5.1	5.1	4.7
Domestic savings	20.3	22.4	22.3	23.3	19.6	21.4	22.8	22.8	23.2	23.7
Public 4/	-0.5	-0.3	0.5	1.9	2.3	1.7	2.3	2.4	2.8	3.1
Private	20.7	22.6	21.8	21.4	17.3	19.7	20.6	20.5	20.4	20.6
Investment	25.4	26.3	28.9	29.1	29.2	30.2	28.5	27.9	28.3	28.4
Public	4.5	5.1	4.7	5.6	5.9	7.3	6.0	5.6	6.0	6.1
Private	20.9	21.2	24.2	23.5	23.3	22.9	22.5	22.3	22.3	22.3
Fiscal sector										
Revenues and grants	24.1	24.6	24.9	25.3	25.6	26.3	26.6	26.7	26.8	26.9
Tax revenue	20.9	22.1	22.4	23.0	23.6	24.4	24.8	25.0	25.2	25.3
Expenditures	28.5	29.8	28.6	28.6	29.4	31.5	30.4	30.0	30.0	30.0
Primary	24.2	26.0	25.4	25.8	26.8	28.4	27.4	27.2	27.1	27.1
Interest	4.3	3.8	3.2	2.8	2.6	3.1	3.0	2.8	2.8	2.8
Overall balance (including grants)	-4.5	-5.2	-3.7	-3.2	-3.8	-5.2	-3.7	-3.3	-3.2	-3.0
Primary balance (including grants)	-0.2	-1.4	-0.5	-0.4	-1.2	-2.1	-0.8	-0.5	-0.3	-0.2
Net domestic borrowing	2.9	2.3	2.7	2.3	1.7	1.7	2.5	2.3	2.1	2.1
Privatization receipts	0.1	1.9	0.1	0.2	1.7	0.4	0.2	0.2	0.2	0.2
Foreign financing	1.4	1.0	0.8	0.6	0.5	3.2	1.0	0.7	0.8	0.7
Public Debt	60.7	57.7	57.8	55.9	54.0	54.4	53.4	52.0	50.8	49.5
Domestic	40.5	39.3	39.9	39.1	37.7	35.9	35.3	34.7	34.0	33.3
External (including publicly guaranteed) 5/	20.3	18.4	17.9	16.9	16.2	18.5	18.1	17.3	16.8	16.2
Monetary indicators										
Broad money growth	8.7	13.5	13.9	16.3	13.7	14.6	14.3	14.2	14.0	13.7
Private credit growth	31.1	36.9	73.6	57.2	48.2	33.4	25.2	22.7	20.9	18.6
Velocity	1.6	1.5	1.4	1.3	1.3	1.2	1.2	1.1	1.1	1.0
Interest rate (3-mth T-bills, end-period)	7.3	6.2	5.4	6.4	6.3	…	…	…	…	…
	(In percent of GDP unless otherwise indicated)									
External sector										
Trade balance (goods and services)	-24.7	-22.2	-24.4	-24.1	-27.1	-26.1	-22.4	-21.5	-21.1	-20.4
Current account balance (including official transfers)	-5.2	-4.0	-6.6	-5.9	-9.5	-8.8	-5.6	-5.1	-5.1	-4.7
Current account balance (excluding official transfers)	-7.7	-5.7	-7.8	-7.2	-10.2	-9.8	-6.4	-5.8	-5.6	-5.2
Official transfers	2.6	1.8	1.2	1.4	0.7	1.0	0.8	0.7	0.5	0.5
Gross international reserves (in millions of Euros)	834	1,025	1,202	1,359	1,469	1,538	1,650	1,743	1,896	2,061
(In months of imports of goods and services)	3.9	3.9	4.0	3.8	3.8	3.8	3.8	3.7	3.7	3.7
(Relative to external debt service)	15.2	17.6	17.8	12.2	11.4	9.7	8.1	7.5	7.8	7.9
(In percent of broad money)	24.6	25.3	25.7	25.3	23.3	21.5	20.1	18.5	17.6	16.8
Change in real effective exchange rate (e.o.p., in percent)	4.1	5.1	0.3	-0.1	…	…	…	…	…	…
Memorandum items										
Nominal GDP (in billions of lek) 1/	694	751	820	893	969	1069	1168	1274	1388	1514

Social Indicators: GNI per capita, World Bank Atlas Method, US$ (2005): $2,570; **life expectancy at birth** (2005): 75 years; infant mortality rate (2005, per thousand births): 16; population 3.1 million (2005); 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 2003–05 are from the official national accounts; GDP data for 2006 are official estimates; GDP data for 2007 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 excluding grants less wages, local government expenditure, and opperations and maintenance.

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

Table 3a. Albania: Monetary Aggregates, 2003–12
(In percent of GDP; end-period)

	Actuals								IMF Projections							
	2003	2004	2005	2006	2007				2008				2009	2010	2011	2012
	Dec.	Dec.	Dec.	Dec.	Mar.	Jun.	Sep	Dec	Mar.	Jun.	Sep.	Dec.	Dec.	Dec.	Dec.	Dec.
Monetary survey																
Broad money	63.9	67.0	69.8	74.6	74.2	74.2	76.7	78.2	76.9	77.6	78.9	81.5	85.2	89.3	93.5	97.4
Currency outside banks	18.0	18.4	18.2	18.3	16.8	16.4	15.9	16.0	15.5	15.9	14.9	17.4	17.0	16.5	16.1	15.7
Deposits	45.9	48.6	51.6	56.3	57.4	57.7	60.9	62.2	61.4	61.7	64.1	64.1	68.3	72.8	77.3	81.7
Domestic currency deposits	32.6	34.0	33.7	35.2	35.3	35.6	35.4	36.2	35.0	35.6	36.0	34.8	37.2	39.6	42.6	45.9
Foreign currency deposits	13.3	14.6	17.9	21.2	22.1	22.2	25.5	25.9	26.4	26.1	28.1	29.2	31.1	33.1	34.7	35.7
Net foreign assets	23.3	25.1	25.7	26.1	25.7	23.8	27.4	23.9	21.8	21.4	21.9	22.3	21.4	20.7	20.1	19.8
Bank of Albania	14.4	15.8	16.9	18.1	18.1	17.7	19.1	17.6	16.6	16.5	16.7	16.9	16.6	16.1	16.1	16.0
Commercial Banks	8.9	9.3	8.8	8.1	7.5	6.1	8.3	6.3	5.2	5.0	5.3	5.4	4.8	4.6	4.0	3.9
Net domestic assets	40.6	41.9	44.1	48.5	48.5	50.4	49.4	54.2	55.1	56.1	57.0	59.2	63.8	68.6	73.4	77.6
Claims on government (net of deposits)	37.5	36.1	33.8	32.2	31.6	31.0	28.9	31.3	30.6	30.3	29.9	29.6	28.3	27.2	26.2	25.2
BOA financing	9.3	7.6	7.1	5.2	5.2	4.8	2.8	4.8	4.3	4.2	4.1	4.0	3.5	3.0	2.5	2.1
Of which: gross credit	10.6	8.7	8.4	7.6	7.2	7.3	7.2	6.9	6.6	6.4	6.2	6.1	5.4	4.8	4.1	3.6
Other (including T-bills)	28.2	28.5	26.6	27.0	26.3	26.2	26.1	26.5	26.2	26.1	25.8	25.6	24.8	24.2	23.7	23.1
Claims on state enterprises and farms	0.0	0.0	0.0	0.0	0.1	0.3	0.2	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Claims on the private sector 1/	7.5	9.5	15.2	21.9	23.8	26.0	27.9	29.9	31.8	33.0	34.1	36.5	41.9	47.1	52.3	56.8
In Leks	1.5	2.1	4.1	6.6	7.0	8.0	8.5	8.7	9.2	10.5	10.2	11.9	15.2	18.6	22.0	25.7
In foreign currency	6.0	7.5	11.0	15.3	16.8	18.0	19.4	21.2	22.6	22.5	23.9	24.6	26.6	28.5	30.3	31.1
Other items, net	-4.4	-3.8	-4.8	-5.6	-7.0	-6.9	-7.6	-7.3	-7.3	-7.2	-7.0	-6.9	-6.3	-5.7	-5.1	-4.5
Memorandum items:																
Reserve money (billions of Lek)	23.1	23.8	24.2	24.4	23.3	23.3	23.3	23.5	22.5	23.1	22.6	24.3	24.2	24.3	24.4	24.5
M1 (billions of Lek)	20.5	22.6	27.3	27.1	24.6	24.1	23.4	25.0	22.6	23.0	21.9	24.7	24.5	24.3	24.3	24.3
M2 (Billions of Lek)	50.6	52.4	52.0	53.5	52.1	52.0	51.3	52.2	50.5	51.4	50.8	52.3	54.2	56.2	58.7	61.7

Sources: Bank of Albania; and Fund staff estimates.

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

Table 3b. Albania: Monetary Aggregates, 2003–12

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

	Actuals								IMF Projections							
	2003	2004	2005	2006	2007				2008				2009	2010	2011	2012
	Dec.	Dec.	Dec.	Dec.	Mar.	Jun.	Sep	Dec	Mar.	Jun.	Sep.	Dec.	Dec.	Dec.	Dec.	Dec.
Monetary survey																
Broad money	443.5	503.2	573.0	666.5	678.6	678.5	713.8	757.5	770.8	794.3	827.2	871.5	995.9	1137.3	1297.1	1474.4
Currency outside banks	125.2	138.1	149.7	163.3	153.3	150.1	147.6	155.0	155.8	162.3	155.7	186.3	198.2	210.5	223.9	238.1
Deposits	318.3	365.1	423.3	503.2	525.3	528.4	566.2	602.6	615.1	632.0	671.5	685.2	797.7	926.8	1073.1	1236.3
Domestic currency deposits	226.1	255.2	276.8	314.1	322.9	325.7	329.4	351.1	350.6	364.5	377.1	372.6	434.7	505.0	591.3	695.4
Foreign currency deposits	92.2	110.0	146.6	189.1	202.4	202.7	236.8	251.5	264.5	267.5	294.4	312.6	363.0	421.9	481.9	540.9
Net foreign assets	161.8	188.8	210.8	233.2	234.9	217.7	254.7	232.1	218.6	219.4	229.9	238.5	250.1	263.4	278.5	300.2
Bank of Albania	99.8	118.6	138.8	161.2	165.9	161.7	177.5	171.0	166.0	168.7	174.9	180.3	193.9	205.3	222.9	241.6
Commercial Banks	62.0	70.2	72.0	72.0	69.0	56.0	77.2	61.1	52.6	50.7	55.0	58.2	56.2	58.1	55.6	58.6
Net domestic assets	281.7	314.4	362.2	433.2	443.7	460.8	459.1	525.4	552.2	574.9	597.2	633.0	745.8	874.0	1018.5	1174.2
Claims on government (net of deposits)	260.1	271.0	277.0	287.9	288.8	283.9	268.7	303.0	306.4	309.9	313.1	316.5	330.4	346.4	363.5	381.9
BOA financing	64.6	57.2	58.6	46.8	48.0	44.3	26.2	46.2	43.4	43.1	42.9	42.6	40.4	38.4	34.4	32.4
Of which: gross credit	73.4	65.7	68.8	67.9	65.5	67.0	66.9	67.0	65.7	65.4	65.2	64.9	62.7	60.7	56.7	54.7
Other (including T-bills)	195.5	213.7	218.4	241.0	240.7	239.7	242.5	256.8	263.0	266.8	270.3	273.9	290.0	308.1	329.1	349.5
Claims on state enterprises and farms	0.0	0.1	0.1	0.2	0.7	2.3	1.5	3.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Claims on the private sector 1/	52.3	71.6	124.4	195.5	217.9	237.7	259.3	289.7	318.5	338.2	357.8	390.6	489.0	600.0	725.1	859.8
In Leks	10.6	15.6	33.7	59.2	64.0	72.9	79.2	84.6	92.3	107.4	107.0	127.6	178.0	237.2	305.1	388.8
In foreign currency	41.7	56.0	90.6	136.4	153.9	164.7	180.1	205.1	226.1	230.8	250.7	263.0	311.0	362.8	420.1	471.0
Other items, net	-30.8	-28.3	-39.2	-50.3	-63.6	-63.1	-70.4	-71.2	-72.7	-73.2	-73.7	-74.1	-73.5	-72.5	-70.2	-67.5
Memorandum items:																
Reserve money (billions of Lek)	160.6	178.6	198.3	217.6	213.3	212.9	216.4	228.2	225.0	236.3	236.9	259.4	283.2	309.3	338.4	370.3
M1 (billions of Lek)	142.0	170.1	223.7	242.4	225.2	220.6	218.0	242.7	226.2	235.5	229.8	264.0	286.2	310.0	337.3	367.9
M2 (Billions of Lek)	351.3	393.3	426.4	477.4	476.2	475.8	477.0	506.0	506.3	526.8	532.7	558.9	632.9	715.5	815.2	933.5
Annual broad money growth	8.7	13.5	13.9	16.3	18.0	15.1	14.8	13.7	13.6	17.1	14.5	14.6	14.3	14.2	14.0	13.7
Annual reserve money growth	-2.0	11.2	11.0	9.8	14.5	9.4	5.4	4.9	5.5	11.0	6.7	9.2	9.2	9.2	9.4	9.4
Annual growth in private sector credit	31.1	36.9	73.6	57.2	58.6	52.6	52.7	48.2	46.1	42.3	37.8	33.4	25.2	22.7	20.9	18.6
Private sector credit as a percent of GDP	7.5	9.5	15.2	21.9	23.8	26.0	27.9	29.9	34.8	37.0	38.5	36.5	41.9	47.1	52.3	56.8
Annual change in credit as a percent of GDP	1.1	2.0	5.6	6.7	7.6	7.9	8.31	7.99	11.0	11.4	10.5	6.3	5.3	5.2	5.2	4.5
Annual M2 growth	9.2	11.9	8.4	11.9	12.9	10.9	7.4	6.0	6.3	10.7	9.0	9.9	13.2	13.1	13.9	14.5
Velocity (annual GDP/BM)	1.6	1.5	1.4	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.2	1.2	1.1	1.1	1.0
Money multiplier (absolute values)	2.8	2.8	2.9	3.1	3.2	3.2	3.3	3.3	3.4	3.4	3.5	3.4	3.5	3.7	3.8	4.0
Currency/Broad Money ratio	28.2	27.4	26.1	24.5	22.6	22.1	20.7	20.5	20.2	20.4	18.8	21.4	19.9	18.5	17.3	16.1
Currency/M2 ratio	35.6	35.1	35.1	34.2	32.2	31.5	30.9	30.6	30.8	30.8	29.2	33.3	31.3	29.4	27.5	25.5
Foreign currency deposits/total deposits	29.0	30.1	34.6	37.6	38.5	38.4	41.8	41.7	43.0	42.3	43.8	45.6	45.5	45.5	44.9	43.8
Gross reserves (millions of euros)	834	1,025	1,202	1,359	1,380	1,396	1,530	1,469	1,429	1,449	1,500	1,538	1,650	1,743	1,896	2,061
Gross reserves (millions of U.S. dollars)	1,026	1,374	1,425	1,796	1,827	1,873	2,126	2,138	2,079	2,109	2,184	2,244	2,421	2,576	2,829	3,104
In percent of broad money	24.6	25.3	25.7	25.3	25.5	25.0	25.9	23.3	22.6	22.2	22.1	21.5	20.1	18.5	17.6	16.8
US Dollar Exchange Rate (end of period)	106.4	92.7	103.4	94.0	94.9	90.6	86.9	82.7	...	...	...	...	...	...	...	...
Euro Exchange Rate (end of period)	133.8	125.9	122.4	123.6	126.4	121.9	123.0	121.6	...	...	...	...	...	...	...	...
3-month T-bill rate (in percent)	7.32	6.15	5.40	6.38	5.59	5.68	5.7	6.3	…	…	…	…	…	…	…	…
BoA repo rate (in percent)	6.50	5.25	5.00	5.50	5.50	5.75	6.0	6.3	…	…	…	…	…	…	…	…

