Report No. 12342-ALB

Albania
Building A New Economy

July 14, 1994

Country Operations
Central Europe Department
Europe and Central Asia Region

FOR OFFICIAL USE ONLY

Document of the World Bank

CURRENCY EQUIVALENT

currency unit = Lek
calendar 1993 1 US$ = Lek 100
March, 1994 1 US$ = Lek 100

List of Abbreviations

AB	Agricultural Bank
BAD	Bank for Agriculture and Development
BoA	Bank of Albania
CMEA	Council of Mutual Economic Assistance
EBRD	European Bank for Reconstruction and Development
EC-PHARE	EC Assistance Program for Eastern Europe
ERA	Enterprise Restructuring Agency
EU	European Union
ESU	Enterprise Support Unit
G24	Group of 24 Industrialized Nations
GDP	Gross Domestic Product
GDT	General Department of Taxes
IDA	International Development Association
IMF	International Monetary Fund
MFE	Ministry of Finance and Economy
MIME	Ministry of Industry, Mining and Energy
MIS	Management Information System
MOLSP	Ministry of Labor and Social Protection
NAP	National Agency of Privatization
NCB	National Commercial Bank
NMP	Net Material Product
PCPP	Preparatory Commission for the Process of Privatization
PIP	Public Investment Program
RCA	Revolving Credit Account
RCB	Rural Commercial Bank
SB	Savings Bank
SII	Social Insurance Institute
SOE	State-Owned Enterprise
VAT	Value-Added Tax

ALBANIA: BUILDING A NEW ECONOMY

Proposals for Transition Policies

This Economic Memorandum provides an analysis of economic developments and policies over the last three years in Albania, and explores policy options to adapt the ongoing economic reform program to a changed environment so as to maintain economic stability and accelerate the process of transformation of the economy. Chapter I reviews the main economic events during 1991-93, and discusses the most important structural changes required for Albania to ensure that the very promising start of the systemic transformation process leads to sustained rapid growth. It stresses the importance of consolidating the results of the stabilization and presents a medium-term scenario for the mid-1990s. Chapter II analyzes the public finances and discusses the reforms required for medium-term fiscal consolidation. Revenues and expenditures have to undergo deep structural changes and, simultaneously, revenue enhancing and expenditure management measures must be implemented. Chapter III reviews progress in disengaging the Government from the inefficient state enterprise and banking sectors. It proposes strategies to carry out restructuring and privatization in a manner consistent with the objectives of fiscal consolidation. Finally, Chapter IV looks at the medium-term growth potential of activities linked to Albania's main resource endowments and recommends further policy actions for their development.

The document reflects the findings of various missions that visited Albania in 1993. The main mission in April 1993 was led by Dominique Dwor-Frécaut, and composed of Ms. Jytte Laursen and Messrs. Luca Barbone, Rune Barneus, David Sewell, Shamsher Singh, Sweder Van Wijnbergen, and Matthew Vogel. Messrs. Koch and Dethier supplied material for the chapter on agriculture. Ms. Laila Tushan was responsible for the production of the Report.

Department Director	Mr. Kemal Dervis
Lead Economist	Ms. Christine Wallich
Division Chief	Mr. Michel Noël
Peer Reviewers	Mr. Roberto Rocha
	Mr. Ishac Diwan

Table of Contents

LIST OF CHARTS, TABLES AND BOXES

Charts

Tables

Boxes

EXECUTIVE SUMMARY

i After 50 years of almost complete isolation, and a deep socio-economic crisis that accompanied the collapse of communism in 1990-92, Albania is emerging as a new, vibrant country eager to build a free market economy and participate fully in world trade and investment. Despite extremely difficult starting conditions, in mid-1992, the newly elected Albanian government embarked on a very courageous IMF and World Bank backed stabilization program. Macroeconomic stability was quickly re-established, with inflation declining from the 200-300 percent range to 25-30 percent almost immediately after the policy package put in place in June-July 1992, including a large devaluation, very tight monetary targets and liberalization of almost all prices. Accompanying the macro-measures was rapid privatization of agriculture, housing and small-scale enterprises. Already in 1993, strong new private sector growth led to an overall GDP increase of about 11 percent, despite continued tight monetary policies. This combination of low inflation and rapid growth in a country lacking the basic institutional infrastructure for a market economy, is a remarkable event, unique in the ECA Region.

ii The challenge is now to turn the early success of the stabilization into long-term sustainable growth. The task involves nothing short of building a new economy. It will require two types of measures. First, the fiscal consolidation has to be continued. This requires structural changes in the nature of revenues and expenditures, as stabilization has mostly relied on measures that cannot be easily replicated to yield further reductions in the deficit. At the same time, the claims of the state enterprise and banking sectors on the budget have to be strictly controlled. Second, conditions favorable to a continued strong supply expansion have to be created. This involves not only the transfer of scarce productive assets to the private sector but also the development of a financial sector, the rehabilitation and expansion of public infrastructure, and the development of a legal framework to define and enforce property rights.

iii This report proposes policies which would encourage rapid growth while maintaining macroeconomic stability. It is structured as follows:

first, the main features of the Government's macroeconomic strategy are discussed and the sustainability of the results so far achieved is assessed.

second, a discussion of public finance presents options with a view to raise revenues and reduce expenditures while maintaining a minimum safety net and initiating a much-needed rehabilitation of public infrastructure and services;

third, the report proposes strategies for continued rapid disengagement of the state from productive activities in order to keep outlays on enterprise and bank support consistent with the path of fiscal consolidation, to achieve a rapid shift to a private ownership economy, and to build a banking system able to provide at least the minimum intermediation required by private sector development; and

fourth, the report examines the growth prospects of activities linked to four of Albania's main natural endowments--agriculture, minerals, water, and, potentially, tourism--and assesses whether the policies under consideration will suffice to promote their rapid development.

I. A Medium Term Framework for Growth

iv The Government adopted an ambitious program of reforms for the period 1993-1996, which is described in the Policy Framework Paper (PFP) prepared in collaboration with the World Bank and the IMF. Under current assumptions, growth is projected to stabilize on a trend of about 6 percent per year from 1995, following a sharp output expansion of about 8 percent in 1994; annual inflation would decrease to about 10 percent; and the fiscal deficit would fall to 8 percent of GDP over the next three years with only 1-2 percent domestic financing. The growth objectives under the program require public investment flows of about 13 percent of GDP on average, reflecting the need to rebuild infrastructure, and increasing public savings. Such a major fiscal effort would require strong actions on revenues and expenditures: revenues would rise by 5 percentage points of GDP and expenditures would fall by 3 percentage points of GDP over 1994-1997. This requires strong structural measures: a new tax base has to be developed and expenditure savings must be sought by rationalizing the social safety net, while expanding and reorganizing public investment.

v With the strong fiscal adjustment, the current account deficit is projected to decline from US$370 million in 1993 to about US$240 million in 1997. Albania also needs to implement a comprehensive action plan in order to solve its external debt problem. It has requested the use of an IDA-Debt Reduction Facility for the buy-back of its commercial bank debt and discussions with commercial banks are underway. Estimates of the financing requirements over 1994-97 amount to US$1.2 billion, including the cost of debt resolution. The projected gaps would have to be met on highly concessional terms for external viability to be a realistic goal by the end of the 1990s.

vi As growth will be private sector-based, the Government needs to maintain an environment conducive to private sector development. This requires first and foremost financial stability, transparent and stable policy rules, an appropriate legal framework, and access to foreign markets, as well as an active privatization policy, development of financial intermediation, and rebuilding of infrastructure.

II. Public Finance: Supporting and Financing Growth

vii In 1994 the fiscal deficit is projected at 16 percent of GDP--although the availability of foreign aid means that only 8 percent will be financed domestically. Nonetheless, this high initial level of the budgetary financing needs implies that, over the medium term, the deficit has to fall relative to GDP through revenue enhancing and expenditure reducing reforms. Implementation of these reforms is, however, constrained by scarce administrative capacity, which has to be built as the economy progresses.

A. Financing Growth

viii The dramatic decline of state enterprises, once the tax base for the Government, is irreversible. Therefore, a new tax base has to be found. This endeavor is constrained by two factors: short-term revenues cannot be sacrificed to the long-term development of a sustainable tax base, and the institutional capacity of the tax administration is very limited.

ix Despite efforts to develop a domestic tax base, over the medium-term, external trade will have to contribute substantially to public revenues. Improving the taxation of external trade by lower but well collected tariffs is therefore an overriding and immediate priority. Domestic taxation efforts are likely

to be more successful if they are concentrated on the taxation of consumption. The current form of taxation of consumption, the turnover tax, is highly distortionary. A move to a simple form of Value Added Tax (VAT) is therefore necessary. Furthermore, the reform of domestic tax policy will require a strengthening of the organization and procedures of the administration of taxation.

Taxation of External Trade

x *Improving Tariff Policy*. The Government is considering changes in tariff policy in three principal areas: tariff rates, classification of goods, and exemptions. The current tariff schedule could be streamlined to three bands. Efforts are also needed to refine the classification system which is currently too aggregative in nature. Finally, the number of exemptions could be reduced, in particular the exclusion from tariffs of imports by individuals for their personal use.

xi *Increasing import duties on Motor Vehicles*. Additional revenues could be generated by increasing the current import duty on motor vehicles. Furthermore, such a tax has the advantage of being relatively easy to collect and would be progressive from an income distribution view point.

xii *Reorganizing the Customs Administration*. Customs field houses are being reorganized to standardize their operations. The authorities are in the process of mobilizing and coordinating international support for a comprehensive training program for customs officers and for the provision of basic equipment. A code of conduct will also be issued. Lastly, more emphasis should be put on audits of the work of customs houses.

Domestic Tax Policy

xiii *Preventing the Erosion of Profit Tax Revenues*. The general profit tax rate has been set at 30 percent with special provisions: temporary tax holidays for new private firms, tax credits for reinvested profits by private firms, and differentiated tax rates according to sectors. Experience in many countries has shown that such incentives are difficult to implement, are costly in revenue foregone, and often yield disappointing results. The removal of these incentives would increase revenues and economize on scarce administrative resources. At this stage, Albania does not have the administrative resources to operate a complex government-financed incentive system.

xiv *Decreasing Collection Cost for the Small Revenue Earners*. The procedures for collecting the small business tax could be greatly simplified without a significant revenue loss to the budget: the number of categories should be reduced and businesses with revenues below specified floors should be ignored for tax purposes.

xv *Preparing for the Introduction of the VAT*. Introduction of the Value Added Tax would be the best solution to the cascading problems of the current turnover tax. The government is planing to introduce a VAT by mid-1995, which is expected to have one rate and a broad base, and to initially focus on the main taxpayers that currently provide the bulk of turnover tax revenues. Preliminary steps to the introduction of VAT include simplifying the current turnover tax and establishing a VAT unit.

xvi *Simplifying the Turnover Tax Regime*. Many of the exemptions from the turnover tax, such as those for manufactured foods and household fuels, appear to have the objective of increasing the progressivity of the tax. Greater efficiency in aiding low-income groups could be achieved through targeted income transfer programs. As the Government has already established the basis for such a

program, the exemptions on basic consumer goods--including the exemption of goods subject to excise tax--should be eliminated over the next two years.

xvii The turnover tax does not establish an annual turnover threshold below which enterprises are exempted from the liability to pay the tax. To economize on scarce administrative resources, the Government is planning to establish a turnover threshold for the payment of the tax, and to implement a lump-sum payment scheme for small taxpayers.

Improving Tax Administration Procedures

xviii A reorganization of the General Department of Taxes (GDT) is underway, supported by a technical assistance program with the World Bank and the IMF. The program includes: (i) reorganization of collection procedures, and (ii) development of an audit plan to cover about 30 percent of taxpayers liable to turnover taxes, rather than the current unrealistic 100 percent. The improvement in revenue collection expected from the above measures is very much constrained by the absence of a systematic taxpayer registration. The GDT will therefore work with the new Social Insurance Institute (SII) in designing its numbering system and require the taxpayers to use SII numbers on payment advice and returns filed at the tax office.

B. Restructuring Public Expenditures to Support Private Sector Development

xix Over the next few years, there will be strong financing needs in two areas: investment in public infrastructure, and restructuring of the public enterprise and financial sectors. Accommodating these higher expenditures and remaining within the targeted overall decline in the ratio of expenditures to GDP will require significant savings in other programs. These could come from the rationalization of the current provisions of the social safety net. At the same time, structural changes are required to improve the impact of Government spending. Public investment has to move from investment in the directly productive sectors to investment in public infrastructure and a reform of the public service has to take place in order to develop further the capacity to manage these changes.

Moving Social Insurance Toward Fiscal Sustainability

xx The financial viability of the two main contributory schemes, unemployment insurance and pensions, is threatened by unsustainable provisions, a shrinking contribution base, and an increase in the number of beneficiaries. In June 1993, the Albanian Parliament passed the Social Insurance Bill, which rationalizes the provisions of the current system and provides a first step in the direction of fiscal sustainability.

xxi Regarding *unemployment insurance*, the 1993 legislation has lowered the replacement ratio by introducing a flat-rate non-indexed benefit and has introduced employee contribution. Furthermore, a number of non-contributory support measures for certain merit categories have been shifted to social assistance and will be fully funded by the budget.

xxii Regarding *pensions*, the Social Insurance Bill reverses the reduction in the contributory base through the imposition of a flat contribution on the self-employed, particularly farmers. Furthermore,

the Bill moves the system towards fiscal sustainability through the introduction of employee contribution, provisions to raise the effective age of retirement, and through the transfer to the budget of merit pensions reserved for preferential categories.

xxiii To manage these changes, the Social Insurance Law has established an autonomous social insurance administration through the Social Insurance Institute (SII). The Government is planning to conduct an actuarial study of the SSI and reassess the need for further changes to the law in order to move the pension system towards actuarial balance. Because of the current difficulties in tax administration, the Government has entrusted the SII with the collection of contributions. In the medium term, collection of social insurance contributions should be transferred to the tax administration to economize on scarce administrative resources.

xxiv Following the adoption of the Social Insurance Bill, the effective rate of wage tax will rise by 1996 to more than 42 percent, a fairly high rate which could induce some enterprises to shed labor or evade the tax. Furthermore, the Government is planning to introduce a moderate wage tax to finance part of health expenditures. The impact of these measures on revenues should be carefully monitored and current plans--including benefit levels--reassessed if necessary.

Better Targeting of Social Assistance

xxv The Government has made much progress in the elimination of the badly targeted and inefficient system of price controls and subsidies. Ideally, income support programs should be means tested. This may not be feasible in Albania given the current limited administrative capacity and the lack of data on the rapidly changing income distribution. The Government has therefore opted for discretionary means testing at the local level through the introduction of a system of block grants bestowed onto each municipal authority according to such parameters as population structure, unemployment, health status, and land distribution.

Developing a Public Investment Program

xxvi Albania's public infrastructure is in such a dilapidated state that it constitutes a major obstacle to private sector development and to foreign direct investment. Rebuilding infrastructure requires a fundamental change in the nature of public investment, which should be used to support the Government's role as a provider of basic services and infrastructure aimed at assisting the development of the private sector.

xxvii To establish effective mechanisms for the control and management of public investment, the Government has prepared a three-year Public Investment Program (PIP) for the 1994-96 period. A key reform in the establishment of better investment management procedures will be the introduction of resource ceilings set at the beginning of the budget cycle. Since preparation and implementation of the budget and the PIP cannot be disassociated, it is crucial that the authorities clarify the responsibilities of the newly created investment department vis-à-vis the Ministry of Finance and establish procedures that ensure compatibility with progress in the control of public expenditures.

Reforming the Civil Service

xxviii The structural changes recommended above will require a strong effort of capacity building in the Government. At present, the machinery of the state is in flux. The mandates of many ministries are

not clear, with inadequate mechanisms in place for policy formulation and coordination in vital reform issues. Civil servants have yet to be trained to comprehend the objectives of their ministry, as well as in their own role in their implementation. Most importantly, the public service pay scale has to be reassessed with a view to retaining high performers. This is a crucial and urgent need which should no longer be neglected. Well performing top civil servants should receive adequate compensation for their efforts; at the same time there are probably substantial redundancies in many ministries.

III. Disengaging the State from Directly Productive Activities

xxix One of the key challenges for Albania is to further reduce the role of the state in the directly productive sectors in a manner consistent with the objectives of the fiscal consolidation. Privatization is the fastest and most efficient way to achieve this objective since it takes enterprises off the books of the state and provides their owners with an incentive to run them profitably. Some large loss makers and the state banks, however, cannot be closed in the short-term; at the same time, they lack the incentive or expertise to carry out the necessary restructuring. The Government therefore should play an active role, within the limits of its administrative and financial resources. Furthermore, since the state enterprises are the main customers of the banks, the reforms of the enterprise and financial sectors will have to proceed in tandem.

A. Downsizing the State Enterprise Sector through Privatization and Restructuring

xxx The Government initially concentrated its efforts on privatization of small-scale units, which has been a highly successful strategy. By the end of 1993, virtually all units with up to ten employees had been privatized. In May 1993, the Government also introduced Decree 248, dealing with the rapid privatization of enterprises with up to 300 employees or less than US$500,000 in book value. To date, about 950 units have been privatized under this decree.

xxxi The Government has now turned its attention to developing a general privatization program for all the remaining State Owned-Enterprises (SOEs) and to devising a funding strategy for different categories of enterprises, based on their privatization prospects and their social and strategic importance. The Government is rapidly implementing this strategy and establishing guidelines for those enterprises that will remain in the public domain over the medium term.

Privatization and Funding Strategy

xxxii Clear rules have been implemented regarding the privatization and funding regime of SOEs involving: (i) SOEs likely to remain state owned in the medium run, mainly the electricity, railways, and water companies; and SOEs with high privatization revenue potential, such as in the oil and gas, and mining sectors; (ii) large loss makers of strategic or social importance to the Government; and (iii) all other SOEs.

xxxiii The SOEs in group (i) require a case-by-case approach to privatization. Utilities will continue to have access to budgetary financing for investments in rehabilitation, mainly through the Public Investment Program. Furthermore, selected utilities will have access to operating subsidies in the short run until all prices are increased to cost recovering levels.

xxxiv Group (ii) enterprises are being taken care of by a special agency, the Enterprise Restructuring Agency (ERA), that is in charge of their privatization. Since the ERA should wind down within 3-5 years, privatization would have to take place within that period. Enterprises that are not privatized by the end of that period will be liquidated. Group (ii) enterprises have access to budgetary funding through a specific envelope administered by the ERA. This envelope can be used to finance the social cost of restructuring (e.g. wages or severance pay) as well as high return expenditures on maintenance and repairs, and, when it would lead to immediate privatization, limited investment expenditures. No enterprises under the ERA have access to financing from the banking system.

xxxv Group (iii) enterprises are to be privatized quickly. A majority of these will be privatized according to the procedures established by Decree 248. To promote a rapid privatization of group (iii) enterprises, the Government intends to remove floor prices and transfer under Decree 248 "large" enterprises that have shrunk to less than 300 employees. For the remaining large enterprises that are not covered by Decree 248, a multi-track strategy emphasizing speed over revenues will be implemented. Group (iii) enterprises have access to credit from the domestic banking system but the Government will not exercise any pressure on the banks' behalf.

xxxvi *Restitution.* Restitution has provided a major avenue for privatization of state assets. The Government is now reviewing its functioning, and will need to address a number of issues that may otherwise slow down privatization through other routes. These include legislation on leasing to allow maximum productive use of assets privatized in this way.

Providing State Enterprises with the Right Economic Signals

xxxvii For the few enterprises that will remain in the public domain over the medium term, the Government intends to create an environment that will provide them with the right economic signals. These will include continued adhesion to the above financing framework; amendments to the state enterprise law; and the restoration of basic ownership functions.

B. Limiting the Scope and Cost of Government Intervention in the Financial Sector

xxxviii The Albanian financial sector consists of three state-owned commercial banks and three small joint ventures. At present, the banking system continues to experience problems: the public banks have not yet acquired the expertise needed to appraise credit, and a large portion of their resources is channelled to loss-making public enterprises. At the same time, a robust informal private financial network has emerged, providing financing to the private sector, but at high cost. The immediate concern of the Government is to put a stop on losses by banks while ensuring that adequate resources are channelled to the private sector. A two-pronged strategy has been developed to this end: placing strict limits on the activities of the state banks, and encouraging the emergence of new private banks, both from domestic sources and from foreign institutions. These short-term emergency actions will be complemented by the medium-term endeavor of building up banking infrastructure.

Restructuring State Banks

xxxix A large proportion of new loans made by the state owned banks, to both public and private enterprises, is in arrears. The banking system continues to be affected adversely by the lack of expertise in banking practices based on market principles and inappropriate regulation and enforcement measures for collateral and claims, as well as by pressure to lend to loss-making state enterprises. It is the Government's intention to eventually privatize the state banks, either wholly or in part, while taking short-term actions to restrict their lending activities to more careful scrutiny and performance-based measures. Specifically, prudent lending limits will be imposed on the Savings Bank (SB), the main deposit taker, which will lend primarily to the Government through the new Treasury market and to engage only in limited lending to the private sector. New deposit taking by the National Commercial Bank (NCB) will be restricted to enterprises. The situation of the Rural Commercial Bank (RCB) can be expected to improve as the extensive technical assistance program takes hold (see below).

Promoting the Entry of Private Banks

xl *Creating conditions for the entry and development of private banks*. Over the medium term, the need for formal credit intermediation is likely to increase; this provides a strong case for allowing entry of additional private banks. To promote a rapid entry of private banks, the Government has adopted a policy of relatively low minimum capital requirements for entry, coupled with relatively high capital adequacy ratio requirements for investors other than internationally recognized banking institutions.

xli *Supervision and regulation*. Supervising private sector participation in financial institutions will require major improvements in the regulatory framework and in the supervision ability of the authorities. The Government has already taken the first steps by issuing a series of regulations and the BoA has begun limited inspections of the banks. However, the staff of the BoA's supervision department needs to be trained and increased. Full-time external assistance in this area is crucial and short-term assistance is currently being sought. In the longer run, this could be strengthened through twinning with a foreign central bank.

xlii *Banking infrastructure*. In addition to restricting the activities of state-owned banks and encouraging the entry of new private banks, a basic banking infrastructure has to be developed through strengthening of legal and accounting framework and the establishment of basic communications and data processing facilities. A payment system has to be developed. A wide-ranging effort to promote commercial banking expertise through on-the-job training of bank staff and the development of a training center is also required.

IV. Developing Albania's Resources

xliii In the medium term, the basis for an economic take-off exists provided the medium-term strategy of the authorities can unleash private entrepreneurship in agriculture, industry and services. To this effect, it is important that policies regarding Albania's main resource endowments--agriculture, mineral, water and, potentially, tourism--be developed to ensure rapid but environmentally sustainable development.

A. Agriculture

xliv Over the last two years, Albania has achieved extraordinary progress towards reforming the agriculture sector, the restructuring of which has produced a strong supply response: for the second year in a row, agriculture is growing at more than 14 percent at an annual rate. The cropping pattern is, however, oriented toward satisfying family needs as the newly established private farmers seek to protect their food security: many farmers have become subsistence-oriented and the marketed surplus is limited. Reforms are required in order to encourage farmers to market their production and specialize according to their comparative advantage. These reforms consist of privatizing processing and marketing enterprises, the rehabilitation of infrastructure, the establishment of a system of rural credit, and development of land policy.

xlv *Processing and Marketing Enterprises.* At present, state enterprises have a *de facto* monopoly in processing, handling, storage, and wholesale distribution of agricultural products. To promote competition, the Government intends to rapidly privatize agro-enterprises. Privatization, while in itself an important objective of the Government, may not, however, suffice to bring about the necessary increase in private sector participation as new private entrepreneurs are competing against established state enterprises. To lower entry costs for potential private investors, the Government encourages private participation at all levels of import, distribution, and processing of all food commodities. Private entrepreneurs are furthermore being supported by credit lines extended through external assistance.

xlvi *Rural Credit.* Presently, the rural credit system cannot service the needs of the emerging private sector. A new agricultural bank has been created to take over the deposits, capital, and performing assets of the former Bank for Agricultural Development. The new Rural Commercial Bank (RCB) has been set up as a joint stock company and has been placed under the banking law. An extensive technical assistance program is being provided under the Agricultural Structural Adjustment Credit to assist with the development of banking expertise in the rural system.

xlvii The creation of the new RCB will not cover all the credit needs of the agricultural sector. Most small farmers are likely to require small, uncollateralized loans that are not profitable for a formal banking institution such as the RCB. In addition to the development of a new RCB, rural credit policy will require the extension of small loans to individual farmers and micro-entrepreneurs, which will be done partly through the decentralized network of Village Credit Funds set up under the Rural Poverty Alleviation Pilot Project.

xlviii *Infrastructure and Extension.* The inadequate infrastructure and extension services constitute yet another obstacle to the marketing of crops by farmers. These have to be rebuilt and restructured to lower farmers' marketing costs and increase agricultural productivity. The Government is concentrating its efforts on irrigation and extension services through programs included in the PIP.

xlix *Land Policy.* Land ownership and ownership rights have to be clearly established to allow the consolidation of land holdings and, most importantly, the use of land as collateral. The Government has decided that sales of agricultural land will be allowed when a proper system of land registration is in place and all claims for compensation by former owners have been resolved. The Government will also develop the legal framework allowing leasing of land, including a property law.

B. The Mineral and Oil Sector

l Although Albania's geological endowment is not such that the country could become a major mineral exporting center, the mineral sector could make a significant contribution to the recovery of exports. With this in view, much is now being done to reorganize the sector and close non-viable activities. Close attention is also being paid to preparing a program of emergency rehabilitation and repairs; and to creating an environment attractive to foreign investors.

li *Reorganization.* The Government is reassessing the organization of the sector and will divest from non-viable activities. Preliminary to the restructuring of the sector, systematic geological surveys need to be undertaken. Sector studies and action plans for copper, nickel, and oil will then be prepared. Such a study has already been carried out for chromium, and a joint venture with foreign partners is being sought for the chromium company (Albchrome). Lastly, the Government intends to carry out a reorganization of its activities in mining development and management.

lii With regard to coal, a general consensus exists on the need to close most of the mines due to technical cost and market difficulties. Recent trends indicate that domestic demand would be in the order of 100,000 tons a year and could be met by the operation of a single mine without further modernization or mechanization.

liii *Rehabilitation.* A cost effective program of initial emergency measures could make a crucial contribution to raising export revenues in the chromium and oil sectors. The Government intends to prepare a list of measures that would directly increase export revenues in the short term, assess their cost, and start mobilizing the required financing from private sources. Investment in directly productive activities, such as oil and mineral extraction, will not, in most cases, come from the Public Investment Budget as these activities are expected to be carried out on a commercial basis and should be self-financing.

liv *Attracting Foreign Investors.* The above measures will protect existing productive capacities. In view of the technological obsolescence of the sector, any expansion in the productive capacities will require foreign investors to bring in much needed capital and know-how. The Government has prepared a *mining law* defining rights and regulating mining activities. Similarly, a *petroleum law*, establishing a framework for all petroleum activities and model contracts for production sharing agreements, has already been approved by Parliament. The mining law also defines a *fiscal regime* for mining enterprises. It provides for the payment of import duties, royalties, corporate income tax, property tax and social security but defines a special regime regarding export taxes, turnover taxes or value added taxes. A tax regime for oil activities--not included in the law--needs to be prepared and enacted. Lastly, the Government needs to step up its *promotion activities*.

C. Water Resources

lv Albania is rich in both underground and surface water resources, which has important implications for the supply of drinking water, agriculture, and hydroelectric power generation. The development of these sectors will have major long-term consequences on water availability, and sustainable development will therefore require adopting a *national water strategy* that coordinates water use across these sectors. To this end, the Government intends to establish a National Water Committee to develop and monitor a national water strategy while assigning responsibility for leasing and control to the National Water Council.

lvi Despite the relative abundance of water, Albania is unable to provide its small population with a sufficient supply of *drinking water* of reasonable quality. Water supply and sewerage systems exist in most urban areas but suffer from extremely poor quality of service, old and inefficient distribution networks, and virtually no maintenance. Furthermore, water charges are currently far below cost recovery levels.

lvii *Irrigation* is crucial for the development of agriculture. Although the quality of the water is naturally good, the mining industry is causing serious pollution of some rivers and lakes that supply water for irrigation. In addition, many drains are polluted by urban effluent due to the insufficient number of water treatment plants.

lviii *Hydroelectricity* accounts for 90 percent of Albania's electricity generation and 23 percent of export earnings. There is substantial undeveloped hydropower potential which, when exploited, will have a major impact on the availability of water. Studies on the potential for electricity exports, and on the impact of new power stations on the availability of water and on the environment, will have to be launched before new projects can be started.

