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Albania: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

July 22, 2005

The following item is a Letter of Intent of the government of Albania, which describes the policies that Albania intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Albania, is being made available on the IMF website by agreement with the member as a service to users of the [IMF](#) website.

Tirana, July 22, 2005

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

Dear Mr. de Rato:

The three-year period of our Poverty Reduction and Growth Facility (PRGF) arrangement, which was approved in June 2002, is now approaching its expiration in November 2005. This arrangement has contributed to the good performance of the Albanian economy over the period and its main objectives have been successfully achieved. For the sixth and last review under the program, all quantitative performance criteria (PC) have been observed. Structural PCs were also observed with the exception of the PC requiring the implementation of the risk assessment module of the ASYCUDA system in five customs houses—largely due to delays in the necessary technical and financial external assistance. However, this assistance is now in place and we implemented the system in the Durrës and Tirana customs houses as a prior action for completion of this review. As these two customs houses represent more than 60 percent of customs traffic in Albania, and as we intend to implement the module in other customs houses over the course of 2005, we are requesting a waiver for the non-observance of this PC. We request completion of the sixth and final review as well as the financing assurances review under the arrangement.

We intend to initiate discussions for a successor arrangement with the IMF as soon as possible, as indicated at the February 28, 2005 meeting of the Executive Board. Until a new program is in place, we will maintain the current macroeconomic policy stance and continue ongoing structural measures. This will enable us to maintain macroeconomic stability and the pace of reform, thus providing an appropriate base, going forward, for the anticipated new arrangement. The attached supplementary Memorandum of Economic and Financial Policies (MEFP) therefore describes not just our economic policies up to the end of the program period, but also our policy intentions and specific targets for the remainder of 2005. These policies are consistent with our November 2001 National Strategy for Socio-Economic Development (NSSD) and the Annual Progress Reports of May 2003 and May 2004.

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

After the end of this arrangement, and while 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 whenever the Managing Director of the IMF requests such consultation. These consultations may include correspondence and visits of officials of the IMF to Albania or of representatives of Albania to the IMF. In continuing with our policy of transparency, we consent to the publication of this letter, the attached MEFP, and the accompanying Executive Board documents on the IMF's website.

Sincerely yours,

/s/
Fatos Nano
Prime Minister

/s/
Arben Malaj
Minister of Finance

/s/
Ardian Fullani
Governor, Bank of Albania

Supplementary Memorandum on Economic and Financial Policies (MEFP) for Albania

I. BACKGROUND

- 1. This memorandum reviews the implementation of the PRGF-supported program, and lays out our policies for the remainder of the program period and our policy intentions following the expiration of the program through end-2005.** It is consistent with the November 2001 National Strategy for Socio-Economic Development (NSSD) and the May 2003 and May 2004 Progress Reports; and supplements the June 2002, January 2003, June 2003, January 2004, July 2004, and February 2005 MEFPs.
- 2. The Albanian economy has delivered an impressive macroeconomic performance over the span of the program, including a prolonged period of rapid, non-inflationary growth.** Confidence in the monetary framework has been enhanced and inflation expectations anchored to the 2-4 percent target of the Bank of Albania (BoA). This has strengthened the lek and allowed the BoA to continue a prudent easing of the monetary policy stance while maintaining inflation generally within the target range and reserves at comfortable levels. On the fiscal front, current expenditure, the deficit, and domestic borrowing have been curtailed, and the 2005 budget is on track to deliver the first surplus on current operations since the beginning of the transition process. The public debt burden has been considerably reduced, reflecting fiscal consolidation, rapid economic growth, and the allocation of half the proceeds of large privatizations to redeem domestic debt. The debt to GDP ratio declined to 55½ percent of GDP at end-2004—a reduction of 9 percentage points of GDP since end-2002, with a further reduction of about ¾ percentage points of GDP expected by the end of 2005.
- 3. Albania has also made progress in structural reform over the course of the program period.** This has been most pronounced in the banking sector. In 2004, the privatization of the Savings Bank placed all commercial banks under private management. The banking system is now displaying increased levels of dynamism and competitiveness—including through significantly greater provision of services and credit volumes—and is poised to play a more pivotal role in economic development. Complementing these developments, the completion of the real-time gross settlement system and significant progress in switching public sector salary payments from cash to the banking system are encouraging the use of banks for normal economic transactions. We expect this process to accelerate following completion of a bulk settlement system, currently in an advanced state of development. In the fiscal area, with assistance from the IMF, and the EU and other donors, the process of reforming and modernizing our customs and tax administrations has advanced—with key actions covered by program conditionality. Adoption of realistic revenue projections and other reforms to the budget process—including greater parliamentary oversight—have brought greater transparency to our fiscal expenditure and budget processes. Substantial reforms have been carried out in the electricity sector, allowing the elimination of the electricity import subsidy in the 2005 budget. Most public concerns have either been privatized, granted under long-term management concessions, or are presently being offered for sale—including Albtelecom, the sale of which we expect to finalize this year. We also improved our statistical capacity, albeit from a low base, and