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, 2003–12
(In percent of GDP)

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
								Projection		
Total revenue and grants	24.1	24.6	24.9	25.3	25.6	26.3	26.6	26.7	26.8	26.9
Tax revenue	20.9	22.1	22.4	23.0	23.6	24.4	24.8	25.0	25.2	25.3
VAT	7.3	7.7	7.9	8.3	9.1	9.3	9.5	9.7	9.7	9.8
Profit tax 1/	1.9	2.2	2.3	2.5	2.2	1.3	1.4	1.5	1.4	1.5
Excise tax	1.8	2.1	2.3	2.6	3.0	3.6	3.7	3.8	3.8	3.9
Small business tax	0.4	0.5	0.5	0.3	0.2	0.2	0.2	0.2	0.2	0.2
Personal income tax	0.9	0.9	0.9	1.0	1.5	1.5	1.6	1.7	1.7	1.7
Customs duties	2.0	1.8	1.7	1.6	1.0	0.9	0.5	0.4	0.4	0.2
Other taxes	1.8	1.6	1.5	1.5	1.5	1.4	1.4	1.5	1.6	1.6
Property and local taxes	0.6	0.7	0.9	1.0	0.7	1.2	1.2	1.2	1.2	1.3
Social insurance contributions	4.1	4.4	4.4	4.4	4.4	4.8	5.1	5.3	5.3	5.2
Non-tax revenue	2.8	2.1	1.7	1.8	1.9	1.6	1.6	1.5	1.5	1.5
Grants	0.4	0.3	0.8	0.5	0.1	0.3	0.2	0.2	0.2	0.1
Of which: budget support	0.0	0.0	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure	28.5	29.8	28.6	28.6	29.4	31.5	30.4	30.0	30.0	30.0
Current expenditure	24.2	24.5	23.6	22.9	23.2	24.0	23.9	23.9	23.7	23.6
Personnel cost	6.4	6.5	6.5	6.3	6.1	6.6	6.6	6.6	6.6	6.5
Of which: contingency	…	…	…	…		0.3	0.3	0.3	0.3	0.2
Interest	4.3	3.8	3.2	2.8	2.6	3.1	3.0	2.8	2.8	2.8
Of which: Domestic	4.1	3.6	2.9	2.6	2.4	2.7	2.5	2.3	2.3	2.3
Operations & maintenance	3.2	3.2	3.0	2.9	2.6	2.6	2.8	2.9	2.9	2.9
Subsidies	0.7	0.7	0.4	0.4	0.3	0.2	0.2	0.2	0.2	0.2
Social insurance outlays	6.5	6.7	6.8	6.7	7.2	7.3	7.0	7.0	7.0	7.0
Of which: contingency	…	…	…	…		0.2	…	…	…	…
Local government expenditure	2.1	2.1	2.4	2.5	2.2	2.7	2.7	2.7	2.7	2.8
Social protection transfers	1.3	1.5	1.2	1.2	1.5	1.4	1.5	1.5	1.4	1.4
Other 2/	-0.3	0.0	…	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital expenditure 3/	4.5	5.1	4.7	5.6	5.9	7.3	6.0	5.6	6.0	6.1
Domestically financed	2.6	3.7	3.0	4.3	5.0	3.5	4.4	4.8	4.8	5.1
Of which: contingency	…	…	…	…	0.0	0.6	0.4	0.4	0.4	0.4
Foreign financed projects	1.9	1.5	1.7	1.4	0.9	3.8	1.6	1.4	1.4	1.4
Capital transfer to KESH	…	…	…	…	0.5	…	…	…	…	…
Lending minus repayment	-0.2	0.2	0.2	0.0	0.4	-0.4	0.0	0.0	0.0	0.0
Reserve and contingency funds 4/ ...	...	...	…	0.0	0.0	0.6	0.5	0.6	0.6	0.6
Cash balance	-4.5	-5.2	-3.7	-3.2	-3.8	-5.2	-3.7	-3.3	-3.2	-3.0
Current balance including grants 5/	-0.1	0.1	1.2	2.4	2.4	2.0	2.5	2.5	2.8	3.1
Financing	4.5	5.2	3.7	3.2	3.8	5.2	3.7	3.3	3.1	3.0
Domestic	3.0	4.3	2.8	2.6	3.8	2.0	2.7	2.5	2.3	2.3
Privatization receipts 6/	0.1	1.9	0.1	0.2	1.7	0.4	0.2	0.2	0.2	0.2
Net borrowing	2.9	2.3	2.7	2.3	1.7	1.7	2.5	2.3	2.1	2.1
Foreign	1.4	1.0	0.8	0.6	0.5	3.2	1.0	0.7	0.8	0.7
Memorandum Items:										
Primary balance	-0.2	-1.4	-0.5	-0.4	-1.2	-2.1	-0.8	-0.5	-0.3	-0.2
Current balance excluding grants	-0.5	-0.3	0.5	1.9	2.3	1.7	2.3	2.3	2.6	2.9
Total spending contingencies 4/	…	…	…	…	0.0	1.4	1.2	1.3	1.3	1.2
Expenditures in priority sectors 7/	7.2	8.3	8.1	9.2	9.4	9.6	10.2	10.2	10.2	10.2
Public Debt 8/	60.7	57.7	57.8	55.9	54.0	54.4	53.4	52.0	50.8	49.5
Domestic general government	40.5	39.3	39.9	39.1	37.7	35.9	35.3	34.7	34.0	33.3
External	20.3	18.4	17.9	16.9	16.2	18.5	18.1	17.3	16.8	16.2
GDP (in billions of leks)	694	751	820	893	969	1069	1168	1274	1388	1514

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

1/ Includes reduction of CIT rate to 10 percent from 2008.
2/ Includes statistical discrepancy.
3/ Excludes capital transfer to KESH in 2007.
55/ Spending contingencies are reported according to their economic classification at outturn.
6/ Revenue including grants minus current expenditure (including the capital transfer to KESH in 2007).
6/ Includes privatization and decapitalization of Albtelekom in 2007 and projected privatization of INSIG in 2008.
7/ Education, health, and road sectors.
8/ Includes securities issued to the Bank of Albania in 2005 to compensate for its foreign exchange valuation losses.

Table 4b. Albania: General Government Operations, 2003–12
(In billions of leks)

		2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
							Projection				
Total revenue and grants		167.2	184.6	204.2	226.3	248.3	281.0	310.9	340.1	371.9	407.7
Tax revenue		145.3	166.0	183.8	205.5	228.4	261.2	290.2	318.2	349.2	382.2
VAT		50.6	58.2	64.5	74.3	87.8	99.9	111.3	123.2	134.9	148.4
Profit tax 1/		13.1	16.3	19.2	22.3	21.0	14.4	15.8	18.6	19.3	22.6
Excise tax		12.3	15.8	18.5	23.0	28.7	38.5	43.4	48.5	53.2	58.5
Small business tax		2.9	4.1	3.8	2.6	2.3	1.8	2.1	2.4	2.6	2.9
Personal income tax		6.4	6.9	7.4	8.6	14.8	16.3	18.4	21.1	24.1	26.4
Customs duties		13.9	13.9	13.6	14.0	9.8	9.4	6.1	5.7	4.9	3.7
Other taxes		12.5	12.1	12.7	13.0	14.5	15.4	16.8	19.2	21.6	24.5
Property and local taxes		4.5	5.0	7.5	9.3	7.1	12.6	14.1	15.8	17.2	19.0
Social insurance contributions		28.6	33.3	36.2	39.3	42.2	51.1	60.1	67.6	73.0	79.4
Non-tax revenue		19.2	16.0	14.2	16.0	18.6	16.6	18.1	19.4	20.4	23.4
Grants		2.6	2.6	6.2	4.8	1.3	3.2	2.6	2.5	2.2	2.0
Of which: budget support	...	0.2	0.2	0.4	1.6	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure		198.1	223.8	234.2	255.2	285.1	336.7	354.7	382.4	415.7	453.5
Current expenditure		167.7	183.8	194.0	204.9	224.8	256.4	279.0	304.5	329.5	357.0
Personnel cost		44.7	49.0	53.7	56.7	59.1	70.8	77.5	83.8	91.1	98.5
Of which : contingency		…	…	…	…		2.8	3.5	3.5	3.5	3.5
Interest		29.8	28.4	26.0	25.0	25.5	33.3	34.8	36.3	39.5	43.1
Of which: domestic		28.2	26.7	24.2	23.0	23.5	29.0	28.9	29.8	32.5	35.4
Operations & maintenance		22.2	24.0	24.5	25.8	25.2	27.9	32.1	37.4	40.7	43.4
Subsidies		5.1	5.1	3.7	3.8	3.4	2.3	2.8	2.9	3.1	3.4
Social insurance outlays		44.8	50.2	55.9	60.0	69.9	77.8	81.9	89.3	97.0	105.5
Of which: contingency		…	…	…	…		1.8	…	…	…	…
Local government expenditure		14.2	15.9	20.0	22.7	21.4	28.4	31.5	35.0	38.1	41.8
Social protection transfers		8.8	11.5	10.2	10.8	14.8	15.4	17.9	19.3	19.3	20.6
Property compensation		…	…	…	0.0	0.5	0.5	0.5	0.5	0.5	0.6
Other 2/		-2.0	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital expenditure 3/		31.5	38.6	38.4	50.4	56.7	78.3	69.7	71.8	82.7	93.1
Domestically financed		18.3	27.6	24.3	38.2	48.2	37.4	51.5	61.0	67.1	77.3
Of which: contingency		…	…	…	…	0.0	6.0	5.0	5.0	6.0	6.0
Foreign financed projects		13.2	11.0	14.1	12.1	8.5	40.8	18.2	17.2	19.8	21.8
Capital transfer to KESH		…	…	…	…	5.0	…	…	…	…	…
Lending minus repayment		-1.1	1.4	1.9	0.0	3.7	-4.0	0.0	0.0	0.0	0.0
Reserve and contingency funds 4/	...	...	...	…	…	0.0	6.0	6.0	7.6	8.0	9.0
Cash balance		-30.9	-39.2	-30.1	-28.9	-36.9	-55.6	-43.8	-42.3	-43.8	-45.9
Current balance including grants 5/		-0.6	0.7	10.2	21.4	23.5	21.6	29.0	31.7	38.4	46.2
Financing		30.9	39.2	30.1	28.9	36.9	55.6	43.1	41.6	43.1	45.1
Domestic		20.9	31.9	23.3	23.5	32.0	21.8	31.2	32.3	32.2	34.4
Privatization receipts 6/		0.9	14.4	0.9	2.0	16.6	4.1	2.4	2.5	2.6	2.7
Net borrowing		20.0	17.6	22.4	20.7	16.9	17.7	28.8	29.8	29.6	31.8
Foreign		10.0	7.3	6.8	5.4	4.9	33.8	12.0	9.3	10.9	10.6
Memorandum Items:											
Primary balance		-1.1	-10.8	-4.0	-3.9	-11.3	-22.3	-9.0	-6.0	-4.3	-2.7
Current balance excluding grants		-3.2	-1.9	4.0	16.6	22.2	18.4	26.3	29.3	36.1	44.2
Total spending contingencies 4/		…	…	…	…	0.0	14.8	14.5	16.1	17.5	18.5
Expenditures in priority sectors 7/		50.1	62.6	66.7	81.9	91.5	102.9	118.8	129.6	141.1	153.9
Public Debt 8/		421.4	433.4	474.4	499.5	523.1	581.6	623.7	662.9	704.3	749.1
Domestic general government		280.8	295.2	327.4	348.9	365.8	383.5	412.3	442.0	471.6	503.4
External		140.6	138.2	147.1	150.5	157.4	198.1	211.5	220.9	232.7	245.7

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

1/ Includes reduction of CIT rate to 10 percent from 2008.
2/ Includes statistical discrepancy.
3/ Excludes capital transfer to KESH in 2007.
4/ Spending contingencies are reported according to their economic classification at outturn.
5/ Revenue including grants minus current expenditure (including the capital transfer to KESH in 2007).
6/ Includes privatization and decapitalization of Albtelekom in 2007 and projected privatization of INSIG in 2008.
7/ Education, health, and road sectors.
8/ Includes securities issued to the Bank of Albania in 2005 to compensate for its foreign exchange valuation losses.