D. Tourism

lix Albania's 470km coastline is rich in biodiversity and its many lakes and rivers support ecosystems with a large number of endemic species. This endowment, together with numerous unexploited historical sites, has strong implications for the development of *tourism*. As infrastructure improves and the political situation in neighboring countries settles, tourism could become a major source of growth, provided that Albania preserves its natural and cultural endowment. Measures to protect biodiversity and historical sites should therefore be taken now.

CONCLUSION

lx Construction of the new Albanian economy began in 1993. In all aspects of economic and political life--property rights, infrastructure, financial intermediation, and taxation, to name but a few--the Government has started from *tabula rasa* to build the institutions required for an open, pluralistic, market-oriented society. With great determination, it has embarked on an ambitious stabilization program and, against seemingly insurmountable odds, re-established economic and political stability. In 1993, after three consecutive years of decline in GDP, Albania achieved a remarkable combination of moderate inflation and healthy growth. This growth has continued in 1994.

lxi This early macroeconomic success has created an extraordinary opportunity for Albania: with successful stabilization come funds from foreign donors. These funds in turn allow investments in human and physical capital that strengthen the supply response, generate more fiscal revenues, nurture the consensus for reform, and eventually reinforce the early success of stabilization. Such a virtuous cycle of stabilization and growth, however, is fragile. The medium-term fiscal situation is not yet secure and the Government must concentrate its effort on building up a revenue generating capacity. Furthermore, with the very difficult situation in the enterprise and banking sectors, the temptation is great to pressure banks into lending to non-viable state enterprises. This temptation must be resisted for it would endanger the remarkable success achieved to far. Growth will come from the dynamism of the private sector that has already demonstrated its creativity over the past year, not from old and outmoded enterprises.

lxii Albania is endowed with a favorable location close to European centers, and generous agricultural, mineral and water resources. To create an environment conducive to the development of these resources, an enormous effort of building institutional capacity and public infrastructure is required. The authorities' absorptive capacity needs to be expanded through the establishment of project implementation and procurement procedures, as well as through the clarification of the responsibilities and roles in each ministry. Albania also needs to impress upon the international community the urgency of shifting the composition of aid from food and emergency supplies to project finance within the overall framework of the PIP. Over the medium term, there are good chances that the dynamism of its people and the coordinated actions by the Government and the international community will take Albania out of poverty and turn the Albanian economy into one of the most dynamic in Central and Eastern Europe.

CHAPTER I. A STRATEGY FOR GROWTH

A. Introduction

1. In mid-1992, Albania began implementing a successful adjustment program. Within the next year, it enjoyed one of the highest growth rates in Eastern Europe;[1] with inflation has stabilized at less than 2 percent a month since mid-1993. The purpose of this introductory chapter is to describe these first years of Albania's transition to a market economy, present the main features of the macroeconomic strategy adopted by the authorities, and assess the sustainability of the good results obtained so far. The main theme of the chapter, and a recurrent theme in this report, is that to turn the early success of stabilization into long term sustainable growth, far reaching structural measures are needed.

2. The task ahead involves nothing short of building a new economy: basically, Albania has abandoned central planning but does not yet have the institutions, expertise, or infrastructure required by a well functioning market economy. The contraction of the state enterprise sector over 1990-92 is not likely to be reversed and means the loss of a tax base for the Government. After 45 years of extreme autarky, the opening of the economy implies a significant downsizing of the industrial sector, despite the current very low labor costs. The privatization of the agricultural sector has resulted in a strong supply response, but also in a sharp decrease in marketed agricultural products as farmers have turned to subsistence agriculture. The need for reform is enormous and covers all sectors of the economy. At the same time, implementation of the reforms is constrained by not only the limited administrative capacity of the authorities, but also by the low level of income per capita which makes the population particularly vulnerable to the cost of adjustment.

3. On the other hand, the speed and vigor of private entrepreneurial response to Albania's "opening" and liberalization have been nothing short of spectacular. Compared with a year ago, the Albanian countryside and cities have changed considerably. Goods of all kinds have become available, investments in trade, services, and construction are beginning to gather speed, and an increasing number of foreign private investors are showing interest. Agricultural products from the newly privatized farms have begun reaching urban centers in modest quantities. In the countryside, private contracting firms supplying mechanized production services with tractors and harvesters have been established. In urban areas, helped by the privatization of trucks and retail shops, trade activity was the first to develop. It was further fuelled by the remittances of Albania workers abroad which provided enough purchasing power for the expansion of trade activity from basic food stuffs to durable consumer goods.

4. Three factors sum up the situation in the middle of 1994: a decisive commitment to reform by the political leadership; weak administrative structures to support the reforms but a remarkable entrepreneurial spirit in agriculture; and trade and small-scale enterprise. A major policy priority is to reform public finance in order to consolidate the results of the stabilization and to rebuild the infrastructure required by private sector development. Others include: privatization and restructuring of the state enterprise and banking sectors to support the budgetary consolidation, transfer scarce capital resources to the private sector, and allow the development of a viable financial sector; and support for small-scale private initiative throughout society and specific efforts to develop Albania's natural

---

1/ Growth in 1993 is estimated at 11 percent. Since no national accounts have been produced in recent years, growth estimates are based on limited output data and should not be taken as definitive. There is, however, widespread evidence of a very strong upturn in economic activity in 1993, continuing into 1994. Cumulative output expansion over the 1993-94 period will probably be close to 20 percent.

endowments in agriculture, mineral, water resources and tourism. This reform program and its macroeconomic implications are discussed in this report.

Box 1.1: Main cultural, social, and demographic characteristics of Albania

- Albania borders on the Adriatic Sea on the west, Greece on the south, and FYR Macedonia, and the Yugoslav provinces of Kosovo and Montenegro on the east and north. About 70 percent of the Albanian territory is mountainous. The Albanians are the descendants of the Illyrians--a non Slavic group--who have lived in the current area since pre-Roman times. Large numbers of ethnic Albanians live mainly in Kosovo, FYR Macedonia, and Montenegro but also, in smaller numbers, in Italy (for centuries), in Turkey, Greece, and in the United States. Currently, about 70 percent of the Albanian population is Muslim, 20 percent Orthodox and 10 percent Catholic, although these percentages are only rough estimates. The religious groups have lived in harmony in Albania over centuries, as evidenced by, for instance, widespread inter-marriage among groups. In the South, there is a small minority of ethnic Greeks: estimates range from 2 to 5 percent of the total population.

- With about 3.4 million inhabitants, Albanian is a small country. In recent years population growth has been in the order of 2 percent per annum, implying a population young by European standards. This is particularly the case in predominantly rural areas where average household size in 1989 was 5.3 persons against 3.9 in urban areas. In 1989, one-third of the population was less than 15 years old, which compares with, for instance, one-fifth in Hungary. Demographic growth has slowed since 1991, largely as a result of the difficult economic situation and the emigration of many Albanians to neighboring countries.

- Albania started the transformation process from communism to a market economy with per capita income significantly lower than that of other Eastern and Central European countries: in 1992 income per capita was estimated at US$290 (Atlas methodology), against a comparable figure of US$2780 for Hungary, US$1690 for Poland, US$980 for the Former Yugoslav Republic of Macedonia. The low level of salaries under central planning was accompanied by wide-ranging entitlements--old age and invalidity pensions, sickness benefits, maternity leave, free health care and education. The system was one of enforced equality, low productivity and stagnant incomes, with the state responsible for all economic activity and social services.

- No recent statistical data are available on income distribution. Under communism, cash income distribution was very egalitarian: by law the highest salary could not be more than two and a half times the lowest one, stifling initiative and failing to allow rewards to those who perform better. Income inequalities have now started to appear, not only between the employed and the unemployed, but also between those receiving remittances from relatives abroad and those who do not. Following the distribution of agricultural land to workers, an additional source of income inequality is the difference in the quality of land, with some villagers in the north east of the country living at below subsistence levels. Salaries in the state sector are still reflecting the extreme egalitarianism of the past.

- Prior to World War II, an estimated 85 percent of the Albanian population was illiterate. In the late 1940s, the Government started comprehensive programs of primary education and developed secondary schooling and higher education. By the time of the political and economic transition, Albania's education system enjoyed the expansive network and virtually universal basic education coverage typical of other Eastern European countries. Illiteracy is almost non-existent, an impressive performance for a country at the income level of Albania. The current fiscal crisis has seriously affected the resources available for education and Albania is now struggling to preserve its past achievements.

- Albania's health status is good for a country at its stage of development. Life expectancy at birth is 72 years, the highest in the world for countries in the income range of Albania, and on par with that of OECD countries. Personal life styles and socio-economic conditions favorable to health, as well as the high priority attached to primary care and public health services, can be credited for this unusual achievement. On the other hand, the health system did not escape the distortions and inefficiencies that marked the rest of the Albanian economy under central planning. The social and political turmoil of 1991-92 further aggravated the shortcomings of the old system and has resulted in the virtual collapse in the provision of many health services.

B. The 1990-1992 Crisis: the Demise of Central Planning and Its Aftermath

5. In Albania, as in the rest of Eastern Europe, the 1980s were a period of economic stagnation; yearly output growth, that had been in the 10 percent range in the 1950s, barely reached 1 percent over the decade. This reflected not only lower levels of investment--with the cessation of aid from China in 1978, the resources that Albania could invest were reduced (see Box 1.2)--but also a marked slow-down in productivity growth. With population growing at 2.1 percent per year, this low output growth resulted in a decline in per capita output. Finally, a major drought in 1990 exacerbated the already difficult situation. Agriculture and hydro-electricity were directly affected,[2] resulting in net imports of foodstuff where Albania was once a net exporter of food, and in the cessation of exports of electricity. It is estimated that GDP fell by 10 percent in 1990, mostly as a result of the drought.

Box 1.2: Main Features of the Albanian Economy

- With about 3.4 million inhabitants, Albania is a small, predominantly rural economy. In 1990, two thirds of the population lived in the countryside, and agriculture provided half of total employment and one third of Net Material Product. Agricultural land was consolidated in state farms and cooperatives that represented 25 and 75 percent of arable land, respectively. The ratio of arable land per worker is low at 1.04 hectares.

- Albania had a broad industrial base which reflected the autarkic nature of the country rather than its comparative advantage: Albania used to produce a very large proportion of its own spare parts and industrial products at a high cost and with low quality. In 1990, industry accounted for about half of Net Material Product and one quarter of employment. In most cases, the current productive equipment has no economic value as it was already obsolete at the time of its installation by the USSR or China. Albania has resources in chromium, copper, nickel and oil, and sizable reserves of water with a strong hydro-electric potential.

- Albania's external debt amounts to about US$620 million or 90 percent of 1992 GDP. Debt in non-convertible currency consists mainly of obligations under former bilateral clearing arrangements and amounts to about 20 percent of total debt. Ninety percent of Albania's debt in convertible currency consists of arrears on debt to commercial banks incurred as a result of ill-advised foreign exchange transactions, or of short-term trade credits contracted at the end of the communist period as the regime was crumbling.

- Albania joined the CMEA in 1949 and established its planning system according to the Stalinist model of that period, an experience common to many other Eastern European countries. Up to 1988, however, all changes were in the direction of increased centralization, and by the late 1980s, the planning system applied in Albania was more extreme than anywhere else in Eastern Europe. Thus, there was no private sector activity in agriculture save for the permission to cultivate a garden sized plot for self consumption. In 1976, the prohibition of private ownership of productive assets was formally incorporated in the constitution. Up to 1991, many prices had not been changed for several decades: the price of bread was changed for the first time since 1945 in July 1992 when it was increased four-fold.

- Such an extreme of command and control made for very low productivity growth, compensated by high levels of investment made possible by huge external transfers from the USSR and China. Investment averaged about 35 percent of GDP during the 1970s. This was supported by massive transfers from the USSR until 1961, when relations were broken following the China/USSR split, and from China until 1978 when relations in turn were broken. It is estimated that between 1950 and 1978 external assistance was the equivalent of 44 percent of investment or 12 percent of Net Material Product.

2/ Agriculture accounted for one-third of Net Material Product, while hydroelectricity more than covered domestic consumption and was an important source of foreign exchange earnings.

6. Against this backdrop of economic declin the Government, following the death of the dictator Enver Hoxha in 1985, began some modest attempts at political and economic liberalization. In 1987, jamming of Italian television broadcast was reduced. Popular pressure for change grew, no doubt influenced by events in neighboring countries and, at the end of 1990, opposition parties were allowed to form. Contested parliamentary elections were held in March 1991, leading to the victory of the Party of Labor, Albania's communist party and the only organized political forum at the time. In mid-1991, labor unrest and demonstrations forced the Party of Labor to enter into a five party coalition.

7. This gradual political liberalization was accompanied by attempts at economic reform which, in the absence of proper incentives and of an overall coherent strategy, had disastrous macroeconomic consequences. In 1988, greater autonomy was accorded to enterprise managers regarding what to produce and how. As a result, the demand for imports increased and transfers from state enterprises to the budget decreased, leading to significant and growing fiscal deficits, as well as to increased pressure on the balance of payments. The coalition Government undertook a number of important economic policy changes in the second half of 1991, including the legalization of private activities, the distribution of the land of the agricultural cooperatives, a partial removal of price controls, and, eventually, the abolition of the plan itself.

8. In a country that was turned from a pre-World War II agrarian society into an extreme version of the Stalinist model, the abolition of the plan led to economic chaos--output declined by 28 percent in 1991 and by 10 percent in 1992. For decades central planning had allocated inputs and set production targets. Its demise resulted in the dissolution of input-output chains: a factory could not produce for lack of inputs, and the factory to which it would have sold its output was in turn immobilized for lack of inputs. Perhaps more than anywhere in Eastern Europe, the abolition of the plan led to a "managerial shock" as enterprise managers were unable to cope with decentralized decision making. Production was disrupted across all sectors of the economy, with many enterprises operating at very low capacity by end-1991, and food shortages developed.

9. These difficulties were compounded by the breakdown of bilateral trade agreements, which resulted in a loss of markets and in the deterioration of the terms of trade. About two thirds of Albania's exports, representing 11 percent of GDP, were directed towards CMEA countries or China through bilateral trade agreements. Albania's trade in non-convertible currencies consisted mainly of exports of raw materials and of imports of manufactured goods, machinery, and transport equipment. In 1990, economic restructuring in CMEA countries shifted demand towards alternative markets and therefore reduced the demand for Albanian exports:[3] in 1991, exports towards the non-convertible currency zone all but collapsed. Furthermore, in 1991, all trade became conducted in convertible currencies and all bilateral balances converted in dollars.

10. External commercial relations and access to imported industrial inputs, were further disrupted by the accumulation of a large external debt. Up to 1988, Albania had no debt in convertible currency. Between end-1989 and mid-1991, however, it accumulated an external debt of roughly US$500 million, or about seven times 1991 convertible currency exports. This debt was mainly the result of ill-advised foreign exchange transactions and unsettled letters of credit, accumulated in an atmosphere of economic

---

3/ Although Albanian exports consisted mainly of raw materials, they were of such a nature, for instance low grade of chromium concentrate or crude oil with high sulfur content, that switching to international markets was difficult.

and political confusion as the old regime was disintegrating. At mid-1991, Albania had defaulted on these obligations and was therefore cut off from banking credit, including crucial trade credit.

Table 1.1 Main Economic Indicators 1989-92

	1989	1990	1991	1992
(percentage change)				
Output growth	10	-10	-28	-10
Agriculture	15	-4	-21	18
Industry	8	-20	-37	-60
Inflation, end of period	0	0	104	237
(percentage of GDP)				
Public expenditures	57	61	62	48
Fiscal revenues	48	47	29	26
Budget deficit (commitment)	-9	-15	33	22
Broad money	24	33	69	59

11. The abolition of the plan led not only to widespread disruptions of production, but also to a loss of control over the state enterprises, with disastrous consequences for fiscal revenues. Under central planning, state enterprises provided the main tax base, as well as the main institutions through which revenues were channelled to the state budget. The output decline of 1991-92 meant a dramatic decline in the tax base. Furthermore, the abolition of the plan, as well as the general crisis of communist institutions, led to a weakening of the control of the Government over state enterprises. Enterprises in surplus decreased their transfers to the budget and granted salary increases to their workers, imported consumption goods or foodstuff, or accumulated financial assets. This translated into a decline in the net contribution of state enterprises to the budget--taxes minus enterprise subsidies--from 35 percent of GDP in 1989 to 4 percent in the first half of 1992. Tax revenues fell from 44 percent of GDP in 1989 to 16 percent in the first half of 1992.

12. Fiscal expenditures rose sharply in 1991-92, partly to counterbalance the decline in output. First, the Government decided in mid-1991 that workers furloughed for lack of inputs were to receive 80 percent of their wages. Second, under political pressure, wages and salaries of all state employees were arbitrarily increased by 50 percent in 1991, before any wide ranging price liberalization measures. These wage increases were financed by the extension of budgetary subsidies to enterprises and by automatic extension of credit from the banking system to the state enterprises. As a result, budgetary subsidies to enterprises increased to 19 percent of GDP in the first half of 1992, from 8 percent in 1989. Eventually, the deficit mushroomed to 44 percent of GDP in the first half of 1992.

13. In this context of financial crisis, the partial price liberalization of November 1991 resulted in runaway open inflation. Prior to the price liberalization, passive monetary accommodation of the fiscal deficit led to a liquidity overhang: domestic credit doubled in 1991 and at end-1991, the ratio of broad

money to GDP had risen to 69 percent, from 24 percent in 1989. With the partial price liberalization of November 1991, monthly inflation climbed into the 10 to 15 percent range.[4]

14. By mid-1992, Albania portrayed a grim picture of economic decline and poverty not seen in Europe this century. Cumulative output decline since 1990 was close to 40 percent, inflation was running at more than 350 percent on an annual rate, foreign exchange reserves were exhausted, the administrative system had all but collapsed, and social unrest was on the rise. Lastly, Albania, which used to be a net exporter of food products, had become heavily dependent on food aid.

C. 1992-93: The Restoration of Social and Economic Stability

15. In December 1991, the Democratic Party withdrew from the coalition Government in order to force early elections that were held in March 1992. These elections--with a rate of participation of almost 90 percent--resulted in a nearly two-thirds parliamentary majority for the Democratic Party. The newly formed Government engaged in a program to restore public order and to stabilize the economy. This was supported by a rapid mobilization of international aid that included a 12 month Stand-By Arrangement from the IMF in July 1992, followed by a three-year arrangement under the Enhanced Structural Adjustment Facility (ESAF) of the IMF in July 1993, balance of payments and emergency support organized under the auspices of the EC/G24, and critical imports and structural adjustment credits from the World Bank.

16. Under the difficult initial conditions of the program, the policy options open to the authorities were fairly limited. With the high macroeconomic imbalances built over 1991-92, the authorities had no choice but to opt for shock therapy, i.e. wide ranging price liberalization and very tight monetary and fiscal policies. Furthermore, with the exhaustion of foreign exchange reserves, the authorities were compelled to float the lek, the Albanian currency unit. The authorities further implemented an income policy through the imposition of nominal wage limits on state enterprises.

17. The core of the adjustment was *fiscal consolidation*. Public expenditures were reduced by the equivalent of 22 percentage points of GDP between mid-1992 and 1993, mainly through cuts in enterprise subsidies and in operations and maintenance.[5] Expenditures on the social safety net were kept constant relative to GDP through a streamlining and better targeting of the benefits. On the revenue side, taxes were increased by 6 percentage points of GDP between mid-1992 and 1993, through the introduction of excises and the broadening of the turnover tax. As a result, the ratio of the deficit to GDP fell from 44 percent in the first half of 1992 to 16 percent in 1993. Taking into account foreign financing, domestic financing of the budget fell from 42 percent of GDP in the first half of 1992 to 10 percent in 1993.

4/ Prices were not liberalized or even administratively increased prior to November 1991. Inflation prior to November 1991 reflects the emergence of a small private sector operating with free prices, at first tolerated by the authorities, and subsequently legalized by the coalition government in the second half of 1991.

5/ The high level of operations and maintenance expenditures relative to GDP in 1991-92 reflects more the collapse of GDP than an abnormally high level of expenditure on these items. In the mid-1980s, expenditures on operations and maintenance were in line with regional averages.

18. These radical measures were translated into a tight *monetary policy*: the ratio of broad money to GDP fell from 64 percent at mid-1992 to 45 percent at end-1993. This tight monetary stance was facilitated by the fiscal consolidation as well as by instructions to banks to lend to public and private borrowers on a strictly commercial basis. It resulted in a severe contraction of credit to state enterprises: credit to state enterprises remained constant in nominal terms throughout 1992-93, which resulted in a 52 percent real cumulative decline over a year and a half. On the other hand, credit to the private sector, starting from a very small base, increased at a very fast pace throughout the period. As a result of this policy, the structure of net domestic credit had radically changed at end-1993, compared with mid-1992, with the Government share increasing from 54 to 70 percent, credit to state enterprises falling from 42 percent to 22 percent, and credit to the private sector increasing from 4 to 8 percent.

19. In the absence of Government paper, *monetary policy* relied mainly on credit ceilings to limit the expansion of balance sheets of banks. Reserve requirements were introduced in 1992 but became fully operational only in 1993. In any case, holdings of excess reserves by commercial banks would have limited the effectiveness of this instrument in influencing bank liquidity. At the same time, the lek was floated and interest rates on lek denominated term deposits were administratively set with a view to attaining positive real rates. In view of the low initial level of foreign exchange reserves, foreign exchange deposits for households and state enterprises were introduced to reduce the pressure on official reserves.

20. The Government adopted as an additional nominal anchor an *incomes policy* designed to bring about a decline in real wage commensurate with the 40 percent decline in output of 1990-92. This policy consisted of the imposition of ceilings on average increases in compensation in each state enterprise. A new wage law embodied tax penalties for average wage increases beyond the centrally determined limit, but these provisions were not implemented in practice for lack of control and enforcement procedures.

21. On the *structural side*, the stabilization program included price reform, exchange and trade system liberalization, banking reform, and privatization. All price controls were eliminated save for a few consumer items and utilities whose prices were sharply increased. The exchange market was unified, private exchange transactions legalized, current account transactions liberalized, and export and import licensing requirements eliminated or reduced. The first efforts toward the development of a two-tier banking system were taken with the implementation of laws on central and commercial banking operations and pursued through technical assistance programs for the institutional development of the central bank and of commercial banks. The distribution of most agricultural land was completed by end-1993, while small-scale privatization proceeded at a brisk pace throughout the period.

22. The *results of the program*, particularly in view of the difficult starting conditions, have been much better than expected. In early 1994, inflation had abated to less than 2 percent a month. The nominal exchange rate appreciated over the summer of 1992, following the initial depreciation associated with the liberalization of the exchange market, and has remained stable since the fall of 1992. Foreign exchange reserves have increased to about 2 months of imports. Real GDP growth, led by private sector activity, is estimated to have reached 11 percent in 1993. The largest contribution came from the agricultural sector, which is estimated to have grown by 14 percent. Albania has now practically weaned itself from food aid, with domestic production and private imports expected to cover most of domestic consumption in 1994. Growth in the construction, transportation, and service sectors has been even more rapid than in agriculture. As a result, unemployment, which reached a peak of about 30 percent in April 1993, had fallen to less than 18 percent by end-year. Most importantly, the social consensus has held,

despite the rigors of the stabilization program: in a survey taken in mid-1993, two out of three Albanians supported the creation of a market economy "largely free from state control".[6]

Table 1.2 Main Economic Indicators 1992-93

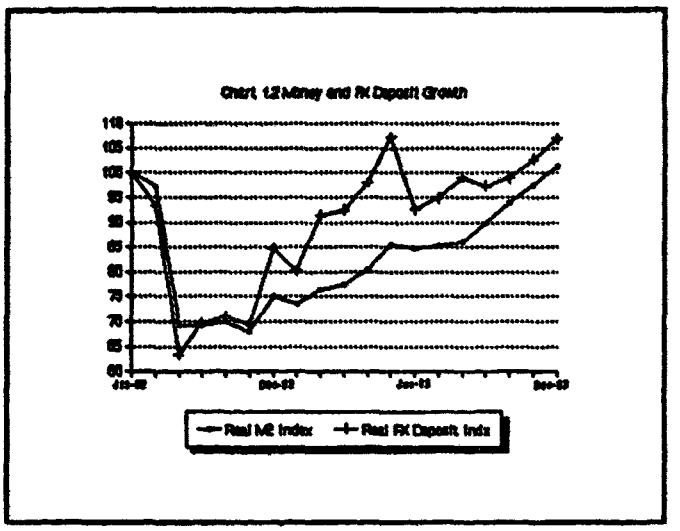
	1992	1993
(percentage change)		
Output growth	-10	11
Agriculture	18	14
Industry	-60	-10
Construction	5	32
Transportation	-20	12
Other services	5	13
(percentage of GDP)		
Public expenditures	48	44
Of which:		
Operations and Maintenance	11	7
Subsidies to enterprises	5	3
Social safety net	16	15
Fiscal revenues	26	28
Of which:		
Counterpart funds	6	4
Tax revenues	17	20
Non tax revenues	2	4
Broad money (end of period)	59	45
Real net domestic credit	-67	3
Real credit to government	-48	5
Real credit to state enterprises	-82	-22
Real credit to private sector	27	112
Inflation (percentage change)	237	31

Sources: Government of Albania and World Bank and IMF staff estimates

6/ USIA commissioned survey conducted by the Independent Center of Sociological Studies in Tirana.

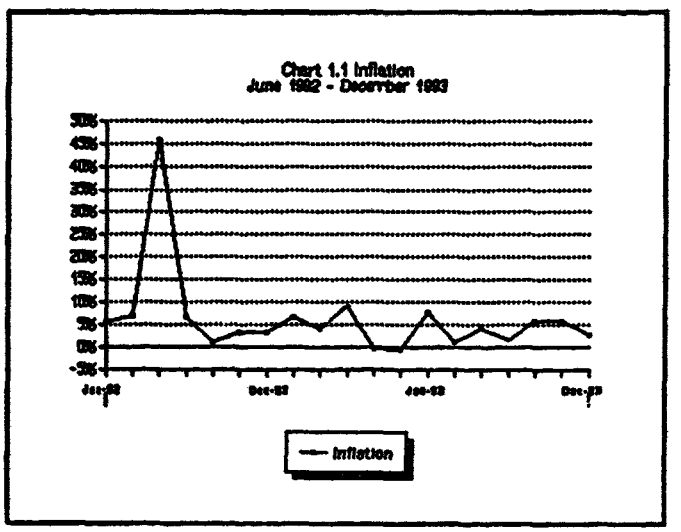
23. The success of the stabilization is evident by the evolution of *real money balances* (see chart 1.1). Real money balances fell at the outset of the program, as the monetary overhang was eliminated through price liberalization. Starting in late 1992, real money balances rose, reflecting a higher money demand associated with lower expectations of inflation. At the same time, the structure of broad money changed, with long-term deposits increasing from 31 percent of total deposits in mid-1992 to 48 percent at end-1993, as a result of the new structure of interest rates implemented at the outset of the program. By spring 1993, interest rates on six-month deposits had turned positive in real terms.[7] Despite the high interest rates offered on lek-denominated assets, the demand for foreign-denominated deposits grew even faster: foreign exchange deposits now represent about one third of total deposits. The growth of foreign exchange deposits has probably alleviated the pressure on the official foreign exchange reserves. On the other hand, the existence of foreign exchange deposits makes the control of banks' liquidity, particularly under a flexible exchange rate regime, more difficult. Their evolution should therefore be monitored carefully.

Chart 1.1



24. Stabilization was made easier by the *lack of inflation inertia*. Because Albania had no experience with inflation, there existed no indexation mechanisms at the time of the price liberalization. The results can be seen from chart 1.2: inflation decreased rapidly following the jumps of August 1992 and January and May 1993 associated with price liberalization or increases in administered prices. This was particularly important in view of the sharp depreciation of the lek at the outset of the program. The unification and liberalization of the foreign exchange market resulted in a jump in the exchange rate from about 50 leks per dollar to about 110 leks per dollar in July 1992. The lek subsequently appreciated in nominal but also in real terms as the domestic inflation rate has yet to converge to the rate of nominal depreciation. The extent of the real appreciation--about 70 percent between July 1992 and December 1993--suggests that

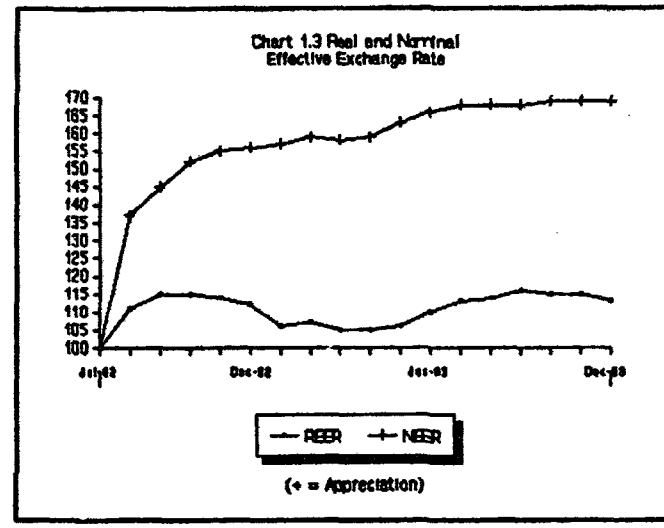
Chart 1.2



7/ Ex-post interest rates.

the initial depreciation went far above the new long-run equilibrium value of the lek.[8] With inflation inertia, this high initial depreciation could have fed in the price level over the medium term, requiring more contractionary policies.