began publishing national accounts—which are now being produced with a decreasing lag. Over the program period, some key poverty indicators have improved—notably absolute poverty, and child and maternal mortality—but the advances are not uniform and a few indicators such as enrollment ratios for education need improvement. External arrears left over from before the transition have been greatly reduced.

4. **Since the time of the last review, the structural reform process has continued, including those reforms covered by program conditionality.** These actions included the extension of the ASYCUDA system to six customs houses (exceeding the end-March 2005 PC) and related procedural reform in the customs administration; and the implementation of the ASYCUDA system risk assessment module for conducting inspections (originally a PC for end March 2005 in five customs houses and completed in the two main customs houses as prior action for this review). We implemented a quick VAT refund system for exporters (PC; end-June 2005); and progressed as planned towards eliminating the stock of VAT refund arrears (SB; ongoing)—improving the actual and perceived efficiency and equity of the tax system. Additionally, we have studied the recommendations of the February 2005 FAD technical assistance mission and are developing an action plan for their implementation. In other areas, we exceeded the program target of extending salary payment through the banking system to 25,000 government employees by end-March (PC); 50,000 by end-June (PC); reaching over 60,000 employees by end-June. In the statistical area, we completed, on a preliminary basis, the 2003 national accounts (SB; end-March 2005). However, submission to Parliament of the five-year statistical plan (SB; end-March 2005) has been delayed owing to the tight legislative agenda in the run-up to the July 2005 elections and to technical objections raised by line ministries. We will submit it to the new Parliament once it has been appropriately revised in consultation with STA. We maintained compliance with our other ongoing structural benchmarks, including the implementation of our action plan for removing administrative barriers to investment.

A. Policies for the Remainder of 2005

5. **We intend to initiate discussions with the Fund for a successor arrangement that will fully articulate the Government's medium-term economic and financial policy priorities.** In the interim period between the expiration of conditionality under the PRGF arrangement and the conclusion of these negotiations, we intend to stay the course of the macroeconomic policies and ongoing structural reform initiatives implemented under the current program, as detailed below.

6. **Budget policy will retain its emphasis on achieving greater fiscal consolidation and debt reduction, and will remain consistent with the fiscal stance agreed with the IMF, including the targets specified in Table 1.** We project that tax revenue collection at end-2005 will reach its budgeted level. However, there are indications of possible shortfalls in privatization revenue (as the budgeted privatization of ARMO encountered weak market interest) and in external budget support, which together could reach $\frac{1}{2}$ a percentage point of GDP. In order to address this possible shortfall and meet our targeted level of net domestic borrowing we are freezing the budgeted Lek 2 billion contingency fund (about $\frac{1}{4}$ of a percentage point of GDP) and will offset fully any further lack of budgetary resources

through expenditure curtailment, preferably in current outlays. We will, therefore, keep our end-year target for net domestic credit to the government consistent with the budget target of Lek 23.4 billion—a reduction of almost ½ percentage point of GDP from the 2004 outturn (after abstracting from the effects of the 2004 Savings Bank privatization). Consequently, we expect a decline of ¾ percentage points of GDP in the level of public debt during 2005. Within these parameters, we intend to achieve the first surplus on current budget operations since the beginning of the transition, thus allowing for increased investment expenditure. We are considering the external financing on commercial terms of a railway line, a project which we may start implementing in 2006. If this goes ahead, we are committed to make offsetting reductions over the period of implementation of the project in net domestic credit to the government by amounts equal to the associated disbursements of nonconcessional financing as they occur—so as to avoid deviating from our intended debt consolidation plan. We will inform and consult with the IMF prior to making any changes to the 2005 budget.