Table 5a. Albania: Balance of Payments, 2003–12
(In percent of GDP)

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
					Est	Projections				
Current account	-5.2	-4.0	-6.6	-5.9	-9.5	-8.8	-5.6	-5.1	-5.1	-4.7
Balance of goods and services	-24.7	-22.2	-24.4	-24.1	-27.1	-26.1	-22.4	-21.5	-21.1	-20.4
Exports	20.4	21.9	22.6	25.1	27.8	27.4	27.8	27.9	28.3	28.7
Goods	7.8	8.2	8.0	8.7	10.0	9.9	10.6	11.0	11.5	12.0
Services	12.6	13.7	14.6	16.5	17.8	17.5	17.2	16.9	16.8	16.7
Imports	45.1	44.1	47.1	49.3	54.8	53.5	50.1	49.4	49.4	49.1
Goods	31.1	29.7	30.3	31.9	37.1	35.6	32.7	32.4	32.4	32.2
Services	14.0	14.4	16.7	17.4	17.8	17.8	17.4	17.0	17.0	16.9
Income balance	3.0	2.4	2.0	2.8	3.0	2.2	2.0	1.9	1.9	1.8
Of which : Interest due	0.4	0.3	0.4	0.5	0.7	0.7	0.9	0.9	0.9	0.9
Private transfers 1/	14.0	14.0	14.6	14.1	13.9	14.0	14.0	13.8	13.6	13.4
Official transfers	2.6	1.8	1.2	1.4	0.7	1.0	0.8	0.7	0.5	0.5
Capital account	5.4	5.6	5.0	5.8	9.3	8.1	5.4	4.8	5.3	5.1
Direct investment	3.1	4.7	3.4	3.6	6.2	3.4	3.7	3.9	3.9	4.1
Other capital	0.8	-0.2	0.6	1.5	2.3	1.4	1.1	0.6	0.9	0.5
Private loans (incl.net trade credits)	0.4	1.3	0.9	0.5	0.9	0.8	0.8	0.8	0.8	0.8
Other financial flows	0.4	-1.5	-0.3	0.9	1.5	0.6	0.3	-0.2	0.2	-0.3
O*f which:* Change in NFA of DMBs (incr = -) 2/	0.4	-1.5	-0.3	0.1	0.9	0.4	0.2	-0.2	0.2	-0.2
Official medium- and long-term loans (net)	1.5	1.1	0.9	0.7	0.7	3.2	0.6	0.3	0.5	0.5
New borrowing	2.0	1.7	1.5	1.6	1.5	4.2	1.8	1.5	1.6	1.7
Multilateral loans	1.5	1.2	1.1	1.1	1.2	1.1	1.2	1.0	1.1	1.1
World Bank	0.7	0.6	0.5	0.5	0.5	0.4	0.4	0.4	0.4	0.3
EBRD	0.3	0.2	0.2	0.3	0.2	0.3	0.3	0.2	0.3	0.3
Other	0.5	0.4	0.4	0.4	0.5	0.4	0.5	0.4	0.4	0.4
Bilateral loans	0.5	0.5	0.4	0.5	0.3	0.5	0.6	0.5	0.4	0.3
Commercial debt					0.0	2.6	0.0	0.0	0.2	0.3
Amortization	-0.5	-0.6	-0.5	-0.9	-0.8	-1.0	-1.1	-1.2	-1.2	-1.1
Errors and omissions 3/	0.3	1.4	2.7	2.5	1.6	1.5	1.3	1.2	1.1	1.0
Net balance	0.5	3.0	1.1	2.5	1.4	0.7	1.1	0.9	1.4	1.4
Financing requirement	-0.5	-3.0	-1.1	-2.5	-1.4	-0.7	-1.1	-0.9	-1.4	-1.4
Available financing	-0.5	-3.0	-1.1	-2.6	-1.4	-0.7	-1.1	-0.9	-1.4	-1.4
Change in net reserves (increase = -) 2/	-0.9	-3.3	-1.1	-2.8	-1.5	-0.8	-1.2	-1.0	-1.4	-1.4
BOP support	0.3	0.3	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Changes in arrears (increase = +) 4/	0.1	-0.2	-0.3	-0.1	0.0	-0.4	0.0	0.0	0.0	0.0
Overdue debt forgiveness	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Rescheduling 4/	0.0	0.2	0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Identified Financing	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.0	0.0	0.0
Of which: World Bank including DPL	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.0	0.0	0.0
Financing gap 5/	0.0	0.0	0.0	0.0	0.0	0.4	0.0	0.0	0.0	0.0
Expected EU Macro-Financial Assistance	...	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Arrears Rescheduling	...	...	0.0	0.0	0.0	0.4	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

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

1/ Bank of Albania data plus IMF estimate (to capture some unrecorded inflows not captured in the BOA estimate).
2/ Net of valuation changes in 2005–2006. In projections for 2007–2010, valuation effects are assumed to be zero.
3/ Net errors and omissions include unidentified flows of private transfers.
4/ In 2006–2007 assumes rescheduling of stock of outstanding arrears, both with official and private creditors.
5/ The financing gap is expected to be fully covered by arrears rescheduling and prospective privatization receipts.

Table 5b. Albania: Balance of Payments, 2003–12
(In millions of Euros)

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
					Est	Projections				
Current account	-261	-235	-437	-426	-747	-776	-541	-536	-584	-596
Balance of goods and services	-1,248	-1,307	-1,617	-1,752	-2,125	-2,289	-2,147	-2,256	-2,424	-2,575
Exports	1,031	1,293	1,498	1,825	2,177	2,406	2,665	2,935	3,254	3,610
Goods	396	486	530	631	783	870	1,018	1,160	1,323	1,508
Services	635	808	967	1,195	1,394	1,536	1,648	1,775	1,931	2,102
Imports	2,279	2,600	3,115	3,577	4,302	4,695	4,812	5,191	5,678	6,184
Goods	1,572	1,752	2,007	2,316	2,909	3,130	3,138	3,401	3,721	4,061
Services	708	848	1,108	1,261	1,393	1,565	1,674	1,790	1,957	2,123
Income balance	152	143	132	203	234	193	188	200	213	229
Of which : Interest due	21	18	25	40	54	64	83	93	102	112
Private transfers 1/	706	826	969	1,024	1,089	1,231	1,342	1,449	1,565	1,691
Official transfers	129	103	79	99	56	89	76	70	62	60
Capital account	274	332	328	420	726	707	521	505	614	639
Direct investment	158	277	224	259	486	297	358	410	452	512
Other capital	42	-13	41	109	184	126	105	67	108	60
Private loans (incl.net trade credits, net)	21	78	63	40	67	70	80	85	90	96
Other financial flows	21	-91	-22	69	117	56	25	-18	18	-36
Of which: Change in NFA of DMBs (incr = -) 2/	21	-91	-22	7	72	31	15	-18	18	-27
Medium- and long-term loans (net)	75	68	63	53	56	284	59	28	53	68
New borrowing	101	100	98	116	121	369	169	158	185	210
Multilateral loans	75	72	73	82	94	93	113	110	121	133
World Bank	36	37	32	36	39	36	40	40	42	44
EBRD	13	13	15	19	14	22	27	25	30	35
Other	25	23	25	27	41	35	46	45	49	54
Bilateral loans	26	28	26	35	26	46	56	48	44	36
Commercial debt					0	230	0	0	20	40
Amortization	-25	-33	-35	-63	-65	-84	-110	-130	-132	-141
Errors and omissions 3/	14	80	182	184	129	132	129	129	129	129
Net balance	27	177	72	178	108	63	109	98	159	172
Financing requirement	-27	-177	-72	-178	-108	-63	-109	-98	-159	-172
Available financing	-27	-177	-69	-178	-111	-64	-109	-98	-158	-172
Change in net reserves (increase = -) 2/	-46	-193	-72	-200	-115	-74	-119	-101	-162	-172
Of which: Change in gross reserves, (increase = -) 2/	10	-191	-77	-197	-110	-69	-112	-92	-153	-165
Use of Fund Resources (net)	1	2	2	-3	-5	-5	-7	-9	-8	-7
Budget support	17	15	3	9	0	0	0	0	0	0
Changes in arrears (increase = +) 4/	3	-12	-17	-7	-3	-35	0	0	0	0
Overdue debt forgiveness	0	0	0	0	0	0	0	0	0	0
Rescheduling 4/	0	12	17	7	0	0	0	0	0	0
Identified Financing	0	0	0	13	7	10	10	3	3	0
Of which : World Bank including DPL	0	0	0	0	7	10	10	3	3	0
Financing gap 5/	0	0	0	0	0	35	0	0	0	0
Expected EU Macro-Financial Assistance	...	...	0	0	0	0	0	0	0	0
Arrears Rescheduling	...	...	0	0	0	35	0	0	0	0
Other	...	...	0	0	0	0	0	0	0	0
Memorandum items:										
Gross usable reserves	834	1,025	1,202	1,359	1,469	1,538	1,650	1,743	1,896	2,061
(months of imports of goods and services)	3.9	3.9	4.0	3.8	3.8	3.8	3.8	3.7	3.7	3.7
Balance of goods and services (percent of GDP)	-24.7	-22.2	-24.4	-24.1	-27.1	-26.1	-22.4	-21.5	-21.1	-20.4
Current account (percent of GDP)	-5.2	-4.0	-6.6	-5.9	-9.5	-8.8	-5.6	-5.1	-5.1	-4.7
Debt service (percent of exports of goods and services) 6/	5.0	4.1	3.9	4.7	4.0	4.5	5.4	5.5	5.5	5.4
Debt service (percent of central government revenues) 6/	4.5	3.9	3.9	5.0	4.5	5.1	6.0	6.1	6.1	6.1
Total external debt stock (percent of GDP) 7/	21.9	20.8	20.9	19.8	19.1	21.2	20.6	19.7	19.0	18.3
Volume of Exports of Goods and Services (percent change)	9.5	20.6	6.9	13.3	21.9	13.7	15.6	13.1	12.4	12.1
Volume of Imports of Goods and Services (percent change)	8.4	10.7	8.4	2.4	14.0	6.3	4.5	7.8	8.3	7.6

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

1/ Bank of Albania data plus IMF estimate (to capture some unrecorded inflows not captured in the BOA estimate).
2/ Net of valuation changes in 2005–2006. In projections for 2007–2010, valuation effects are assumed to be zero.
3/ Net errors and omissions include unidentified flows of private transfers.
4/ In 2006–2007 assumes rescheduling of stock of outstanding arrears, both with official and private creditors.
5/ The financing gap is expected to be fully covered by arrears rescheduling and prospective privatization receipts.
6/ Public and publicly guaranteed debt only.
7/ Public and private external debt, including arrears. Debt stock converted into Lek at the e-o-p exchange rate.

Table 6. Albania: IMF Core Indicators of Financial Soundness, December 2003–December 2007

		Dec-03	Dec-04	Mar-05	Jun-05	Sep-05	Dec-05	Mar-06	Jun-06	Sep-06	Dec-06	Mar-07	Jun-07	Sep-07	Dec-07
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	18.1	16.9	16.4	17.5	17.1
(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	17.1	15.9	15.4	16.7	16.0
(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	5.9	6.4	6.2	6.9	5.8
	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	6.2	6.8	6.6	7.3	6.2
	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	6.8	7.0	7.1	7.6	7.6
(iv)	Nonperforming loans net of provisions as a percent of capital														
	Nonperforming loans net of provisions as a percent of regulatory Tier 1 capital	4.8	4.8	4.5	3.0	4.1	4.4	6.2	9.5	7.7	7.2	7.8	8.5	9.0	12.0
	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	6.8	7.4	7.9	8.5	11.2
	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	6.3	7.1	7.4	8.2	9.1
(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	20.2	20.8	20.0	21.0	20.7
(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	5.5	6.9	0.8	7.1	1.8
	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	5.2	6.5	0.8	6.7	1.7
	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	4.8	6.3	0.7	6.4	1.4
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	57.6	55.8	53.6	52.4	49.8
(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	69.5	73.2	69.2	71.4	0.6
(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	1.4	1.4	1.5	1.6	1.6
(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	3.1	3.2	3.1	3.4	3.4
(xi)	Sectoral distribution of loans to total loans	na	na	na	na	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	92.6	93.0	93.1	94.3	92.7
(xiii)	Noninterest expenses to gross income	57.4	66.2	81.5	75.3	76.7	76.3	71.4	72.9	68.5	65.7	61.1	59.4	58.0	58.5
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	265.5	251.2	230.7	227.0	215.5
	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	71.9	72.4	71.1	71.1	72.5
	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	44.0	45.2	45.7	46.5	46.9
	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	34.6	40.3	40.4	41.6	36.4
	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	31.7	33.7	35.9	37.1	39.4
	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	469.5	478.4	504.4	485.7	516.4

Source: Data provided by Bank of Albania.

Table 7. Proposed Structural Performance Criteria and Benchmarks under the PRGF and EFF Arrangements 1/

	Purpose of measure	Proposed Test Date
I. Prior Actions		
1. Increase the capital of BoA by transferring to it 86,000 ounces of gold.	*To improve BoA's capital position in conformity with best practice (MEFP ¶28)*	...
2. Implement an electricity tariff increase.	To improve the finances of KESH, thereby safeguard public finances and improve the environment for privatization of the utility (MEFP ¶19).	...
II. Structural Benchmarks		
A. Reduce fiscal vulnerabilities		
3. Take measures to reduce the quasi-fiscal losses of KESH to 1.2 percent of GDP.		*15-Jun-08*
4. 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).	*To improve overall efficiency and equity in resource mobilization through (i) improvements in the efficiency, transparency, and governance of the VAT and customs administrations (ii) provision of more rapid refunds and other incentives for the development of a sustainable system based on self enforcement MEFP (¶15).*	Ongoing
5. 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
6. Introduce modifications into the VAT refund system whereby claims will be paid automatically if validity checks are met (as outlined in the IMF TA report on tax administration of October 2007).		*End-April 2008*
7. Prepare semi-annual reports (within one month of the end of each semester) on the stock of external arrears.	To increase transparency, aid in financing assurances, and promote debt sustainability (MEFP ¶33)	Ongoing
8. Increase the number of taxpayers paying social security contributions (excluding agricultural workers and voluntary contributors) to 410 thousands.	To safeguard the fiscal viability of the social insurance system and the overall public finances, and improve equity (MEFP ¶15)	End-July 2008
B. Improve public expenditure management		
9. Safeguard the efficient use of nonconcessional foreign project loans:	To ensure that the ambitious infrastructure development program is designed and implemented in an efficient manner consistent with debt sustainability (MEFP ¶16)	
(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
C. Strengthen the financial system		
10. Complete the delivery vs. payments system for government securities.	*To develop the secondary market for government securities, thereby improving financial efficiency and the operation of the monetary transmission mechanism (MEFP ¶27)*	*End-October 2008*

1/ Text in italics refers to new conditionality not carried over from the third review under the program (IMF Country Report No. 07/244).

Table 8. Albania: External Financing Requirement and Sources, 2003–2012
(In millions of Euros)

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
					Est.		Projections			
Current account (incl. official transfers)	261	235	437	426	747	776	541	536	584	596
Amortization	34	40	43	72	75	95	120	139	140	149
Of which : IMF	8	8	7	9	11	10	10	9	8	7
Change in gross reserves (increase = +)1/	-10	191	77	197	110	69	112	92	153	165
Reduction in arrears	-3	12	17	7	3	35	0	0	0	0
Total financing requirement	282	477	574	703	935	975	773	769	878	910
Available financing	282	478	577	703	932	939	773	768	878	910
Foreign direct investment	158	277	224	259	486	297	358	410	452	512
Other capital	42	-13	41	109	184	126	105	67	108	60
Official medium- and long-term loans	101	100	98	116	121	369	169	158	185	210
Multilateral (excluding IMF)	75	72	73	82	94	93	113	110	121	133
Bilateral	26	28	26	35	26	46	56	48	44	36
Commercial						230	0	0	20	40
IMF disbursements	10	10	9	6	6	5	3	0	0	0
Other 2/	-44	76	185	184	129	132	129	129	129	129
Debt rescheduling	0	12	17	7	0	0	0	0	0	0
Budget support	17	15	3	9	0	0	0	0	0	0
Identified financing	0	0	0	13	7	10	10	3	3	0
Of which : WB FSAC/PRSC/EU	...	...	0	13	7	10	10	3	3	0
Financing gap	0	0	0	0	0	35	0	0	0	0
Expected EU macro-financial assistance	...	...	0	0	0	0	0	0	0	0
Debt rescheduling (mostly clearance of bilateral arr	...	...	0	0	0	35	0	0	0	0
Other	...	...	0	0	0	0	0	0	0	0

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

1/ The change in gross reserves is net of valuation changes for 2005–2006. In projections for 2007–2010, valuation effects are assumed to be zero.

2/ Includes errors and omissions.