Chart 1.3



25. Perhaps the most surprising--and welcome--outcome of the stabilization program has been *the profile of output*. In other Eastern European countries, stabilization has been associated with a sharp decline in output. Furthermore, in many stabilization plans in market economies, particularly money-based programs, stabilization has led to an initial recession.[9] In Albania, most of the output decline seems to have taken place before the stabilization program. Two types of explanations can be advanced for the recovery of output during stabilization: on the one hand, credit conditions may not have been as tight, as suggested by the monetary statistics, whereas the growth rate of 1993 reflects a shift of the aggregate supply schedule brought about by the structural measures taken early under the program.

26. Under the program, *real credit* to state enterprises has fallen sharply while outstanding bank credit to the private sector represented only about 5 percent of GDP by end-1993. Nevertheless two factors may have eased the credit situation of firms. First, a rise in inter-enterprise arrears: after the cut in bank credit and budgetary subsidies, state enterprises started to accumulate arrears (see chapter 3). By end-1992, the amount of gross arrears, including tax arrears, represented 180 percent of the outstanding credit to state enterprises in the banking system. In early 1993, the Government implemented a clearing exercise and adopted a series of regulations to limit the future growth of arrears. There is, however, some evidence that inter-enterprise arrears have continued to accumulate in 1993, particularly vis-a-vis the main utilities. Second, fuelled by remittances from Albanian workers abroad, the informal banking sector seems to have played a very important role in financing private sector activities. The fact that, until mid-1993, the credit ceilings were not binding, is evidence that monetary stance was not as tight as planned.

27. Set against the 40 percent cumulative decline of 1990-92, the 11 percent of growth of 1993 may appear as a modest catch-up. The high growth of 1993 is, however, much more than a catch-up on past output decline: over the past year and a half the structure of the Albanian economy has fundamentally

---

8/ In view of the structural changes taking place in Albania, such long run equilibrium is anybody's guess. Nevertheless, it can be argued that exchange market liberalization carried out in a context where no credible inflation hedge existed is likely to have resulted in an exchange rate reflecting a stock, rather than flow demand.

9/ See E.G. Calvo Vegh, Inflation stabilization and nominal anchors, IMF Papers on Policy Analysis and Assessment, 1992

changed. First, industrial production has collapsed, and agriculture now represents more than 50 percent of value added. Second, agriculture has been privatized: as a result, over a year and a half, the share of the private sector in GDP has grown from nearly 0 to more than 60 percent. The much faster response of output to the new incentive system, relative to other Eastern European countries, reflects to a large extent the much stronger responsiveness of the private sector to changing incentives. Albanian state enterprises have yet to restart production on a large scale. Lastly, the early adoption of appropriate price incentives has been crucial, particularly in the agricultural sector. Because of the difficult fiscal situation, the Government sold food aid at world market prices, which stimulated domestic production and private imports and ensured that food dependency was only a transitory phenomenon.

28. An additional factor in the success of the adjustment program was the quick mobilization of *external aid*, and the steady inflow of remittance from Albanian workers abroad. In 1993, aid inflows are estimated to have reached nearly 50 percent of GDP or US$470 million.[10] Emergency aid played a crucial role in keeping the social consensus for the reform. Through counterpart funds, it has also provided non- inflationary financing to the budget. In addition, *remittances from Albanian workers abroad* are estimated to have reached 18 percent of GDP in 1993 or US$200 million. Together with a still strong sense of extended family, they have provided an informal safety net that has greatly helped to maintain the consensus for the reforms. They have also provided the start-up capital for many new activities and fuelled demand for services and construction.

D. 1994-97: A Medium-Term Framework for Growth

29. The challenge is now to turn the early success of the stabilization program into long-term non-inflationary growth. This section presents a macroeconomic framework that extends the results of 1992-93 over the medium term and discusses the various policies and assumptions underlying this scenario. The Government has adopted, in a Policy Framework Paper (PFP) negotiated with the World Bank and the IMF in mid-1993, an ambitious program of reforms for the period 1993-96, including a basic macro-economic framework for the period. The scenario presented in this section is an update, prepared by the World Bank, of the PFP scenario prepared in mid-1993. In view of the weak statistical basis and the tremendous structural changes currently taking place, medium-term macroeconomic projections can only be a tentative exercise. Nevertheless, they have to be attempted in order to assess the consistency of the various policies and objectives.

30. Under current assumptions, *growth* would stabilize on a trend of about 6 percent a year in the second half of the 1990s. The economy's expansion would be private sector-based and would come mainly from a combination of continued progress in agriculture, the development of Albania's mineral and energy resources, and a strong expansion of small-scale activities in services and manufacturing. Inflation would continue to fall over the period and would reach 7 percent a year in 1997. This fall in inflation would be supported by a major fiscal effort. Fiscal adjustment would require strong actions both on the expenditure and on the revenue side: revenues would rise by 5 percentage points of GDP and expenditures would fall by 3 percentage points of GDP over 1994-97. The evolution of credit to the private sector reflects increasingly successful institution building in the banks. As their capacity to discriminate between good and bad borrowers develops, the program will make more room for credit expansion to the private sector.

10/ Although the ratio of aid to GDP appears very large, it is distorted by the highly depreciated exchange rate, as well as by the pricing of some forms of aid.

Box 1.3 How high is the real income of Albanians?

- Compared with the mid 1980s, real income in Albania has declined by two-thirds according to the Atlas methodology estimates of GDP per capita. Yet, when questioned in a nationwide survey, two out of three Albanians found the economic situation better than under communism. Although no recent data on standards of living are currently available, five broad types of factors can explain this apparent paradox.

- First, the exchange rate has probably depreciated far beyond its new long-run equilibrium value, as any visitor venturing in an Albanian restaurant or shop knows too well.

- Second, the pre-reform GDP was probably overstated, with the subsequent economic decline overestimated. Under central planning, mismeasurement of output was widespread due to reporting incentives. Since managers were rated according to their fulfillment of the plan targets and all inputs were under bureaucratic control, there were strong incentives to increase reported output.

- Third, the post reform GDP is underestimated as many private sector activities are difficult to record. With the rapid increase in the share of the private sector in GDP, new reporting mechanisms have to be established. Although such mechanisms are currently being developed they are not yet operational and no reliable data exist on private sector activity: currently only the Ministry of Agriculture conducts surveys of private enterprises in its sector. Furthermore, because most of the private sector is informal, its measurement is fairly difficult.

- Fourth, the consumer price index is probably overestimating the true increase in the cost of living. The current consumer price index is a Laspeyre index which uses initial period weights. In a period of rising prices, this index overestimates the cost of living because it fails to pick up substitution effects caused by changes in relative prices. These effects are likely to be important in Albania, where the opening of the economy has brought many changes in the range and prices of goods available to Albanians. Furthermore, the current consumer price index does not pick up qualitative effects, which are delicate to measure in any country. These qualitative effects are likely to be important as goods manufactured abroad have replaced the goods produced under the old autarkic system. Lastly, the price index does not capture positive effects such as the savings in work and leisure time made possible by the end of queuing and searching for goods, or the new ability of consumers to choose the goods they want among the many varieties now available.

- Fifth, GNP exceeds GDP by a very wide margin, as a result of remittances from Albanian workers abroad. Albania has a very large percentage of its working-age population living abroad, primarily in Italy and Greece. Profit remittances from this group represent a substantial portion of national income. Official estimates indicate that GNP was more than 30% higher than GDP in 1993. These estimates are based on Bank of Albania foreign exchange transactions and customs data on private goods imports. The actual level of remittances may be higher.

31. With the fiscal contraction envisaged under the program, gross national *savings* are projected to rise over the medium term to about 14 percent of GDP from dissavings equivalent to about 18 percent of GDP in 1993. Government savings would rise to 1 percent of GDP in 1997 from dissavings of 9 percent of GDP in 1992. On the other hand, the growth objectives under the program would require public investment flows of about 13 percent of GDP on average. These unusually high ratios of investment to GDP reflect the need to rebuild infrastructure as well as the low and unsustainable levels of 1991-92 when investment fell close to 5 percent of GDP. With the strong fiscal adjustment, the current account deficit is projected to decline from US$369 million in 1993 to US$270 million in 1997. This improvement is based on a yearly growth of exports close to 20 percent in real terms. Starting from exceptionally low levels, this would bring exports back to about the pre-crisis level of convertible currency exports by 1996, based on recovery of minerals, energy, agriculture, and small-scale

manufacturing. Total imports would increase moderately as private imports would replace emergency aid.

32. The medium-term outlook remains overshadowed by the adverse effects of the *large external arrears* on confidence, trade, and foreign investment. Albania has undertaken to implement a comprehensive action plan to solve its external debt problem. In this context, it has requested the use of an IDA-Debt Reduction Facility for the buy-back at a considerable discount of its commercial bank debt. The Facility will provide for the financing of legal and financial advisors and for part of the cost of the buy-back. Discussions with commercial banks are underway and the Government is actively seeking cofinancing to fund the operation.

33. Based on the above scenario, preliminary estimates of *financing requirements* over 1994-97 amount to US$ 1.2 billion--including the costs of the debt resolution. For external viability to be a realistic goal by the end of the 1990s, the projected gaps would have to be met on highly concessional terms and the large external arrears problem must be resolved in a manner compatible with Albania's exceptionally weak external position. Most of the funding is expected to be provided on concessional terms and to come from IDA, the IMF, the EU, and the G24, mainly as project financing.

34. The key to *long-term financial stability* is not only the pursuit of fiscal adjustment but also the implementation of a long-term solution to the current problems of the banking sector. So far, the fiscal adjustment has relied on measures difficult to replicate, such as cuts in enterprise subsidies or cuts in operations and maintenance expenditures. This implies that structural measures are needed to bring about a further fall in the deficit. On the revenue side, a new tax base has to be developed. On the expenditure side, savings have to be sought from the rationalization of social safety net provisions while public investment has to be expanded and reorganized.

35. Because the current decline in state enterprise production is irreversible, a new tax base has to be developed. The development of such a tax base will face three constraints: (i) in view of the urgency of the budgetary crisis, the loss in income sometimes associated with the initial steps of tax reform must be minimized; (ii) the gradual build-up of capacity in the tax and customs administrations must be the overriding constraint that determines the pace and sequencing of the tax reform; and (iii) the growing sectors of the economy--small-scale farming and services--are mostly informal and notoriously difficult to tax. In this context, the strategy of the Government is two-pronged: develop a simple and non-distortionary form of consumption tax, and strengthen tax and customs administrations.

36. Albania is currently spending a large share of its *budget* on transfers to households. Extensive social safety net provisions have helped weather out the rigors of the stabilization but, as the economy recovers, substantial savings could be made by making social insurance fiscally sustainable and better targeting social assistance. These savings will be used to finance the much-needed rebuilding of infrastructure. Rebuilding infrastructure will also require a radical change in the nature of public investment from investment in directly productive activities to investment supporting basic public services. The Public Investment Program will have to be developed further to establish procedures for public investment programming and management. To become sustainable, these changes will have to be accompanied by a strengthening and reorganization of the civil service (see chapter II).

Table 1.3 A Possible Growth Scenario 1993-97

	Estimated		Projected		
	1993	1994	1995	1996	1997
GDP and Prices					
GDP growth	11	8	6	6	6
Inflation, period average	85	27	14	10	8
8 Inflation, end of period	31	24	10	9	7
Money (% change unless otherwise indicated)					
Growth of broad money [a]	74	33	25	19	15
Reserve accumulation (US$M)	119	40	20	15	15
Credit	56	33	25	18	14
To the public sector:	39	31	11	4	0
Budget	58	40	14	5	3
Public enterprises	1	3	0	0	0
To the private sector [b]	321	47	132	71	42
Public finance (as % GDP)					
Overall balance	-16	-16	-14	-9	-8
Domestic financing	10	8	5	2	1
Foreign financing	6	8	9	7	7
Total revenue	28	27	29	32	32
o/w tax revenue	20	21	25	30	30
Total expenditure	44	43	43	41	40
Savings and investment (as % GDP)					
National savings	-18	-3	6	10	14
Foreign savings [c]	32	18	15	12	10
Domestic investment	14	15	21	22	24
External financing (US$M)					
Uses	488	395	299	279	270
Current account deficit	369	302	279	257	241
Amortization and others	0	0	0	7	14
Debt buyback [d]		53			
Reserve accumulation	119	40	20	15	15
Sources	488	395	299	279	270
Direct investment	18	45	50	55	60
Projected disbursements	159	150	127	77	60
Official transfers	311	118	72	11	0
Grant for debt buyback d/		52			
Gap		30	50	136	150

Source: Government of Albania and World Bank and IMF staff estimates
[a] End-year, percent change from previous period
[b] Large increase in 1993 due to low stock of existing private sector credit in 1992
[c] Foreign savings includes official transfers
[d] Represents grant-financed buyback of external commercial debt obligations at 10 percent of face value, end-1994.
Difference between source and use of funds is paid from reserve accumulation.

37. Fiscal adjustment is unlikely to translate into low long-term inflation unless the problems of *the banking system* are addressed. Because the Government guarantees household bank deposits, the bad

portfolio performance of state banks[11] creates a public liability which could result in monetary expansion, should the Government need to intervene to bail out depositors. While the state banks have inherited a portfolio of non-performing loans from their activities under central planning, they have also continued to extend bad loans, partly as a result of public pressure to lend to non-creditworthy borrowers. To address this situation, the Government will refrain from exercising pressure on the banks but rather, will allocate to the most important non-creditworthy borrowers an earmarked budgetary envelope. Furthermore, the Government intends to promote the entry of small but highly capitalized private banks.

38. To some extent the *growth performance* of 1993 is exceptional in that the legalization of private activities allowed new activities to be carried out with very high rates of return. Basically, the private entrepreneurs who were the first to break into new markets have benefitted from high rents. In the medium term, growth can be expected to revert to a trend from the very high rate of 1993. Nevertheless, there is much that the Government can do to help sustain a high growth trend. As growth will be private sector-based, a key Government policy to ensure the success of the adjustment program is to refrain from direct intervention in private economic decisions. Rather, the Government should strive to create an *environment conducive to private sector development*. Such an environment will require, first and foremost, financial stability, transparent and stable policy rules, an appropriate legal framework, access to foreign markets. An active privatization policy, the development of financial intermediation and enough credit expansion, and the rebuilding of infrastructure are also necessary.

39. Access to foreign markets will be of particular importance for private sector development. With the constraints posed on domestic demand by the adjustment program and the small size of the domestic market, growth is likely to be based on expansion of external trade. With Albania's favorable location close to Italy, access to EU markets will play a crucial role. In March 1992, the Council of Europe decided to include Albania in the Generalized System of Preferences (GSP), which grants preferential tariff treatment (mostly on unprocessed goods) to developing countries. Furthermore, all quotas on imports from Albania have been removed, except for textiles and a few agricultural goods. In view of the small size of the Albanian economy relative to that of the EU's, prospects for enhanced access to EU markets look quite favorable.

40. While the speed of privatization of agriculture and the associated supply response, have been remarkable, privatization of industry and service enterprises has proceeded more slowly. In particular, the Government has adopted a restitution law which could delay privatization and constitute an obstacle to foreign direct investment. To speed up privatization, the Government needs to address some provisions of the restitution law, continue with the successful privatization of small units, and implement a privatization program for larger enterprises emphasizing speed over revenues.

41. So far, growth has taken place in informal activities, for instance, small-scale farming financed through informal channels or requiring very little working capital or start-up funds. Indeed, one of the reasons why the tight monetary policy has been accompanied by a strong supply response was that new activities to date have not relied on banking credit and therefore have not suffered from the tighter lending conditions imposed by the stabilization program. However, this is likely to change as the scale of the newly started firms expands and as activities with a longer production cycle and with significant start up costs--for example, construction--develop. These new activities will need banking credit for their continued development and expansion. This will require an effort in two directions: strict adherence to

---

11/ There are currently no private banks in Albania.

the fiscal deficit targets will be necessary to allow enough growth in credit to the private sector while keeping to the inflation targets, and while viable financial intermediation will have to be developed, mainly through a licensing policy conducive to the entry of private banks.

42. Albania's weak and dilapidated infrastructure remains a major impediment to private sector development. The state of the road system is worse than anywhere else in post-communist Europe, water supply and electricity are unreliable, and the telecommunication network highly is highly deficient. The lack of infrastructure could have a particularly adverse impact on agricultural development. Until now, agricultural growth has mostly resulted in self consumption as farmers sought to reestablish their food security. Proper infrastructure, in particular roads and irrigation, will play a crucial role in encouraging farmers to expand and market their production.

43. The main risk to the scenario presented in this section remains that of a fiscal slippage. Now that the worst of the financial crisis is over, the sense of urgency is not as strong and there is renewed pressure to increase public expenditures. Furthermore, the revenue situation remains uncertain. There is presently no infrastructure for modern tax collection as in the tightly controlled and centralized society that Albania used to be, the scope for non-compliance and tax evasion was very limited and penalties very high. In a democratic, market-oriented society, the enforcement of tax laws involves more complex informational requirements, which the present tax administration is poorly equipped to provide. Should the tax effort fall short of the program targets, Albania will have to implement a range of measures including increased reliance on the taxation of external trade and further cuts in current expenditures, compatible with its long-term development objectives.

44. The remainder of the report proposes strategies and policies to bring about the medium-term growth and inflation path presented in this chapter. It is structured as follows:

45. Chapter II discusses how public finances could be reformed to reduce the deficit through revenue-increasing and expenditure-reducing measures, while a minimum social safety net is maintained and the much-needed rebuilding of public infrastructure is initiated;

46. Chapter III presents options to reduce the Government's involvement in the enterprise and financial sector as well as to keep public expenditures on enterprise and banking reform consistent with the fiscal targets, speed up the privatization process, and build a viable banking sector; and

47. Chapter IV examines the growth prospects of activities linked to Albania's main resource endowment and assesses whether the policies presented in the previous chapters will suffice to promote their rapid development.

Box 1.4: Foreign Trade and Direct Foreign Investment Prospects

- Total trade under central planning remained small relative to GDP in view of the small size of the Albanian economy--exports and imports in 1990 were equivalent to 14 and 22 percent of GDP, respectively--reflecting the autarkic nature of the economy. Exports in non-convertible currencies consisted mainly of food products and minerals while exports in convertible currencies were dominated by raw materials, mainly minerals. The majority of imports in convertible and non-convertible currency consisted of manufactured goods, machinery, and transport equipment.

- With the abolition of the plan, the statistical system of Albania has to be rebuilt from scratch to adapt to the characteristics of a market economy. While this institution building is in progress, no reliable data on trade are presently available. Nevertheless, from anecdotal evidence and data gathered from partner countries, the following qualitative assessment can be made.

- With the collapse of the CMEA and of trade through arranged agreements with Eastern Europe, the last two years have seen a dramatic shift in trade flows for Albania. A collapse of exports during 1991 and 1992 is being followed by a modest renewal of resource-based exports such as minerals and energy (to Greece) by the public sector, while agricultural exports can be expected to continue to increase as privatized state farms in the form of joint ventures export such products as tobacco, tomatoes, olive oil, and medicinal herbs. In the medium term, exports of labor-intensive industries can also be expected to bring export levels back to or beyond pre-democracy convertible currency levels, although, given low productivity, unit labor costs remain high despite the very depreciated exchange rate.

- Merchandise imports were artificially high in 1992/1993 due to the urgent need for food and other humanitarian assistance. In 1992, imports of goods were more than 75% of measured gross domestic product, although ratios to GDP have to be carefully interpreted in view of the likely huge gap between measured and actual GDP. While the public sector imports foodstuffs and commodities, partner countries' trade data are quite revealing about the medium-term pattern being established in the current account by private activity. These data indicate imports at 100% of gross domestic product, implying a significant amount of private sector imports entering the country without being registered. Private sector imports seem to be financed by remittances from workers primarily established in Greece and Italy. As many as 300,000 migrant workers in these countries could be providing financing for the many small-scale imports of consumer durable goods, automobiles, and trucks. High levels of remittances should be expected to continue financing the current account through the medium and long term, as the difference in income per capita between Albania and its neighbors is likely to last.

- With its location close to EU markets and its low labor costs, Albania will benefit in the long run from sustained foreign direct investment flows, provided it can create an attractive environment for foreign investors. Albania already has a liberal foreign investment regime; in particular there are no local ownership requirements, no restrictions on repatriation of capital and dividends, and there is a growing number of bilateral tax and investment treaties. In order to increase Albania's attractiveness to foreign investors, the 1992 Foreign Investment Law was amended in September 1993, mainly to eliminate separate authorization requirements for foreign investment, with the exception of large investments in a small number of strategic sectors.

CHAPTER II. PUBLIC FINANCES: MAINTAINING STABILITY AND SUPPORTING GROWTH

A. Introduction

48. *Fiscal consolidation* over the past year and a half has been impressive: the fiscal deficit has decreased from the equivalent of 42 percent of GDP in the first half of 1992 to an expected 16 percent of GDP in 1994. These good results need to be extended and improved over the medium term in order to foster a continued decline in inflation while allowing the development of credit to the private sector. The overall deficit compatible with the growth and inflation targets of the scenario presented in Chapter 1 declines from 16 percent of GDP in 1993 to some 8 percent in 1997. Most of this could be financed through long-term concessional credits from abroad, leaving about 1 percent for domestic financing by 1997.

49. This chapter discusses the options that are available on the revenue and on the expenditure side to maintain stability, while at the same time improve the underlying strength of public finances and make public expenditures more efficient. In Section B, a strategy to reconcile the short-term objective of increasing revenues and the medium-term goal of capturing a new tax base is proposed. The assessment of the potential increase in tax and other revenues, coupled with the financeable deficit just discussed, gives the resource envelope under which public expenditures will need to be constrained in the next four years. Options to achieve these targets and restructure public expenditures are reviewed in Section C.

50. *The Macroeconomic Context for Fiscal Reform.* In 1994, the third year of the adjustment program, the fiscal deficit is still estimated at 16 percent of GDP, of which 8 percent will be financed domestically. Such a high level of deficit reflects two factors: first the extreme initial imbalance and second, the fact that fiscal consolidation in the second half of 1992 was based on measures difficult to replicate, such as cuts in investment, compression of the civil service wage bill, and elimination of subsidies to enterprises. These two factors define a narrow path for medium-term fiscal consolidation: the deficit has to fall relative to GDP through revenue enhancing and expenditure reducing measures while, at the same time, revenue and expenditures have to undergo deep structural changes.

51. Implementation of the fiscal reform is constrained by a limited administrative capacity, which has to be built as the economy progresses. The prospects for increased revenues are directly determined by the capacity of the tax administration. The tax administration is small, relative to the size of Albania, but can neither expand, nor absorb a large number of new employees, because of the current lack of organization and the need to train its staff. This implies that new tax instruments should be initially very simple to administer, in order that their introduction not lead to a short-term revenue loss. On the expenditure side, the new role of the Government as the provider of basic public services and infrastructure requires the retraining of civil servants and a refocusing of their activities. For instance, new procedures to reflect the changing nature of public investment have to be put in place and an administration of social insurance--a nonexistent concept under central planning--has to be created.

52. This buildup of administrative capacity must be forward-looking; it must prepare for the provision of the public services that will be required in the post-transition Albanian economy. Of particular importance is the shrinking of the formal sector and the expansion of the informal sector (see box 2.1). This structural transformation has important implications for the reform of public finance. The growing sectors of the economy--small-scale manufacturing, services, and farming--are well known for being difficult to tax. Since only limited revenue can be expected from these sectors in the short term, taxation

efforts should be concentrated on the development of simple forms of taxation of consumption. Furthermore, with the shrinking of the formal sector, social insurance programs will play a less important role in the provision of a social safety net over the medium term. An overhaul of the system is therefore required.

Box 2.1: Growth and Informal Sector Expansion

- The formal sector is composed of large enterprises--mainly state enterprises--registered with the tax and the social security administrations and having access to bank credit. It is rapidly shrinking in size and number as a result of the ongoing privatization and restructuring of the state enterprise sector (see chapter III). The informal sector is composed of small enterprises that may not be registered with the tax or social security administration and that may not have access to bank credit because of their size or their inability to provide collateral. This sector is rapidly expanding; there are strong signs of activity from small-scale manufacturing or services--particularly trading enterprises--and the privatization of agricultural land has led to the creation of about 500,000 very small farms. In fact, most of the agricultural sector has become informal.

- Prospects for a renewed expansion of the formal sector are linked to direct foreign investment, because of the thin domestic capital base. Although in the medium to long term, Albania's natural endowment and favorable location close to EC markets make it a likely recipient of foreign investment flows, short-term prospects for sustained flows of foreign investment are not very good in view of regional instability and the stumbling block posed by the dilapidated state of infrastructure. There are no doubt many profitable opportunities; whether they will be exploited will depend a lot on the overall political stability of the region.

53. Overall structural changes in both revenues and expenditures will include fiscal decentralization and renovation of intergovernmental financing. New legislation on local budgets, giving new responsibilities to elected local authorities, devolving assets, and creating local revenue sources is being prepared for introduction in the 1995 budget year. This legislation is still being developed and should provide a consistent, equitable, and encompassing framework for transferring some revenue and expenditure responsibilities to the local level.

54. As was stressed in the previous chapter, quantitative targets at this time are only illustrative. In view of the weak statistical basis and of the structural changes that are currently taking place, it is very difficult to attach a specific quantitative impact to any of the measures. In this context, a narrow quantitative framework would be unhelpful. The fiscal targets will have to be re-assessed as events unfold and the statistical basis improves. What is needed is not a set of rigid quantitative targets or mechanistic policy rules but a combination of revenue-raising and expenditure-reducing measures compatible with Albania's long-term development. For instance, offsetting shortfalls in tax revenues with cuts in public investments, which have high rates of return, could temporarily prevent an increase in the fiscal deficit but would also have adverse consequences for Albania's growth prospects. An acceptable solution would have to bring about a reduction in the deficit without jeopardizing the much-needed investments in human and physical capital.

B. Financing Growth

Background and Strategy

55. Over the 1994-97 period, tax revenues are expected under the adjustment program to increase by the equivalent of 5 percentage points of GDP. This represents an exceptional effort in any country, and especially for Albania: like most formerly planned economies, it already has a tax to GDP ratio at the high end of the ratios prevailing in countries with similar income per capita (see table 2.1).[12] Nevertheless, it can be argued that some room for an increase in revenues over the next few years exists. First, Albania's GDP is considerably underestimated, which results in overstated tax to GDP ratios. Second, the average effective tariff on imports in 1993 was only about 6 percent,[13] which indicates that the revenue potential of external trade has not been sufficiently tapped. This section proposes a comprehensive program of reform of tax policy and administration to bring about a significant increase in the tax to GDP ratio.

Table 2.1: Country Comparison of Revenue Structure (as percent of GNP) [a]

	Albania	Romania	Hungary	CSFR[b]	India	Sri Lanka	Malawi
Total revenue	19.3	37.3	55.6	49.2	14.3	20.4	23.7
Tax revenues	17.1	34.3	46.9	44.1	11.5	18.3	20.6
Income tax	3.2	13.1	10.0	11.5	2.2	2.6	8.3
Social security tax	3.4	10.8	16.2	0.0	0.0	0.0	0.0
Goods and services	7.4	8.7	17.4	18.2	5.1	9.4	7.9
Trade and tax duties	3.0	1.2	3.2	3.1	4.1	5.3	4.2
Other	0.1	0.6	0.1	11.3	0.1	1.0	0.3
Non-tax revenues	2.2	3.0	8.6	5.0	2.8	2.1	3.1

Source: 1993 World Development Report and Government of Albania.

[a] Albania figures based on 1992; all other countries, 1991.

[b] Czech and Slovak Federal Republic.

12/ These high tax ratios may be explained by the still large share of state enterprises in the formal sector of formerly planned economies and the fact that these economies have good experience in taxing state enterprises. As the state enterprise sector shrinks, tax to GDP ratios in former planned economies may go back to the levels prevailing in market economies with similar levels of income per capita.