7. **We will continue ongoing reform initiatives in our revenue administrations.** With respect to the General Directorate of Customs (GDC) we will extend the ASYCUDA computer system to a total of 10 customs houses by end-December 2005. This will leave only small customs houses outside the system which handle a negligible fraction of our external trade. Also, we will extend the related system of risk assessment-based selection for inspections to six customs houses over the same time frame. With respect to the General Directorate of Taxation (GDT), we intend to strengthen implementation capacity, with the goal of raising efficiency and ultimately the rate of revenue mobilization. In this regard, we will implement reforms to strengthen the effectiveness of the large taxpayer unit (LTU) and, more generally, of our manpower resources through internal performance assessments and training, particularly on auditing procedures. To this latter end, we have already initiated training of tax officers in a newly created tax administration training center, and established a system of linking employment tenure to successful completion of a series of structured exams. By end-December 2005, we expect to have vetted the entire audit staff and top management of GDT in this manner. Measures to improve the LTU will include establishing and making operational by end-September 2005 a new set of clear and objective criteria for inclusion of taxpayers under the LTU—permitting no exceptions—and concentrating control of these taxpayers within the LTU in Tirana. By September 2005, we will implement a program in the Durrës tax office for selecting taxpayers for 80 percent of all fiscal visits on the basis of an objective, computer-based, risk assessment system. We intend to extend this program subsequently to all tax offices. We plan to maintain and improve the newly introduced quick VAT refund system for exporters. In this connection, we will provide quarterly reports to the IMF of total VAT refunds requested, accepted, refused, and paid; as well as of progress in clearing VAT refund arrears incurred prior to the current system. We will refrain from granting contractual corporate income tax holidays or special tax treatments to individual companies.

8. **We will continue to direct monetary policy towards maintaining price stability and retain the flexible exchange rate regime, with foreign exchange interventions limited to smoothing fluctuations and keeping reserve cover at about four months of imports.** The REPO rate will remain our main policy instrument, supported by our reserve money program. Over the remainder of 2005, we anticipate a continuation of existing trends:

broadly stable money demand as a percent of GDP, rapid private sector credit growth from its current low level, and a trend decline in the ratio of currency in circulation to broad money, reflecting both increased confidence and financial intermediation.

9. **With IMF and World Bank assistance, we will pursue reforms to foster financial sector development based on the conclusions of the FSAP.** Our reforms will aim at improving the quality, breadth and depth of financial intermediation; reducing cash-based transactions and the informal economy; and maintaining and improving the efficiency of the financial system. Consistent with the FSAP recommendations, we will retain the treasury bill window at the BoA as a means for the public to gain access to the primary treasury bill market. The minimum threshold for accessing this window will remain unchanged and we will introduce a cost-recovery fee. We will extend the payment of salaries through the banking system to 70,000 government employees by end-September 2005. In addition, we will make every effort to extend this method of salary payment to the staff of public enterprises and to encourage payment of utility bills and tax obligations in this manner. We will complete and make operational the inter-bank bulk clearing system by end-September 2005. By end-2005, we will put in place the necessary regulations and legal framework for introducing a credit reporting bureau within the BoA. Also by end-2005, we will complete an analysis on the feasibility and modalities of extending deposit insurance to depositors in credit unions. We will ensure that the BoA retains its policy and operational autonomy, and we will take no legislative or regulatory action that weakens the full control over the bank's budget—including staff compensation levels—currently exercised by the BoA's Supervisory Board. We will refrain from creating any public financial institution, as well as from taking an equity stake, or issuing any explicit or implicit government guarantee to a financial institution. And we will press ahead with divesting our minority interest in two commercial banks by end-2005.

10. **We will continue implementing other ongoing structural measures.** We expect to finalize the sale of Albtelecom by the end of 2005; and remain committed to allocate its proceeds—as well as the proceeds of other future large privatizations—to priority investment projects and domestic debt redemption in equal parts. We expect to issue tenders for the sale of the government's stake in AMC and to prepare the privatization law for Albpetrol by end-September 2005; and plan to examine an alternative privatization strategy (including management or concession contracts) for ARMO in light of the weak market response to its recent tender. We will continue to implement our action plan to modernize KESH in collaboration with the World Bank. We remain committed to carry out independent feasibility studies for large projects funded by commercial non-concessional borrowing and to subject them to open tenders, except in exceptional circumstances foreseen in our legislation. We will provide to the Fund a quarterly listing and status report on all projects being considered for nonconcessional foreign financing; and will inform and consult with the Fund prior to contracting any additional nonconcessional external debt. In the area of national accounts, we will complete the advance GDP estimate for the first quarter of 2005 by end-September 2005 on a preliminary basis; and the preliminary 2004 GDP estimate by end-2005.

11. **We will continue to make good faith efforts to conclude the rescheduling of our arrears on inoperative payments agreements.** Currently we are engaged in negotiations that aim at advancing as much as feasible the clearance process with official creditors by the end of the program; and with private creditors by end-2006. However, despite the absence of formal disputes, in some cases protracted negotiations might require a longer time frame to finalize the clearance process.