Table 9. Albania: Actual and Projected Payments to the Fund, 2003–12
(in millions of SDRs)

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
					Est.	Projections				
Obligations from existing drawings										
1. Principal										
PRGF repayments	6.8	6.4	6.2	7.6	6.7	9.6	9.1	8.0	7.1	5.8
GRA repurchases	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.5	0.8
2. Charges and Interest 1/										
PRGF Interest	0.3	0.3	0.3	0.4	0.28	0.24	0.19	0.14	0.11	0.07
GRA and SDR Net Charges	0.0	0.0	0.0	0.00	0.15	0.25	0.25	0.25	0.23	0.20
Total obligations	7.1	6.7	6.5	8.0	7.1	10.1	9.5	8.4	8.0	6.9
(percent of quota)	15	14	13	16	15	21	20	17.3	16.4	14.1
Cumulative obligations (existing and prospective)										
1. Principal										
PRGF +EFF repayments	6.8	6.4	6.2	7.6	6.7	9.6	9.1	8.1	7.6	6.6
2. Charges and Interest 1/										
PRGF Interest	0.3	0.3	0.3	0.4	0.3	0.3	0.2	0.2	0.1	0.1
GRA and SDR net charges	0.0	0.0	0.0	0.0	0.2	0.3	0.4	0.4	0.2	0.2
Total obligations	7.1	6.7	6.5	8.0	7.2	10.2	9.7	8.7	8.0	6.9
(Percent of quota)	15	14	13	16	15	21	20	18	16	14
Outstanding Fund credit 2/	60.8	62.4	64.3	61.5	57.0	52.3	45.6	37.6	29.9	23.2
o/w projected under the current arrangements	…	…	…	…	4.9	4.9	2.4	…	…	…
Breakdown of Fund credit										
Extended Arrangements				2.4	4.9	7.3	8.5	8.4	7.9	7.0
PRGF Arrangements	60.8	62.4	64.3	59.1	52.1	45.0	37.1	29.1	22.0	16.2
Memorandum items:										
Outstanding Fund credit										
In percent of:										
Exports of goods & services	7.0	5.5	5.2	3.8	2.8	2.4	1.8	1.4	1.0	0.7
GDP	1.4	1.2	1.2	1.0	0.8	0.6	0.5	0.4	0.3	0.2
Quota	125	128	132	126	117	107	94	77	61	48
Total obligations										
In percent of:										
Exports of goods & services	0.9	0.6	0.5	0.5	0.4	0.5	0.4	0.3	0.3	0.2
GDP	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1

Source: Fund staff estimates.

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.

ANNEX I: FUND RELATIONS

As of January 31, 2008

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	50.22	103.12
Reserve position in Fund	3.35	6.89

III. **SDR Department**:	SDR Million	Percent Allocation
Holdings	8.06	N/A

IV. **Outstanding Purchases and Loans**:	SDR Million	Percent Quota
Extended Arrangement	4.87	10.00
PRGF arrangements	50.47	103.63

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	4.87
PRGF	2/01/2006	1/31/2009	8.52	4.87
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				
	2008	2009	2010	2011	2012
Principal	7.96	9.08	8.15	8.15	7.43
Charges/Interest	0.45	0.40	0.35	0.29	0.20
Total	8.41	9.48	8.50	8.44	7.63

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 expect to resolve by end-2007. Albania has not imposed new restrictions under Article VIII. The exchange rate stood at 82.57 lek per U.S. dollar at end-January, 2008.

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. The extent and focus of Fund TA over the past two years is briefly reviewed below.

Technical assistance from MCM has focused on two main areas: monetary policy and banking supervision. In the monetary policy area, a resident advisor assisted the Bank of Albania during the initial transition to an implicit inflation targeting regime. This is followed by short expert visits that focused on monetary policy decision processes, as well as more technical background work such as modeling and forecasting. The results of the TA have been favorable, with a significant boost in quality of the monetary policy decision-making process, as evidenced, inter alia, by inflation performance as well as research output. In the banking supervision area, following assistance in the implementation of a Supervisory Development Plan through 2005, TA missions have helped the authorities focused on stress testing, rapid credit growth and other emerging issues. A mission in February 2008 focused on assisting the authorities to draw up an action plan for the future development of their banking supervisory practices. Ongoing assistance with the implementation of a credit registry contributed to the successful inauguration of the registry at end-2007.

Recent technical assistance from FAD has concentrated in two main areas: tax administration and debt management. In strengthening tax administration, Fund TA covered improving the large taxpayer operations, review of computerization program, and transfer of responsibility for the collection of social insurance contributions from Social Insurance Institute to the General Department of Taxation. FAD also provided assistance on reform and development of public debt management, including the strategic, legal and institutional framework, development of domestic securities market and the integration of debt and cash management.

Recent technical assistance from LEG included help legislative drafting and supervisory guidance for AML/CFT and banking supervision, and for amendments to the Central Bank Law—and related agency agreements between the Bank of Albania and the Ministry of Finance.

Technical assistance from STA covered three main areas: national income accounts, balance of payments and data dissemination. While a previous resident technical expert financed by the Fund helped official statistical agency improve national accounts coverage to informal sector, a new peripatetic technical assistance project is expected to start in January 2008 to increase frequency and enhance accuracy of these accounts. In strengthening balance of payments statistics, Fund TA supported the rapid progress with regard to the accuracy and frequency of data. However, poor source data constitutes a problem in making further progress especially in analyzing current transfers. A data ROSC mission visited Albania in March 2006. While Albania is successfully subscribes to GDDS, the authorities have expressed their intension of subscribing to the SDDS. A recent

TA mission has evaluated the requirements for the SDDS and concluded that the main obstacle is the lack of quarterly national accounts data. A recent mission also assisted the authorities in updating and rebasing the consumer price index.

Generally, the authorities welcomed the technical assistance from the Fund and made extensive efforts to adopt the TA recommendations. 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 63 loans mostly in IDA commitments totaling US $924.1 million, IFC commitments of US $125 million, and MIGA guarantees totaling US $8.6 million. The quality of the active portfolio has continued to improve, with an increasing focus on long-term capacity development and implementation through Government structures.

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

3. The government is currently finalizing the new National Strategy for Development and Integration (expected for October 2007) and is committed to better address the link between the strategic planning process, the Medium Term Budget Program (MTBP) and the annual budget in the context of newly established Integrated Planning System (IPS). The IPS aims to allow the Government of Albania (GoA) to prioritize its expenditures based on a national strategy that focuses on the European Integration agenda. A government executed multi-donor trust fund (MDTF) has been established with financing from various donors in order to ensure increased and transparent linkage between NSDI objectives and government policy and budget allocations and expenditures

Bank Group Strategy

4. Reflecting Government priorities, the CAS (2006–09) program seeks to support Albania's efforts in strengthening governance, sustaining a private sector-led growth and improving service delivery**.** The new CAS recognizes that more coherent efforts need to be made to address the challenge of poor governance in Albania, and introduces a 'Governance 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:

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

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

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

5. The CAS proposes a lending range of US$ 75–US$ 196 million, with actual lending to be determined by the pace of reform in key sectors. The proposed lending program is 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 Operations (DPO) building on the success of the PRSC series in the previous CAS. The CAS employs also targeted program of WBG Analytical and Advisory Activities (AAA) support.

6. The active World Bank portfolio includes 18 investment projects with a total commitment of $291.5million, of which about $255.3 million remain to be disbursed. The investment side of the Bank's portfolio has performed well. Three projects were approved by the Board in 2006: (i) Albania Avian Flu (June, 27); (ii) BERIS (October, 26); (iii) Education Excellence and Equity Project (June 1). Two new projects have been approved in February 2007, the Transport Project and the Land Administration and Management Project**.** The fist Development Policy Operation (DPO1) is expected to be approved on March 29, 2007.

Bank-Fund Collaboration in Specific Areas

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

8. **Public expenditure management**: Albania's weak systems of Public Financial Management (PFM) and related fiscal institutions constitute a main risk for macroeconomic stability and high quality fiscal adjustment. Over the past years, the Bank has complemented IMF policy conditionality and technical assistance with a multi-pronged assistance program including lending operations and fiduciary and diagnostic work. Under the new CAS, the Bank will continue its support to the GoA 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 policy reform conditionality in the Development Policy Operation (DPO) that focus on public investment management, .

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

10. **Public sector reform**: The civil service and broader public sector employment structures require continued engagement and support. The Bank and IMF will need to work closely to ensure that an appropriate framework remains in place to allow the Government to move ahead with efforts to (a) strengthen accountability mechanisms for public entities, both Ministries and subordinated agencies, rendering them 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, both through improved adherence to the requirements of the Civil Service Law, as well as through a cautious, measured 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 DPO continues to engage on civil service reform.

Power sector reform: While the Bank has taken the lead in developing the policy agenda, the sector's fiscal impact has also motivated conditionality in previous IMF-PRGF arrangements. Since mid-2006, KESH's financial situation has deteriorated significantly as a result of the following factors: (a) severe shortage in electricity supply in the region which led to a significant rise in import electricity prices; (b) unfavorable hydrology since late 2006; (c) a sub-optimal management of hydro resources in the last quarter of 2006; and (d) poor performance of the utility as indicated by declining collection ratios and increased losses. The Bank and the Fund confirmed their support to the Government's efforts to overcome the ongoing crisis and are working with the authorities to prepare, and agree on, a set of measures to improve the performance in the power sector to avoid potential negative implications on growth and macroeconomic stability.

11. 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 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 have recently completed a long-delayed tender for a new thermal power station.

12. **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.

13. **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.

14. The WBG in conjunction with the IMF are assisting the Government in the completion of the financial sector reform agenda and support the implementation of the recommendations of the 2005 Joint IMF-World Bank Financial Sector Assessment Program (FSAP). The DPO 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.

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

16. **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 is using 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 (approved in February 2007) in conjunction with the DPO 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.

ANNEX 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.[1] Albania participates in the General Data Dissemination System (GDDS).

A data ROSC reassessment 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 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 data ROSC report was published on the IMF's external website in October 2006.

A further review of progress towards SDDS subscription was carried out in October 2007. The mission found that the Bank of Albania has started disseminating draft versions of the Advance Release Calendar and the National Summary Data Page, covering data from the Institute of Statistics (INSTAT), the Ministry of Finance (MoF) and the Bank of Albania (BoA). The mission concluded that Albania will be ready for SDDS subscription within 12 to 18 months, assuming that the current momentum in improving data can be maintained. The main obstacles are in real sector statistics; the forthcoming peripatetic technical assistance project will be important in overcoming them.

The ROSC reassessment mission found 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 adoption of an inflation targeting regime; and (iii) growing national interest in joining the European Union. However, due to severe resource constraints at 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, planned Memoranda of Understandings between INSTAT and the MoF and the BoA should facilitate data sharing and coordination among these agencies.

[1] This data ROSC was completed before the formal adoption of the Data Quality Assessment Framework.

A. Real Sector

Price statistics

STA has provided considerable technical assistance on price statistics. The consumer price index (CPI) is reported regularly for publication in the *International Financial Statistics (IFS)*. In 2001, a revision of CPI weights was initiated by INSTAT based on a new household budget survey; the revised index 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 in the CPI as they become significant.

INSTAT has updated the CPI weights using the results of a new national-level HBS conducted during the period October 2006-September 2007. An STA TA mission in November 2007 assisted the authorities in resolving compilation issues for the new CPI.

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 other available price data.

National accounts

National accounts are compiled from 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. While technical assistance has been provided on methodological procedures, source data still do not provide sufficient information to compile reliable estimates on the nonobserved economy. In November 2005, INSTAT released major revisions of the GDP estimates (for 1996–2003) and updates for 2004, reflecting methodological improvements.

The ROSC reassessment 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.

STA missions visited Albania in November 2004 and March 2005 to assist the authorities in improving the timeliness of the annual estimates and in developing quarterly national accounts. INSTAT has benefited from technical assistance from 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. In addition, STA will provide further technical assistance to Albania through peripatetic missions during 2008–2009.

External trade

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

B. Government Finance

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, (about 1520 individual budget institutions), local government (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 provide the MoF with a mandate to compile and disseminate 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 projects; and iv) the extrabudgetary funds. External donor financed-projects that do not pass through the treasury system, represent a weakness in source data., Following the ROSC mission's recommendation that MoF accelerate work aimed at formally adopting the *GFSM 2001*-based reporting format and improve source data coverage for external donor-financed projects, the authorities have recently begun reporting quarterly fiscal data for publication in the *International Financial Statistics* using the *GFSM 2001*-based monthly

Statement of Sources and Uses of Cash. Albania has submitted fiscal data to the Fund for publication in the *Government Finance Statistics Yearbook* for 2001–2006.

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 disseminated 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 contrasts 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.

In January 2005, the BoA reported its monetary data to STA using Standardized Report Forms (SRFs). The monetary data in the SRFs format have been published in the quarterly *IFS Supplement* since September 2006. The reporting of monetary data in the SRFs format 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 monetary statistics, the 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.

C. Balance of Payments

The data compiled by the BoA are methodologically sound, although some of the estimates, particularly for international transactions 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 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 bank reporting

system to verify data from enterprise surveys. It also recommended incorporating the results of the direct investment survey as well as investigating 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 statistics, the ROSC reassessment 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, inspect the financial accounts of firms, and 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.

The most recent technical assistance mission visited Albania during September–October 2007. It further reviewed the remittances and travel service estimates and reconciled the financial account and International Investment Position. The mission noted strong progress in adopting earlier recommendations but advised that estimation methods for transactions outside the banking system (mostly remittances and investment transactions by nonresident Albanians) require further improvement.

D. 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 would need 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 MARCH 5, 2008

	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]	Data Quality – Accuracy and Reliability[8]
Exchange Rates	03/05/08	03/05/08	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	12/12/07	02/12/08	M	M	M		
Reserve/Base Money	02/14/08	02/18/08	D and M	D and M	M and M	O, O , O , LO	O, LO, LO, O, O
Broad Money	12/12/07	02/12/08	M	M	M		
Central Bank Balance Sheet	02/14/08	02/18/08	D and M	D and M	M and M		
Consolidated Balance Sheet of the Banking System	12/12/07	02/12/08	M	M	M		
Interest Rates[2]	02/26/08	02/26/08	D	D	D		
Consumer Price Index	01/2008	02/11/08	M	M	M	O, LO, O, LO	LO, LO, LO, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	12/2008	02/14/08	M	M	M	LO, O, O, O	LO, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	12/2008	02/14/08	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	08/2007	11/05/07	Q	Q	A		
External Current Account Balance	12/2007	03/03/08	Q	I	I	O, O, O, LO	LNO, O, LO, LO, O
Exports and Imports of Goods and Services	12/2007	03/03/08	M	Q	Q		
GDP/GNP	2006	12/2007	A	A	A	O, LNO, O, LNO	LNO, O, LNO, LO, LO
Gross External Debt	06/2007	10/2007	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 published on October 31, 2006, and based on the findings of the mission that took place March 8-22, 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 8, except referring to international standards concerning source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

ATTACHMENT I

Tirana, March 14, 2008

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Strauss-Kahn:

The current Fund-supported program, approved in January 2006, remains broadly on track, despite some delay in implementing needed increases in electricity tariffs. All quantitative and structural performance criteria have been observed and economic prospects remain favorable, both from the near- and medium-term perspectives. Growth continues to be buoyant, underlying inflation is low, and confidence in the currency and the banking system remains strong. Debt is on a declining and sustainable path. In addition, past and ongoing structural adjustment is now supplying tangible benefits to the economy. We are, consequently, well placed to fully implement the ambitious reform agenda described in the attached Memorandum of Economic and Financial Policies (MEFP).