13/ This number was obtained as the ratio of collected import duties to non-aid financed imports of goods.

56. Albania's tax system is in a state of crisis. As in all other centrally planned economies, the state enterprise sector was the main source of revenues. The most important source of tax revenues was the turnover tax, which accounted for about half of total tax revenues over the latter part of the 1980s. Profit tax and amortization transfers[14] accounted for about one-third of total tax revenues, although this high level of revenues has to be set against a sustained level of budgetary subsidies to enterprises. Wage taxes represented on average about 15 percent of tax revenues over the same period[15] (see table 2.2).

57. In 1993, tax revenues reached 20 percent of GDP, a drop of nearly 25 percentage points from their mid-1980s levels. The major revenue earners have become the turnover tax (5 percent of GDP), excise taxes (4 percent of GDP), wage taxes (3 percent of GDP), and customs duties (3 percent of GDP). The high level of profit tax revenues (4 percent of GDP) is misleading as one-third consists of taxes on Central Bank profits that are more than compensated by interest payments from the budget (see table 2.2). To obtain a proper assessment of the revenue generating capacity of the Government, consolidated public sector accounts, including both the Budget and the Central Bank, should be produced.

58. Most of the decline in tax revenue between the mid-1980s and 1993 is accounted for by a decline in profit and turnover tax revenues (see table 2.2). While the decline in profit tax revenues relative to GDP is explained by the low profitability of state enterprises, the decline in turnover tax revenues relative to GDP reflects a structural transformation, namely the declining share of state enterprise output in GDP. Because this decline cannot be expected to be reversed, a new tax base has to be found.

59. Such an endeavor is constrained by two considerations: first, short-term revenues cannot be sacrificed to the long-term development of a sustainable, efficient, and equitable tax base and, second, the institutional capacity of the tax administration is limited. In view of the urgency of the budgetary crisis, the loss in revenues sometimes associated with the initial steps of tax reform must be minimized. On the contrary, tax revenues need to be increased in the short term in order to make up for the decline in counterpart revenues from the sale of food aid--from 14 percent of total revenues in 1993 to less than 1 percent in 1996. Furthermore, not much revenue should be expected from other privatization proceeds over the next few years: the old equipment in place has very little economic value and the privatization of the few state enterprises with valuable assets, e.g., the mining corporations, may not bring about significant revenues in the short term, although these enterprises could lead to a new tax base in the long term.

60. The short-term revenue constraint implies that the reforms of the tax system should go in the direction of simplification in order not to jeopardize the collection capacity of the tax administration. Existing tax instruments should be simplified and their emphasis redirected to raising revenue rather than to influencing economic choices or redistributing income. Any new tax instruments should be very

---

14/ Amortization transfers represent a fixed portion of the book value of assets that has to be paid every year. They are equivalent to a minimum asset tax, and were used by governments in socialist countries (in theory) to finance new fixed assets (investment).

15/ As a result of the ongoing reform of the social safety net, wage taxes are now collected by the Social Insurance Institute (SII) and finance exclusively social security expenditures, namely pensions. They will therefore be discussed in the next section on expenditures, in the context of the discussion of budgetary expenditures on the social safety net.

simple to administer. Lastly, the Government should concentrate its scarce administrative resources on the main revenue earners in the short term: import duties, turnover and excise taxes, and profit taxes.

Table 2.2: Structure of Budgetary Revenues in 1989 and 1993

	% of GDP		Share of Total Revenues	
	1989	1993	1989	1993
Tax revenues	44.2	20.0	91.6	71.6
Turnover tax	22.6	5.3	46.9	19.0
Profit tax[c]	11.1	4.0	23.0	14.3
Social security	4.9	2.8	10.2	10.0
Excise taxes	0.0	3.8	0.0	13.6
Personal income tax	0.0	0.1	0.0	0.4
Small business tax	0.0	0.5	0.0	1.8
Import duties	0.0	3.2	0.0	11.5
Non-tax revenues	4.0	7.9[b]	8.4	28.3[b]
Total Revenues	48.2	27.9	100.0	100.0

[a] Projections
[b] Includes mostly proceeds from the sale of counterpart food aid.
[c] The level of profit tax revenues is misleading. In 1989, budgetary subsidies representing 7 percent of GDP were paid to state enterprises. In 1993, state enterprises were no longer receiving budgetary subsidies, but about one-third of the profit tax revenues were paid by the Central Bank and were more than compensated for by budgetary payments of interest on Government debt to the Central Bank.

61. Despite efforts to strengthen domestic taxation, external trade--mostly imports--is likely to provide the main tax base in the medium term, as shown by the experience of market economies with income levels comparable to that of Albania.[16] All options for revenue mobilization from domestic activities should, of course, be explored before resorting to external trade taxation. However, in view of the small size of the domestic economy, its location close to EU markets, and the restriction placed on domestic demand by the stabilization program, external trade is likely to be the main growth sector over the next few years. The protective effects of taxing external trade are limited since there are almost no domestically produced goods competing with imported items. As domestic production diversifies, external trade taxes are likely to become increasingly distorted and emphasis on taxing external trade is therefore recommended *only* a short-term measure to increase revenues.

62. In the first half of 1993, despite a strong growth in non-aid financed imports, revenue collections were half of the projected amount. Improving the taxation of external trade has become both a short- and medium-term priority. Import duties were introduced for the first time in 1992 and the customs

16/ Table 2.1 Country Comparison of Revenue Structure does not show the full contribution of external trade to tax revenues as a significant proportion of the tax on goods and services is actually levied on imports.

service is still in its infancy. The customs administration is currently overwhelmed by a regime of import duties that is far too complicated. Both policies and administration need a far-reaching overhaul that has to start as soon as possible.

63. Domestic tax efforts should turn towards the development of indirect taxation as private sector growth is likely to be informal, primarily due to the development of small scale farming, services and manufacturing, which are notoriously difficult to tax. The current form of taxation of consumption, the turnover tax, is highly distortionary. As a result, a very complex regime of multiple rates and exemptions has been introduced which, in the medium term, could overwhelm the tax administration and result in a loss of revenues. A move to a form of Value Added Tax (VAT) that is easy to administer is necessary.

Box 2.2: A Land Tax

- While all agricultural land has been privatized, private farmers are currently not taxed and food products are exempted from the turnover tax. In many countries the most commonly used means of taxing farmers has been to tax marketed commodities or exports. This approach is not applicable in Albania where the marketing of agricultural goods remains mostly informal. Therefore, presumptive taxation through the institution of a land tax should be considered.

- Three options are open to the authorities: a tax based on land area; a tax based on net income or market value of the land; or a tax that relies on objectives measures of soil qualities and other factors as proxies for presumptive income. A tax based solely on land area would be simplest to administer but would be regressive since the tax burden as a function of land value is largest on the least productive land and lowest on the most productive land. A tax on net income or market value would be very costly to administer in the Albanian context where there is presently no well-established land or lease market that could provide an estimate of market value. In many respects, a tax based on objective features of the land such as quality or location would be the easiest to administer as there is no need to rely on market assessment. Moreover, the tax can be adjusted for inflation by simply adjusting the tax rate on the constant quality index of the land, and it can distinguish between as many or as few types of land as can be handled by the tax administration.

- Experience in other countries has shown that the land tax is successful where/when it is administered by the local authorities. The introduction of the land tax in 1994 seems premature since the local administrative capacity is very weak. Furthermore, with agricultural land divided into about 500,000 small holdings, collection, even if handled by the local authorities, could be extremely expensive, particularly since there exists no central registry of land ownership. Therefore, the tax is unlikely to yield significant revenues until significant improvements in land registry and local administrative capacity have taken place.

64. In mid-1992, the Government passed the Law on the Organization and Functioning of Local Government which establishes the authority of local governments to determine expenditures funded by local tax revenues. This law was followed by the first local elections of district, municipal, and commune officials. In addition, prefectures have been established and prefectors have been appointed. Important responsibilities have already been delegated to the local authorities; for instance, the administration of block grants to distribute social assistance to the local population (see next section). At the same time, a variety of assets have been devolved to local governments, which now must begin to administer expenditures for these assets. Over time, funding responsibility will also be transferred to the local governments. In the medium term, as the local authorities take an active role in the supply of local public services, e.g., local road construction and maintenance, garbage collection and disposal, or local utilities, a local tax base will have to be developed. Following the privatization of agricultural land and public housing, such a tax base could be constituted by local property. Since the Government should not spread

its very limited tax administration capacity over too many tax instruments, implementation of the property tax should be left to the local authorities, as is the case for the land tax to be introduced later in 1994. The property tax, in effect a land tax in the countryside, could be operational once local administrative capacity has matured and a central property registry for both rural and urban areas, currently nonexistent, has been established.

65. In the meantime, taxation efforts should be concentrated on increasing central Government revenues. With an extremely weak statistical basis both on tax revenues and on the sectoral composition of output, it is difficult to make meaningful revenue projections for particular taxes. Nevertheless, available data on external trade suggest that about one-third of the tax revenues over the next few years could come from raising the average tariff on imports to about 20 percent through more efficient tariff policy and collection. The remainder of the tax effort would have to come from domestic taxes, and through improved tax policies and administration.

Tapping the Revenue Potential of External Trade

66. Customs duties account for a fifth of tax revenues in the 1994 budget, and traditionally are one of the main sources of revenue in countries of Albania's per capita income. In 1993, however, customs revenues collected were less than three-quarters of the programmed amount. This can be partly attributed to a tariff law fraught with too many tariff bands, an insufficiently detailed nomenclature, and many exemptions. The collection of revenues is also hindered by a limited administrative capacity: the Customs Service is in its infancy with the Customs Code approved only in September 1992. To address this emergency situation, the Government needs to improve its tariff policy and launch a comprehensive program for the reorganization of customs. Should the various measures described in this section fail to produce an increase in revenues by 2 or 3 percentage points of GDP within the 1994-1997 period, the Government should consider more radical steps, such as contracting out the customs services to a specialized, foreign company, even if this option itself is not devoid of problems.

67. *Improving Tariff Policy.* Albania should consider, as soon as possible, changes in tariff policy in three principal areas: tariffs, nomenclature, and exemptions. The current tariff schedule has 5 different tariff rates, ranging from 0 to 35 percent which, although relatively simple compared to many other countries, stretches the limited administrative capacity in the customs administration [see box 2.3]. The tariff structure should be streamlined to two or three bands, ranging from 10 to 30 percent, to make tariffs more uniform. This would increase transparency and greatly reduce the administrative complexity.

68. Serious efforts are needed to refine the *classification system* in the tariff structure. At present, the EU's Harmonized System (H S) for the classification of goods is partially used but only two digits (chapter heading) are usually required by the Tariff Law. The level of aggregation is sufficiently broad that television sets and industrial machinery are included in the same tariff category and alcohol is not distinguished from other beverages. Since, in some cases, customs headquarters require the full eight-digit number, the legislation should be changed to make it compulsory. Using the full eight-digit classification would, however, result in further complexity in the implementation of the tariff schedule. This makes the reduction in the number of tariff bands to three even more important.

69. The number of *exemptions* in the new tariff law has gone up from six to thirteen. The exemptions include goods imported by passengers for their personal use, wheat and flour imports financed by international and bilateral aid agencies, as well as standard exemptions on temporary admissions,

inward processing,[17] warehousing, transits, grants in kind, and Government imports. The exclusion from tariffs of imports by individuals for their personal use should be abolished. These imports include not only personal items such as clothing, but also large appliances such as television sets and refrigerators. This customs treatment results in a substantial loss of revenues. Removing the exemption would be progressive since it would tax the wealthier Albanians who can afford to travel abroad or who are receiving support from relatives living abroad. This provision should accordingly be replaced by the limited allowance for personal baggage of travellers that is standard customs procedure in much of the rest of the world. The Government should also reconsider the exemption of goods financed under aid projects since, in cases where these goods are used by non-budgetary entities, the exemption results in a loss of revenues.

70. The Government has introduced a 5 percent import surcharge on all imported goods as an emergency measure to maintain revenues. This surcharge should remain in effect until (i) the simplified new tariff structure is in place; and (ii) tariff collection net of the surcharge has risen by 3 or 4 percentage points of GDP. It could then be gradually reduced provided overall fiscal developments are on target. In the short run, however, depending on budgetary pressures, it may well be desirable to raise the surcharge to 7 or 8 percent until stability is ensured.

71. *Increasing import duties on motor vehicles.* Until 1991, private ownership of vehicles was illegal. After the political liberalization, the number of vehicles in Albania has grown very rapidly. It is estimated that in 1992 alone about 25,000 cars were imported. These vehicles are presently taxed once, when they are imported, at the rate of US$400 per car, as well as yearly, at the rate of US$50 per vehicle. Experience in other countries, for instance India, indicates that the tax could be significantly increased. Such a tax not only brings in more revenues, it is also progressive from an income distribution view-point since only the better-off own cars.

72. *Reorganizing Customs Administration.* This involves improving the organization of field offices, designing training programs and incentive systems for officers, developing better procedures and establishing internal audit functions.

73. Customs offices are presently organized in headquarters located in Tirana and in sixteen outfield Customs houses at land borders, sea ports, and inland locations. The staff at smaller field Customs houses is not specialized, with each officer performing, in turn, acceptance of customs declarations, their review, and the physical examination of goods. Large field offices, however, have specialized sections dealing with statistics, special clearance schedules, and finance. A standard organization should be set up at all customs houses, whereby a Chief would be responsible, and accountable, for supervising authorizations and waivers up to a certain level. Higher value cases would be referred to headquarters. Deputies would be in charge of supervising day-to-day work. The staff should be divided in three distinct sections--acceptance, reviewing, and goods examination--reporting directly to the Chief.

17/ Inward processing is a system where raw materials can be imported for the purpose of producing end products which will be re-exported. Duty is paid on imports of raw materials and refunded when processed goods are re-exported.

74. With 320 employees, the customs administration seems adequately staffed relative to the number of customs entries processed at major locations.[18] However, many officers are in need of training and incentives. Furthermore, customs offices, lack basic equipment and no documentation is available to facilitate the work of customs officers apart from instruction manuals designed by an expatriate expert and recently translated into Albanian. All officers should be provided with identity cards, as designated under the Customs Law. Over the next few months, the authorities should mobilize and coordinate international support for a comprehensive training program for customs officers and for the provision of basic equipment to offices. At the same time, a career plan should be designed for officers of all ranks, and should emphasize the possibility of promotion through internal examinations. A code of conduct should also be issued, warning officers of disciplinary action, possibly leading to dismissal and/or criminal prosecution when serious breaches are detected. Incentive payments taken out of the 2 percent of the collection provided for under the tariff law could be paid to good performers.

75. There is scope for immediate improvement in the work output of Customs officers through the introduction of better procedures. Over the coming months, the Government should:

(a) introduce procedures to ensure that all goods taken into the country are reported to Customs and that they are not allowed to be removed or disposed of until a proper entry has been lodged, verified and cleared, and duty paid or secured;

(b) improve Customs entry processing by ensuring that entries are completed only by the importers, that the full eight digit nomenclature is used, and that once accepted and logged, entries are not returned to importers for corrections or cancellation; apply penalties for misdeclarations; and

(c) introduce a guarantee system to ensure the later payment of duty when goods have not yet been cleared; closely monitor refunds, which should be approved by headquarters above a certain level; and exercise tight control over exemption claims.

76. At this stage, computerization of customs operations should not be given priority. Computerization of inadequate procedures is unlikely to result in improvement of customs administration. It should therefore only be considered when the new procedures are working properly and when customs officers have achieved a good command of their responsibilities under the above-mentioned procedures.

77. A monthly reporting system from field offices to headquarters was recently introduced but is not functioning, despite commendable efforts by headquarters staff. Furthermore, the internal audit division consists only of three officials, and therefore cannot conduct frequent and unannounced visits of field offices. As a result, little or no control is exercised over the work of the field officers, and when irregularities are spotted, no serious action is taken against the offenders. Internal auditing should be expanded, partly through the recent transfer of Financial Police officers to the customs administration (see box 2.3). Emphasis should be put on audits of the work of customs houses and the review of samples of entry forms. The internal audit division should report directly to the Director General of Customs.

18/ Each officer has an average of less than 2 entries a day to process.

Box 2.3: The Financial Police

- The financial police has recently been reduced to 900 officers (from 1200) but still maintains a broad mandate to ensure compliance with all fiscal regulations. It not only undertakes control of tax payers and importers, but also of the customs administration and of the GDT, which results in duplication of their work. It enjoys wide discretionary powers, with limited accountability and judicial review of its actions. A plan is being developed to end the duplication of work between the financial police and the customs administration, and to separate clearly the responsibilities of the tax officers and the financial police with the role of the financial police strictly limited to controls, at the request of the tax administration.

Increasing Domestic Tax Revenues

78. The scarce administrative resources available to the Government should be concentrated on increasing revenues and preparing for the introduction of the VAT. Increasing revenues involves higher rates on products subject to excise taxes, broadening of the base of the profit tax, rationalization of the regime of the small business tax, and introduction of a vehicle tax. Preparation for the introduction of the VAT involves the simplification of the existing regime of the turnover tax, as well as the establishment of a small administrative structure in charge of policy development.

79. *Increasing revenues. Excise taxes* were introduced in 1992 and are currently levied on alcoholic beverages, mineral water and soft drinks, tobacco products, and petroleum by-products at rates ranging from 30 to 80 percent. Revenues could be increased and collection simplified through increases in rates. The Government has already increased the excise on diesel and gasoline products with a resulting retail price now close to Western European levels. Comparisons of tobacco and alcoholic products prices with neighboring countries also suggest a scope for increased excise tax rates.

80. The general *profit tax* rate has been set at 30 percent with special provisions: temporary tax holidays for new private firms, tax credits for reinvested profits by private firms, and differentiated tax rates according to sectors. These provisions should be abolished: their impact on investment and growth is highly uncertain and they are likely to lead to an erosion of the tax base in the medium term. At present, very few firms are affected by these provisions which target new firms--including new foreign owned firms--and their removal would have a negligible impact on revenues. Over the medium term, however, as the formal sector expands, the number of firms benefiting from these provisions will increase significantly. If these provisions have not been abolished, the tax base could be severely eroded.

81. Although tax holidays and tax credits for reinvested profits are currently used in many Central and Eastern European states as incentives for investment, their effectiveness is highly questionable (see box 2.4). Tax holidays for new private firms target more directly the creation of new firms than new investment. Tax credit for reinvested profits discriminate against investment based on the source of financing. In both cases the desired variable, investment for new production, is badly targeted. In addition, these measures discriminate against public enterprises, which runs contrary to the policy of subjecting public enterprises to the same market-based environment faced by private enterprises. Lastly, both types of measures are exceedingly difficult to implement as they require a monitoring of the firms' current accounts and balance sheets.

82. While the general profit tax rate has been set at 30 percent, revisions to the profit tax law adopted in March 1993 have created additional rates of 40 percent in the tourism sector and zero in "priority touristic zones." There is overriding evidence from many countries that the market is best placed to choosing winning activities. The most efficient allocation of resources and consequently, the highest income level in Albania will occur from letting all industries compete on a "level playing field" with a single non-discriminatory profit tax rate.

83. More generally, experience indicates the considerable difficulties in designing and targeting investment incentives in developing countries and the disappointing results from these incentives in practice. The removal of these incentives would economize the use of scarce administrative resources. It would also provide an important signal for investors that the Albanian Government intends to let the market increase productivity and income and to continue to refrain from interventionist industrial policy. (See box 2.4)

84. The *small business tax* has good revenue potential in the medium-term, but its administration will have to be greatly simplified. Currently, it produces less than 3 percent of tax revenues but uses up about half of administrative resources available[19] (see table 2.3). The disappointing performance of the small business tax can be expected to improve in the medium term, in line with private sector development. As the scale and scope of the small business tax will have to be greatly expanded to capture the growing sectors of the economy, a simplification of the collection procedures is necessary. More particularly, the number of categories should be reduced and businesses with revenues below specified floors should be ignored for tax purposes so that the cost of collection from very small businesses is not excessive in relation to revenue gained.[20] Since the revenue potential of this tax will only materialize in the medium- term, the threshold should be set high in order to select a limited number of taxpayers with good medium term potential that can be handled with limited administrative resources.

85. *Preparing for the Introduction of the VAT.* Currently the largest revenue yielder, at 26 percent of total tax revenues, is the turnover tax. The general rate is 15 percent and applies to most non-food items at the wholesale level. The importance of this tax requires that caution be used in dealing with its shortcomings, which are nonetheless substantial. The tax contains a complex system of exemptions and differentiated rates and has no minimum threshold. Applying the tax at the wholesale level results in a substantial element of cascading as goods are subjected to the turnover tax both when they are imported or manufactured and when they are sold by a wholesaler. The solution to the cascading problem of the turnover tax would be to move to a Value Added Tax (see box 2.6). A program for the introduction of the VAT--now scheduled for mid-1995--is being prepared with technical assistance from international agencies. In the meantime, and as a preliminary step, the current turnover tax system could be simplified.[21] In addition, a VAT unit needs to be established within the General Department of Taxes.

86. Many of the *exemptions from the turnover tax*--such as those for manufactured foods and household fuels--appear to have the objective of increasing the progressivity of the tax. One would indeed expect these goods and services to be more important in the budgets of consumers with low

---

19/ Some of this may be start-up costs as the tax is new and procedures are not yet well established.

20/ Small merchants could be taxed though the introduction of an annual "patent". Evidence of payment would be provided by a stamp to be prominently displayed. This tax would be particularly suitable for financing local governments.

21/ The recommended simplifications of the turnover tax are likely to bring in additional revenues. On the other hand, they will constitute one more change in the tax regime that has to be absorbed by the private sector. In order to provide a more stable environment for the private sector, the Government may prefer to wait for the introduction of the VAT, rather than to implement these changes right away.

Box 2.4: Tax Holidays

- Tax holidays and other forms of preferential tax treatment to attract foreign investment, similar to the ones adopted in Albania, have been used in many developing countries in the past decade and, more recently, in other Central and Eastern European countries. There is no clear evidence, however, that these tax incentives have been important factors in determining the flow of private foreign capital. At the same time, such tax incentives result in loss of tax revenue and, in many cases, cause significant distortions.

- The commonly-stated objective of tax incentives is to encourage long-term investment in durable capital, thereby increasing the productive capacity in the host country. Tax holidays are poorly targeted instruments for this purpose since tax revenues are foregone on all assets, including already existing equipment. A better targeted instrument would be to allow accelerated depreciation, extended to all investments in equipment, which would result in a smaller loss of revenues. Furthermore, this would avoid discriminating against the source of financing and against already established firms. Commonly, tax holidays are extended only to some sectors of the economy with the consequence of distorting the allocation of resources. Market forces are better at ensuring the optimal allocation of resources, and the tax regime should therefore be designed in a manner to cause the least distortions.

- Tax holidays, commonly extended for five years to encourage investment in particular sectors, are the most used form of attracting foreign direct investment (FDI) in developing countries. In most of Asia, the use of tax holidays and other tax incentives to attract foreign direct investment (FDI) has grown over the last decade, largely attributed to "competition" between neighboring host countries in securing private foreign capital flows. In the same period, many Latin American countries have decreased the use of tax incentives, due in large part to changes in the tax regime in the United States, home country of most FDI flows to Latin America. While it is clear that the flow of FDI to Asia has been increasing rapidly in the last decade, FDI flows to Latin America, for instance to Mexico, have recently increased sharply. This broad evidence therefore suggests that tax incentives are not the only or even the main determinant in attracting foreign capital for investments. A more specific example would be Indonesia which abolished the use of tax holidays in 1989 and, in the period since then, has been among the largest recipients of FDI flows.

- It is clear from many observations that tax issues are only one, and by far not the most important, factor influencing investment decisions. The credit rating of the country is among the most important factors, which, in turn, is determined by the political and macroeconomic stability of the country. The risk of war, of nationalization of industries, of hyper-inflation, of rules against repatriating profits, etc., play a much more substantial role since these factors determine the profitability of potential investments. The level of corporate income tax is therefore only a marginal issue in determining the flow of FDI.

- The appropriate level of taxation of foreign direct investment also depends on the tax regime in the home country. Many countries, including the United States and many countries in Western Europe, use systems of fully taxing income earned abroad and give credits for taxes paid abroad. The effect of extending tax holidays in Albania under such circumstances is simply to transfer revenue from Albania to the home countries in the United States and Western Europe. A system of corporate taxation without exemptions, set at levels comparable to other countries, is therefore the best way to increase revenues and avoid distortions between established and new firms, as well as between different sectors of the economy. Such a system is unlikely to discourage flows of foreign direct investment. Finally, removing tax exemptions will ease the administrative burden of tax collection, which is crucial given Albania's scarce administrative resources.

incomes. Yet, any consumer of these goods, whether low-income or not, also benefits from their exemption from the tax. At the same time, the exemption results in a substantial loss of tax revenues. Greater efficiency in aiding low-income groups would be achieved through targeted income transfer programs as described in the second part of this chapter. As the Government is currently putting in place a system of income transfers targeted at the most needy, the exemptions on basic consumer goods--including the exemption of goods subject to excise tax--should be eliminated over the next few years. Removing exemptions and adopting a single rate would not only simplify administration, but also increase revenues.

87. The turnover tax does not establish an *annual turnover threshold* below which enterprises are exempted from the liability to pay the tax. Instead of a specific threshold, the law provides for an exemption of any business carried out by a "physical person". Such "small businesses" are subjected to a different tax regime (see box 2.5) where they have to pay an annual license fee and a tax of either a flat amount or a percentage of their gross receipts. While this provision provided a simple test when the tax was introduced, it will not be appropriate for a more complex economy, where businesses with large turnover will be run by a physical person. Furthermore, because of the difference in these two tax regimes, it is likely that many enterprises will try to retain the small business status and the employment of many workers and their social insurance liability could go unreported. Finally, while in 1993 more than 2500 firms were subjected to the turnover tax, 19 taxpayers were responsible for 90 percent of domestic turnover tax revenues. To economize on scarce administrative resources, the Government needs to establish a turnover threshold for the payment of the tax. This threshold should be set in such a way as to maintain 90 to 95 percent of current tax revenues.

Box 2.5: The Small Revenue Earners

- The *small business* tax consists of a flat amount specific to various professions or of a percentage of revenues with a fixed floor assessed each year. For instance, TV repairmen are assessed at 12,000 leks per annum; carpenters, electricians, and plumbers at 9000 leks. Wholesale traders pay 6 percent of revenues but not less than 50,000 leks per year. Attempts to vary tax assessments are also made with capacity serving as a proxy for revenues; this is done, for example, by the size of vehicles in transportation of goods and people. It is estimated that approximately 38,000 small businesses were subjected to this tax in 1993, which suggests very high collection costs relative to potential revenues.

- A *personal income tax* has recently been introduced, albeit, with very high thresholds that exempt practically all the working population. This is not uncommon in countries at Albania's per capita income level. Since not much revenue can be expected from such a tax in a country with Albania's characteristics, the threshold should be kept high enough to limit collection costs.

Table 2.3: Small Revenue Earners

	Second Half of 1992		1993[a]	
	% GDP	% Tax Revenues	% GDP	% Tax Revenues
Small business tax	0.4	2.0	0.5	1.8
Personal income tax	0.0	0.2	0.1	0.4

[a] Estimated

88. To alleviate the *cascading effect of the turnover tax* over large integrated industries, such as mining combinates and leather processing, a special regime has been introduced. The purchases by "economic communities" and "economic branches" belonging to these industries of equipment and raw materials from within Albania are not subject to the turnover tax, and the rate applied to the final products of these enterprises is 20 percent instead of the standard 15 percent. This feature of the law is difficult to interpret, both for tax officers and taxpayers, and its complex features cause distortions and can be a source of fraud. Since the taxpayers benefitting from this special regime are large enterprises,

they should be included in the limited number of enterprises subjected to the VAT. Therefore, this complex regime should be abolished when the VAT is introduced.

89. *A full time unit to prepare for the introduction of the VAT* should be established. This unit could consist of about five staff working full time on policy coordination and control, drafting of laws and regulations, and operating systems and procedures. Its major tasks would be:

(a) preparation of the legislation to be submitted to Parliament; the law will include a definition of the tax base, the exemptions, the threshold for registration, the rate structure, the payment obligations, and the penalties for non-compliance;

(b) consultation with the private sector to prevent the enactment of complex provisions, test the design of the VAT, and ensure better compliance;

(c) publicity and taxpayer information to outline the benefits of the VAT and to prepare taxpayers;

(d) organizational issues and staffing; VAT staff will need to be trained prior to the implementation of the VAT; operational systems and procedures will have to be defined.