12. For the remainder of 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: Policy Intentions for September-December 2005 1/

	End-Sep. 2005	End-Dec. 2005
(In billions of lek)		
Ceiling on net domestic credit to the government 2/	17	23
Ceiling on net domestic assets of the BOA	-13	-12
Indicative total tax revenue targets 3/	289	336
(In millions of US dollars)		
Floor for net international reserves of the BOA 4/	346	386
(In millions of Euros)		
Nonaccumulation of new external payments arrears, excluding interest on pre-existing arrears 5/ 6/ 7/	0	0

1/ The policy intentions outlined in this table, and their adjustors, are defined in the Technical Memorandum of Understanding (TMU). Targets are defined as cumulative changes from end-2003, except where noted.

2/ Data is cumulative within 2005.

3/ Defined as all revenues collected by the GDT, GDC, and SSI. Aggregate revenue so defined includes all revenues collected on behalf of local governments, but excludes revenues collected by local governments directly.

4/ Valued using end-2003 exchange rates.

5/ As defined in the TMU.

6/ Cumulative changes as of end-December 2002.

7/ This policy intention applies on a continuous basis.

Table 2. Albania: Structural Policy Intentions under the PRGF Arrangement and Up to the End of 2005.

	Proposed test date
A. Key Policy Intentions	
1. Deployment of the ASYCUDA system in 10 customs houses.	End-December 2005
2. Implement the risk assessment module of the ASYCUDA system in 6 customs houses to perform inspections.	End-December 2005
3. The salaries of 70,000 employees of budgetary institutions to be paid through the banking system.	End-September 2005
B. Other	
4. Establish and implement a set of clear and objective criteria for inclusion of taxpayers in the large taxpayers unit of the General Directorate for Taxes.	End-September 2005
5. Concentrate control of large taxpayers in the large taxpayers unit in Tirana..	End-September 2005
6. Implement in the Durrës tax office a program for selecting taxpayers for 80 percent of all fiscal visits on the basis of an objective, computer-based risk assessment system.	End-September 2005
8. Prepare advance GDP estimates for the first quarter of 2005.	End-September 2005
9. Complete the preliminary 2004 national accounts.	End-December 2005
10. Complete and make operational the inter-bank bulk clearing system at the Bank of Albania.	End-September 2005
11. Prepare quarterly reports (within one month of the end of each quarter) on the stock of external arrears.	Ongoing
12. Clear overdue VAT refunds originated prior to June 2004 by allocating to this end 1 percent of VAT gross revenue on a quarterly basis.	Ongoing
13. Prepare quarterly reports on the aggregate amounts of the VAT refunds requested, refunds paid and refunds rejected.	Ongoing
13. Safeguard the efficient use of nonconcessional foreign project loans through:	
(i) Conducting an independent feasibility study for any large project (as defined in the TMU) financed through non-concessional commercial borrowing.	Ongoing
(ii) Provide a quarterly listing and status report on all projects being considered for nonconcessional foreign financing.	Ongoing

Table 3. Albania: Quantitative Performance Criteria and Indicative Targets, 2004–05 1/

	End-Mar. 2004 2/			End-Jun. 2004			End-Sep. 2004 2/			End-Dec. 2004			End-Mar. 2005 2/			End-Jun. 2005
	Actual	Prog.	Prog. (Adj.)	Actual	Prog.	Prog. (Adj.)	Actual	Prog.	Prog. (Adj.)	Actual	Prog.	Prog. (Adj.)	Actual	Prog.	Prog. (Adj.)	Prog.
	(In billions of lek)															
Ceiling on net domestic credit to the government 3/	6	6	6	-5	12	1	3	11	13	18	16	18	2	6	7	12
Ceiling on net domestic assets of the BOA 4/	-24	-7	-7	-38	-5	-15	-17	2	3	-11	7	9	-19	-13	-13	-12
Indicative total tax revenue targets, millions of Lek 5/	36	36	36	74	76	76	116	116	116	160	161	161	199	199	199	244
	(In millions of US dollars)															
Floor for net international reserves of the BOA 4/ 6/	104	57	57	182	71	141	212	71	62	273	83	69	275	240	240	254
	(In millions of Euros)															
Ceiling on contracting or guaranteeing of public and publicly-guaranteed non-concessional external debt 7/ 8/ of which: 1-5 years	19 0	120 0	120 0	46 0	141 0	141 0	46 0	155 0	155 0	126 0	171 0	171 0	126 0	240 0	240 0	280 0
Ceiling on public and publicly-guaranteed external debt with original maturities up to and including 1 year 7/ 8/ 9/	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Nonaccumulation of new external payments arrears, excluding interest on pre-existing arrears 7/ 8/ 9/	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0

1/ The performance criteria and indicative targets envisaged under the program, and their adjustors, are defined in the Technical Memorandum of Understanding (TMU). Targets for September 2004 and beyond are defined as cumulative changes from end-2003, except where noted. Targets prior to March 2005 refer to targets set during the fourth and previous reviews.