On this basis, we request completion of the financing assurances review, and completion of both the fourth review under the three-year Poverty Reduction and Growth Facility arrangement and the fourth review under the three-year Extended Fund Facility arrangement. We also request the fifth disbursement and purchase under these arrangements in an aggregate 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 provides a detailed description of our policy intentions over the final year of the 2006–2009 program period. It is fully consistent with our new National Strategy for Development and Integration (NSDI) for 2007–2013, which was completed in March 2008.

II. Economic Developments

2. **Macroeconomic events since the last review have been dominated by a regional drought which impacted on the electric utility (KESH) and agricultural production**. The resulting supply shocks have created challenges for macroeconomic management and structural policies.

- **Domestic hydro-electricity production and small-scale rain-fed farming have been adversely affected**. The financial position of KESH deteriorated considerably more than had been anticipated at the time of the third review. Although electricity losses were reduced in line with the World Bank-supported Seventh Power Sector Action Plan, the collection target (excluding collection of arrears from budgetary and nonbudgetary institutions) was not achieved. Effective collections as a share of total power supplied to the grid increased to 52.5 percent, but still remained low by regional standards. Meanwhile, the drought-induced decline in energy production decreased the supply of electricity available to the economy in 2007, while its partial replacement with expensive imports hurt the utility's cash flow and financial results. Dry conditions also effected agricultural output, which led to pressure on retail food prices, import volumes, and import costs.

- **Cost pressures built up.** Higher food prices and increased power interruptions fed into 2007 inflation. From August-October, these supply shocks drove headline inflation slightly above the Bank of Albania's (BoA) 3±1 percent target band. The BoA policy rate was raised by ¼ percent in each of September and November, and this helped to stave off second round effects and to keep inflationary expectations anchored at low levels. Inflation ended the year around the midpoint of the target range.

3. **Growth became broader based thus offsetting the drought's effect.** The strong performance of exports and the tourism sector, as well as continued productivity gains in manufacturing, compensated for the slowdown in agriculture and the decline in electricity production, resulting in growth of about 6 percent in 2007. Export growth reflected both the very rapid expansion of new export products such as chromium and oil, and solid performance of traditional exports. Structural reforms have raised productivity in the tradable sector and have strengthened our export capacity. Still, the current account deteriorated to

9½ percent of GDP as a result of higher import spending on electricity, food, and the machinery and equipment needed for the construction of the large road projects .

4. **Despite the drought, the 2007 budget was executed broadly as planned.** Revenue collection was slightly lower compared with the program but still 0.6 percent of GDP higher than in 2006. Improvements in tax administration and tax measures implemented in 2007 helped offset a reduction in custom duties. Personal income tax, VAT and excise tax collection have been particularly strong. However, profit tax and property and local tax collection underperformed, partly reflecting administration problems related to local elections. Additional electricity imports and a delayed tariff adjustment drained KESH's financial position and required budgetary transfers of Lek 8 billion, of which lek 3 billion was in the form of a loan to be repaid in 2008. Lower-than-budgeted spending on interest and wages allowed us to keep total current spending in line with the lower revenue, below the program. At the same time the capital budget could not be fully executed reflecting problems with project implementation. We have transferred lek 0.7 billion to the expropriation fund, to maintain its balance at 0.3 percent of GDP, the same as at the end of 2006. The budget recorded an overall deficit of 3.8 percent of GDP compared with the 3.9 percent envisaged under the program. At the same time, higher-than-projected privatization proceeds reduced net domestic borrowing from 2.3 percent of GDP to 1.7 percent.

5. **Financial conditions have been supportive**. Albania has so far escaped any fallout from unsettled global financial market conditions. The current rate of increase in credit broadly balances the need to support growth with the need to mitigate risks to financial stability. The latter is also helped by our already strong and growing capacity in banking supervision and the predominant use of credit for investment rather than consumption.

6. **We have also made considerable progress in structural reform since the time of the last review**.

- **Tax administration:** In October, the Large Taxpayer Office (LTO) was transformed into a full service office (SB; end-October 2007) and all large taxpayers now have the possibility of electronic filing and payment. We removed all inactive taxpayers from the tax registry (PC; mid-December 2007). We developed a comprehensive cross-agency campaign aimed at improving compliance in relation to social security contributions (SB; end-December 2007) and a joint working group has been set up with representatives from the Ministry of Finance, General Tax Directorate and Social Insurance Institute. By end-September 2007, all approved VAT refund requests submitted during the first half of the year had been paid and the average delays between submission and payment had been reduced. We provided to the Fund quarterly reports on the aggregate amounts of the VAT refunds requested, refunds paid and refunds rejected (SB; ongoing). Concerning customs, we provided the Fund with quarterly reports on progress made in the use of the risk assessment module of the ASYCUDA system to perform inspections (SB; ongoing). We are expanding and upgrading our customs houses and are monitoring the movements of goods between borders and in-land custom houses. Lastly, following the extensive consultations with stakeholders and external experts, we have submitted to parliament a new law on tax procedures which is in line with best international practice.

- **Public expenditure management**: Following extensive consultations with a number of stakeholders, we have submitted the new organic budget law to Parliament. The law provides for the establishment of a more comprehensive budget process, covering both regular budget organizations and special (extrabudgetary) funds at both the central and local government levels. It will strengthen the role of the Medium-Term Budget Program in the annual budget preparation process. The new procurement law allows public institutions to procure for up to seven years, rather than one year, in exceptional cases determined by the characteristics, complexity, and financing of the project or contract. We introduced within–year budgetary reviews of investment projects and developed a register of public investment projects facilitating the redirection of investment allocations to sectors with higher implementation capacity. Finally, as part of the preparation of the 2008 Budget, we have introduced new Public Investment Management Procedures that should help consolidate the public investment portfolio and give priority to larger investments with higher impact.

- **Debt management:** The Debt Management Unit has been upgraded to a General Directorate, with separate front and back offices, and in the next few months we expect to staff the new positions. We continue to extend the maturity of our domestic public debt: the average maturity has increased from 250 days in November 2006 to 409 days in December 2007, significantly reducing rollover risk. In December 2007, for the first time, we successfully issued a 7-year bond. We are also improving IT capacity in debt management by establishing an integrated management system that is already operational for external debt. To safeguard existing gains, we continue to conduct independent feasibility studies for any large project (as defined in the attached Technical Memorandum of Understanding—TMU) financed through nonconcessional commercial borrowing; provide a semi-annual listing and status report on all projects being considered for nonconcessional foreign financing; and prepare semi-annual reports on the stock of external arrears (all SBs; ongoing).

- **Financial markets:** We completed the establishment of a credit bureau within BoA (SB; end-December). In the securities market, foreign and domestic nonbank institutions were given full access to government securities auctions on a competitive basis (SB; end-September); and four domestic banks have been licensed by the Financial Supervisory Authority (FSA) to act as registrars for treasury bonds, allowing them to facilitating purchases and sales for their clients on the primary and secondary markets. FSA’s new online publicly-monitorable system will track sales of securities and aid in expanding volumes on the secondary market. In the insurance sector, the recent entry of three reputable foreign companies, and the subsequent scope for management improvement, reflect our ongoing efforts to improve regulatory oversight and sector financial health. We improved our supervisory oversight, enforced international standards for capitalization, and set up a new IT system at FSA for reporting sales of automobile third party liability insurance and for administering claims. We also improved the coverage and quality of reinsurance contracts of companies operating in the sector.

- **Financial sector supervision:** We created a new Financial Stability Department (FSD) within the BoA to more pro-actively monitor the entire financial system without detracting from the Banking Supervision Department's (BSD) concentration on individual bank-specific issues. Our capacity to supervise individual banks and raise the safety of commercial banks' loan portfolios have also improved. The new regulations introduced in December 2006 in response to the rapid credit growth have been effective in both limiting lending and enforcing capital increases to improve loan safety. Our capacity and expertise in stress testing and off-site bank supervision is also improving, from a relatively high base, and we now conduct a full inspection of every bank at least once a year, while supplementing these with partial, more focused risk-based periodic inspections as needed. We intended to transfer supervisory authority over all leasing companies to the BoA by end-October 2007, the timetable agreed under the program (SB; end-October 2007), but did not achieve this due to problems with multi-agency coordination. However, we will submit the necessary legislation to Parliament by end-April, 2008.

- **Business environment:** The National Registration Center (NRC)—a one stop-shop for business registration—was set up and the legal timeline for business registration has been reduced from 8 days to only 1 day. The cost to register a business has been reduced to 100 lek and other administrative requirements have been streamlined, as necessary. The NRC has been in great demand and we are working to strengthen our capacities both within the NRC and in the regions—we opened windows for business registration in the biggest municipalities in 2007, and will open more in 2008.

- **Statistics:** The field work for the household budget survey—covering about 5,600 households at the national level—was concluded in October 2007. This survey provides for a wider coverage than the previous survey of 2000. We obtained preliminary results for the labor force survey following the completion of fieldwork in June 2007. To strengthen short-term economic indicators, we are improving the coverage, timing and quality of our STS business survey. In December 2007, we revised the products and product weights for the CPI basket based on the 2007 household budget survey, to properly incorporate developments in our economy and consumption patterns.

- **Trade:** In line with the Interim Agreement for Free Trade with the EU we further reduced duties on a range of products, including agricultural products, in January

2008, lowering the overall weighted tariff by over half a percent in 2008. The Central Europe Free Trade Agreement (CEFTA) came into force in July 2007 for 5 CEFTA parties, with full implementation from November 2007. The free trade agreement with Turkey was ratified by the Albanian parliament and is currently being finalized.

- **Privatization:** Albtelecom was privatized for €120 million.

7. **The adoption of the new National Strategy for Development and Integration (NSDI) 2007–2013 was a key milestone.** The new strategy sets our goals of integration into the European and NATO structures, the democratization of society, the consolidation of the rule of law, and for further economic and social development. It is the product of a wide-ranging and in-depth consultation with parliament, civil society, development partners and other interested stakeholders. The NSDI—and the thirty six detailed sector and cross-cutting strategies that underlie it—will from now on form the basis of our medium-term budget planning.

III. Strategy, Objectives, and Policies

8. **Our medium-term economic strategy aims to deliver continued strong, private sector-led growth.** Macroeconomic and financial sector stability are the essential prerequisites but we also address the institutional and infrastructure deficiencies that could otherwise impede rapid productivity growth. A combination of well-anchored fiscal policy, strong central bank credibility, and low structural—including wage—rigidity in our economy continues to afford us considerable resilience to unexpected shocks.

- **The inherent flexibility of our economy, including on wages, allows us to benefit from ongoing structural changes with a minimum of short-term disruptions**. This flexibility has increased the efficiency of macroeconomic policy transmission. But at the same time, it imposes strict discipline, since such efficiency crucially depends on the maintenance of low inflation expectations—which are themselves closely linked with perceptions of fiscal stability and BoA's credibility.

- **Continued adherence to our medium-term fiscal framework based on a small, but increasingly efficient model of government remains a cornerstone of our strategy.** This has been effective in maintaining market confidence, imbuing development spending with greater predictability, and consolidating our public finances. Reform efforts will concentrate on reducing vulnerabilities; improving efficiency of core activities; and, wherever possible, offloading noncore functions to the private sector. This will substantially improve the attractiveness of Albania as a destination for foreign investment.

- **Monetary policy will remain our main policy response to short-term threats to price stability.** Strong communication and pro-active interest rate setting have helped us anchor inflation expectations. Still, our present situation—where a fiscal surplus through most of 2007 has helped offset otherwise strong domestic demand, enabling the BoA to focus on avoiding spill-over effects of cost-push inflationary pressure—has highlighted the potential role for fiscal policy in demand management and countercyclical operations. Greater prioritization of expenditure, a move to a medium-term capital budget, and the availability of short-term demand indicators, including on wages, might provide some scope for assigning fiscal policy a more active demand management role without damaging the fact and perception of fiscal stability. In the year ahead, we intend to explore the scope for fiscal rules that would allow some more room for automatic stabilizers on the revenue side.

- **Financial sector stability will be promoted through further regulatory and supervisory reforms**. Difficulties for creditors in executing collateral remain a concern. And there is a need to further improve international cooperation with the home country supervisors of our major banks. Moreover, despite its moderation in line with projections, credit growth is still high and remains a potential source of risk for macroeconomic and financial sector stability. We will also continue to strengthen nonbank financial sector supervision with support from the World Bank.

- **Restoring the power utility's finances and privatizing its distribution arm are critical to ensure a stable supply of electricity over the medium term.** We are adopting measures to quickly stabilize KESH's financial position, which is also important for maintaining fiscal stability. We are progressing with the privatization of the distribution arm of KESH by end-2008 and are undertaking a number of initiatives to increase domestic production and capacity to import electricity.

- **Greatly improving the public transportation infrastructure is another key goal.** With the benefit of foreign finance, we have made significant progress on building the new road corridor between Durres and the Kukes region, and we expect a key part of this corridor—the Rreshen-Kalimash road—to be completed in mid-2009.

A. Macroeconomic Framework

9. **Our underlying medium-term macroeconomic framework remains appropriate, despite the effects of recent supply shocks**.

- With the return of normal rainfall, growth is projected at 6 percent in 2008 and beyond, as recovery in construction and agriculture sectors offset the return of manufacturing growth to normal levels. We expect the current account deficit to improve over the medium term as export growth remains strong, remittances buoyant, and electricity imports decline to more moderate levels.

- Underlying inflation is expected to remain in the BoA's target range, although electricity tariff increases may push headline inflation temporarily higher. Further slowing of credit growth should help contain demand pressures, and we expect second round effects to be successfully contained with an appropriate monetary policy stance.

10. **Risks to this framework lie in a possible further deterioration in the energy situation, rekindled credit growth, and adverse global or regional developments**. We have protected the 2008 budget with augmented contingencies, but the risks to growth and macroeconomic stability from continued energy disruptions are less easily mitigated. The potential effect on growth would begin with the direct impact of lower domestic energy production. But the ongoing diversion of budget funds from productive uses to electricity imports, and the effect of energy shortages on our investment climate could also damage our growth potential over the longer term while in the short term negatively impacting growth and likely raising inflation expectations. A renewed acceleration of credit growth would add pressure from the demand side. We will mainly rely on the in-built flexibility of our economy, including the exchange rate, to address slowing market growth abroad or geopolitical or regional risks.

B. Fiscal Policy

11. **After the acceleration of the road program, we will cap our overall fiscal deficit at no more than 4 percent of GDP**. With this cap serving as an effective fiscal anchor, the increase of our debt burden in 2008 due to the accelerated implementation of the road project will be temporary, and we would expect to regain a downward trajectory beginning in 2009. In this manner, we will finish this nationally-important project quickly, while retaining credible commitment to our fiscal strategy of keeping government small, increasing the share of priority spending, and further reducing public debt. Over the medium term, we expect our debt burden to fall below 50 percent of GDP and, given conservative revenue assumptions, for expenditure to remain in the 30 percent of GDP range. However, in line with longstanding program agreements, receipts from large-scale privatization and currently-unbudgeted gains from tax administration could create one-off departures from these key parameters; in particular, half the revenue of any unbudgeted privatization will be used to reduce domestic debt while half would be expended on well-conceived investment projects.