90. *Improving Tax Administration Procedures*. The General Department of Taxes (GDT) includes approximately 400 employees. The number is small relative to the size of the country,[22] but it is not recommended at this stage to increase its size. It needs to be reorganized and its staff thoroughly trained before it can absorb significant numbers of new recruits. Simplifying and strengthening tax administration procedures involves in the very short term, more efficient collection through a lower frequency of tax payments, better tax return forms, and systematic record keeping. In the medium term, audit and registration procedures should be improved.

91. *Collection procedures* are unnecessarily complicated for both taxpayers and collectors. All taxes except the turnover tax are paid monthly through the banking system or the post office; the turnover tax is paid every 5 days. Payment of the turnover tax every 15 days would greatly simplify the work of the GDT without any serious impact on revenue flows to the Government. Tax return forms have been recently designed for all the major taxes but have many deficiencies. In particular, they are not based on self-assessment principles. In the case of the turnover tax, for instance, an unreasonable volume of information is required: description of goods, quantity, volumes, etc. In the case of the profit tax and the small business tax, taxpayers must visit their tax office every three months to discuss their tax liabilities on the basis of their balance sheets and their books of accounts. A large amount of GDT capacity is devoted to the assessment of the returns filed by these taxpayers. New tax forms based on self assessment and using the Social Insurance Institute (see para. 83) identification numbers should be introduced. They should include basic data to allow a selection of taxpayers likely to have understated their income and to determine who should be audited. Such a system based on voluntary compliance and ex-post control would release valuable resources.

22/ The capacity of the tax administration depends, of course, on its efficiency, particularly regarding the technology it uses, currently a manual one. Once the tax administration becomes sufficiently well organized to be computerized, it may be large enough for Albania.

Box 2.6: A VAT for Albania

- The introduction of the VAT would provide *a solution to the cascading caused by the turnover tax*. It would only tax the final consumer since at each stage of the production distribution chain, it is only collected on the difference between sales price and costs, i.e., wages plus profits. Each enterprise subject to the VAT deducts the VAT it paid on its inputs from the VAT it owes on its final product. In this way, only value added is taxed.

- A VAT adapted to Albania's circumstances would have to be *simple to administer* with only one rate and no exemptions--investments would be taxed, but the VAT paid on investments should, of course, be deductible from the VAT owed. In fact, the VAT should avoid multiple rates and exemptions even in countries with a sophisticated tax administration. New Zealand, for instance, has recently adopted a form of VAT very similar to that recommended for Albania. Furthermore, in most OECD countries, tax reform has moved in the direction of the simplification of the VAT, with a reduction in the number of rates and exemptions. In order not to overwhelm the tax administration, the VAT would be initially applied only to enterprises with a turnover above a threshold set in such a way as to capture the main tax payers at the wholesale and retail level.

- The VAT would also provide *a basis on which to build a modern tax collection system*. Once the VAT is introduced, the entire tax collection system should be overhauled and streamlined. New and more formal arrangements will have to be made between the tax administration and the banks for the collection of tax revenues.

- It is often argued that the VAT is *a regressive tax*. As with almost any consumption tax, this is likely to be the case, but a complex system of multiple rates and exemptions would not be the best way to make the tax system more progressive. First, the loss in revenues stemming from exemptions may be much higher than the income transfer that would be necessary to compensate the poor for a loss in purchasing power resulting from the VAT. Second, multiple rates and exemptions are not only difficult to administer, but also lead to tax evasions and create distortions. Most importantly, what matters is not the regressivity of one tax instrument, but that of the entire system of Government revenues and expenditures: a regressive VAT could be compensated for by a well-targeted system of transfers, with a positive net result for the poorest segment of the population.

92. The current manual *registers* maintained by the tax offices hinder the control of stopfilers. A simple system of manual cards should be set up where a single card would contain a taxpayer's entire records. Once well-established manual procedures are developed, a computerized system could be introduced. In the meantime, a pilot project should be established to implement a computer-based system for monitoring compliance with basic filing and payment obligations for *all* taxes payable by those taxpayers liable to pay VAT in Tirana.[23] In establishing this project, the first system application to be developed would be the VAT. In a relatively short period, the project could be extended to payments of excise taxes, withholding tax on wages, and profit tax (and in the longer term, social security contributions). As the next step, the project could be extended to Shkoder and then, as required, to other important regional centers.

93. The improvement in revenue collection to be expected from the above measures is very much constrained by the absence of *systematic taxpayer registration*. Local tax offices have started to issue

23/ In Albania, 80 percent of the private companies are concentrated in two towns: Tirana (65 percent) and Shkoder (15 percent).

taxpayer registration numbers. However, these numbers are not suitable for computer processing,[24] there is no central registry, and taxpayers have not been advised of their numbers which are therefore not used in their declarations. At the same time, the Social Insurance Institute (SII) is in the process of establishing an automated social registration file and issuing social security numbers to all of its payers and clients. In order to avoid duplication of work and to facilitate the exchange of information between the social insurance and the tax administration, the GDT should work with the SII in designing its numbering system and should require taxpayers to use the SII numbers on payment advice and returns filed at the tax office.[25]

94. At present, the objective of the GDT is to realize a 100 percent audit coverage, which is unrealistic. To ensure compliance, an *audit plan* should be developed to cover about 30 percent of taxpayers liable to turnover taxes. The identification of taxpayers to be subjected to audit should be based on information across the different taxes and an audit list should be established after proper sampling. A standard audit report and procedures should be designed to keep audits short, between 3 to 5 days. Enough staff should be allocated to this function and training should be organized for those tax officers in charge of auditing the turnover and excise taxes. The role of the Financial Police (see box 2.3) should be strictly limited to checks to ensure that enterprises maintain proper accounts and issue sales invoices and should take the form of specific intervention at the written request of tax officers.

C. Restructuring Public Expenditures

Background and Strategy

95. The previous section presented possible strategies to raise the ratio of tax revenues to GDP to reach the target of 30 percent in 1996. To keep with the target of a ratio of deficit to GDP of 8 percent in 1997, expenditures would have to decrease by about 3 percentage points of GDP between 1994 and 1997. As was stressed previously, these projections are, at this stage, only illustrative and may have to be reassessed as events unfold. Nevertheless, in view of the high ratio of expenditures to GDP inherited from central planning, a reduction in the level of public expenditures is clearly warranted.

96. At the same time, over the next few years, there will be strong financing needs in two areas: investment in public infrastructure and restructuring of the public enterprise and financial sectors. The dilapidated state of infrastructure constitutes a major stumbling block to private sector development and to direct foreign investment. For instance, the lack of usable roads between villages and cities discourages farmers from marketing their crops, and the lack of infrastructure in potential touristic sites is a major disincentive for foreign investors (see chapter IV). For these reasons, the projections have allowed for sustained levels of public investment going from the equivalent of 8 percent of GDP in 1993 to 14 percent in 1997, of which 8 percent will be domestically financed. These levels are necessary to catch up on the lack of maintenance during the 1980s, and the destruction of infrastructure that took place

---

24/ The numbers do not include a check digit, which is a digit computed as a combination of the digits in the sequential part of the number and serves to validate the entry of the number for purposes of computer processing.

25/ In the medium term, the tax collection functions of the SII should be transferred to the GDT--see discussion of social insurance in next section.

in 1991-92, a period of great social and political instability. In addition, the crisis in the state enterprise sector and the banking system requires direct budgetary intervention. The costs of this intervention, which consists mainly of direct support to the restructuring of large enterprises and recapitalization of the banking sector (see chapter 3), are expected to decline from about 5 percent of GDP in 1993 to about 1 percent in 1997.

Table 2.4: Expenditures
(in Percent of GDP)

	1993	1994	1995	1996	1997
Total expenditures	44.0	43.0	43.0	41.0	40.0
Support to enterprise and financial sector reform	2.6	2.2	2.1	1.5	1.0
Investment	5.1	9.5	9.2	9.2	8.1
Gross social expenditures	14.8	13.5	12.0	10.5	10.3

97. To accommodate these higher expenditures and keep with the targeted overall decline in the ratio of expenditures to GDP, savings have to be made from other categories of expenditures, the wage bill, operations and maintenance, or transfers to households. The scope for savings on operations and maintenance and on the wage bill is very limited in view of the cuts already effected under the stabilization program over the past year. This leaves transfers to households as a prime candidate. The steep decline in income over 1991-92 has been accompanied by a sharp rise in transfers to households as an emergency social safety net was put in place. This emergency social safety net has helped to maintain the social consensus during the first phase of the adjustment program, when real incomes declined sharply; since 1991, real wages have decreased by about 30 percent. Now that the economy is starting to grow again, savings should be sought from the rationalization of the current provisions of the social safety net.

98. These reforms have to be carefully sequenced. Despite the good prospects for high growth, Albania's per capita income is still very low, which makes its population particularly vulnerable to the social costs of the transition. Without an effective social safety net, the human cost of transition could be extreme, and the consensus for the reforms could erode. Yet, the current level of spending on transfers is not compatible with either the necessary decrease in the fiscal deficit or the projected increase in infrastructure spending and in expenditures on financial and public enterprise restructuring. The Government intends to improve this policy trade off between social and fiscal sustainability by moving social insurance programs toward fiscal sustainability and through a better targeting of social assistance programs.

99. While these measures are being implemented, structural changes are required to improve the impact of Government spending. Specifically, public investment has to move from investment in the directly productive sectors to investment in public infrastructure and basic services. In addition, a reform of the civil service has to take place in order to develop the capacity to manage these changes. A public investment program is needed as a formal framework for the planning and management of public investment, as well as an instrument for aid coordination. Civil service reform is necessary to improve the overall coordination and implementation of the reform program. Most importantly, adequate incentives should be provided to retain high caliber civil servants.

100. To sum up, the strategy of the Government to restructure public expenditures consists of: (i) moving social insurance toward fiscal sustainability; (ii) better targeting of social assistance; (iii) maintaining and implementing a public investment program; and (iv) reforming the civil service.

Box 2.7: Structure of Public Expenditures

- Albania has very recently introduced a new budgetary classification system that allows a decomposition of expenditures by functions in the 1993 budget (see table below). The two largest categories of expenditures are general services (administration expenditures that cannot be attached to a specific category) and welfare (transfers to households including subsidies) that represent about 46 percent of the total. Expenditures on the social sectors--health and education--and on infrastructure--housing, transport, and communication--come next with about 15 percent each. About 14 percent of total expenditures is spent on the directly productive sectors--industry and agriculture--and 9 percent on defense and public order.

TABLE 2.5: 1993 Budget Composition By Object

	Percent of total expenditure
1. General Services	21.3
2. Defense	5.7
3. Public Order & Safety	3.3
4. Education	6.9
5. Health	6.6
6. Welfare	25.0
7. Housing & community	8.1
8. Cultural affairs	0.5
9. Industry & mining	11.7
10. Agriculture, forestry, fisheries	2.3
11. Transport & communication	7.7
12. Other expenditures	0.7
TOTAL	100.0

- A decomposition of expenditures by economic type shows that the largest category of expenditures is, by far, transfers to households (35 percent of the total). These transfers consist of various price subsidies, contributory and non-contributory programs. The wage bill represents 16 percent of the total, followed by investment, and operations and maintenance, representing about 13 percent each. Interest expenditures represent 5 percent of the total (see table below).

TABLE 2.6: 1993 Budget Composition By Economic Classification

	Percent of total expenditure
1. Wages and salaries	16.3
2. Interest (net)	4.7
3.Operations & maintenance	12.6
4. Subsidies	16.2
5. Transfers	34.5
6. Investment	12.7
7. Other	3.0
TOTAL	100.0

Moving Social Insurance Toward Fiscal Sustainability

101. Under central planning, lifetime employment was guaranteed by the State, the notion of social insurance was almost non-existent, and the relation between contributions and benefits was at best tenuous. Thus, the financial viability of the main two contributory schemes, unemployment insurance and pensions,[26] is threatened by overly generous provisions, as well as the shrinking of the contribution base, and an increase in the number of beneficiaries. In 1993, net budgetary outlays on pensions and unemployment insurance amounted to nearly 8 percent of GDP and 16 percent of total budgetary expenditures. The Albanian Parliament passed in June 1993 the Social Insurance Bill that rationalizes the provisions of the current system and provides a first step in the direction of fiscal sustainability.

102. *Unemployment Insurance*. In 1993, it is estimated that contributions to unemployment insurance covered less than 11 percent of estimated benefits and, as a result, net budgetary contributions to the unemployment insurance system absorbed 9 percent of total expenditures.[27] The deficit of the unemployment insurance system is, however, a transitional problem that contains its own sunset provision given the limited duration of benefits (one year) and the shrinking of the formal sector. Therefore, the reform of unemployment insurance consists mainly in the rationalization of current provisions. Unemployment benefits used to be set at 70 and 60 percent of employees' past wages and financed by an employer contribution representing 6 percent of the wage bill. The new legislation has lowered the replacement ratio by introducing a flat-rate non-indexed benefit and has introduced employees' contributions which are to rise to 3 percent of wages over the medium term. A number of non-contributory support measures for certain merit categories--former political prisoners, military personal, seasonal workers, and university graduates without work history--have been shifted to social assistance and will be fully funded by the budget. Lastly, administration has been improved; responsibility for the payment of benefits has already been transferred from state enterprises to the local labor offices. These measures are expected to result in net budgetary savings amounting to 2.1 percentage points of GDP in 1996 relative to 1992, which is consistent with the programmed decline in expenditures of the base scenario (see chapter 1) and with constant real individual pensions.

103. *Pension System*. The pension scheme is financed on a pay-as-you-go basis through employers' contributions. In 1993, contributions represented 2.8 percent of GDP against 4.9 percent of GDP in 1989. This is partly explained by the aging of the population, but mainly by the shrinking of the formal sector--particularly through the privatization of state farms and cooperatives--and the rise in unemployment since 1991. The shrinking of the contributory base will be difficult to reverse since creation of new employment is likely to take place in the informal sector, which is notoriously difficult to tax.

104. At the same time, *benefit provisions* are not sustainable; in 1993, gross expenditures on pensions amounted to nearly 7 percent of GDP and 13 percent of total budgetary expenditures. Normal retirement

---

26/ Other programs include sickness, maternity, childbirth, death, and allowances for persons disabled at birth, which are relatively small from a financial point of view.

27/ Unemployment benefits are paid out by local labor offices that receive contributions directly from state enterprises located in their region. Labor offices only receive from the budget the complement required to pay out benefits. Since there exist no comprehensive data on contributions from state enterprises to labor offices, the gross amount paid out in unemployment benefits is not known.

age is 55 for women and 60 for men, lower than in most other countries. The benefit period was raised relative to periods of actual contribution through generous eligibility requirements for earlier retirement for certain categories of workers, and short waiting periods for eligibility to full pension There was also preferential treatment of certain categories of merit, for special service, and for hazardous work. Consequently, the effective retirement age is currently about 52 for women and 58 for men. Furthermore, provisions allowing early retirement due to unemployment have been used increasingly. Whereas 7 percent of new retirements fell into this category in 1991, the number rose to 38 percent in 1992. Given that pensions are higher than unemployment benefits and have unlimited benefit periods, this approach to protection of the unemployed is expensive, and will carry budgetary repercussions for many years. Early retirement provisions should therefore be abolished.

Table 2.7: Outlays for Pensions and Unemployment Benefits 1992-96

	1992	1993	1994	1995	1996
As Percent of GDP:					
Pensions, Gross [a]	6.8	6.4	6.6	6.5	6.0
Social Security Contributions	3.4	2.8	3.1	3.5	4.1
Pensions, Net	3.4	3.6	3.5	3.0	1.9
Unemployment Benefits, Net	3.2	4.2	2.2	1.7	1.1
As Share of Total Expenditures:					
Pensions, Gross	14.5	14.5	14.9	15.6	15.5
Pensions, Net	7.2	8.2	7.9	7.2	4.9
Unemployment Benefits	5.0	9.5	4.9	4.1	2.8

[a] With an average yearly increase in GDP of 5 percent, the decrease in the pension to GDP ratio by about 1 percent over 1993-96 years allows for constant real individual pensions.

105. The pension system has the potential of creating a *long-term structural problem* in the fiscal accounts. The combination of generous benefit provisions and a shrinking contributory base resulted in 1993 in a deficit of the pension system equivalent to 3.6 percent of GDP and absorbed nearly 7 percent of total budgetary expenditures. And, while there was one pensioner for six contributors in 1980, in 1992 there were only about 3 contributors for each pensioner. To address this imbalance, the Social Insurance Bill introduced a two-tier system consisting of a basic mandatory scheme that provides support as a sum of: (i) a flat-rate component at the minimum level of subsistence and a contribution-related incremental component based on individual records of number of years of contributions, and (ii) optional private insurance schemes. The Bill reversed the reduction in the contributory base through the imposition of a flat contribution on the self-employed, particularly farmers. The law also moves the system towards fiscal sustainability through the introduction of employees' contributions, with the sum of employer and employee contributions rising progressively to 33 percent of the wage by 1996, provisions to raise the effective age of retirement to 60 years for men and 55 years for women, and through the transfer to the budget of merit pensions reserved for preferential categories, such as war veterans and ex-political prisoners for which no contributory history is required. These measures are expected to reduce the deficit of the pension system from the equivalent of 3.4 percent of GDP in 1992 to 0.5 percent by 1996, as required by the base scenario. Should these efforts fall short of the targets, additional measures should be considered, including an increase in the effective retirement age and/or a lengthening of the required contributory period, and possibly a reduction in indexation provisions.

106. *Social Insurance Institute*. To manage these changes, the Social Insurance law has established an autonomous social insurance administration and funding to be effected by the Social Insurance Institute (SII). The functions of the Social Insurance Institute consist mainly of : (i) reviewing contributions and benefit structure in light of social and economic developments; (ii) establishing an autonomous Social

Insurance Fund and gradually building up reserves; and (iii) delivering benefits and collecting contributions through local social insurance agencies and the establishment of a central insurance register for personal identification and eligibility recording. Under the new law, unemployment benefits are still administered and delivered by local labor offices, controlled by the Ministry of Labor and Social Protection. To avoid duplication of work and establish economies of scale and scope, the administration and delivery of unemployment benefits should be transferred to the SII. In most countries, social insurance contributions are collected by the tax administration. Because of the current difficulties in tax administration (see above), the Government has entrusted the SII with the collection of contributions. In the medium term, collection of social insurance contributions should be transferred to the tax administration.

107. *Next Steps in Social Insurance Reform.* These various measures are expected to result in an *effective wage tax rate* of more than 42 percent in 1996. This is fairly high and could induce many enterprises to shed labor or try to evade the tax, which could have an overall negative impact on social insurance revenues. Furthermore, the Government is considering the imposition of an additional wage tax to finance health expenditures. Such a tax, which is not expected to contribute in a major way to the financing of health expenditures, would increase even more the burden on wages in the formal sector and thus could have a negative impact on formal employment and possibly on revenues. Therefore, the impact of these reforms on revenues should be carefully monitored as implementation proceeds, and the current plans re-assessed if necessary.

Better Targeting of Social Assistance

108. The aim of the reforms described above is not only to move social insurance toward actuarial balance, but also to establish a clear distinction between social insurance, where the level of benefits is based on past contributions, and social assistance, where the level of benefits is based on needs. These reforms have to be complemented by a rationalization of social assistance provisions to target the most needy.

109. *Current Social Assistance Provisions.* The current system of social assistance consists of the remaining price subsidies and controls on bread and on a few essential products;[28] a land-based income supplement program based on family size and quality of land; a temporary program of transfers to cushion the impact of the recent increase in bread prices to cost covering levels; and a program of cash transfers for families without other sources of income ("ndihma ekonomika"). The Government is committed to the progressive elimination of the badly targeted and inefficient system of price controls and subsidies that currently represents 8 percent of total budgetary expenditures. This is to be replaced by targeted systems of income support. The transition has to be properly sequenced as the remaining subsidies should not be eliminated before a system of income support is operational.

110. *Ndihma Ekonomika.* Ideally, income support programs should be means tested. This may not be feasible in Albania given the current limited administrative capacity and the lack of data on the rapidly

---

28/ Price controls exist on: energy (electricity, kerosene and firewood), water, medicine, telecommunication, urban transportation, school books, and public housing rents. The prices of sugar beet, wheat, and bread are also controlled, but were raised to cost recovering levels on July 1, 1993.

changing income distribution.[29] The Government has therefore opted for discretionary means testing at the local level. The new Social Assistance Act develops further the "ndihma ekonomika" program through the introduction of a system of block grants bestowed to each local authority at the municipal level according to such parameters as population structure (age and size of family), rate of unemployment, status of health (mainly malnutrition), and the distribution of land. The local authorities are responsible for distributing this aid, following guidelines set by the Ministry of Labor and Social Protection (MOLSP) and the Social Assistance Act. The maximum benefit is currently set at 1410 leks or about US$13 a month for a family of 3. Although the scheme is not limited to the long-term unemployed, it provides the only benefit for which the long-term unemployed can apply when their unemployment benefits expire.

111. This program is still relatively small, amounting to only 3 percent of total budgetary expenditures in 1993 and expected to increase to 5 percent in 1994. It requires a substantial effort of institution building to develop the administrative capacity required at the local level. The authorities have already engaged in substantial activities to develop this capacity and coped reasonably well with the influx in mid-1993 of 150,000 unemployed whose unemployment insurance benefits had expired. In particular, courses to train benefit administrators and social workers were organized by the MOLSP. Nevertheless, the scheme is expected to come under a lot of administrative and financial pressure in the coming years. As the administrative capacity develops further, it is planned to expand the scheme and to merge the land-based income supplement program with it. In the meantime, a serious effort at training and organizing better civil servants is required for the development of the program.

Table 2.8 Expenditure of Various Social Aid Programs, 1992-96

	1992	1993	1994	1995	1996
As percentage of GDP:					
Price subsidies	3.6	2.2	1.8	0.0	0.0
Ndihma ekonomika	0.5	1.2	2.0	2.0	1.6
Other [a]	0.3	2.8	3.1	3.5	2.9
As share of total expenditures:					
Price subsidies	8.2	5.0	4.1	0.0	0.0
Ndihma ekonomika	1.1	2.7	4.5	4.7	4.1
Other [a]	0.7	6.3	7.0	8.3	7.5

[a] Land-based compensation and merit pensions

112. *Next steps in Social Assistance Reform.* It is projected that about 3.5 percent of GDP would be spent in 1996 on social assistance through the central Government budget. In view of the very low income per capita and widespread unemployment, this will not be enough for the financing of poverty alleviation programs on a large scale. Such programs will have to be financed outside the central budgetary process, possibly through resources coming directly from external donors. Proper means testing will remain difficult over the medium term and, to economize the use of scarce administrative resources, poverty alleviation programs should rely as much as possible on self targeting mechanisms. The Government has already developed a pilot project on poverty alleviation in rural areas which consist of micro-credit schemes and of local public works. The program is financed by external donors and has no impact on the central Government budget, with local contributions mainly in kind and coming from the municipalities. While the micro-credit part of the program is not specifically targeted at the poor, the infrastructure component could have an impact on poverty if it were properly targeted through a

29/ One of the main sources of income disparities seems to be access to remittances from family members working abroad.

combination of work and low wages. Furthermore, because the program is administered by villages, it helps foster a sense of social contract, much needed after 45 years of dictatorship. The Government needs to explore further avenues for the development of self-targeted poverty programs. Other countries have used a variety of self targeting techniques; for example, Mexico has located the shops selling subsidized flour in poor areas. There is no fixed recipe for the development of targeting mechanisms, which have to be devised in each country according to its specific social and economic characteristics. Lastly, some mechanisms of poverty monitoring should be established; such as, extending the household survey of living conditions in Tirana to cover the whole country and updating it regularly.

Developing a Public Investment Program

113. The retrenchment in social spending described above is required not only for the fiscal consolidation, but also to make headroom for a badly needed expansion of public investment. Albania's public infrastructure is in such a dilapidated state that it constitutes a major obstacle to private sector development and to foreign direct investment. In the absence of roads or a functioning irrigation network, price liberalization in agriculture will not have much impact on supply. Without reliable provision of electricity and water, the prospects for developing manufacturing look bleak. Public investment fell to 4.3 percent of GDP in 1992 and, despite an increase to 5.1 percent of GDP in 1993, the level remains too low. To start the much needed rebuilding of infrastructure, levels of public investment of about 9 percent of GDP on average would be necessary over the next few years, provided that the institutional capability required to run an expanded public investment program can be developed.

114. *The new nature of public investment.* This higher level of spending has to be accompanied by fundamental changes in the nature of public investment. In the late 1980s, 75 percent of public investment was allocated to the industrial and agricultural sectors, reflecting the dominant role of the state in the economy. There was virtually no private sector investment. In the future, investment in commercial enterprises will be undertaken primarily by the private sector. The function of the public investment program will be to support the Government role as a provider of basic services such as health and education, key utilities such as power and water supply; infrastructure, covering roads, railways, telecommunications, and urban and rural infrastructure; and such services as research, extension, and market development aimed at assisting the development of the private sector.

115. Furthermore, the provision of public services and infrastructure should support the small-scale sector. For instance, developing an irrigation network for small farmers should have priority over investing in a state-of-the art network of telecommunications. Such a public investment strategy would also have a more favorable impact on income distribution. Experience in many countries has shown that growth based on efficient small-scale agricultural development is more likely to reduce poverty than growth based on a capital intensive industrial strategy.[30]

116. Particular efforts are required to rebuild the *health and education* infrastructure. Before the upheaval of 1991-92, Albania had established a health service system whose reach and performance were unusually high for a country at its stage of economic development. On the other hand, the health system

---

30/ For example, Brazil's average per capita income tripled between 1960 and 1980 and a third of the population moved out of poverty. Indonesia's average per capita income, over a comparable period (1971-87), grew by less than half that of Brazil, but the poverty reduction achieved was greater (over 40 percent). Moreover, Indonesia is now growing much faster than Brazil.

did not escape the distortions that marked the rest of the Albanian economy. The hospital network was overextended to a point where critical economies of scale broke down, local drug production was inefficient, and the country's isolation resulted in out-of-date technology. During the crisis of 1991-92, the already fragile stock of outdated and poorly maintained medical equipment fell into near total disrepair. Modernizing the health system will require large investments in rehabilitation and re-equipment as well as a reorganization of the sector. The Government is in the process of preparing a reform program to restructure the health system to improve its cost effectiveness and to rehabilitate and upgrade existing facilities. It is actively seeking support from the international community to finance this program.

117. Prior to the 1991-92 crisis, Albania's education system enjoyed the expansive network and virtually universal basic education coverage typical of other European centrally planned economies. Primary education was universal and schooling coverage for 14 to 17 years old was 70 percent in urban areas. However, during the turmoil of 1991-92, about one-third of school facilities was badly damaged. The unusable facilities, combined with the lack of relevance of the curriculum to the new economic situation, the loss of teachers, and the disruption in the provision of textbooks, have led to a sharp drop in levels of enrollment. Rehabilitation of schools and textbooks to minimal standards is a high priority, as is developing a new curriculum. The Government has prepared a sectoral investment plan and is actively looking for donor support.

118. The 1993 public investment budget marked a sharp break with past practices: investment allocated to the directly productive sectors--agriculture and industry--represented only 18 percent of the total. Furthermore, more than half of that investment is for the rehabilitation and completion of irrigation infrastructure. About three-quarters of public investment was allocated to infrastructure, mainly in transport and communications and energy. However, the public investment planning process is still under the strong influence of the procedures that applied under central planning. Line ministries' requests against the last three annual budgets were several times the available resources, emphasizing the need to introduce a ceiling-based budget process. Budget formats, by failing to identify individual investment projects, lack transparency and do not show anticipated trends in financing that would allow ministries to plan their programs more effectively.

119. *The establishment of control and management procedures*. To establish effective mechanisms for the control and management of public investment, the Government has prepared a three-year Public Investment Program (PIP) for the 1994-96 period. The PIP exercise comprises the definition of sector strategies, the establishment of procedures, and a comprehensive listing of projects and project profiles. The strategies identify the role and functions of the Government in each sector of the economy, the programs necessary to carry out these functions, and the main investment priorities to support these programs. To the extent possible, the strategies have relied on existing sectoral studies. In view of the limited administrative capacity, the project profiles include significant technical assistance components. Projects and sectoral strategies should be further developed to include project specifications and technical assistance priorities in each sector.

120. A key reform in the establishment of better investment management procedures will be the introduction of *resource ceilings* for the line ministries. These should be set at the beginning of the budget cycle in order to provide a realistic framework within which ministries can prepare their budget requests and thereby reduce arbitrary cutbacks in the later stages of budget preparation. For the investment budget, the ceilings should be based on the financial resource framework set for the PIP, while for the recurrent budget, they should reflect the findings of the sector policy and program review

exercises regarding the appropriate role of the Government in the sector concerned. As much as possible, the investment program should be integrated into three-year budgetary projections. Furthermore, the newly developed budget format, which identifies individual projects and distinguishes between investment and recurrent expenditures, should be implemented as soon as possible. Coordination and management of the PIP will be the responsibility of a new Government department that needs to work closely with the Ministry of Finance regarding financing of the program. Furthermore, the establishment of such practices will require, both in the MoF and in the line ministries, a reorganization of the ministries as well as the individual training of the civil servants involved in the exercise.