2/ Data in this column are performance criteria, except for revenue targets. Data in all other columns are indicative targets.

3/ Data is cumulative within each calendar year.

4/ For end-March and end-June 2004, targets are defined as cumulative changes as of end-December 2002.

5/ All revenues collected by the GDT, GDC, and SSI. Includes all revenues collected on behalf of local governments, but excludes revenues collected by local governments directly.

6/ Up to end-June 2004, valued using end-December 2001 exchange rates. After end-June 2004, valued using end-2003 exchange rates.

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

8/ Cumulative changes as of end-December 2002.

9/ These performance criteria apply on a continuous basis.

Table 4. Albania: Performance Criteria and Structural Benchmarks under the PRGF Arrangement

	Test-date	Status
A. Prior Actions for the Sixth Review		
1. Implement the risk assessment module of the ASYCUDA system in the Tirana and Durrës customs houses to perform inspections.		Completed
B. Performance Criteria for the Sixth Review		
1. Deployment of the ASYCUDA system in 5 customs houses.	End-March 2005	Met
2. Implement the risk assessment module of the ASYCUDA system in 5 customs houses to perform inspections.	End-March 2005	Not Met. 1/
3. The salaries of 25,000 employees of budgetary institutions to be paid through the banking system.	End-March 2005	Met
4. The salaries of 50,000 employees of budgetary institutions to be paid through the banking system.	End-June 2005	Met
5. Implement a system of quick VAT refunds with audits carried out ex post based on risk assessment selection for qualified taxpayers.	End-June 2005	Met
C. Structural Benchmarks under the Sixth Review		
1. Presentation to Parliament of 5-year Statistical Program.	End-March 2005	Not Met 2/
2. Completion of preliminary 2003 national accounts.	End-March 2005	Met
3. Government of Albania's to continue to implement its action plan for removing administrative barriers to investment (NSSED chapter 7, Section on Ministry of the Economy).	Ongoing	Met
4. Prepare quarterly reports (within one month of the end of each quarter) on the stock of external arrears.	Ongoing	Met
5. Clear overdue VAT refunds originated prior to June 2004 by allocating to this end 1 percent of VAT gross revenue on a quarterly basis.	Ongoing	Met
6. Prepare quarterly reports on the aggregate amounts of the VAT refunds requested, refunds paid and refunds rejected.	Ongoing	Met
7. Safeguard the efficient use of nonconcessional foreign project loans through:		Met
(i) Conducting an independent feasibility study for any large project (as defined in the TMU) financed through non-concessional borrowing.	Ongoing	Met
(ii) Provide a quarterly listing and status report on all projects being considered for nonconcessional foreign financing.	Ongoing	Met

1/ A waiver is being requested (paragraph 1 of the Letter of Intent). The actions specified under this performance criterion were partially carried out subsequently as a prior action for this review.

2/ As discussed in paragraph 4 of the MEFP.

ALBANIA

TECHNICAL MEMORANDUM OF UNDERSTANDING

This memorandum defines the quantitative benchmarks and performance criteria established in the Memorandum of Economic and Financial Policies (MEFP) for end-June 2004–end-March 2005.

A. Net Domestic Credit to the Central Government

1. For the purposes of the program, the **central government** covers the State Budget, the Social Security Institute (SSI), and the Health Insurance Institute (HII).
2. **Net domestic credit to the central government** (NCG) is defined as gross domestic credit in lek and in foreign currency extended to the central government (as defined above) by the banking system, savings and loan institutions (SLIs), and other domestic lenders;¹ less the sum of central government financial assets held in the banking system and in the SLIs.
3. The following definitions apply to **gross domestic credit to the central government**:
 - (i) **Gross domestic credit in lek and in foreign currency extended to the central government includes:** (a) securities (including treasury bills and bonds) issued by the central 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 central government by BoA, DMBs, SLIs, and other domestic lenders; and (c) negative balances in government deposits with BoA, DMBs and SLIs.
 - (ii) **Gross domestic credit in lek and in foreign currency extended to the central government excludes** (a) the onlending of foreign project loans to all parts of central government; and (b) advances on profit transfers by the BoA. The value of the stock of gross domestic credit to government will also exclude the claims held by the units of central government as defined above (in particular, the SSI and the HII).
 - (iii) The stock of gross domestic credit extended to the central government and held by the BoA and DMBs in the form of treasury bills will be valued at issue price. The stock of gross domestic credit extended to the central government and held by the BoA in the form of other securities and direct loans to government will be valued excluding accrued interest. The stock of

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

gross domestic credit extended to the central government and held by the DMBs in the form of fixed and variable income securities will be valued at face value. The stock of all gross domestic credit extended to the central government and held by SLIs and other domestic lenders will be valued at face value².