12. **Containment of fiscal risk is a central component of our strategy.** The principle risks remain the deterioration in the financial position of KESH, the still uncertain cost of the Durres-Kukes road project, and remaining uncertainties relating to revenue collection. We will mitigate these by ensuring that by the time of the next mid-year expenditure review, sufficient allocative flexibility remains so that we can, if necessary, reallocate at least 1½ percent of GDP of expenditure. These reallocations will be made only in consultation with the Fund and in accordance with clear guidelines aimed at minimizing discretion and maximizing transparency. Combined with successful implementation of our reform agenda for KESH, described below, we believe these measures will be sufficient to fully protect the

2008 budget outcome. However, should additional risks emerge, we stand ready, in consultation with the Fund, to take appropriate actions.

13. **The 2008 budget will allow for an acceleration of capital spending, thereby implying a temporary increase in the overall deficit by 1.4 percentage point of GDP to 5.2 percent, financed by faster mobilization of foreign financing.**

- **Tax policy changes will contribute to an increase in tax revenue** to about 24½ percent of GDP in 2008, in spite of the cut in the corporate income tax (CIT) rate from 20 to 10 percent, at an annual cost estimated at 1 percent of GDP. The cost of this cut will be recovered from the full-year impact of the excise and environmental tax measures introduced in mid-2007, the elimination of VAT exemptions for profit generating businesses that were previously considered not-for-profit (such as private schools and medical centers), and from the introduction of reference wages for social security and measures to increase the social security contributions. Following the reduction in the CIT rate, we are not planning any further major tax changes in 2008. However, in line with our obligations resulting from the membership in the World Trade Organization (WTO) and regional commitments, we will continue gradually reducing our external tariffs. We have also closed several loopholes in VAT administration by eliminating the problematic self-invoicing scheme for agro-producers, and by introducing a compensating scheme for farmers who pay VAT on their purchase without being entitled to credit it on their sales. Furthermore, to boost local government revenues, we plan to increase the property tax rate (while leaving municipalities the right to adjust this within a margin of 30 percent), and will transform some national charges into local charges.

- **Budget expenditures will temporarily increase to about Lek 337 billion (31½ percent of GDP)**. Current expenditures are projected to increase to some 24 percent of GDP, accommodating wage increases in priority sectors such as health and education. There will be a one-off increase in capital spending from 5.9 percent of GDP to 7.3 percent, reflecting the acceleration of the Rreshen-Kalimash road project, the cost of which is now projected at €530 million, excluding VAT, about €100 million higher than originally estimated. The cost increases are mainly due to changes to the project design and higher cost of inputs, which could yet increase further. While we are currently exploring design changes that could lower budget costs in 2009, we have offset the 2008 budget effects by compensating reductions in other capital spending.

14. **The increased capital spending in 2008 will mainly be reflected in higher imports and a widening of the trade deficit**. We do not expect the incremental spending to add significantly to domestic demand pressures, as wages are unlikely to rise given the still high rate of unemployment in Albania. Moreover, while the budget makes room for all our spending priorities, we do not intend to execute them all, and will in this way hold the fiscal

deficit to 5.2 percent of GDP. Should this target be in jeopardy, we will make offsetting reductions in other expenditure in the context of the midterm budget review. As the increase solely reflects an acceleration of disbursements of foreign financing within the given overall program limit, it will also not adversely impact debt sustainability over the medium term.

15. **Further tax administration improvements are critical to improve the business climate and bring actual collections more in line with potential yield**. We will improve the VAT refund process and continue to provide to the Fund quarterly reports on the aggregate amounts of the VAT refunds requested, refunds paid and refunds rejected (SB; ongoing). Furthermore, we will introduce by end-April 2008 (SB) a VAT refund system where claims are paid automatically if validity checks are met, as outlined in the IMF TA report on tax administration of October 2007. Following the transformation of the LTO into a full service office for all large taxpayers in Albania, we intend that by the end of June 2008, all education activities, audit, assessment, accounting, enforced collection measures and other administrative actions will be fully conducted by the LTO. We will implement the recommendations of the working group to meet our commitment to increase the number of taxpayers paying social contributions (excluding contributions paid by agricultural workers and voluntary contributors) to 410,000 by end-July 2008 (SB). We will continue expanding and upgrading our customs houses, 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 (SB; ongoing).

16. **We will ensure our external debt position remains sustainable.** We will keep external borrowing within the program's existing external nonconcessionary borrowing ceiling of €680 million. We will use foreign financing of €230 million to finance the Rreshen-Kalimash project in 2008; and will reduce our overall recourse to nonconcessional external borrowing by using half the receipts of any large privatization to finance this project. We will also continue to conduct independent feasibility studies for large projects (as defined in the TMU) financed through nonconcessional commercial borrowing; provide to the Fund a semi–annual listing and status report on all projects being considered for nonconcessional foreign financing; and prepare semi-annual reports on the stock of external arrears (all ongoing SBs). We will also refrain from financing large development projects through state-owned special purpose vehicles (SPVs) until we have developed additional capacity to fully evaluate such schemes.

17. **We will further strengthen our debt management capacity.** We have approved the Public Finance Sector Strategy for 2007–13. We will complete the computerization of debt by including domestic debt and will promptly fill the remaining vacancies in the General Directorate, including that of the General Director. We are also developing new forms of government securities to further reduce debt-related vulnerabilities, and will explore the feasibility of accessing international capital markets. In 2008, we might also consider issuing Albania's first benchmark Eurobond in international markets, and we are seeking technical

assistance from our US Treasury Adviser and possibly from the IMF or World Bank to assist us in our preparations.

C. Reform of the electricity sector

18. **A sustainable solution to the energy crisis will require stabilizing the financial position of KESH and privatizing the distribution arm of KESH over the next year.** In 2007, we instituted limited load shedding of power to partly offset the shortfall in production; and the new management of KESH took measures to improve efficiency, reduce waste and theft, and raise collection rates, including through a stricter approach to cutting off service to nonpaying customers. Arrears of budgetary and non-budgetary institutions to KESH accumulated up to end-2006 were cleared in August. But notwithstanding our efforts to ensure that these institutions henceforth pay power bills in a timely manner, a new round of arrears had to be cleared by end 2007.

19. **In February 2008, to boost the cash flow of KESH and to begin bringing prices closer to cost-recovery levels, the independent regulator (ERE) approved an about 15 percent increase in electricity tariffs**. Raising tariffs to cost recovery levels and limiting electricity losses are key to reduce the large quasi-fiscal losses of KESH. The increase, which became effective in March 2008, closed some of the gap between local tariffs that had remained unchanged since mid-2006 while international prices of electricity had doubled. At the time of the previous tariff hike in 2006, we instituted a social safety net program targeted to low-income consumers. However, we have experienced administrative problems in disbursing funds under the program. Therefore, we have not increased tariffs for consumption below 300 kWh per month to protect the poorest household consumers until we build capacity for a better targeted safety net program. Given the high demand for electricity in winter, we decided to phase in the move to cost recovery levels by holding the February increase to 15 percent, with another increase to be taken in summer. This phased approach has the added value of allowing us to assess the success of our efforts to raise effective collections and the potential need for electricity imports based on hydrological developments when determining the size of the next adjustment. In any event, we will take measures to reduce the quasi-fiscal losses of KESH to 1.2 percent of GDP (SB; June-15, 2008); and will also raise the effective collection rate in 2008 to 62.5 percent by further limiting losses to 32 percent and boosting collections to 92 percent. In collaboration with the World Bank, work on a new action plan is continuing. These measures are expected to increase KESH's revenue by about ¾ percent of GDP.

20. **We are also progressing towards privatization of the distribution arm of KESH**. IFC—the privatization advisor to KESH—has helped us set up a program aimed at privatizing by end–2008. We will identify qualified bidders by end-June 2008. In parallel, we are establishing the required regulation and market structure with assistance from USAID. In this regard, we will finalize rules for the electricity market and the methodology for tariff adjustment by end-March 2008. We are aware that the privatization agenda—while

technically feasible within 2008—is subject to complex risks. The Ministry of Economy, Trade, and Energy is carefully monitoring the process to ensure close coordination between KESH, the regulator, IFC, and donors.

21. **We are developing additional sources of electricity supply.** Construction of a thermal power plant, financed jointly by the World Bank, EIB and EBRD, has already started—the plant will increase power supply by 700 GWh a year upon completion in 2009. Awarding the concession contract for the thermal power plant at Fier will further increase power supply. Additionally, with IFC assistance, we have closed the prequalification phase of the Ashta hydro power project, which will be awarded on concession basis through international open tender. We are also progressing with small hydro power concessions. Work on a new transmission line to Montenegro has begun with assistance from KfW which, when completed, will significantly increase our import capacity.

D. Monetary, Exchange Rate, and Financial Sector Policies

22. **We will continue our efforts at anchoring low inflation expectations and remain vigilant and react quickly to any rise in underlying price pressures**. We will continue to proactively use our policy rate if needed to reassure markets and contain any second-round inflation effects. On the demand side, with fiscal policy well-anchored, the principle risk stems from resurging credit growth; while on the supply side, further energy shortages would raise prices as the increasing costs of self-generated electricity are eventually passed on to consumers or if the KESH situation was perceived to undermine successful budget execution.

23. **Open and transparent communication with the market is a key element in our strategy**. We are therefore expanding our outreach and ensuring that price developments and the reasons for our policy measures are clearly conveyed to the market. In this respect, we believe INSTAT's recent decision to develop and publish additional measures of inflation—such as average inflation and core inflation (from which volatile or administrative prices such as food and electricity have been excluded)—will provide us with additional means to illustrate the underlying inflation situation to the market.

24. **Monetary policy will continue to adapt to the changing structure of the financial system**. Our current monetary policy framework—a reserve money program with quantitative targets set in consultation with the Fund and with changes to the repurchase rate as the main policy instrument—has served us well and will be retained along with the flexible exchange rate. Further development of the interbank and secondary markets will help improve the monetary transmission mechanism over the medium term. Pending these improvements, however, over the course of 2008, we will continue to supplement monetary policy measures with regulatory and supervisory measures. This will improve the quality and safety of commercial banks' growing loan portfolios, while reining in the growth of credit from the supply side. We also stand ready to protect financial stability in case a drastic

increase in collaterizable assets follows the planned large-scale formalization and titling of real estate, which could trigger an unsustainable boost to credit demand.

25. **We attach priority to improving our capacity to oversee and regulate banks**. The banking system remains solvent, liquid and profitable. We are nonetheless vigilant about potential risks. Not only is credit growth still rapid, but the loan portfolio has been built up during a time of unprecedented economic expansion, and has therefore not been tested by adverse economic conditions. Moreover, collateral execution remains difficult, calling into question the effectiveness of a major pillar supposed to safeguard financial stability. Over the course of 2008, we therefore intend, as a matter of priority, to further improve our supervisory capacity by:

- Taking necessary legal and administrative steps to improve the ability of commercial banks to execute collateral.

- Establishing MOUs with the home country supervisors of major banks, including Austria and Italy, for the sharing of information; and promulgating additional measures to improve the execution of collateral.

- Providing regular training opportunities to staff of the BSD, FSD, FSA, and Deposit Insurance Agency, and addressing staffing and any organizational needs.

In order to properly prioritize and augment this considerable agenda, and to ensure its full consistency with international best practice, a Fund technical assistance mission recently visited Tirana to review our existing banking supervision capacity and to assist us in designing future policy and administrative improvements. We intend to utilize the mission's recommendations as an input to developing a medium-term plan for the further development of our banking and financial sector supervisory capacity.

26. **We will also strengthen incentives for banks to analyze risks**. We might require banks to formally discuss risks, particularly those arising from rapid credit growth and foreign currency lending, in the meetings of their boards of directors, to boost their risk management, or to raise reserve and provisioning requirements for activities with high risk, such as lending in foreign currency to insufficiently-hedged borrowers. Banks' exposure to the indirect credit risk embodied in unhedged foreign currency lending could be further mitigated by limiting such loans to a specific multiple of capital. We are also considering the introduction of simple rules that would target consumer credit, including credit cards, such as loan to disposable income ratios and transparency and disclosure requirements; the reintroduction of loan to value requirements for all types of loans, including mortgages; and greater monitoring of loan maturity gaps.

27. **Further financial market development is essential to improve the efficiency of monetary policy and financial intermediation**. Our priority is now to develop interbank and secondary markets. To this end, we will develop a delivery versus payment system

(DVP) for government securities, capable not only of simultaneous delivery and settlement for sales, but also for private repurchase operations (SB; end-October 2008), and have requested Fund TA to help design and implement the system. We expect such a system, alongside a reduction in the frequency of primary auctions, to raise volumes in the secondary market for government debt and foster the development of the interbank market. The necessary legislative changes needed to remove obstacles to private party repurchase operations have already been drafted and will be submitted to Parliament. We also expect to fully automate the primary market for government treasury bills and bonds as part of the same IT project, thereby allowing the entire auction process to be completed within a single day compared with three days currently. Nonetheless, the treasury bill window at BoA will be maintained until it is clear that the new system provides a fully acceptable alternative means of ensuring nonbank access to government securities on an equitable basis. Lastly, we will protect progress made to date in privatizing the banking system.

28. **We have taken steps to strengthen the balance sheet of the BoA**. As a prior action for this review, we transferred over 86,000 ounces of gold to BoA in order to ensure a positive level of capital at end-2007. We also increased the permissible level of BoA's paid in capital from lek 750 million to lek 2,500 million, which removed a legal obstacle that had prevented BoA from using retained earnings to increase its reserve fund. Looking ahead, we will aim to adopt international best accounting practices in the calculation of BoA profits and to make securities to compensate BoA for any unrealized valuation losses fully marketable by end-May 2008. We will take no legislative or regulatory action that weakens the independence of the BoA, including its control over it's budget and its authority to decide on compensation levels.

29. **We intend to maintain the pace of reforms in the nonbank financial sector**. In the insurance sector we have an ambitious work program, developed together with the World Bank, which is centered around the introduction of risk-based supervision, as well as implementation at FSA of an IT platform for offsite reporting and internal analytics. In addition, we will review and update all insurance laws and regulations, with an emphasis on the legislation governing motor vehicle third party liability and reinsurance. The legal framework governing the private pension industry is under discussion and will also be reviewed and updated. 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.

E. Data Issues

30. **We will continue to improve statistics, particularly the national accounts and short-term economic indicators.** Strengthening the methodology and timeliness and increasing the frequency of national accounts statistics remain a top priority over the short and medium term. We have undertaken a number of surveys to improve the basis for the national accounts and other important data, such as consumer price data. In particular, data

from the national labor force survey of 2007 will enhance the reliability of our national accounts statistics. To strengthen short-term economic indicators, we are improving the coverage, timing and quality of our STS business survey. We will strengthen the collaboration of INSTAT and the BoA to improve the quality of our balance of payments statistics, particularly data on workers remittances and foreign direct investment. We appreciate the extensive technical assistance from the Statistics Department of the IMF and will continue to work with the IMF to implement the recommendations of the 2006 data ROSC, as well as our plan to move towards SDDS status.

F. Other Structural Reforms

31. **Privatization of strategic public enterprises will continue in 2008**. The significant interest shown by foreign insurance companies in the Albanian insurance sector makes us confident we will be able to sell INSIG this year or next. In the oil sector, we have selected the privatization advisor for ARMO and the international privatization tender is expected to open in spring 2008. We will also intensify our efforts to divest the assets of Albpetrol-One, which we recently formed by merging Albpetrol and Servcom. We also intend to offload our remaining minority stake in the mobile telephone company AMC.