Table 2.9: Composition of 1993 Public Investment Program

	Percent of Investment	Percent of GDP
Agriculture	13.3	0.8
Industry and mining	4.4	0.3
Energy	19.4	1.2
Construction, housing and water supply	21.6	1.3
Transport and communication	29.2	1.7
Health	6.0	0.4
Education	2.1	0.1
State institutions	4.0	0.2
TOTAL	100.0	6.0

121. The line ministries will be specifically responsible for the preparation of *project profiles*. Currently, these are descriptions of project areas without sufficient detail. They should be developed further to include an evaluation of the project by cost-benefit analysis or another appropriate technique summary details including cost, duration, starting date, geographical coverage and funding status, as well as a brief description of the project itself. The description should list the main project objectives, provide some background and rationale, present the main components, assess the likely project impact, include an updated status of implementation, and refer to the existing documentation. Such profiles should be first established on individual cards that would be regularly updated. Once these manual procedures are well functioning, computerized links with budget and foreign aid data bases could be envisaged.

122. The Public Investment Program will provide a comprehensive listing of all the investment projects the Government intends to finance together with their financing sources. Investment in state enterprises that are providers of services in sectors such as urban infrastructure and utilities are included in the PIP. Budgetary support to enterprises not involved in the provision of public services will be limited to enterprises under the Enterprise Restructuring Agency (see next chapter), restricted to the budgetary envelope set aside for that purpose, and channelled exclusively through the ERA.[31] Once the PIP becomes operational, no project will receive funding allocation from the investment budget until it has first been included in the PIP.

123. Although the primary objective of the PIP is not *aid coordination*, its implementation will largely depend on foreign aid sources. A resource framework has been established which will involve an assessment of external financing available. This resource framework has to be closely monitored and updated regularly to remain useful. To that effect, a database needs to be developed to track progress in securing external financing for each investment project and related technical assistance. This should be linked to the efforts to produce a comprehensive database on aid. As the composition of aid is starting to shift from emergency assistance to investment projects, it is crucial that the PIP be developed further as soon as possible.

31/ Subsidies to public enterprises selling goods at a controlled price (see paragraph 66) may take place during a transitory period.

124. Some of the projects included in the 1994 investment budget are not included in the PIP. Furthermore, work on the institutional development of the PIP was delayed in early 1994, because of uncertainty regarding its administrative *location*. This was recently resolved by creating a new Government department for PIP and aid coordination. Unless carefully managed, this decision could have very adverse consequences for both the budget and the PIP since investment expenditures, directly or through operations and maintenance, represent one-third of total budgetary expenditures. Preparation and implementation of the budget and of the PIP cannot be disassociated, and it is therefore crucial that the new department and the Ministry of Finance cooperate closely and that proper procedures, which ensure compatibility with progress in the control of public expenditures, are established.

Reforming the Civil Service

125. The structural changes recommended in this section will require a strong effort of capacity building in the Government. Following the elections of March 1992, a decision was taken to reduce the number of ministries in order to cut down their cost and improve their efficiency. Many ministries were merged and their functions have changed dramatically over the past year. The mandates of many ministries are not clear, with inadequate mechanisms in place for policy formulation and coordination on vital reform issues. Civil servants have yet to be trained in the objectives of their ministry and in their own role. The Government needs to step up its efforts in the organization and management of the civil service, the coordination of economic policy, and in the provision of incentives to retain high caliber civil servants.

126. *Civil Service Management*. A general review of the role and organization of each ministry has already started. This review has so far concentrated on the former Ministry of Finance and Economy and the former Ministry of Trade and Foreign Economic Relations, and has made specific recommendations on organization, staffing and training. Following its recommendations, a new Ministry of Finance and a new Ministry of Industry and Trade have been created. This review will be extended to other ministries. In addition to specific reviews of ministries, general management practices need to be assessed. Basic management routines--particularly communication--have to be strengthened. Moreover, in the past, much of the work was executive and administrative in nature. With the shift in Ministry focus from an executive body towards becoming an enabling institution, different management skills are now required. Project management skills to help managers set clearer objectives with their staff have to be developed. The Government needs to mobilize external assistance to set up a training center for civil servants.

127. *Coordination of Economic Policy*. The Ministry of Finance has had the lead responsibility for economic policy analysis and developing economic policy objectives, including macroeconomic analysis and forecasting, determining economic policies and strategies, and coordinating and evaluating sector policies and strategies. Nevertheless, economic policy at the highest level is a collective responsibility of the Council of Ministers (COM). Over the past year, some coordination problems between the MoF and the line ministries have appeared, caused largely by the absence of formal mechanisms for the exercise of that collective responsibility. To remedy these problems, a new investment agency, reporting directly to the COM, is being created. Furthermore, an economic group of the COM, chaired by a Deputy Prime Minister in charge of economic reforms, has been established. The role of the Deputy Prime Minister is to coordinate and energize the reform process across ministries. At present, the exact role and competency of the investment agency vis-a-vis the MoF and the line ministries is being determined. To ensure consistency with the overall economic development objectives, it is essential that these roles are clarified and formal mechanisms for coordinations are developed as soon as possible.

Furthermore, the new agency will need to be staffed quickly and in accordance with the functions it has to carry out.

128. *Civil Service Pay Scale and Special Incentives*. The improvements in motivation and incentives that can be expected from the above reforms will not be enough to keep high caliber individuals in the civil service unless the issue of the pay scale is also addressed. Civil service pay is now far out of line with private sector salaries and has serious detrimental consequences for the recruitment and retention of qualified staff. As the private sector grows, and, with it, demand for qualified staff, these problems will become even more acute. A long-run solution to these problems involves focussing public sector activities on core programs, cutting back on non essential ones, and promoting a lean and efficient civil service. In the meantime, the Government should take the following measures: (i) review staffing levels for further reduction in order to release funds for pay increases; (ii) decompress further the current salary scale to reflect the pay differentials existing in the private sector; (iii) develop training programs and ensure that staff benefiting from them will remain in the civil service for an agreed period; (iv) give the Council of Ministers a new discretionary incentive fund of 2 to 3 percent of the total salary bill to distribute to the 300 best performing senior civil servants in the form of a year-end bonus payment. The office of the Deputy Prime Minister of Economic Affairs should prepare the proposals which should then be endorsed by the Council of Ministers. The 1994 budget includes a provision for selective increases for key civil servants. A long-run solution to the incentive problems in the civil service will, however, require a review of staffing levels and functions.

CHAPTER III. DISENGAGING THE STATE FROM DIRECTLY PRODUCTIVE ACTIVITIES

A. Introduction

129. The Albanian enterprise sector found itself in a deep crisis after the demise of the previous economic and political regime in 1992. Outdated technology, limited market knowledge, overstaffing, and a chaotic ownership and incentive framework made it impossible for state-owned enterprises (SOEs) to make a quick adjustment to new products or markets. Many SOEs have stopped operation altogether or are operating far below capacity. The result has been a sharp decline in industrial production of a magnitude not seen elsewhere in Eastern and Central Europe, from 42 percent of GDP in 1990 to 14 percent of GDP in 1993. With the collapse of much of the industrial sector, virtually all assets of the state banks were wiped out. Concurrent with the decline of industrial production, has been the rapid growth in agriculture; this followed the early successful privatization of all agricultural land, one of the main determinants of the impressive supply response in 1993. Furthermore, small-scale private activities have grown rapidly in retail trade, handicrafts, construction, and services. In effect, Albania is undergoing a very rapid de-industrialization.

130. The challenge that the Government now faces is to manage the consequences of the decline in industrial production by disengaging itself from the obsolete and inefficient state enterprise and banking sectors in a manner consistent with the objectives of the fiscal consolidation described in the previous chapter. The fastest and most efficient way to achieve this objective is privatization. Transferring scarce capital resources to the private sector will not only help ensure that banks and firms are run on a commercial basis, but also remove the prospect of future public liabilities arising from the operations of loss-making state banks and public enterprises. Prospects for immediate privatization are, however, dim for some state enterprises and the state banks which are in such a weak state that running them profitably on a commercial basis would require a complex and costly restructuring.[32] Under such circumstances, many private investors may prefer to start up entirely new concerns rather than to purchase an already existing enterprise or bank with uncertain prospects of returning to viability.

131. Immediate closure of some of the enterprises that cannot be privatized and of the state banks is, however, not an option for the Government. The enterprises least likely to be privatized are also most likely to be sizeable. Immediate closure would have a sizeable impact on employment, and therefore is not politically feasible in view of the high current levels of unemployment (18 percent of the population). State banks cannot be closed either; a minimum provision of financial services is required for the development of Albania and no private banks presently exist that could provide such services. A hands-off policy is no more an option than outright closure. Left on their own, large loss makers and banks are unlikely to carry out the required restructuring and would end up wasting more resources. Lacking the necessary expertise, financial resources, and an appropriate incentive framework, they would probably continue to accumulate further losses which would, sooner or later, translate into budgetary outlays.

132. To promote an orderly disengagement of the state from directly productive activities, some form of temporary public intervention is in order. The two guiding principles for this intervention should be to: (i) promote private sector entry, and (ii) contain the cost of public intervention within the framework of the adjustment program. This requires that reform in the banking and state enterprise sectors be tackled simultaneously. Promoting private sector development requires not only an active privatization

---

32/ Such a restructuring is already under way in the Agricultural Bank, financed under the Agricultural Adjustment Sectoral Loan of the World Bank (see chapter IV).

policy, but also the development of a viable system of financial intermediation. A necessary condition for the development of a viable financial system is to shelter banks from pressure to lend to loss makers. This in turn requires the privatization of the state enterprise sector, as well as the establishment of mechanisms to prevent arm-twisting of the banks. At the same time, to remain within the overall framework of fiscal consolidation, it is necessary to place a fixed and declining limit on public transfers to banks and enterprises. This requires not only that a clear and explicit limit be placed on budgetary subsidies to enterprises, but also that banks be sheltered from political pressure since, sooner or later, bad loans through state banks necessarily translate into a budgetary funded recapitalization.

Box 3.1: The Albanian State Enterprise Sector

- In late 1993, about 1,500 SOEs were registered--a large share was not operating--in all sectors of the economy, but the industrial sector was the most prominent. In 1990, industry accounted for approximately 45 percent of Net Material Product, absorbed 42 percent of gross investment, and provided employment for about 23 percent of the working population. Manufacturing constitutes the largest part of the overall industrial sector, with nearly 80 percent of total industrial production in 1990. Manufacturing is divided between light and food industries, 50 percent of industrial production in 1990, and heavy industries, 30 percent of industrial production in 1990, which were mainly producing spare parts for the existing industrial equipment. Much of the rest of the industrial sector consisted of the mining sector, based on the export of chromium, copper, and nickel ore.

- Until 1991, central Government ministries exercised detailed control over all activities of their respective SOEs, which were basically production units with little or no independent responsibility for many basic enterprise functions, and with domestic centrally determined transfer prices that had no relationship to world market prices. State enterprises have now become legally autonomous entities but, in practice, often turn to the line ministries for technical and financial support. Following several recent reorganizations, the principal responsibility for the industrial sector is now vested unambiguously with the Ministry of Industry, Energy and Mining, but construction enterprises are under the Ministry of Construction, and agro-industrial SOEs under the Ministry of Agriculture. Other ministries, such as Transport and Trade and International Economic Relations, also have SOEs under their authority.

- Starting from a very small base, Albania experienced rapid industrial growth until about 1980. Between 1950 and 1975, in response to high rates of investment, total industrial output grew rapidly although the quality and real value of industrial products was never put to an international market test. During the past decade, growth decelerated substantially as a result of the closing of the economy and the cessation of all external assistance after 1978. During the 1980s, industrial production grew at less than 3 percent per year. It fell by 7.5 percent in 1990, and by 40 percent in 1991 and 1992. In most industrial sub-sectors, output is now at a fraction of pre-1990 levels. A large number of factories have closed altogether or operate sporadically; more than half of the state-owned enterprise (SOE) labor force has been dismissed.

- This sharp decline (of a magnitude not observed elsewhere in former socialist economies) is the result of a number of factors linked to the total collapse of the extreme brand of central planning of the previous regime. Until 1991, all prices were set centrally, with minimal change between five-year plan periods. All productive assets were owned by the state; production was controlled through large SOEs. Each SOE reported to a sector ministry, which exercised control over investments, production levels, direction of trade, and utilization of surpluses. SOE managers functioned inside a bureaucratic machinery, so that most of them have little relevant experience when it comes to managing autonomous enterprises in a competitive environment. The system also led to much inappropriate investment, endemic overmanning, and the use of old-fashioned technologies.

Box 3.2: Recent Developments In the Financial Sector

- Over the past three years, the banking system has evolved from a mono-bank system, where the State Bank of Albania undertook all central and commercial banking operations, to a two-tier system. Now, central banking functions are handled by the Bank of Albania (BoA), and there are three specialized commercial banks -- the Savings Bank (SB), the Bank for Agriculture and Development (BAD), and the National Commercial Bank (NCB), all of them Government-owned. The Savings Bank is mainly engaged in deposit taking. Although it has increased lending significantly in the last year, most of its lending portfolio consists of advances to NCB and BoA. The National Commercial Bank lends to all commercial enterprises. Its liabilities consist mainly of loans from SB and BoA and of state enterprises' deposits. In September 1993, the Bank for Agricultural Development was liquidated, its deposits and good assets transferred to a new bank, the Rural Commercial Bank (RCB), that is to specialize in lending to the agricultural and rural enterprise sector and is currently undergoing an extensive program of technical assistance (see Chapter IV).

- Agreements have been reached on two joint venture banks, both partners of NCB, to enter Albania. The Italian-Albanian Bank, a joint venture with the Banco di Roma, has recently started operations on a relatively small scale. It focuses primarily on providing services such as letters of credit and payments transfers, and on lending to export-oriented entities. The Islamic-Albanian Development Bank is expected to begin operations in the near future. Finally, the Dardanian Bank, a foreign state-owned bank, is establishing a branch in Albania, initially specializing in handling remittances from Albanians living in Kosovo.

- Since mid-1992, banks have been instructed to begin lending only on strictly commercial criteria, and at their own risk. In early 1993, when inter-enterprise arrears accelerated, in large part due to the difficulty of obtaining bank credit, the Government acted decisively to put a stop to the practice of using payment orders insufficiently backed by funds as a way for enterprises to get credit. However, the Government extended public guarantees on bank loans to several state enterprises and agencies during the last half of 1993. As a result, banks continued to extend loans to non-viable public and private enterprises. This practice put in jeopardy the whole program of fiscal adjustment, as well as the institutional build-up of the banking sector. In April 1994, the Government stopped this practice by issuing a decree prohibiting the extension of Government credit guarantees on any loans made by domestic banks.

- The system of interest rates, which were highly negative in real terms in 1992, was also reformed. Floors were instituted on deposit rates which made them positive in real terms, and guidance is provided on lending rates. In view of sharply lowered inflation rates in 1993, rates were lowered by about 4 percent across the board in June 1993. More importantly, the Government intends to review and revise rates on a bi-monthly basis--banks are inadequately equipped to recalculate rates on loans any faster than that.

- The reform agenda will pose a major challenge to the limited implementation resources available to the Government. In order to help coordinate all of the work being done, the Government has recently established a *Committee for the Modernization of the Financial Sector*. The Committee is composed of senior staff members from the BoA and the MoF, and will be assisted by a full-time external advisor. A series of working groups will be established on the various functional aspects of the committee's responsibilities, including through the incorporation of working groups that are already operational. The Committee's mandate is to agree upon and implement an action plan to: (i) allow the entry of private financial intermediaries; (ii) improve the governance of existing state banks; (iii) develop modern banking expertise and infrastructure; and (iv) develop a regulatory and supervisory framework.

133. Public intervention is limited by the weak administrative capacity and the limited financial resources available to the Government. Privatization and restructuring efforts cannot be separately undertaken for each of the more than 1,200 remaining state enterprises. Although there are only three state banks, building a commercial banking expertise and capacity up from scratch is likely to be a very costly and lengthy exercise. Scarce administrative and financial resources need to be concentrated where they will have the biggest impact and, as much as possible, to be supplemented by private expertise. This is an additional reason for placing the emphasis of the reform program on rapid privatization of SOEs and promotion of private initiative in the banking sector. Over the longer run, banks could take an active

role in the restructuring of state enterprises as is being done by some banks in the Czech Republic and in Poland. This is not currently within the reach of the banks, but as financial sector reform proceeds, the accumulated expertise should be tapped to complement the efforts of the Government.

B. Downsizing the State Enterprise Sector through Privatization and Restructuring

Introduction

134. The strategy for the enterprise sector is to ensure the orderly liquidation of public loss makers, coupled with quick privatization of viable assets and enterprises. This involves making clear and explicit which of the remaining state-owned enterprises (SOEs) will be publicly funded, specifying why and for what period of time. Although explicit budgetary subsidies to state enterprises have stopped since mid-1992, SOEs have continued to receive transfers in the forms of non-transparent budgetary funding, through arm-twisting of the state banks and, until recently, public guarantees on bank loans. Access to public resources should, however, be determined by the privatization prospects of enterprises, as well as by their social and strategic importance, and it is important that such access takes place through explicit budgetary transfers. By providing explicit budgetary subsidies to large loss makers of social importance and not applying any pressure on the banks on behalf of any enterprises, the state-owned banks would be able to operate on the basis of commercial, market-oriented criteria, lending only to those it found creditworthy. In this way, more credit is likely to reach viable private opportunities. Furthermore, the process of continuing to publicly finance SOEs would be subjected to an overall budget constraint. "Leakages" through *forced* loss-making lending to SOEs by the banking sector, which later return as a quasi-fiscal deficit, would be substantially reduced.

135. As mentioned above, privatization is the most efficient way to manage the consequences of the de-industrialization. Speed rather than revenue, except for a few specific enterprises, is therefore the main concern of the Government. Aside from the quick privatization of agricultural land, the privatization of small-scale units (with up to ten employees) has been highly successful, with virtually all units privatized by the end of 1993 (see box 3.3). In May 1993, the Government adopted Decree 248, which established procedures intended to speedily privatize small- and medium-scale enterprises, covering firms with less than 300 employees and/or US$500,000 in book value (see below). Much progress has been achieved, with more than 950 of the approximately 1,200 enterprises privatized to date.

136. Following these successes, the Government has now turned its attention to developing a general privatization program for the remaining SOEs and devising a funding strategy for different categories of enterprises, based on their privatization prospects and their social and strategic importance. Some large loss makers, however, are not likely to be privatized soon, nor are they likely to be closed down immediately. Other enterprises, such as the main utilities, will remain in the state sector over the medium term since these services cannot be provided by the private sector in the near future. For those enterprises that will remain in the public domain, the Government is establishing clear rules to govern their access to budgetary and banking resources. The main purpose of such rules would be to protect both the banking system and the budget by making transfers to socially important enterprises explicit and by keeping them within a finite budgetary envelope. Finally, the Government intends to review the restitution law, adopted in April 1993, with the aim to assess its implication for rapid privatization.

Box 3.3: First Achievements in Privatization

- The privatization process was undertaken at the beginning of 1991, with the establishment of two institutions responsible for the restructuring and privatization of SOEs. These are the Preparatory Commission for the Process of Privatization (PCPP), an inter-ministerial body responsible primarily for the preparation of the privatization cases, and the National Agency for Privatization (NAP), a separate agency under the Council of Ministers which was given regulatory and administrative functions, including the approval of privatization transactions, a somehow unclear division of labor. Both PCPP and NAP established local branch offices in each of Albania's 28 (now 37) districts. In mid-1993, in order to strengthen NAP as the Government's main privatization authority, the Government put in place a high-level governing Board to provide policy coordination with other ministries, and also to give more coherent policy backing for NAP initiatives. NAP's Board members are appointed by the Prime Minister and the Board is chaired by the Deputy Prime Minister. In the future, the PCPP is to be merged into the NAP which will further strengthen the privatization authority and make the best use of scarce administrative resources.

- Privatization of small-scale units with up to ten employees has been a large success, with virtually all small-scale units, primarily in the fields of retail trade, services, and handicrafts, privatized by the end of 1993. The main element in the success of this privatization has been its rapidity; the vitality and growth, particularly of the retail/commercial sector, has been highly visible in Tirana and other major cities. Most of these units were initially sold to the employees at book value, which was often a fraction of market value. To counteract rising resentment against the beneficiaries, the book value was upwardly adjusted by inflation in mid-1993 and NAP placed increased reliance on auctions, particularly for the more attractive assets.

Privatization and Funding Strategy

137. From the point of view of privatization regime, importance to the Government and hence funding regime, Albanian state enterprises (SOEs) can be classified into three major groups. These are: (i) SOEs likely to remain state owned in the long term and SOEs with high privatization revenue potential such as in the oil and gas, and mining sectors; (ii) large loss makers of strategic or social importance to the Government; and (iii) all other SOEs. For each group a privatization and funding strategy has to be implemented.

138. *Group (i) – Long-term SOEs and SOEs with high privatization revenue potential.* This group of enterprises include utilities such as the electricity company, the local water supply companies, and natural monopolies, for instance, railways and telecommunications. These companies are likely to remain *in the public domain* over the medium term and the Government is seeking support from external donors to prepare restructuring and rehabilitation plans, as well as general guidelines for their operation. Of particular importance will be the establishment of rules governing the relations between the budget, the banks, and the utilities. Furthermore, financial viability will require sufficient internal resource generation through appropriate pricing policies.

139. Other enterprises in group (i) include SOEs in the oil and gas, and mining sectors (some 60-70 SOEs). This group should contain only *core strategic SOEs*. For example, the Albpetrol "family" of SOEs contains everything from drilling and exploration, to pipelines to enterprises producing equipment used in drilling (see chapter IV). "Non-core" SOEs in this group have been reclassified into group (iii) SOEs and will be privatized separately. Enterprises in this group have a high privatization revenue potential and since they stand the best chance of attracting foreign investors, they will need a traditional, "case-by-case" approach to privatization. The first success is likely to be achieved with Albchrome, the chromium company for which the Government, with assistance from EBRD, is currently negotiating with

a foreign joint venture partner. The Government needs to ensure that the National Agency for Privatization (NAP) has the appropriate policies in place to permit this to happen for the remaining strategic SOEs. Furthermore, it should rely on foreign technical assistance to finance the requisite valuations, strategic work, preparation of prospectuses, and other related "investment banking" activities.

Box 3.4: Inter-Enterprise Arrears

- In 1992, in conjunction with the deep decline in production, the rise in wage costs and the elimination of budgetary subsidies and automatic credit extension from the banking system, many enterprises resorted to financing their activities through inter-enterprise arrears. These arrears accumulated in the banking system as invoices for which there were no funds that were accepted by the banks. In turn, the banks decided which invoices to pay as funds were coming into the account of an SOE. By December 1992, the amount of arrears--including tax arrears--had reached approximately (on a gross basis) lek 18 billion, or some 20 percent of GDP.

- The Government in early 1993 instructed banks to change the payment mechanism by replacing receivable invoices with payment orders and to return to the SOEs the payment orders for which insufficient funds would be available for payment. It also made compulsory payment of interest on outstanding balances, on terms equivalent to commercial bank credit, thereby eliminating an incentive for its overuse. In addition, enterprises that have not serviced their commercial obligations for over 3 months were to be barred from further deliveries as long as they remained in arrears. In practice utilities--particularly the electricity company--have found it difficult to follow the last instruction, especially when the debtor in arrears was a large state enterprise.

- The Government also proceeded to "unclog" the payments system by transferring to two blocked accounts all outstanding receivables and payables. It subsequently decided to allocate some lek 1.7 billion (1.7 percent of GDP) for a clearing exercise. All net outstanding claims were first netted against outstanding arrears to the budget. All net creditors were then compensated, with the smaller enterprises usually repaid on most of their outstanding claims while the large net creditors received less than 20 percent of their outstanding balance.

- These measures have contributed to some normalization of the transaction and payments systems. The changes to the rules on commercial credit should also provide incentives against further abuses. On the other hand, the arrears clearing exercise has established a precedent of the Government bailing out state enterprises through the budget and through a net drawing of resources from the largest net creditors, i.e., the enterprises most likely to be viable. There is already some evidence that inter-enterprise arrears have started to accumulate again outside of the banking system. It is thus important that the Government establish its credibility by refusing to condone a further emergence of tax arrears and that it prepare a program for clearing the remaining arrears.

140. Enterprises in group (i) should be financially solvent. They should therefore be entitled to have *access to credit* from domestic banks. Because they are likely to be politically powerful, these enterprises should only be allowed to have access to credit from domestic public banks in a carefully monitored manner. They could, in the context of the PIP, receive funding for investment. To the extent that output prices for some of these enterprises are set administratively below cost, selected utilities may receive operating subsidies from the budget. Guidelines clarifying their relations with the budget and the banks should be issued in the context of restructuring and rehabilitation plans.

141. *Group (ii) -- Large loss makers of social importance.* This group should contain all the socially sensitive loss makers. So far 32 such enterprises have been identified by the Government but more may have to be added, for instance SOEs in arrears to the banks. Such enterprises are being taken care of under a special agency, the Enterprise Restructuring Agency (ERA, see below) which is in charge of their

privatization or liquidation. To avoid duplication of efforts in *privatization*, ERA will draw on NAP as needed. NAP will sign off on final privatization transactions.

142. Group (ii) enterprises *will not have access to the banking system* but will receive *budgetary subsidies* through a special, earmarked envelope. The rationale is that if large loss makers cannot be closed or privatized, they should receive resources in a transparent manner through outright budgetary subsidies. As long as loss makers remain in operation, by definition they have to rely on a resource transfer from either the budget through outright subsidies, the banking system through loans granted on lenient terms, or other enterprises through the accumulation of arrears. The granting of soft loans by state banks is akin to a budgetary subsidy since it will translate into a non-performing portfolio and eventually into a budget-financed recapitalization of the banks. In the process, the integrity of the banks' balance sheets and of their lending practices will be seriously affected. The accumulation of inter-enterprise arrears is no more conducive to an orderly restructuring of the state sector (see box 3.4): in effect, resources are transferred from net creditor enterprises, which are also likely to be the ones with better viability prospects, to enterprises with poor viability prospects. Furthermore, since net creditors are state owned, the extension of credits that cannot be recovered to loss makers will eventually translate into lower budgetary revenues.

143. The *Enterprise Restructuring Agency* (ERA) has been set up to allocate the funds set aside for group (ii) enterprises. For SOEs that it decides should be closed, ERA resources could be used, inter alia, to pay workers until the plant is finally shut down. Alternatively, these payments could be made in a lump sum, in the form of severance payments. Furthermore, ERA resources could be used to cover the cost of physically dismantling SOEs that are liquidated. For SOEs which have some privatization prospects, the decision of what to finance is more difficult. High return expenditures, such as on maintenance and repairs, may be justified in some cases. In addition, ERA might consider financing investments; but this would be on a very limited scale, and only in the context of facilitating privatization of the SOE, (in the form of the SOE's contribution to a joint venture, for example). Such ERA contributions to SOEs should probably be in the form of low interest bearing loans. Foreign-financed technical assistance is being used to prepare restructuring plans.

144. To ensure success of ERA, it is also crucial that it include all SOEs for whom financial support will need to be justified on a political basis. In order to maintain credibility of the privatization process, SOEs should *not*, in the future, have the option to transfer into ERA, except in exceptional circumstances. To add credibility to the list of SOEs in ERA, the Bank of Albania and the National Commercial Bank (NCB) should be consulted to propose candidates--since in the future any SOEs determined not creditworthy by NCB would be denied credit.

145. Most importantly, ERA should be subject to a *sunset provision*: it should close down within three to five years of the beginning of its activities. This sunset provision will ensure that a finite limit is placed on budgetary transfers to SOEs and therefore that a hard budget constraint be imposed on group (ii) enterprises. To leave ERA, SOEs will either have to be privatized or liquidated. SOEs that will not have been privatized by the time ERA winds down its activities will be liquidated.

146. *Group (iii) -- all other SOEs*. About 85 percent of these are covered by Decree 248 passed in May 1993 by the Council of Ministers. This decree established procedures intended to speedily privatize approximately 1,200 small- and medium-sized enterprises--firms of less than 300 employees or less than US$500,000 in book value--and introduced auction as the main technique for *privatization*. Keeping in mind the limited institutional capacity, the auctions were decentralized to the local level. District

branches of NAP make decisions regarding the auctions and run them. To maintain a balance in decision-making, the Boards of NAP branches comprise (at least in most cases) 21 individuals, representing a broad spectrum of elected and appointed officials from several political parties. The local boards have, however, the power to exempt units from auction procedures, to exclude any bidder, and to request business plans. Moreover, Decree 248 establishes a system of coefficients that favors workers' collectives. Such privatization support to workers is widespread in Eastern Europe but care must be taken that it does not generate conflict with the laws on privatization and foreign investment.