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

- (i) **Central 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 central government. For the purposes of program monitoring, standard gold deposits will be valued at the program price of gold (SDR 280.6 per ounce)³.
- (ii) **Central government financial assets held at the Bank of Albania exclude:** (a) foreign currency deposits related to foreign financed projects; and (b) deposits serving as the counterpart for non-standard gold and other precious metals owned by the central government.
- (iii) **Central government financial assets held at the DMBs include:** (a) all deposits of central government in domestic and foreign currency; (b) all loans extended by central government to commercial banks; and (c) payable amounts owed by the DMB to central government.
- (iv) **Central government financial assets held at the SLIs include** all deposits of central government held at the SLIs.

5. **For the purposes of program monitoring**, central government financial assets in foreign currency will be converted from Lek to SDRs at the end-of period Lek/SDR exchange rate prevailing on the test date; and then converted to Lek at the end-December 2003 Lek/SDR exchange rate of Lek158.1/SDR.

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

³ The lek value of standard gold deposits will be (a) converted to US dollars using the current end-of-period lek/US dollar exchange rate; (b) then converted to ounces of gold using the current US dollar market price of gold; (c) then converted to SDRs at the program price of gold (SDR 280.6 per ounce); and (d) then converted to Lek at the program Lek/SDR exchange rate of Lek 158.1104/SDR.

6. The breakdown of the categories of net domestic credit to the central 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 from end-December 2004.

B. Net Domestic Assets

8. The stock of **net domestic assets (NDA) of the Bank of Albania** are defined as the difference between reserve money—defined as the sum of currency issue (less lek notes and coins held by the Bank of Albania) and commercial bank reserves held at the BoA—less the net international reserves of the Bank of Albania (Section C), with all foreign currency assets and liabilities valued in local currency for program monitoring purposes at an exchange rate at end-December 2003. Under this definition, the level of the NDA was Lek 72 billion as of end-December 2003. The NDA limits will be cumulative changes from end-December 2003 and will be monitored from the accounts of the Bank of Albania.

C. Net International Reserves

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

10. During this program, for monitoring purposes, the exchange rates of the SDR and non-dollar currencies will be kept at their end-December 2003 levels and holdings of

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

monetary gold will be valued at SDR 280.6 per ounce. Excluded from gross international reserves are holdings of nonconvertible currencies, claims on nonresident financial institutions denominated in nonconvertible currencies, and other claims which are not readily available. Under this definition, the level of NIR was US\$832.7 million at end-2003.

D. Adjusters for NCG, NDA, and NIR

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

End-September 2005	Lek 15.3 billion, (US\$144.6 million).
End-December 2005	Lek 15.7 billion, (US\$148.4 million).

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

12. The ceilings on NCG and NDA, and the floor on NIR are defined based on the assumption that **foreign budgetary and/or balance of payments loan financing** (excluding IMF financing, project and commodity loans, and macro-financial assistance from the EU) will amount, on a cumulative basis, from January 1, 2004, to:

End-September 2005	US\$ 20.0 million.
End-December 2005	US\$ 20.0 million.

In cases where total foreign loan financing exceeds this projection, the ceilings on NCG to the government and NDA of the Bank of Albania will be adjusted downward, and the floor on NIR will be adjusted upward by the amount of the excess⁵.

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

E. External Debt and Arrears

14. As set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-00/85) August 24, 2000), the term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets

⁵ For the NCG adjuster, the lek equivalent of deviations from the programmed amounts in terms of dollars is converted at an exchange rate of Lek 106.5 per U.S. dollar.

(including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows: (i) loans, i.e., advances of money to obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and (iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property. Arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

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

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

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

18. **Large projects** (as referred to in MEFP paragraph 21 and Table 2) financed by nonconcessional foreign borrowing are defined as those projects involving total nonconcessional foreign borrowing in excess of US\$25 million.

F. Tax Revenues

19. 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

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

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;
- (vii) The foreign exchange cashflow of the Bank of Albania, including the level of NIR;
- (viii) Daily average exchange rates;
- (ix) Trade flows;
- (x) Periodic updates of balance of payments estimates.