32. **We are also making progress in other reforms to improve our business and investment climate**. We will continue our efforts in implementing the Regulatory Reform agenda, led by a high level Task Force, to ease market entry barriers; to make the regulatory environment more transparent, predictable, and simple; and to ensure a level playing field for local and foreign business. To support the development of SMEs, we will continue to encourage donor support for micro credits, in compliance with the finalized SME Medium-Term Strategic Program for 2007–2009; and carry out the necessary actions to make our new Competitiveness Fund and Export Guarantee Fund fully operational and effective, relying more on the increased capacities of Albinvest. We are also taking measures to improve the commercial court system and we are pursuing land registration, including the legalization of informal housing, in order to enhance contract enforcement and property rights and ensure long-term sustainable development.

G. External Arrears

33. **We continue to clear or reschedule our arrears on inoperative payment agreements**. Further progress was made in 2007 in clearing or rescheduling arrears to official and private creditors including the rescheduling of arrears to Poland and Bulgaria. However, some negotiations have taken longer than expected. We remain in negotiations with official creditors from Greece, Russia and Serbia and Montenegro, are reconciling terms with Algeria, Cuba and Vietnam, and are negotiating with a number of private companies. The slow pace of negotiations meant that we did not fully clear or reschedule our arrears by the end of 2007. But discussions are in progress, and we aim to conclude them by end-2008.

We will not accumulate new external payments arrears. Once all arrears have been cleared or rescheduled we will begin discussions with the Fund with a view to accepting Article VIII.

H. Program Monitoring

34. The sixth disbursement and purchase under the PRGF/EFF-supported program will be based on the end-March, 2008 quantitative performance criteria (Table 1 and the TMU); and completion of the fifth review and financing assurances review. The fifth review under the PRGF and EFF arrangements is expected to be completed no later than August 1, 2008; and the sixth review no later that February 1, 2009. 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 2007-December 2008 1/

	Actual	End-June 2007	Prog. (Adj.)	Actual	End-September 2007	Prog. (Adj.)	Actual	End-December 2007	Prog. (Adj.)	End-March 2008	End-June 2008	End-September 2008	End-December 2008
		Prog.			Prog.			Prog.		Prog.	Prog.	Prog.	Prog.
							(In billions of lek)						
Ceiling on net domestic credit to the government 2/	1	16	20	-12.4	22.0	32.3	21.4	25.1	26.4	6.3	12.6	18.9	25.2
Ceiling on accumulation of net domestic assets of the BOA 3/	-9	12	12	-16.8	16.6	10.1	-1.7	23.5	17.0	1.7	10.1	6.1	23.4
Indicative total tax revenue target 4/	100	97	97	156.9	155.0	155.0	221.3	221.0	221.0	51.1	108.6	171.2	244.7
							(In millions of US dollars)						
Floor on accumulation of net international reserves of the BOA 3/	232	91	91	165.8	-24.9	50.4	130.5	28.6	103.9	-58.6	-25.2	30.9	92.9
							(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	164	380	380	180.0	380.0	380.0	278.0	380.0	380.0	515.0	515.0	650.0	680.0
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	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	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-2007 except where marked. Data for end-March 2008 and end-September 2008 are proposed performance criteria, except where marked. Data for end-June 2008 and end-December 2008 are indicative targets.

2/ Cumulative change within the calendar year.

3/ For end-December 2007 and end-September 2007, cumulative change from end-December 2006. For end-June 2007, 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. From September 2007 includes small business tax. Targets defined as cumulative changes within each calendar year.

5/ Applies on a continuous basis.

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

	Proposed Test Date
I. Prior Actions	
1. Increase the capital of BoA by transferring to it 86,000 ounces of gold.	...
2. Implement an electricity tariff increase.	...
II. Structural Benchmarks	
A. Reduce fiscal vulnerabilities	
3. Take measures to reduce the quasi-fiscal losses of KESH to 1.2 percent of GDP.	*15-Jun-08*
4. 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
5. 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	Ongoing
6. Introduce modifications into the VAT refund system whereby claims will be paid automatically if validity checks are met (as outlined in the IMF TA report on tax administration of October 2007).	*End-April 2008*
7. Prepare semi-annual reports (within one month of the end of each semester) on the stock of external arrears.	Ongoing
8. Increase the number of taxpayers paying social security contributions (excluding agricultural workers and voluntary contributors) to 410 thousands.	End-July 2008
B. Improve public expenditure management	
9. 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
C. Strengthen the financial system	
10. Complete the delivery vs. payments system for government securities.	*End-October 2008*

1/ Text in italics refers to new conditionality not carried over from the third review under the program (IMF Country Report No. 07/244).

ATTACHMENT II

ALBANIA

TECHNICAL MEMORANDUM OF UNDERSTANDING

This memorandum defines the quantitative performance criteria, benchmarks and indicative targets established in the Memorandum of Economic and Financial Policies (MEFP) up until end-December 2008; and associated reporting requirements.

A. Net Domestic Credit to the Government

1. For the purposes of the program, the **government** includes the State Budget, the Social Security Institute (SSI), the Health Insurance Institute (HII), the Expropriation Fund, local governments, and the accounts of all entities (including special purpose vehicles) that are used to operate or manage public-private partnership (PPP) projects.

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

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

   (i) Gross domestic credit in lek and in foreign currency extended to the government includes: (a) securities (including treasury bills and bonds) issued by the government and held by the Bank of Albania (BoA), deposit money banks (DMBs), SLIs, and other domestic lenders; (b) loans and advances extended to the government by BoA, DMBs, SLIs, and other domestic lenders; (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)[2]; and (e) any other form of financial obligation of the government the issuance of which resulted in

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

[2] This was equivalent to lek 15.505 billion at end-December 2007.

borrowing funds by the government or a payment for an existing payment obligation of the government.

(ii) Gross domestic credit in lek and in foreign currency extended to the government excludes advances on profit transfers by the BoA.

(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 plus accrued interest. 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 including 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 issue price plus accrued interest. 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[3].

(iv) For the purposes of program monitoring, gross domestic credit to the government in foreign currency will be converted from lek to Euros at the end-of period lek/Euro exchange rate prevailing on the test date; and then converted to lek at the program exchange rate of lek 121.6/Euro.

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 (Euro 569.2 per ounce)[4].

(ii) Government financial assets held at the Bank of Albania exclude: (a) foreign currency deposits related to foreign financed projects; and (b) deposits serving

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[3] Under current reporting standards, the stock of all gross domestic credit extended to the government and held by the SLIs and other domestic lenders is only available at face value.

[4] The lek value of standard gold deposits will be (a) converted to Euro using the current end-of-period lek/Euro exchange rate; (b) then converted to ounces of gold using the current Euro market price of gold; (c) then converted to Euro at the program price of gold (Euro 569.2 per ounce); and (d) then converted to lek at the program lek/Euro exchange rate of lek 121.6/Euro.

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 DMBs 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, foreign currency-denominated government financial assets will be converted from their lek value (obtained from the BoA and aggregate DMBs' balance sheet) to their currency of denomination at the end-of period lek exchange rate for that currency prevailing on the test date; and then converted to lek at the lek exchange rate for that currency prevailing at end-December 2007. Those foreign currency-denominated government financial assets for which the currency of denomination is unknown, will be converted from their lek value (obtained from the BoA and aggregate DMB's balance sheet) to Euros at the end-of period lek/Euro exchange rate for that currency prevailing on the test date; and then converted to lek at the lek/Euro program exchange rate of lek 121.6/Euro.

6. Under these definitions, the stock of net domestic credit to the government was lek 360.3 billion at end-December 2007. 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 2007. Under this definition, the level of NDA was lek 93.9 billion as of end-December 2007. The NDA limits will be cumulative changes from end-December 2007 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. 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. The government's foreign currency deposits at the Bank of Albania are excluded from reserve liabilities[5], with the following exception: those government deposits that arise from the proceeds of the foreign currency-denominated syndicated loan contracted to finance part of the Rreshen-Kalimash road will be included in reserve liabilities. Reserve assets and reserve liabilities will both be expressed in US dollars. The NIR limits will be cumulative changes from end-December 2007, and will be monitored from data supplied by the Bank of Albania.

10. During this program, for monitoring purposes, the bilateral exchange rates between the Euro and non-dollar currencies will be kept at their end-December 2007 levels and holdings of monetary gold will be valued at Euro 596.2 per ounce. Under this definition, the level of NIR was US$1,624.4 million at end-December 2007.

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, 2008 will be as follows:

End-March 2008	lek 481 mn.	(Of which US$0.0 mn. in foreign currency);
End-June 2008	lek 962 mn.	(Of which US$0.0 mn. in foreign currency);
End-Sept 2008	lek 4,100 mn.	(Of which US$12.0 mn. in foreign currency);
End-Dec 2008	lek 4,100 mn.	(Of which US$12.0 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)

[5] 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[6].

12. The ceiling on NCG:

- 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).

- will be adjusted downward by the amount of fiscal expenditure that was authorized by the 2008 budget, but legally expended in the first 14 days of 2009 and legally credited to the 2008 fiscal year.

- will be adjusted upward by the amount of fiscal expenditure that was authorized by the 2007 budget, but legally expended in the first 14 days of 2008 and legally credited to the 2007 fiscal year.

- Will be adjusted upwards by the disbursed amount of the foreign currency-denominated syndicated loan contracted to finance part of the Rreshen-Kalimash road that is sourced through resident banks or other resident lenders. There will be no adjustment to the NCG target for this purpose for disbursements of this loan that are sourced through nonresident lenders.

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, 2008, to:

End-March 2008	US$0.0 mn;
End-June 2008	US$0.0 mn;
End-Sept 2008	US$0.0 mn;
End-Dec 2008	US$0.0 mn.

[6] 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.

The ceilings on NDA of the Bank of Albania and NCG 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.[7]

14. The NDA ceilings will also be adjusted to reflect the impact of any change in the required reserve ratio of commercial banks with the Bank of Albania. Should reserve requirements in lek (foreign currency) be changed from the 10 percent on all deposits held in lek (foreign currency), then the NDA ceiling will be adjusted by multiplying the change in the reserve requirement by the programmed deposits for which required reserves are held in lek (foreign currency). The total adjustment to the NDA ceiling will be the sum of the adjustment made for any change in the reserve requirement on lek deposits and the adjustment made for any change in the reserve requirement on foreign currency deposits. Before making any change to the required reserve ratio, the authorities will consult with IMF staff. For the purpose of this adjuster, the programmed level of deposits in lek and foreign currency are defined as follows:

	In lek (lek bn.)	In foreign currency (lek bn.)
End-March 2008	350.6	264.5
End-June 2008	364.5	267.5
End-September 2008	377.1	294.4
End-December 2008	372.6	312.6

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

[7] 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.

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[8]. 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 medium- and long-term external debt as defined in paragraph 16 will be adjusted downwards by the disbursed amount of the foreign currency-denominated syndicated loan contracted to finance part of the Rreshen-Kalimash road that is sourced through resident banks or other resident lenders. There will be no adjustment to the limit on medium- and long-term external debt for this purpose for disbursements of this loan that are sourced through nonresident lenders.

18. 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.

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[8] For the purposes of program monitoring, "external" means owed to a non-resident, and includes both foreign currency- and local currency-denominated debt (where debt is defined in paragraph 15 of this memorandum).

Debt falling within the limit shall be valued in Euros at the exchange rate prevailing at the time the contract or guarantee becomes effective.

19. 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 December 31, 2007 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 December 31, 2007; and (ii) external arrears that are subject to debt rescheduling agreements or negotiations.

20. **Large projects** (as referred to in MEFP paragraph 16 and MEFP Table 2) are defined as those projects involving total nonconcessional borrowing in excess of Euro 20 million.

F. Tax Revenues

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

G. Monitoring and Reporting Requirements

22. 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).

(xiii) Monthly information regarding the balances held by the Expropriation Fund at BoA disaggregated into foreign currency and domestic currency.

(xiv) Monthly data regarding the currency composition of government deposits at BoA and the aggregated deposit money banks, disaggregated by transferable and other deposits.

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.

(xii) Monthly information regarding the balances held by the Expropriation Fund at deposit money banks and SLAs disaggregated into foreign currency and domestic currency.

(xiii) The amount—and detailed breakdown—of fiscal expenditure that was authorized by the 2008 budget, but legally expended in the first 14 days of 2009 and legally credited to the 2008 fiscal year; and the amount—and detailed breakdown—of fiscal expenditure that was authorized by the 2007 budget, but legally expended in the first 14 days of 2008 and legally credited to the 2007 fiscal year.

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.

The Albanian Electricity Corporation KESH will supply to the Fund:

(i) Detailed monthly data on production, imports, and consumption of electricity.
(ii) Detailed monthly data on losses and collection rates.

Table 1. Albania: Calculation of Net Domestic Credit to Central Government for Program Monitoring Purposes, December 2007–December 2008

(In millions of lek)