147. Recent data show that of the cases of privatization under Decree 248, only about 5 percent was sold by auction. Of the remaining cases, about 65 percent was sold to employees, while about 35 percent was sold by exemption, either due to restitution claims or to a single qualified interested party. Most sales were made at, or about, book value. However, despite its flaws, *Decree 248* has moved the privatization process forward: so far, about 750 enterprises have been privatized. Continued rapid privatization is complicated by the extension of the filing period for restitution claims (see below). It is important that the Government maintains the momentum of privatization by addressing the restitution issues through the measures proposed below and by updating the list of enterprises to be privatized under the decree. Many "large enterprises" now fall under the 300 employees threshold and could be disposed of quickly under Decree 248.

148. While an *auction* remains the most transparent way of privatizing, its outcome necessarily reflects current wealth endowments. As in most other post-communist societies, wealth endowment following market reform reflects the results of the past non-market driven accumulation process. It is therefore understandable that the population supports mechanisms such as those of Decree 248, with the intention of putting limits on the benefits that the new market brings to the heirs of the old order. It is, however, important that the privatization process remain transparent, in order to establish its legitimacy and build a social consensus on private ownership. A deferred payment scheme for auctioned assets under which individuals would be able to pay the Government over a period of years, at a very low interest, could constitute a transparent privatization mechanism, one not based on initial endowment of wealth. Equity shares in the privatized companies would be withheld by the Government in an escrow account pro-rata actual payments. Such a scheme would have the added advantage of speeding up privatization by providing additional resources to the most entrepreneurial members of society.

149. *SOEs larger than 300 employees or than US$500,000 in book value* that do not fit in groups (i) and (ii) number about 200. Many of these today have shrunk to fewer than 300 employees and should be reclassified as small SOEs and dealt with under Decree 248 as well. Once it is known how many SOEs still qualify as large, appropriate methods can be devised to privatize them. As with Decree 248, the main emphasis ought to be on speed of transferring the SOE into private hands so that steps to revitalize/rationalize the enterprise can be implemented as early as possible, before assets are lost or fall into further disrepair. Therefore, any scheme that is devised needs to be simple and able to be implemented rapidly. It should be developed keeping in mind that in the majority of cases the only real interest in buying these SOEs is likely to be shown by the SOEs managers and employees. Auctions, without a reserve price, with or without vouchers, and which give a certain discount to employees and managers, are likely to be the speediest method here.

150. Neither large nor small group iii SOEs should receive *any* budget financing. *Outside financing* may be provided by banks, should they find these SOEs creditworthy. No political pressure on banks should be exercised on behalf of these SOEs. In this way, these SOEs would be moved to privatize in order to survive, or be liquidated.

Restitution

151. In April 1993, the Parliament of Albania adopted the Law on Restitution and Compensation that awards ownership of non-agricultural land[33] to ex-owners who can prove their claims. Under the law, the ex-owner also has the right to purchase the buildings sitting on the property to be restituted at book value. If these buildings have already been privatized, the law creates co-ownership between ex-owner and new owner. Under this co-ownership of buildings, the new owner leases the buildings for two years from the ex-owner at a rate determined by the legislation, after which they must strike their own commercial arrangement. This provision applies in particular to the retail units already privatized under the small-scale privatization program. According to the law, ex-owners are given six months to register their claims. The law also provides for an extension beyond six months, where there are "justifiable" reasons that the ex-owner was not aware of his or her rights. As a result, the deadline for filing claims has been extended twice and is now set for end August 1994.

152. Although restitution is one of many possible ways of transferring public assets to the private sector, it is possible that the Law will result in a number of problems. First, there is a danger that the law could result in the reversal of some privatizations, which would be unfortunate since uncertainty as to ownership of land could hinder development of a real estate market, and delay investment. Second, although the implementation regulations stipulate that after six months ex-owners will only be entitled to compensation,[34] they leave open the possibility of restitutions beyond six months for "justifiable" reasons. This complicates the above issue further. Most importantly, the complexity of the law, the inadequacy of the land title and registry system, the imprecision of Albania's inheritance laws, and the lack of administrative resources and trained judges could mean that, based on present regulations, the restitution process could take years.

153. There is still much that could be done to limit the potential adverse economic impact of the current legislative framework and the Government intends to review its functioning. The question of the duration of the period during which ex-owners can file their claims has to be settled; if need be, through a new decree that would list the "justifiable" reasons for granting an extension and set the duration of this extension. Disputes arising from the restitution law should be litigated in either an administrative tribunal or a specialized court created specifically for the purpose of speedy resolution of such conflicts. In order to mitigate the adverse impact of the law on restitution on ownership rights and thereby on investment, legislation on leasing should be developed as soon as possible. A new law on the leasing of agricultural land is being prepared by the Ministry of Agriculture (see chapter IV). It should be incorporated into a wider and coherent framework establishing a legal basis for leasing and sub-leasing. This is also required for the development of the financial sector.

33/ The compensation of ex-owners of agricultural land is discussed in chapter IV.

34/ This implementation regulation conflicts directly with the main law that adopts ownership to ex-owners as its central principle.

Providing State Enterprises with the Right Economic Signals

154. For the few enterprises that would remain in the public domain over the medium term, the Government needs to create an environment that would provide them with the right economic signals through continued adhesion to the above financing framework, amendments to the state enterprise law, and the restoration of basic ownership functions.

155. *Legal Framework.* Under the State Enterprise Law of 1992, Albanian SOEs are not incorporated. The relevant parent ministry or local authority appoints an internal board of directors for each SOE, and in theory they have thereafter little authority over the enterprises. In addition, the current legislative framework has many deficiencies. It contains no reference to the possible use of outside directors. There is a clear prohibition against dividend payments to the owner (the State). There are no clear procedures for the transformation of the SOEs into company form on par with private enterprises. There is also widespread confusion concerning which types of SOEs would be owned or controlled by local authorities. This is primarily the case for smaller SOEs of local character. Since no transparent guidelines exist for these decisions, it is not clear whether the transfers are permanent or temporary, and the implications for the disposal of assets have not been worked out.

156. *Ownership and governance.* For the few enterprises that would remain in the public domain, governance should be improved and clarified. The law should also be amended to allow the payment of dividends to the State. As a way of providing an unambiguous financial target against which to measure performance, a minimum dividend policy should be introduced, replacing the current "amortization tax".[35] Furthermore, the law should be modified to allow for the transformation of SOEs into joint stock companies and for a timetable for the gradual corporatization of most SOEs. In the Albanian context, the importance of corporatization should not be exaggerated. Rapid privatization is, and should remain, the key priority for most enterprises. Nevertheless, for those that remain majority public-owned, corporate-type governance will be preferable to direct control by Ministries, or no control at all.

C. Limiting the Scope and Cost of Government Intervention in the Financial Sector

157. Albania's current banking system emerged from a series of restructuring measures which began in late 1991. Prior to its break-up, the former State Bank of Albania undertook all the central and commercial banking activities of a centrally planned economy. The "commercial banking" departments of the Central Bank historically performed a budgetary and accounting function, providing payment services for SOEs and allocating credit in accordance with a central plan. The Savings Bank (SB) served as a repository for nearly all household deposits, and the activities of the State Agricultural Bank (SAB), which were taken over by the Bank for Agriculture and Development (BAD) in 1991, were limited to providing credits to the former state farms and cooperatives. To convert the system into a two-tiered system, the State Bank of Albania was broken up, creating a new Central Bank, the Bank of Albania. Its commercial operations became the National Bank of Albania (NCB); and along with the remaining banks (SB and BAD) began carrying out commercial banking activities, that included taking deposits and

---

35/ If SOE managers are not maximizing profit, the profit tax may not be neutral and may in fact be a disincentive to the accumulation of profit. In this context, a minimum dividend policy, which is equivalent to a minimum asset tax, could provide an incentive to make some profit.

lending to both households and enterprises. In 1993, BAD was broken up, transferring the good assets and loans to a new Rural Commercial Bank (RCB) and leaving the non-performing assets with BAD.

158. In spite of restructuring efforts over the past three years, development of a viable commercial banking system has been relatively slow. Many of the factors hindering progress are problems inherited from years of centrally planned banking principles. Banks historically operated as collection and disbursement agents for the Government. Banking practices were not subject to market-based criteria, but rather shaped by line ministries that issued directives to the banks on financing needs of state-owned enterprises and farms. Consequently, banks made significant loans to troubled SOEs that are now in arrears. With the collapse of SOE output, virtually all assets of the banking system were wiped out.

159. The Government initially dealt with these issues by removing bad SOE loans from the books of the banks and instructing banks to adopt commercial-based lending practices, while developing skills through technical assistance and training. In late 1992, all outstanding SOE debt incurred prior to July 1992 was forgiven and recapitalization of the state-owned banks by issuing bonds was announced. This bond issue, however, has been delayed until a complete assessment of the recapitalization/liquidity needs of the banks can be clearly determined, and until the banks have demonstrated the ability to operate according to modern banking techniques in accounting, risk assessment, and porfolio management.

160. A complex web of interbank transactions remains to be settled. This web results from technical difficulties experienced upon the break-up of the monobank and prevents a clear assessment of the health of individual banks' portfolios. For example, NCB has loans from SB and BoA, while simultaneously having made (a now irrecoverable) loan to BAD, and significant deposits with BoA. As a first step, NCB balance sheet needs to be sorted out. This has been done only once, and it is clear that it needs to service its liabilities, should it be able to apply to the BoA for liquidity. The Government has recently implemented a plan to clear all interbank arrears, which resolved outstanding disputes regarding interbank advances and obligations, and should facilitate a more efficient resource allocation in the interbank market.

161. Despite the good intentions of the Government, there are indications that some of the inadequate banking practices of the past continue to afflict the financial sector. A large part of new loans made by the state owned banks to both public and private sectors is in arrears. This includes those made since "new" thinking went into effect in mid-1992 and bank managers were told that they and their banks would bear the consequences of their actions. At end-1993, delinquencies were approximately 13 percent of the stock of new loans of the National Commercial Bank (NCB), about 23 percent for the Savings Bank (SB), and about 7 percent for the Rural Commercial Bank (RCB), most of which were at least 60 days overdue. The magnitude of the problem may be understated, as "long-term" loans (greater than one-year maturity) are not considered delinquent until they become due. While most banks' resources are still channelled into loss-making public enterprises, non-performance is currently more prevalent in the private sector than in the SOE sector. This indicates that the problem is not only one of pressuring banks to lend to SOEs. The immediate concerns regarding the financial sector are to limit losses by banks, while channelling adequate resources to the private sector. To achieve these objectives, the Government has adopted a two-pronged strategy: (i) restrict lending possibilities of the state-owned banks to limit further risks and encourage the entry of new private banks, and (ii) improve the overall banking infrastructure by strengthening the supervisory and regulatory framework in the financial sector.

Restructuring State-Owned Banks

162. In many countries experience has shown that in practice it is extremely difficult to protect public banks from political pressures. Furthermore, the development of sound banking skills and management of the state banks can only be achieved over time. The RCB in Albania provides a relevant example. Established in mid-1993, it was unencumbered with bad loans and received a sizeable amount of technical assistance to ensure that it has the capacity to make good loans, yet it has seen its delinquent loans rise steadily to about 7 percent of its portfolio. It is therefore important to provide an environment conducive to the development of private banks, in addition to improving the skills in the existing state banks. Entry and development of private banks is being encouraged through limits imposed on activities of state-owned banks and by the adoption of an appropriate licensing policy.

Table 3.1: Monetary and Banking Indicators
(In percent of GDP unless otherwise indicated)

	1980	1985	1988	1989	1990	1991	1992
Deposits	12.7	13.1	15.9	17.5	23.0	42.2	38.9
Household deposits	4.5	6.4	8.7	8.4	10.2	21.8	11.7
Deposits per capita in $[a]	96.9	86.7	107.5	127.9	148.8	43.3	79.6
Total domestic credit	24.7	32.6	37.5	41.5	56.2	114.8	65.5
Credit to industry [b]	37.7	34.8	33.6	32.1	39.7	41.7	14.1
Credit to agriculture [c]	11.7	12.2	16.1	15.5	19.2	23.6	6.9
Lending Rate [d]	2.0	2.0	2.0	2.0	2.0	2.0	39.0

[a] Excludes foreign currency assets held by the public outside of banks.
[b] Credit to state enterprises
[c] Credit to state farms and cooperatives
[d] 12 month lending rate. Prior to 1992, the rate of 2 percent applied to all maturities.

163. It is the Government's intention to eventually privatize the state banks, either wholly or in part, while taking actions to limit further risks to the banking system. Lending possibilities will also be restricted by more careful scrutiny and performance-based measures. In summary, this involves: (i) restricting the deposit-taking activities and interbank borrowing of NCB to prevent it from having access to large resources that could be mislent; (ii) directing most of the lending activities of the SB towards the financing of the Government deficit, while allowing some limited, pilot lending to the private sector; and (iii) continuing to develop RCB as a specialized bank for viable agricultural activities. The situation of the RCB can be expected to improve as the extensive technical assistance program takes hold (see chapter IV). As the banks become healthier and more experienced in commercial banking practices, plans for the restructuring and eventual privatization of the state banks should be developed.

164. The *Savings Bank* is good at deposit mobilization--it holds 85 percent of household deposits. On the other hand, it is weak at lending: its portfolio of direct loans represents about 7 percent of its deposit base and about half these are in arrears. The SB has little experience in assessing risk and evaluating the viability of proposed ventures. Much of the rest of its deposits are lent to the BoA and through BoA refinancing, effectively to the Government or to other banks. Onlending to the National Commercial

Bank threatens a far greater part of its deposit base. It is therefore recommended that the SB continues to mobilize household deposits and that its lending be restricted to the Government, to be placed in the new Treasury Bill market, and limited lending to the private sector. This would be a moderate approach, designed to curtail SB's high rates of non-performance and risky attempts at universal banking, while allowing the bank to gain expertise by restricted lending to the private sector, under careful supervision.

165. The *National Commercial Bank* is insolvent and, since mid-1993, illiquid. Its resources consist mainly of enterprise deposits, SB loans, and refinancing from the BoA. Since mid-1993, it has begun to raise household deposits. A quarter of the loans it has made since June 1992, when all arrears were removed from its balance sheet, are non-performing. So far, NCB has been kept afloat by forced lending from the SB and by refinancing from BoA. The NCB should be prevented from mobilizing household deposits, and from borrowing directly from other banks. The BoA could lend to NCB but will only be extended credits based on an assessment of NCB's performance. This would provide BoA with the ability to control losses derived from NCB's stock of non-performing loans, mostly to the SOE sector, while providing an incentive for NCB to make prudent lending decisions. The advantage of this approach is that it prevents access by the NCB to several sources of funds--household deposits, interbank loans, and BoA loans--to fund its losses.

Promoting the Entry of Private Banks

166. *Creating conditions for the entry and development of private banks.* As mentioned earlier, an active informal credit market has emerged, providing financial resources to the emerging private sector at a very high cost. This is obviously not an optimal situation and the entry of private banks could channel these resources into the formal financial system. The RCB is already benefitting from an extensive program of technical assistance and channelling a foreign credit line to the agricultural sector. However, the restrictions placed on the activities of the SB and NCB will severely limit the amount of credit that can be channelled to the non-Government sector. Furthermore, over the medium term, the need for formal credit intermediation will probably increase and there is therefore a strong case for fostering rapid entry of additional private banks. This will be achieved through a transparent licensing policy, privatization of existing state-owned banks, and the creation of conditions conducive to the development of private financial intermediation.

167. Albania is virtually the only market economy in the world with no domestic private banks. This is largely the result of a fear among the licensing authority in the past that private bankers would either be unable to operate a bank, or, as in other countries, steal deposits from the population. Licensing guidelines for Albanians who wish to open banks are currently in the process of being revised. Care should be taken that these criteria are transparent and designed to encourage private entrants, while also providing them with the incentive to operate soundly. Experience in neighboring countries has shown that well established foreign banks may not respond quickly to this new policy. Minimum capital requirements should therefore be set low enough to permit investors to open relatively small banks, while the owners of the bank could be given a strong incentive to operate their bank in a sound manner by setting a high minimum capital adequacy ratio. To encourage the entry of private banks, BoA should publicize the new licensing requirements and private banks should be given full autonomy to conduct their operations in the most market-efficient way, subject to the terms of their licenses. This would support a market-based allocation of Albania's scarce financial resources.

168. *Development of supervision and regulation.* Supervision and regulations will be required to maintain systemic stability. For instance, on-site supervision will be required to ensure that banks are

in compliance with the capital to asset ratios. Building up regulation and supervision is a long-term endeavor. The Government has already taken the first steps: a series of regulations has been issued by the Bank Supervision Department of the Bank of Albania. These include regulations for capital adequacy, minimum capital requirements for existing banks, classification and provisioning against bad loans, foreign exchange exposure, and bank reporting requirements. BoA staff have also begun making limited inspections of the banks. However, the staff of the BoA's supervision department needs to be increased and trained. Full-time external assistance to the supervision department to assist it with the supervision function and train staff at the same time is crucial and will be provided during the coming months. Over the longer term, this could be extended through a twinning arrangement with a foreign central bank.

Developing Modern Banking Expertise and Infrastructure

169. Reduced public interference will allow the banks to operate on a commercial basis. In addition, a basic banking infrastructure has to be developed through the strengthening of the legal and accounting framework and the establishment of basic communications and data processing facilities. A payment system has to be developed. A wide-ranging effort to promote commercial banking expertise through on-the-job training of bank staff and the development of a training center is also required.

170. *Infrastructure.* The minimum legal infrastructure required for the functioning of the banking system has to be developed. Gaps and inconsistencies in the legal framework need to be identified and priorities for the further development of legislation established. A new *Central Banking Law*, and a *Law on Commercial Banks*, passed in April 1992, provided the legal basis for the current banking system. A major impediment to the development of banking activities remains the uncertainty surrounding title and enforceability of legal rights, which has to be addressed. Albania's newly developing legislative scheme as a whole represents a "cut and paste" of models drawn from various foreign sources as well as remnants of Albania's prior legal system and some new laws drawn from Albanian sources. These laws are often incompatible with each other, with many contradictions arising from the definition of the same terms in different laws. A *legal review* has been started to identify the main gaps and inconsistencies. As a priority for the development of banking activity, laws should be passed to create a reliable system for evidencing ownership and conveyances as well as to allow for the creation and perfection of security interests in collateral of all sorts, including real property and movables. Land laws to address the need for a debt recovery package in the area of land, including evidence of title and the creation of simplified extra-judicial mechanisms for foreclosing on mortgages, are also necessary. A registry for collateral has to be set up.

171. The *accounting framework* has to be further developed. A new Accounting Law, modelled after the French accounting law, was implemented in December, 1992. This law adopts, for the first time in Albania, a complete set of Western accounting principles and valuation methods. In addition, BoA has been developing its accounting system and reporting requirements for banks. The commercial banks are initiating work on developing their own charts of accounts. However, the accounting work done at the banks needs to be coordinated. This will have save money since development costs will not be duplicated. The existence of accounting systems developed along a common framework will also facilitate future realignments of banks and branches. Furthermore, actions need to be taken to develop the accounting and auditing professions in Albania. As an initial step, training programs are being developed with external assistance.

172. The creation of the basic banking and payment infrastructure requires a feasibility study to design an appropriate *courier system* to speed the movement of information, reports, transactions and currency.

The feasibility of a centralized data and transaction processing center needs to be reviewed. A service bureau could have the advantage of lowering average transactions costs, and facilitate banking entry and exit. This would help ensure that banks do not invest in excess processing capacity and that their branches can be realigned easily.

173. *Payment System*. Presently, virtually all payments for goods and services are made in cash. This is inefficient and cannot support Albania's shift from a centrally planned economy to a market-based economy. Efforts to develop a payment system were started in late 1992 and have so far concentrated on the introduction of "checks". Future plans include the establishment of local clearing houses in major cities; the modification of current check laws; and the creation of check distribution channels.

174. *Training*. State-owned banks should be institutionally strengthened through technical assistance and twinning, beginning with their accounting and information systems and their credit policies and procedures. *Technical assistance and twinning* should bring in bank personnel, rather than advisors. In this way, they would not only provide on the job training, but also have an immediate impact on banks' procedures and policies. On credit, in particular, qualified external experts should be brought in as line managers to help ensure that all lending is done on a commercial basis. Foreign banks brought in through twinning arrangements could be offered an equity stake as part of their management fee and thus be induced to take a longer-run interest in the banks. Since these programs are fairly costly, they should be provided mostly through external aid, and the Committee for the Modernization of the Financial Sector should play an active role in the coordination of external aid to avoid duplications and inconsistencies.

175. A *bank training center* was established earlier this year to respond to the tremendous need to educate the staff of the banks in modern banking practices. Although operating on a limited basis, plans are underway to develop a full-scale training program for the center. Training efforts have to be stepped up with the development of a more comprehensive curriculum and training materials at the bankers training center, intensive training of instructors, and coordination with banks on assessments of training needs for their staffs. The possibility of a twinning arrangement with another training center in Eastern Europe to provide instruction and or materials should be examined. This will be cheaper than a similar association with a Western institution.

D. Conclusion

176. The framework described in this chapter can do much to help the Government to adhere to its 1994 financial program:

(a) all transfers to politically important enterprises should be effected through transparent budgetary subsidies. It is therefore important that the Government brings all enterprises deemed to be politically sensitive under the ERA;

(b) for all other enterprises, clear rules governing their relations with the budget and the banking system--along the lines of this chapter--should be publicized; and

(c) lastly, privatization efforts aimed at the larger enterprises should be stepped up. This will not only decrease the pressure for loss-making lending from banks, but also allow

faster growth, higher fiscal revenues and, in general, promote the sustainability of the reforms. In this context, the proposals in the "note on vouchers in the form of privatization leks" put forward by the Deputy Prime Minister should help accelerate the process.

177. The Government attaches great importance to the development of a commercial banking sector. Considerable financial resources have already been spent on this endeavor. If arm-twisting of the banks does not stop, these efforts will be lost. Institutional build up of the banking sector requires not only that they be free from political pressure, but also that relations between the Central Bank, the commercial banks, the budget, and the state enterprises be transparent and sound. In early 1994, considerable progress has been made in this direction. This progress must be consolidated by completion of the inter-bank arrears clearance and by a solution to the problems of the National Commercial Bank under the guidance of the Central Bank. Finally, clarification of the regulatory framework for private banking and active encouragement for private entry will hopefully lead to a greater role for formal private banks starting in 1995.

CHAPTER IV. DEVELOPING ALBANIA'S NATURAL RESOURCES

A. Introduction

178. In the medium-term, there are good chances that, despite its currently very low level of income per capita, Albania will escape the poverty trap and reach much higher levels of productivity and income. The arable land is rich and fertile, with ample rainfall and a potential for rapid yield gains, as was shown by the strong supply response to privatization. Albania has an ample hydroelectric potential, and some oil and gas reserves. The country also has mineral resources in chromium, copper, and nickel. The climate is excellent, with an inviting coastline ideal for the development of tourism. Finally, present wages are a fraction of the already low wages in neighboring countries. Although unit labor costs are currently high, due to low productivity, this could allow competitive labor-intensive production of simple industrial products. The labor force lacks modern industrial skills but illiteracy is almost non-existent and women have universal access to basic education. The health status of the population compares very favorably with that of low- and even middle-income developing countries

179. The basis for an economic take-off therefore exists provided that the medium-term strategy of the authorities can unleash private entrepreneurship in agriculture, industry, and services. The policies presented in the previous chapters lay the foundations for rapid private sector growth through the consolidation of the excellent early results of stabilization, rapid privatization, the creation of an operational financial sector, the rebuilding of infrastructure, and the development of the legal, administrative, and institutional support systems required for a market economy. There are already tangible signs that this reform program has taken root: for the second year in a row, agriculture is growing at more than 14 percent, and there is strong evidence of rapid development of small-scale services and some manufacturing in cities.

180. This chapter looks at the medium-term growth potential of activities linked to some of Albania's main resource endowments--agriculture, minerals, water, and tourism-- and discusses whether the policies presented so far in this report will suffice to bring about a rapid development. Where necessary, further policy actions are recommended. Section B deals with agriculture; Section C with mineral resources; Section D with water resources; and Section E with tourism.

B. Agriculture

181. After the collapse of the centralized agricultural production system, agricultural production initially declined sharply and Albania became dependent on food aid imports. Over the last 12 to 18 months, Albania has achieved extraordinary progress towards reforming the agriculture sector along market economy lines as described below. Indeed, these reforms have already outpaced those of most of the other reforming countries in the region. Already, practically all of the land previously controlled by state-run cooperatives and state farms has been fully privatized, and major reforms in price and trade liberalization have been achieved. As a result, production grew by a healthy 18 percent in 1992 and is estimated to have increased by a further 14 percent in 1993. Despite the small average size of farms, 1.4 ha, further substantial productivity gains can be expected over the next few years. The cropping pattern is, however, oriented toward satisfying family needs as the newly established private farmers seek to protect their food security: most farmers have become subsistence-oriented and the marketed surplus is limited. Reforms are required in order to encourage farmers to market their production and specialize

according to their comparative advantage. These reforms consist of privatizing processing and marketing enterprises, rehabilitation of infrastructure, establishment of a system of rural credit, and land policy.

Box 4.1: Main Features of Agriculture

- Albania is mountainous, and only about 32 percent (700,000 ha) of its 28,000 km^2 is arable. Agriculture is nevertheless the primary sector of the Albanian economy. The sector's contribution to GDP, which was close to 35 percent during the 1980s, is expected to reach about 50 percent in 1993, with livestock accounting for about half of output. The most important field crops are wheat and maize. Irrigation facilities cover 60 percent of arable land and some 430,000 ha are used as pasture lands.

- About 50 percent of the labor force is employed in agriculture and forestry (705,000 people in primary production and an additional 100,000 in related sectors), and two-thirds of the population live in rural areas. The land/man ratio is unusually low: 1.5 ha per worker, compared for instance with 10.5 ha per worker in Bulgaria.

- Prior to the privatization of arable land, state farms held 25 percent of agricultural land, usually of higher quality, and the remainder was held by cooperatives. It is expected that the privatization of state farms and cooperatives will result in about 500,000 farms of an average size of 1.4 ha.

- Prior to the recent reforms, the agriculture sector in Albania was one of the most extreme examples of the application of Marxist ideology. All the land was state-owned or clustered into state-dominated agricultural "cooperatives," input and output marketing was fully controlled by the state, labor migration within rural areas or to urban areas was basically prohibited, and prices and subsidies were set by the state in a way that bore no relation to costs. While a somewhat similar pattern was found in other Eastern European and CIS countries, the tentative reform efforts that took place in most of these countries during the eighties did not take place in Albania, so that the country has been faced with the need for a very abrupt transition.

- The entire state-owned agricultural marketing and processing sector is in a distressed situation. Factories work at 5-20 percent of their 1989 capacity. Their operations are highly inefficient; they are incurring large losses and have a large stock of debt. The decline in output and increasing subsistence orientation of farmers have cut deliveries to agro-processing enterprises. In 1992 and 1993, fewer than 10 percent of private farmers delivered part of their wheat to the *grumbullimi*--purchasing centers coupled with large milling and storage facilities--and kept most of the harvest for household bread production.

- Albania's agricultural exports during 1988-90, mainly livestock, beverages and tobacco, averaged about US$24 million to non-socialist countries and about US$81 million to socialist countries. This represented 37 percent of the value of exports. Trade with former socialist countries has declined sharply since the CMEA collapse, and small quantities of melons and other items are now exported to convertible currency markets. Since 1990, the (often illegal) export of sheep, goats and cattle to Greece has been playing an increasing role.

- In 1991-92, Albania became heavily dependent on *food aid*, and food aid price policy has had a critical influence on the level of domestic prices. The domestic production of wheat fell from 613,000 tons in 1989 to 270,000 tons in 1992 and wheat imports from food aid have made up the balance of needs. Food aid shipments include not only wheat and flour, but also sugar, rice, cooking oil, meat, milk powder, butter, cheese, and eggs donated by the EC, Italy and other countries. Domestic production of vegetable oil and sugar is estimated by the Government to cover only 6 to 15 percent of domestic needs. Since early 1993, private food imports have started to replace food aid. In the future, food aid will be largely limited to wheat and flour shipments and much reduced quantities are expected. Only 100,000 tons of wheat and 36,000 tons of flour have been committed by donors after July 1993

Processing and Marketing Enterprises

182. As the quantity of food aid decreases, farm gate prices will become largely determined by the market structure of the agro-processing industry. To ensure that farmers receive a price close to import parity levels, the Government intends to develop competition in output marketing and processing through increased private sector participation. Private sector activity is already developing at a rapid pace in agriculture-related activities such as output marketing, food processing, rental of tractor services, input supply, workshops, etc. There are, however, important barriers to entry for private entrepreneurs in those sectors. Private business competes on an unequal footing with state-owned enterprises, especially state-owned mills and bakeries which continue to receive the bulk of food aid shipments and donor-financed agricultural inputs.