The Ministry of Finance will supply to the Fund:

- (i) The summary fiscal table, including the overall budget deficit, on a cash basis;
- (ii) Issuance of treasury bills by the MOF, including gross value and cash received;

- (iii) Privatization receipts;
- (iv) Information on the contracting and guaranteeing of new debt;
- (v) Information on the stock of short-, medium- and long-term debt;
- (vi) Information on all overdue payments on short-, medium- and long-term debt (with assistance from the Bank of Albania).
- (vii) Information on the stock of VAT refunds claimed and refunds paid out every month.

The General Directorate of Customs will supply to the Fund:

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

The General Directorate of Taxation will supply to the Fund:

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

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

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

Table 1. Albania: Calculation of Net Domestic Credit to Central Government for Program Monitoring Purposes, December 2003–March 2005
(In billions of lek)

		Dec-03	Mar-04	Jun-04	Sep-04	Dec-04	Mar-05
1.	Treasury bills held outside central government	271.4	277.1	271.9	277.3	279.7	279.9
Of which:							
1. (i)	Held by Bank of Albania 1/	70.4	66.2	62.9	62.9	62.8	63.0
1. (ii)	Held by deposit money banks 1/	184.2	192.4	188.9	192.7	193.1	191.5
1. (iii)	Held by savings and loan institutions 2/	0.0	0.0	0.0	0.0	0.0	0.0
1. (iv)	Held by other domestic lenders (excluding holdings of HHI and SSI) 2/	16.8	18.5	20.0	21.6	23.7	25.4
	Of which:						
1. (iv) (i)	INSIG	1.5	1.5	1.5	1.5	1.6	1.8
1. (iv) (ii)	Individuals and firms	15.3	17.0	18.6	20.1	22.2	23.7
1. (iv) (ii) (i)	Of which: BoA window	9.5	10.4	11.4	12.5	13.8	15.1
Plus:							
2.	Other central government debt held outside central government (millions of lek)	6.4	6.8	11.8	11.0	14.5	18.8
Of which:							
2. (i)	Held by Bank of Albania 3/	1.4	1.0	4.4	1.0	1.0	1.0
2. (i) (i)	Other securities 3/	1.4	1.0	1.0	1.0	1.0	1.0
2. (i) (ii)	Short-term direct loans to government 3/	0.0	0.0	3.4	0.0	0.0	0.0
2. (ii)	Held by deposit money banks 4/	5.0	5.8	7.4	10.0	13.5	17.8
2. (ii) (i)	Fixed income securities 4/	5.0	5.8	7.4	10.0	13.5	17.8
2. (ii) (ii)	Variable income securities 4/	0.0	0.0	0.0	0.0	0.0	0.0
2. (iii)	Held by savings and loan institutions 5/	0.0	0.0	0.0	0.0	0.0	0.0
2. (iv)	Held by other domestic lenders 5/	0.0	0.0	0.0	0.0	0.0	0.0
Equals gross domestic credit to government:		277.9	283.9	283.6	288.2	294.1	298.7
Less:							
3.	Assets of central government (excluding HHI and SSI)	7.5	7.2	18.1	14.0	6.4	8.7
Of which:							
3. (i)	Deposits held at Bank of Albania 6/	4.9	4.5	14.9	11.5	4.9	5.1
3. (i) (i)	In domestic currency	3.3	2.9	3.0	3.0	3.3	3.4
3. (i) (i) (i)	Transferable deposits in lek	2.9	2.5	2.3	2.5	2.8	2.9
3. (i) (i) (ii)	Deposits in lek for projects	0.4	0.4	0.6	0.5	0.5	0.5
3. (i) (ii)	In foreign currency at program exchange rates and program price of gold 7/ 8/	1.6	1.6	12.0	8.6	1.7	1.7
3. (i) (ii) (i)	In foreign currency evaluated at current exchange rates	1.6	1.6	10.6	8.1	1.5	1.6
3. (i) (ii) (i) (i)	Transferable deposits in foreign currency evaluated at program exchange rate 7/	0.0	0.0	9.7	7.0	0.0	0.1
3. (i) (ii) (i) (i) (i)	Transferable deposits in foreign currency evaluated at current exchange rate 9/	0.0	0.0	9.1	6.5	0.0	0.1
3. (i) (ii) (i) (ii)	Standard gold deposits of government evaluated at fixed exchange rate and gold price (Lek mms.) 8/	1.6	1.6	2.3	1.6	1.7	1.7
3. (i) (ii) (i) (ii) (i)	Standard gold deposits of government at current exchange rate and gold price (Lek mms.) 8/	1.6	1.6	1.5	1.5	1.5	1.5
3. (i) (ii) (i) (ii) (i) (i)	Number of ounces of gold equivalent	36.5	36.4	51.1	36.4	37.3	37.3
3. (ii)	Assets held at deposit money banks	2.6	2.7	3.1	2.4	1.5	3.6
3. (ii) (i)	Deposits 10/	1.8	1.6	1.4	1.2	1.4	1.6
3. (ii) (i) (i)	Deposits in domestic currency	0.1	0.3	0.1	0.2	0.2	0.3
3. (ii) (i) (i) (i)	Transferable deposits in domestic currency	0.1	0.3	0.1	0.2	0.2	0.3
3. (ii) (i) (i) (ii)	Other deposits in domestic currency	0.0	0.0	0.0	0.0	0.0	0.0
3. (ii) (i) (ii)	Deposits in foreign currency evaluated at program exchange rates	1.7	1.4	1.3	0.9	1.2	1.3
3. (ii) (i) (ii) (i)	In foreign currency evaluated at current exchange rates 7/	1.7	1.3	1.2	0.9	1.1	1.2
3. (ii) (i) (ii) (i) (i)	Transferable deposits in foreign currency evaluated at current exchange rates	1.7	1.3	1.2	0.9	1.1	1.2
3. (ii) (i) (ii) (i) (ii)	Other deposits in foreign currency evaluated at current exchange rates	0.0	0.0	0.0	0.0	0.0	0.0
3. (ii) (ii)	Loans from government to DMBs	0.5	0.5	0.4	0.4	0.4	0.4
3. (ii) (iii)	DMB payables to government	0.4	0.6	1.3	0.9	-0.3	1.7
3. (iii)	Held at savings and loan institutions 10/	0.0	0.0	0.0	0.0	0.0	0.0
Less:							
4.	Deposits of HHI and SSI	2.2	2.8	2.6	2.7	2.1	2.1
Equals:							
5.	Stock of Net domestic credit to central government (1+2-3-4)	268.1	273.9	263.0	271.5	285.7	287.8
5. (i)	Change since December 2003	...	5.8	-5.1	3.4	17.6	19.7
5. (ii)	Change since December 2004	2.1
6.	Memorandum items:						
6. (i)	Current exchange rate (Lek/SDR, eop)	158.1	157.5	148.8	148.7	143.9	146.8
6. (ii)	Current exchange rate (Lek/US dollar, eop)	106.4	106.4	101.5	101.2	92.7	97.2
6. (iii)	Program exchange rate (Lek/SDR, eop) 12/	158.1	158.1	158.1	158.1	158.1	158.1
6. (iv)	Program price of gold (price in SDRs dollars per ounce as at end-December 2003)	280.6	280.6	280.6	280.6	280.6	280.6
6. (v)	Market price of gold (price in US dollars per ounce)	417.0	423.0	280.6	412.4	437.1	427.3
6. (vi)	Current exchange rate (US dollar per SDR, eop)	1.49	1.48	1.47	1.47	1.55	1.51