		Dec-07	Mar-08	Jun-08	Sep-08	Dec-08
1.	**Treasury bills held outside central government**	239,825	...	...	...	...
Of which:						
1. (i)	Held by Bank of Albania 1/	66,955	...	...	...	...
1. (ii)	Held by deposit money banks 1/	131,810	...	...	...	...
	In domestic currency	131,810	...	...	...	...
	In foreign currency at program exchange rates	0	...	...	...	...
	In foreign currency at current exchange rates	0	...	...	...	...
1. (iii)	Held by savings and loan institutions 2/	0	...	...	...	...
1. (iv)	Held by other domestic lenders (excluding holdings of HHI and SSI) 2/	41,060	...	...	...	...
	Of which:					
1. (iv) (i)	INSIG	1,581	...	...	...	...
1. (iv) (ii)	Individuals and firms	39,479	...	...	...	...
1. (iv) (ii) (i)	Of which: BoA window	23,756	...	...	...	...
Plus:						
2.	**Other central government debt held outside central government (millions of lek)**	137,451	...	...	...	...
Of which:						
2. (i)	Held by Bank of Albania 3/	15,505	...	...	...	...
2. (i) (i)	Other securities	15,505	...	...	...	...
2. (i) (i) (i)	Of which: for BoA valuation losses	15,505	...	...	...	...
2. (i) (ii)	Short-term direct loans to government 3/	0	...	...	...	...
2. (ii)	Held by deposit money banks 4/	121,946	...	...	...	...
2. (ii) (i)	Fixed income securities 4/	121,946	...	...	...	...
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:		377,277	...	...	...	...
Less:						
3.	**Assets of central government (excluding HHI and SSI)**	10,253	...	...	...	...
3. (i)	Deposits held at Bank of Albania 6/	12,365	...	...	...	...
3. (i) (i)	In domestic currency	7,435	...	...	...	...
3. (i) (i) (i)	Transferable deposits in lek	4,541	...	...	...	...
3. (i) (i) (ii)	Term deposits of government and deposits in lek for projects	465	...	...	...	...
3. (i) (i) (iii)	Domestic currency portion of Expropriation Fund	2,429	...	...	...	...
3. (i) (ii)	In foreign currency at program exchange rates and program price of gold 7/ 8/	4,930	...	...	...	...
3. (i) (ii) (i)	In foreign currency evaluated at current exchange rates	5,757	...	...	...	...
3. (i) (ii) (i) (i)	Transferable deposits in foreign currency evaluated at program exchange rate 7/ 9/	3,172	...	...	...	...
3. (i) (ii) (i) (i) (i)	Transferable and other deposits in foreign currency evaluated at current exchange rate 9/	3,172	...	...	...	...
3. (i) (ii) (i) (i) (i) (i)	Of which: Foreign currency portion of Expropriation Fund at current exchange rates	0	...	...	...	...
3. (i) (ii) (i) (ii)	Standard gold deposits of government evaluated at program exchange rate and gold price (Lek mns.) 8/	1,758	...	...	...	...
3. (i) (ii) (i) (ii) (i)	Standard gold deposits of government at current exchange rate and gold price (Lek mns.) 8/	2,585	...	...	...	...
3. (i) (ii) (i) (ii) (i) (i)	Number of ounces of gold equivalent	25,411	...	...	...	...
3. (ii)	Assets held at deposit money banks	-2,112	...	...	...	...
3. (ii) (i)	Deposits 10/	1,670	...	...	...	...
3. (ii) (i) (i)	Deposits in domestic currency	165	...	...	...	...
3. (ii) (i) (i) (i)	Transferable deposits in domestic currency	165	...	...	...	...
3. (ii) (i) (i) (ii)	Other deposits in domestic currency	0	...	...	...	...
3. (ii) (i) (ii)	Deposits in foreign currency evaluated at program exchange rates	1,504	...	...	...	...
3. (ii) (i) (ii) (i)	In foreign currency evaluated at current exchange rates 7/	1,504	...	...	...	...
3. (ii) (i) (ii) (i) (i)	Transferable deposits in foreign currency evaluated at current exchange rates	1,504	...	...	...	...
3. (ii) (i) (ii) (i) (ii)	Other deposits in foreign currency evaluated at current exchange rates	0	...	...	...	...
3. (ii) (ii)	DMB payables to government	-3,911	...	...	...	...
3. (ii) (iii)	Ministry of finance short-term lending to commercial banks	129	...	...	...	...
3. (iii)	Held at savings and loan institutions 10/	0	...	...	...	...
Less:						
4.	**Deposits of HHI and SSI**	6,735	...	...	...	...
Equals:						
5.	**Stock of Net domestic credit to central government (1+2-3-4)**	360,289	...	...	...	...
	Change since December 2007	...				
6.	Memorandum items:					
6. (i)	Current exchange rate (Lek/Euro, eop)	121.560	...	...	...	...
6. (ii)	Current exchange rate (Lek/US dollar, eop)	82.670	...	...	...	...
6. (iii)	Program exchange rate (Lek/Euro, eop)	121.6	121.6	121.6	121.6	121.6
6. (iv)	Program price of gold (Euros per ounce)	569.2	569.2	569.2	569.2	569.2
6. (v)	Program price of gold (US dollars per ounce)	837.0	837.0	837.0	837.0	837.0
	Program exchange rate (US$/Euro, eop)	1.4704	1.4704	1.4704	1.4704	1.4704
6. (vi)	Market price of gold (price in Euros per ounce)	837.0	...	...	...	...
6. (vii)	Current exchange rate (US dollar per Euro, eop)	1.4704	...	...	...	...

1/ Evaluated at issue price plus accrued interest.
2/ Evaluated at face value (data on treasury bill holdings of SLAs and other domestic lenders are currently available only at face value).
3/ Includes accrued interest.
4/ Valued at issue price plus accrued interest.
5/ Evaluated at face value.
6/ Includes transferable deposits of government in domestic and foreign currency, lek deposits of central government for projects; deposits of the Expropriation Fund; and standard gold deposits of government (footnote # 8). Excludes non-standard gold deposits; excludes all nongold precious metal deposits of government; and excludes government deposits in foreign currency for projects.

7/ Value to be determined using methodology outlined in the TMU.

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 Euro using the current end-of-period lek/Euro exchange rate; (b) then converted to ounces of gold using the current market price of gold; then (c) converted to Euro at the program price of gold of Euro 569.2 per ounce; and then (d) converted to lek at the program Lek/Euro exchange rate of Lek 121.6/Euro.

9/ Including account set up to hold privatization revenue.
10/ Includes all deposits of central government in SLIs.

Statement by the IMF Staff Representative
March 27, 2008

1. This statement updates on developments since the preparation of the staff report (www.imf.org). The additional information does not change the thrust of the staff appraisal.

2. **The authorities have implemented the prior actions for the review:**

- A law transferring ownership of the requisite amount of gold from the Albanian Government to the Bank of Albania entered into force on February 27, 2008.

- An increase in the average electricity tariff of about 15 percent became effective for the March 2008 billing period.

3. **The recent explosion at an armament dismantling facility will lead to unanticipated fiscal expenditure, but does not threaten program targets.** The accidental explosion outside Tirana on March 15, 2008 was devastating and led to significant loss of life and property damage in the surrounding area. The authorities want to expedite compensation for the victims and property damage. They intend to meet this unanticipated fiscal expenditure by utilizing part of the existing 1.6 percent of GDP of contingencies in the 2008 budget. The modalities and extent of potential compensation are not yet finalized, but estimates range between 0.1 to 0.4 percent of GDP. As payment arrangements are still being worked out, the authorities expect to meet any related expenditure within the limits of the end-March 31, 2007 performance criterion on net credit to government. To provide sufficient margin to deal with other risks, notably related to the electricity sector and potential infrastructure cost overruns, staff advises the authorities to replenish contingencies, in particular by limiting planned wage and social benefit increases.

4. **The Albanian authorities intend to complete the remaining structural benchmark set at the time of the Third Review**. This benchmark—the submission of legislation to parliament providing for the transfer of supervisory authority over the leasing industry to the Bank of Albania—was originally scheduled for end-October, 2007, and is now envisaged to be carried out by end-April 2008.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

Press Release No. 08/67
FOR IMMEDIATE RELEASE
March 31, 2008

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes the Fourth Review Under the PRGF and EFF Arrangements with Albania and Approves US$4 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) on March 28, 2008, completed the fourth review of Albania's economic 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$4 million), which will bring the total disbursements to Albania under both arrangements to SDR 12.2 million (about US$19.9 million).

The concurrent three-year arrangements under the PRGF and EFF, amounting to the equivalent of SDR 17 million (about US$27.9 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 adherence to prudent macroeconomic and structural policies has contributed significantly to its strong macroeconomic performance, despite challenges from a difficult external environment. In 2007, growth improved and inflation remained within the target band, notwithstanding a drought and rising food and energy prices. The structural agenda has advanced, particularly in the fiscal area, while the privatization program is nearing completion. However, deep seated problems in the electricity sector came to the fore again.

"The authorities' medium-term fiscal framework appropriately balances the need for additional infrastructure and development spending with macroeconomic stability concerns, while aiming to contain the role of government and provide an enabling environment for private sector activity. The authorities intend to adopt a deficit ceiling of no more than 4 percent of GDP for 2009 and subsequent years. This should provide a credible anchor for fiscal policy over the medium term, give additional assurance that the downward trajectory for public debt will be maintained, and deliver welcome support to monetary policy in keeping inflation expectations well anchored.

"The existing monetary policy framework, based on an independent central bank and a floating exchange rate, has served the economy well and remains appropriate. The authorities' timely policy actions over the past year have demonstrated their commitment to price stability and helped contain inflationary expectations despite strong headwinds from a drought and higher world food and energy prices. Limitations in the effectiveness of monetary policy have required supplementary regulatory and prudential measures; and it is important that supervisory and regulatory capacity—already at a relatively high level—continue to improve in line with the rapidly maturing financial system.

"A sustainable reform of the electricity sector is a priority as it would also help mitigate attendant risks to the macroeconomic framework and limit quasi-fiscal losses. Collections must be boosted, transmission losses cut, and tariffs raised. The tariff increase this month was an important initial element, but further efforts are needed to stem the sector's quasi-fiscal losses, to improve chances for a successful privatization of the distribution company targeted later in 2008, and to assure a reliable electricity supply over the medium term," Mr. Portugal said.

Statement by Mr. Arrigo Sadun, Executive Director for Albania and Mr. Francesco Spadafora, Senior Advisor to Executive Director March 28, 2008

On behalf of the Albanian authorities, we thank staff for the well-written and informative reports, which are further proof of the remarkably close and constructive cooperation with the authorities.

Overview

Thanks to prudent monetary and fiscal policies, the Albanian economy has been able to weather very well the external shocks that occurred in 2007, particularly a severe regional drought and rising food and energy prices. Growth accelerated to 6.0 percent, from 5.0 percent in 2006, fueled by robust industrial and mining production and export growth (+19.0 percent in nominal terms on an annual basis), and is expected to remain at 6.0 percent also in the current year.

Average inflation should increase from 2.9 to 4.0 percent in 2008, as a consequence of the recent exogenous price increase and power disruption, but is expected to decline to about 3.0 percent in 2009, in line with the Bank of Albania's (BoA) 3±1 percent target band. Underlying inflation is somewhat lower (2.5 percent) and inflation expectations remain well anchored, thanks to the vigilance of BoA and its prompt actions to raise the policy rate three times in 2007 so as to avoid second-round effects.

Strong increases in VAT and personal income tax revenues contributed to meet the 2007 budget target (3.9 percent of GDP), despite additional expenses of about 1.0 percent of GDP reflecting an emergency transfer to the state-owned electricity company KESH and higher social security outlays. In 2008 the overall budget deficit will register a one-time spike, from 3.8 to 5.2 percent of GDP, as a result of an acceleration in capital spending related to a major road project, but will decline to 3.7 percent in 2009 already.

Against the background of a broadly favorable macroeconomic scenario, the authorities are fully aware of some challenges, including: new delays in the planned reforms of the energy sector and rapid credit growth, despite some recent moderation.

Fiscal Policy

In the face of the ongoing uncertainties with KESH and cost overruns with the Rreshen-Kalimas road project, the 2008 budget outcome has been protected against heightened risks

with contingency reserves of about 1.5 percent of GDP, which would allow for a flexible reallocation of expenditure if needs be. The authorities have also committed to the assessment, through a midterm budget review and in consultation with the Fund, of the need for expenditure cuts in the event of risks to the deficit ceiling.
After this year's temporary acceleration of capital spending, the authorities plan to adopt in the near future an explicit fiscal deficit cap of 4 percent of GDP. This will give the automatic stabilizers on the revenue side some room for maneuver and help bring the debt burden to below 50 percent of GDP.

Over the last two years the authorities have carried out a major overhaul of the tax system, by introducing flat personal income and corporate tax rates. As a result, the direct tax structure has become less distortionary and easier to administer.

One of the key objectives of the authorities for this year is to make substantial improvements in the transport infrastructure. However, they are committed to reallocating potential savings from under-execution of the road project to reduce the budget deficit.

Monetary and financial sector policies

As a result of tighter monetary policy, complemented by more stringent prudential and regulatory measures, credit growth, a major concern this time last year, has been contained and is expected to further decrease to a more sustainable pace. The authorities recognize that potential risks stem from the ongoing large scale formalization and titling of real estate, as this reform will presumably lead to an expansion of available collateral. Thus, they stand ready to use monetary policy to counteract any unwarranted increase in credit growth.

The banking system is largely foreign owned (about 90 percent of total assets in 2007, up from 47 percent in 2003) and is well-capitalized and profitable. The authorities are aware that enhanced vigilance is nonetheless required, given that the loan portfolio of commercial banks has been built up during favorable circumstances and therefore remains untested by adverse economic conditions. To further safeguard the system's financial stability, they will take the necessary legal and administrative steps to improve the ability of commercial banks to execute collateral.

The Bank of Albania has made considerable progress in its capacity to supervise individual banks and now conducts a full inspection of every bank at least once a year. In parallel with the rapidly maturing financial system, BoA plans to establish Memoranda of Understanding with the home country supervisors of major banks.

To improve the effectiveness of monetary policy, the authorities aim at developing efficient interbank and secondary markets. To this end, they are in the initial phase of developing a delivery versus payment system for government securities. Furthermore, foreign and domestic non bank institutions have recently been given full access to government securities auctions. In December 2007, for the first time, the Albanian authorities were able to issue a Lek 6 billion bond with a 7-year maturity, as a way to reduce rollover risk and attract foreign investors in government securities. They also intend to gain access to international capital markets and may plan to issue Albania's first Eurobond in 2008.

Macroeconomic implication of the difficulties in the electricity sector

Deep-seated problems in the electricity sector still condition the macroeconomic performance of the Albanian economy. Although part of the recent decline in electricity generation is attributable to a regional drought, chronic power disruptions have taken a toll on inflation, the budget deficit and current account (because of the ensuing need to import more costly energy).

In order to achieve a more lasting solution and ensure a stable supply of electricity over the medium term, the authorities are in the process of privatizing the distribution arm of KESH by end-2008, under the advice of the IFC. Furthermore, they are establishing the required regulation and market structure with assistance from USAID. Meanwhile, in order to stabilize the company's finances and address the potential fiscal risk, they have committed to take additional measures to meet the newly-introduced structural benchmark of reducing the quasi-fiscal losses of the company to 1.2 percent of GDP by mid-June 2008. To this end, they rely on tariff increases and improvements in collections. A 15 percent tariff increase has become effective in the current month and another one is foreseen in summer. Furthermore, the authorities aim to raise the effective collection rate by 10 percentage points in 2008, up from 52.5 percent the year before, including through a stricter approach to cutting off service to nonpaying customers. Overall, the above measures are expected to increase KESH's revenues by about 0.75 percent of GDP.

The authorities are also developing additional sources of electricity supply. Construction of a thermal power plant, financed jointly by the World Bank, EIB and EBRD, has already started and should be completed by 2009.

Structural issues

The objective of the authorities' medium-term economic strategy is to foster continued strong private sector-led growth. They are aware that macroeconomic and financial sector stability is a necessary condition that has to be complemented by structural reforms.

All quantitative program targets and all but one of the structural benchmarks (SBs) for the fourth review have been met. SBs are related to improving public expenditure management, reducing fiscal vulnerabilities and strengthening the financial system. In particular, the Large Taxpayer Office has been transformed into a full-service office and all large taxpayers now have the possibility to file and pay electronically. A cross-agency campaign to improve social security compliance has also been conducted and inactive taxpayers have been removed from the tax registry. Furthermore, a credit bureau has been set up within the Bank of Albania to improve banking supervision. The only structural benchmark that was missed relates to the submission of legislation to Parliament for transferring supervisory authority over the remaining leasing companies to the Bank of Albania. A draft of the law is currently being reviewed by the Ministry of Finance.

To improve public expenditure management, a new budget law has been submitted to Parliament and will strengthen the role of the Medium-Term Budget Program, and a register of public investment projects has been introduced to increase the capacity of execution.

The Albanian authorities set forth their poverty reduction strategy for 2007-13 in the recently approved National Strategy for Development and Integration (NSDI). The strategic priorities are: a commitment towards integration in the E.U. and NATO; the democratization of the society; the consolidation of the rule of law; and the achievement of rapid and sustainable economic and social development. The NSDI is being integrated into the three-year Medium-Term Budget Program (MTBP), which identifies policy objectives as intermediate steps to the achievement of the NSDI goals.