1/ Evaluated at issue price.

2/ Evaluated at face value (data on treasury bill holdings of SLAs and other domestic lenders are currently available only at face value).

3/ Excludes accrued interest.

4/ Valued at face value (data on fixed and variable income securities held by DMBs are currently available only at face value).

5/ Includes accrued interest.

6/ Includes transferable deposits of government in domestic and foreign currency, lek deposits of central government for projects; and standard gold deposits of government. Excludes all non-standard gold deposits; and excludes all nongold precious metal deposits of government; and excludes government deposits in foreign currency for projects.

7/ The reported lek value of foreign currency denominated assets of government will be converted to SDRs using the current end-of-period lek/SDR exchange rate; and then converted back to lek using the program Lek/SDR exchange rate of Lek 158.1104/SDR.

8/ Standard gold deposits are usable by government and therefore included in the definition of government assets. The lek value of standard gold deposits will be (a) converted to US dollars using the current end-of-period lek/US dollar exchange rate; (b) then converted to ounces of gold using the current market price of gold; then (c) converted to SDRs at the program price of gold of SDR280.6 per ounce; and then (d) converted to lek at the program Lek/SDR exchange rate of Lek 158.1104/SDR.

9/ Including account set up to hold the Savings Bank privatization revenue (Account No: 11.2.2.1.4)

10/ Includes all deposits of central government.

11/ Equals 50 percent of shortfall in privatization revenue.

12/ The program Lek/SDR exchange rate is the value of this rate at end-December 2003 (Lek 158.1104/SDR).