183. At present, state enterprises have a de facto monopoly in processing, handling, storage, and wholesale distribution of agricultural products. To promote competition in these markets and ensure that farm gate prices remain close to import parity levels, the Government will encourage private sector participation through privatization and the creation of conditions favorable to private sector development. There are currently 442 enterprises under the Ministry of Agriculture and several important domestic or foreign trade enterprises under the Ministry of Trade. The Government is committed under the Agriculture Sector Adjustment Credit to privatize these enterprises along the lines of the strategy described in chapter 3. To date, 620 small- and medium-scale agro-enterprises out of a total of 820 are in the process of being privatized. The Government intends to privatize the larger agro-industrial state enterprises on a case-by-case basis, which involves sector studies that are currently being prepared.

Table 4.1: Selected Agricultural Production, 1985-92
(Thousand tons)

	1985	1986	1987	1988	1989	1990	1991	1992	1993
Food Crops									
Wheat	603	576	593	637	613	613	297	270	370
Maize	274	347	309	237	307	227	129	130	130
Vegetables	368	388	390	307	392	393	362	560	580
Agro-industrial Crops									
Cotton	26	25	23	14	17	12	1	2	1
Tobacco	20	24	25	14	19	14	7	12	14
Sugar Beet	228	193	192	125	262	169	58	65	70
Livestock									
Milk	375	383	411	443	460	517	527	580	648
Eggs (millions)	239	255	283	286	324	343	270	270	350
Meats	71	66	71	79	82	92	84	90	95

Source: Ministry of Agriculture and World Bank staff estimates.

Rural Credit

184. As mentioned in chapter 3, a working financial sector is a prerequisite for private sector development. Presently the rural credit system cannot service the needs of the emerging private sector. Like the rest of the banking sector, the former Bank for Agricultural Development (BAD) was hindered by a portfolio of non-performing loans, a lack of expertise in modern commercial banking techniques, and the absence of basic data processing and inter-branch communication networks. In addition, BAD was extending small uncollateralized loans to private farmers that are unlikely to be profitable for a formal banking institution. BAD was restructured under the name of Rural Commercial Bank (RCB) and, since October 1993, has started operating on a commercial basis. The restructuring of RCB and concommitant liquidation of BAD has to be accompanied by the establishment of informal credit mechanisms to service the needs of small borrowers.

185. *Formal Credit System.* Due to its network of 27 branches and 160 rural agencies and its experience with agricultural credit, the Rural Commercial Bank (RCB) is expected to become the predominant rural bank. It is to be completely restructured along the lines of the strategy described in chapter 3 to create a rural financial intermediary operating on a commercial basis. RCB has been created to take over the deposits, capital, and performing assets of BAD. RCB has been set up as a joint stock company and placed under the banking law. RCB will mostly finance private sector activities, but it will be allowed, subject to a portfolio ceiling, to lend on a commercial basis to those agricultural state enterprises that it deems creditworthy. RCB may act as an agent to the Government to onlend budgetary resources to state enterprises included in the Public Investment Program (PIP). The Government will in this case assume the risk and remunerate RCB with an adequate service fee.

186. Despite a recent increase in the bad loan portfolio, RCB is performing reasonably well and its management is committed to take the necessary actions to ensure the bank's credibility. During its first months of operation, the share of loans affected by arrears above 90 days in RCB increased from 4.1 percent as of October 1, 1993 to 4.9 percent as of January 31, 1994. The main reasons for this increase are: (i) staff in RCB have had little exposure to responsible and risk-based lending in the past; (ii) the RCB inherited private sector loans made by the former BAD with one year maturity -- these became due at the end of 1993; and (iii) the legal framework that empowers banks to enforce overdue loan payments, to cancel loans, and to seize the assets and property of the borrower has not yet been developed. Staff training has recently been initiated in RCB and the legal framework should be developed under the Government's financial sector reform program (see chapter 3). Finally, RCB has developed a comprehensive reporting system for bad loans which is an important step towards enabling financial audits following international accounting standards. Independent external auditors are currently conducting the first audit of RCB.

187. Institutional development of the new bank will require long-term support through external assistance, intensive training of bank staff, and installation of urgently required office equipment. The Government will actively support the required institutional development program for the bank through provision of World Bank-financed technical assistance, equipment, and extensive training. During the first two years after RCB's creation, the Government intends to concentrate technical assistance for RCB in the following key areas: credit policy and procedures, loan portfolio supervision and credit review, financial management, accounting and MIS, branch management and rehabilitation, resource mobilization, human resources development, and international banking.

188. *Informal Credit System.* The creation of RCB will not cover all the credit needs of the agricultural sector. Most small farmers are likely to require small, uncollateralized loans that are not profitable for a formal banking institution such as RCB. Currently, most of the small farmers' credit needs are met by the informal sector: traders, farmers, and small entrepreneurs receive short-term credit from relatives, neighbors, and friends. In the next few years, these informal channels are not, however, likely to be sufficient to cover all requirements.

189. In addition to the development of RCB, rural credit policy will require the extension of small loans to individual farmers and micro-entrepreneurs which could be done through the decentralized network of Village Credit Funds set up under the IDA-financed Rural Poverty Alleviation Pilot Project, with expected total lending of about US$ 10 million over four years. Agricultural lending under the Revolving Credit Account (RCA) of the EC-PHARE program and lines of credit from bilateral donors for agricultural imports will also provide short-term credit over the next few years. The network of village credit funds should be extended as it will provide one of the main sources of credit to the informal rural sector over the next few years.

Infrastructure and Extension

190. Yet another obstacle to the marketing of crops by farmers is constituted by the inadequate infrastructure and extension services. These should be rebuilt and restructured to lower farmers' marketing costs and increase agricultural productivity. Albania's already substandard rural infrastructure was extensively damaged during 1991-92. Albania's rural roads are in very poor repair and many villages cannot be reached by road during the winter. Following the abolition of the state enterprises' monopoly on agricultural trade, wholesale agricultural markets need to be built in the districts. The irrigation network was extensively damaged during the social and political upheaval of 1991-92. The Government has already started some rehabilitation work on rural infrastructure through the Public Investment Program of the budget and through the Rural Poverty Alleviation Project, with social funds administered by the local authorities. Much remains to be done; in the medium term, the Government will concentrate its efforts on irrigation and extension services.

Box 4.2: Agriculture and Environment

- Agricultural activities could have a serious impact on environment through soil erosion and degradation and through deforestation. The steady increase in livestock over the past two years could lead to overgrazing that in turn could exacerbate soil erosion. Hillside terracing has been widely practiced over the past 30 years and has led to soil erosion, mainly because of inadequate maintenance of terraces. Past excessive use of pesticide and fertilizer caused by inadequate pricing has led in some areas to excessive concentration of chemicals in the soil. Deforestation is most pronounced in near-urban and most easily accessible forest areas. An adequate response to these problems involves mainly pricing policies as well as the implementation of an appropriate regulatory framework.

191. *Irrigation.* About 60 percent of arable land was irrigated, but since 1991, maintenance of irrigation infrastructure and drainage systems has been reduced considerably and construction work on new or improvement schemes stopped. Under central planning, the irrigation network was supervised and maintained by district-based Water Enterprises and by specialized state-owned construction companies controlled by the Ministry of Agriculture. Water enterprises were responsible for delivering the water to state farms and cooperatives which maintained and operated most canals in their respective areas.

Water enterprises must now make deliveries to about 500,000 individual farmers and collect charges from them as well as maintain the network of canals. To face this challenge, the policy of the Government should include the following elements:

(a) rehabilitation of existing equipment;

(b) assistance to individual farmers to improve efficiency of water use;

(c) strengthening of Water Enterprises through the provision of equipment and technical assistance;

(d) creation of Water User Associations to be entrusted with the operation and maintenance of tertiary and quaternary canals. A draft Irrigation Code establishing the regulatory framework for irrigation and drainage management will be presented to Parliament in the first half of 1994; and

(e) establishment of water charges for irrigation and drainage.

192. *Extension*. The existing extension system has to be re-oriented to take into account the new structure of land ownership and the emergence of private farmers' associations. To initiate the reform, the Government is preparing, with assistance from IDA, PHARE, and USAID, a Master Plan for the Reform of Agricultural Extension Services. Lastly, an action program to develop legislation for consumer protection and to adapt the functions of the state organizations supervising food safety and inspection, standardization, import/export certification, and of laboratories analyzing food products is under preparation.

Land Policy

193. Land ownership and ownership rights have to be clearly established to allow the consolidation of land holdings and, most importantly, the use of land as collateral. Most land holding is now private: as the Government has opted for compensation rather than restitution of agricultural land to former owners, privatization of cooperatives and state farms has proceeded at a brisk pace. No proper titling system is however in place, which constitutes a major obstacle to the development of a land market. While a land registration system is being established, the Government intends to develop the legal framework allowing leasing of land, including a property law.

194. *Land registry*. As yet, no title documents as such exist, and no system of land registration is in effect, although, in time, the information on each *tapi* (see box 4.3) will form the basis of registered titles. To date, there exists no local expertise in recording, displaying, and protecting property rights. The creation of an orderly land market depends on effective land registration and, at the very least, leasing laws, appropriate development controls, and the establishment of a land registry where rights in land can be unambiguously and authoritatively recorded. Such a registry is also necessary for developing land or property taxes. The Government is presently implementing a Land Market Action Plan with assistance from the Land Tenure Center of the University of Wisconsin, including a modern land registration system. The Land Registration Act has been prepared and was submitted to Parliament in April 1994.

195. The Government has decided that sales of agricultural land will be allowed *when the system of land registration is in place and all claims for compensation by former owners have been resolved.* As land registry systems are established and land title documents properly recorded, the Government plans to sanction sales on an ever widening basis, district by district, until transfers of agricultural land throughout the entire country are permitted. To do otherwise would result in a chaotic, unregulated market which would be open to abuse and unending conflicts over who really owns what.

196. *Leasing of land.* The situation is different concerning the timing of permissible leasehold interests on former state farm and agricultural cooperative land. Law 7715 of June 1993 amending the basic Land Law allows leasing of land by owners of agriculture land, and contractual leasing arrangements (under the Civil Code) are under preparation. Pending total freedom to sell and lease all land, the Government has decided to turn all "in use" holdings of farm land and of some cooperative land[36] into Government leases of reasonable, fixed duration. It will also provide the basis on which the leasing of former cooperative land by existing owners may be realized. It should include the following elements:

(a) all the terms of the current de facto "in use" holdings of ex-state farm land in order to obviate the need, during this transitional stage, for individual lease contracts;

(b) the right to sub-lease, with a definition of all terms and conditions; the original and copy of each relevant *tapi* might then simply be stamped appropriately, with the words "Lessee" (and possibly "Sub-lessor" or "Sub-lessee") after the "user's" name to indicate the formal change of status and rights;

(c) rules concerning the automatic transmission of rights on the occurrence of an event, such as the death or bankruptcy of the lessee or sub-lessee;

(d) provisions dealing with valuation of land and the mortgaging of leasehold interests;

(e) the lessee of state land would pay a nominal rent to the Government, as lessor, in accordance with a simple statutory formula based on the area (and perhaps location) of his or her plot.

197. *Property law.* As of now, there is no real body of property law defining the rights and obligations of owners and those having other rights in land, such as leasehold and mortgage rights, as well as "user" rights. The legal status of "user" rights is obscure. Without the right to transfer, lease, or inherit these rights, users are unlikely to have sufficient incentives to improve their lands. Moreover, restrictions on user rights and land transfers preclude the use of land as a guarantee for credit. Property law principles have to be integrated in a coherent framework, including a lease law, a mortgage law, and a conservation act to cover collateral and debt recovery principles. In order to avoid taxing the overburdened court system, the emphasis of the processes defined in the law should be extra-judicial. Administrative tribunals to adjudicate land issues based on factual disputes could be used by creditors to foreclose on mortgages for non payment or other forms of default.

36/ Prior to the adoption of the law on compensation for former owners of agricultural land, some cooperative land was leased rather than given to workers because of potential conflict arising from the claims of former owners.

Box 4.3: The Privatization of Agricultural Land

- *Compensation of Former Agricultural Land Owners.* The Parliament voted on 22 April 1993 a law to compensate land owners who have received none or only part of the agricultural land that was in their possession prior to 1946. Restitution, as such, is not being contemplated for agricultural land. Rather, previous owners of up to 1,000 hectares are to be compensated by vouchers denominated both in lek and value units, tradeable for cash or, at face value, in sales of to-be-privatized SOEs. The former owner (or her heirs) of any parcel of 15 hectares or less is to receive "full" compensation for these hectares. Prior owners of additional hectares, up to a maximum of 1,000, are to receive compensation on a decreasing scale basis, so that no prior owner or her heirs may receive full compensation on more than 46 hectares. The value of each voucher is to be fixed by the Council of Ministers at some future date. A State Council of Compensation with district offices is to implement the compensation process.

- Land distribution in former *agricultural cooperatives* started in 1991 and has been radical. By January 1993, 90 percent of the land previously owned by cooperatives (representing 75 percent of arable land) had been distributed to individual farmers. The distribution process is almost completed and has created some 380,000 family farms with an average size of about 1.4 hectares, often subdivided into two or three separate plots.

- *Liquidation of State Farms.* State farms are situated mainly in the coastal plains and cover 25 percent of good arable land. In 1991, their marketed surplus dropped to almost zero. Given that large operational holdings are likely to be inefficient and would require large amounts of Government resources to survive in an undistorted market environment, the Government has decided to turn the land over to the private sector through land leases to state farm employees. One-fourth of the total state farm area is composed of land originally acquired from cooperatives and the remainder from state farms built on reclaimed land. The Government has distributed most of the land of ex-cooperative state farms through property rights for former workers. The main share of non-cooperative state farm land was distributed to workers through assignment of rights to use of the land. About 10 percent of total state farm land will remain state property and will be managed by existing joint-ventures with foreign companies. Fixed assets and working capital of state farms are sold, with sales revenues being utilized to repay loans extended by the Bank for Agriculture and Development (BAD) to state farms since July 1, 1992.

- Entitled to receive land are all state farm workers registered on pay-rolls as of August 1992 and members of their family, and other selected persons who contributed to the creation of state farms at their founding. The fact that the law on the compensation of former land owners was passed by Parliament on 22 April, 1993 has accelerated the process of land distribution as restitution claims will not be allowed. As of June 1993, virtually all state farm land has been released through issuance of a preliminary land title ("tapi"). Land was distributed on an egalitarian basis to entitled persons, resulting in an average land holding per capita of between 0.2 and 0.3 hectares.

C. The Mineral and Oil Sector

198. Although Albania's geological endowment is not such that the country could become a major mineral exporting center (see box 4.4), the mineral sector could make a major contribution to the recovery of exports. The mineral sector currently suffers from the same afflictions as the rest of the state enterprise sector: obsolete equipment and technology, disruption of production and supply lines, lack of managerial expertise to carry out a restructuring. In addition, the sharp decline of production of 1991-92 could have irreversible consequences on the short-term foreign exchange earning capacity of the sector if emergency repairs are not carried out quickly. While these are needed to maintain production at current levels, an expansion of production would require large capital investment and modern technologies that can only be brought in by foreign partners. Much work remains to be done to reorganize the sector and close nonviable activities; to prepare a program of emergency rehabilitation and repairs; and to create an environment attractive to foreign investors.

Sector Reorganization

199. The Government needs to implement a wide-ranging exploration program, reassess the organization of the sector, and divest itself from nonviable activities in geology, nickel, and coal. Oversight of the sector resides in the vice-ministry for mining, geology, chemistry, and metallurgy of the Ministry of Mining and Energy (MoME). A Directorate of Mining in the MoME supervises 28 mining and processing enterprises covering coal, iron-nickel, salt and minor industrial minerals. Separate corporations for all activities relating to oil, copper, and chromium have been established which include activities as diverse as extraction, transport, refining, marketing, and geological and technological research in many separate units.

200. *Geological exploration.* As a preliminary to the restructuring of the sector, considerable geological exploration is needed to identify viable mining projects. In past years, exploration did not use modern technology, did not adopt profit-oriented approaches and criteria, and was conducted on a piecemeal basis without sufficient emphasis on geological interpretation. This resulted in redundant information on known deposits which was inadequate for the in-depth geological interpretations required to plan further exploration. Accordingly, there is a need to re-evaluate existing reserves and to carry out a considerable amount of exploration based on cost effective approaches and modern technologies. The Government needs to mobilize international support to obtain modern geological equipment and technical assistance, to modernize the laboratories, and to train its personnel.

201. *Sector studies.* Some of the many activities carried out by the sector corporations may not be viable, in particular, the processing of mineral ore. A study on the organization of the chromium sector has been prepared by EBRD. A similar study should be prepared for the copper and oil sectors, and a plan of action to carry out the restructuring of the chromium, oil, and copper sectors needs to be developed and implemented.

202. *Copper.* Prospects for renewed copper production are not good in view of the poor quality of copper ore and the inefficiency of copper processing technologies. An assessment of the sector is likely to lead to the closure of many mines and processing facilities. Prospects for bringing in foreign investors are not promising either: viable copper mining and processing facilities would probably best be transferred to present management and workers.

203. *Nickel.* The current closure of the nickel sub-sector, until a significant recovery of international prices, seems reasonable and well based. The decision to renew production should be subordinated to the implementation of the restructuring plan of the Elbasan metallurgical complex, one of the ERA enterprises, where nickel-related installations are located. In particular, a proposed large-scale nickel project should not be considered for a pre-feasibility study until the future of nickel processing facilities becomes clearer.

204. *Coal.* On coal, a general consensus exists on the need to close most of the mines owing to technical cost and market difficulties. This approach is in conflict with decisions to maintain production at four mines, and investments in a new washing plant during 1993, in order to meet demand from communal institutions such as hospitals and brick factories. Recent trends indicate that such demand would be in the order of 100,000 tons a year and could be met by the operation of a single mine without further modernization or mechanization. The main coal mines have been placed under the ERA umbrella and are to be closed. The ERA will prepare a plan to mitigate the social impact of the closures: the unemployment problem could be eased by implementing cleaning-up tasks at the mines.

Box 4.4: Main Features of the Mineral and Oil Sector

- Albania's unusual geology--the abundance and diversity of ultramafic strata--results in mineral ore reserves that are thinly veined, fragmented, located deep in the ground, limited in size, and spread all over the country. This makes Albanian ore comparatively more expensive to prospect, assess, and mine. Albania's main endowment in mineral consists of chromium, copper, and nickel. Mining activities expanded strongly in the 1980s as new investments came on stream and the mining sector accounted for about 3 percent of Net Material Product in the late 1980s, and more than 35 percent of exports.

- Known reserves of copper and chrome are relatively small but estimated to be sufficient to support production for three decades, at existing levels of installed capacity. The deposits are characterized by their small size and the low grade of copper and chromium content. Furthermore, most known reserves are affected by deep seated mineralization, which requires significantly costlier underground mining than abundant surface deposits.

- Nickel reserves in Albania are substantial, ranking as the world's third largest behind New Caledonia and the Dominican Republic. As in the case of other minerals, nickel deposits are disadvantaged by low grade and deep seated mineralization.

- Coal reserves are characterized by poor calorific quality with high contents of ash and sulphur; thin and highly fractured seams which require underground mining; and the existence of methane gas at mining faces.

- There are significant onshore oil and gas reserves, and prospection for offshore fields in the Adriatic Sea has already been started by five foreign oil companies under production-sharing agreements with the Government. Domestic crude oils are characterized by high gravity with unusually high contents of sulphur and heavy metals, which result in a high proportion of heavy fuels in the refined product.

- Despite investments made in the 1980s, much of Albania's mining technology is quite primitive, labor intensive, and environmentally unsound. Ore technology for treatment and metallurgy is predominantly of Chinese design, dating back to the 1960s, and is obsolete.

- The sector was severely affected by the general collapse of the economy: exports of minerals dropped from US$140.9 million in 1989 to US$18.3 million in 1992. Oil exports ceased altogether in 1991 and have not resumed. With the disruption of supply lines and the shortages of foreign exchange, mining enterprises were unable to obtain necessary spare parts, inputs, and consumables. As a consequence, both mines and oil wells were left inactive and the physical facilities suffered serious deterioration.

205. *Reorganization*. The relations between MoME and the mining corporations need to be clarified. For instance, MoME has a supervisory role over the oil company, although all activities and expertise in petroleum have been concentrated in the company. These include some functions which would be considered Government responsibilities in other countries such as sectoral policies, monitoring of field operations, and negotiations with foreign companies. The new status of the oil company recognizes that the legal responsibility of regulation and negotiations with foreign partners lies with the ministry. This new status should be speedily implemented and sufficient staffing resources should be allocated to MoME to allow satisfactory performance of its functions.

206. Within the vice ministry, separate corporations were also established for geological activities (including geological surveys and various enterprises undertaking drilling and exploration) and for mineral processing research. The Government needs to divest itself from the 12 geological enterprises, which are mostly dedicated to drilling in an ineffective manner, and from the Mineral Processing Research

Institute, which covers a broad range of activities and has wider intra-sector capabilities as an engineering/construction firm. These should be included in the list of small and medium enterprises to be privatized rapidly.

Box 4.5: Mining and Environment

- The main environmental issues in the mining sector are related to the disposal of waste material, smelting, and working conditions. Of particular concern is the current poor operating condition of plant and equipment, serious inadequacies in plant ventilation systems, dust collection and precipitation systems, and in the design of railing dams and spills. These problems are exacerbated by the extremely poor sulfuric acid plants which need renovation and modification to reduce sulphur dioxide pollution. The draft mining law sets out goals for environmentally sound mining activities but these general provisions should be outlined in detail in regulations.

Rehabilitation of Existing Mining Facilities and Wells

207. A cost effective program of initial emergency measures could make a crucial contribution to raising export revenues in the chromium, copper, and oil sectors. While most of the sector is technologically obsolete, a productive capacity exists which can be utilized for a short period of time to generate exports. The Government needs to prepare a list of measures that would directly increase export revenues in the short term, assess their cost, and start mobilizing the required financing from private sources. Investment in directly productive activities such as oil and mineral extraction should not come from the Public Investment Budget, as these activities are expected to be carried out on a commercial basis and should be self-financing. Private participation in these activities is crucial and should be actively sought.

208. The shortage of inputs and spare parts of 1991-92 has led to a decline in chromium ore extraction. Foreign expertise and capital in the chromium sector are crucial for the long-term development of Albania's potential for mineral exports. To this end, the Government has been seeking to privatize Albchrome (the chromium company) with the support of foreign direct investment. With assistance from the EBRD, a potential foreign joint venture partner has been found and negotiations are now underway.

209. The overall assessment of the copper sub-sector should lead to a short-term emergency survival plan to allow for minimum improvements needed at mines, concentrators, and smelters. These measures would permit a return to a modest profit level. Current plans to build up additional smelting installations should be abandoned, as these are technically unsound and uneconomic, due to major comparative resource and scale disadvantages.

210. Some 400 oil wells are not producing due to problem of sand that gets into the pumps, and could be made functional at reasonable cost. The existing oil and gas fields, which are not licensed to international companies, should be rehabilitated as soon as possible to reverse the collapse of oil and gas production. Some modest investments are also required in the pipeline system and pumping stations. Given the good qualifications of Albania's petrol engineers, these tasks could be carried out at a reasonable cost.

Attracting Foreign Investors

211. The above measures will protect the existing productive capacities. In view of the technological obsolescence of the sector, any expansion in the productive capacities will require foreign investors to bring much needed capital and know-how. Negotiations for a joint venture in the chromium sector are about to be concluded. To increase foreign participation in other sectors, the Government should step up its promotion efforts. Sector corporations should be included in the list of large strategic enterprises to be privatized through complex tenders and negotiated sales (see chapter III). As a preliminary to this privatization effort, a legal and fiscal framework need to be defined.

212. *Legal framework.* With assistance from the EBRD and the Association, the Government has prepared a *mining law* defining rights and regulating mining activities which was presented to Parliament in late December 1993. Under this law, all state-owned mining enterprises are to be operated as autonomous, profit-oriented concerns and subjected to the same rules as private enterprises. State-owned mining enterprises are further authorized and encouraged to enter into joint ventures with private investors. Two important issues related to the law remain to be settled: (i) the rights of local authorities in the award and management of mining rights; and (ii) whether royalties should be charged and, if so, by what level of government. A single agency should be responsible for implementing all facets of the mining law, including attraction of foreign investment as well as monitoring technical and environmental regulations, since this would ensure consistency and limit the use of scarce administrative resources and technical expertise. The importance of royalties for a non-renewable resource should not be underestimated since royalties will be the main source of Government revenue from mining in the near future. The proposed method in the draft law is conservative and quite competitive by international standards. A petroleum law establishing a framework for all petroleum activities and model contracts for production sharing agreements has been enacted in the fall of 1993.

213. *Fiscal regime.* The mining law also defines a fiscal regime for mining enterprises that provides for the payment of import duties, royalties, corporate income tax, property tax, and social security but defines a special regime regarding export taxes, turnover taxes, or value added taxes. A tax regime for oil activities--not included in the law--needs to be prepared and enacted as soon as possible (see chapter II).

214. *Promotion efforts.* Lastly, the Government needs to step up its promotional activities. Increased exploration efforts should lead to the publication of a mining promotional brochure to spell out the objectives of its policy and to present its strategy. The publication of such a brochure would reduce perceived risks from investors and familiarize them with existing opportunities in Albania. Efforts to promote petroleum have to be intensified, with the Government making data readily available and without charge to oil companies. Several foreign companies have expressed interest in the oil company and these contacts are being pursued at present.

D. Water Resources

215. Despite irregular precipitation, Albania is a water-rich country with an annual average of 3,080m^3 per capita, which is the highest value in Central and Eastern Europe countries. Albania is both rich in underground water potential because of abundant precipitations and its geological structure, and in surface water, with a very important network of rivers and lakes. This water potential has important implications for the supply of drinking water, agriculture, hydroelectric-power generation, and for the environment.

The development of these various sectors will have major long-term consequences on water availability. At the same time, water resources development and management is spread across many ministries and institutions. Sustainable development requires long-term planning of water uses across sectors. Current water development and management has to be reorganized, and a national water strategy developed.

Table 4.2: Exports of Mining Products, 1980 and 1985-92
(Values in million US$)

	1980	1985	1986	1987	1988	1989	1990	1991	1992[a]
Total mining exports	53.2	40.9	116.9	100.9	119.4	140.9	88.7	39.2	18.3
Share of mining exports in total (%)	14.5	13.4	37.6	32.4	37.5	37.2	31.0	53.6	26.2
Chromium	21.6	21.5	52.3	39.4	41.2	53.3	38.4	13.5	4.9
ore	17.9	15.7	36.7	28.7	30.4	36.9	24.7	7.4	3.1
concentrate	3.7	5.8	15.7	10.7	10.8	16.4	13.7	6.1	1.8
Ferro-chrome	2.0	2.4	11.6	12.1	33.6	35.9	17.3	15.5	10.4
Copper	7.2	5.6	17.9	19.2	20.2	25.5	16.2	5.3	2.6
concentrate	2.1	0.4	0.8	1.5	2.0	2.7	1.7	0.8	1.3
wire & cable	5.1	5.3	17.1	17.6	18.2	22.8	14.4	4.4	1.3
Iron-nickel ore	3.7	2.7	7.1	9.4	7.9	5.6	7.6	1.5	0.3
Coal	0.2	0.8	5.2	4.3	4.9	4.8	3.0	1.2	0.0
Other	18.5	7.9	22.9	16.6	11.8	15.8	6.3	2.3	0.1

Notes: [a] Data for 1992 are estimated on the basis of information supplied by the Statistics Department.
Exchange rates are: US$ = 8 leks for 1980-1991; US$ =73 leks for 1992.
Sources: Department of Statistics, Ministry of Finance and Economy, and staff estimates.

Water Resources and Economic Activity

216. *Drinking water*. Despite the relative abundance of water, Albania is unable to provide its small population with more than a meager supply of drinking water of uncertain quality. Although most urban areas have a high level of coverage of water supply and sewerage, the quality of service is extremely poor; distribution networks are old and inefficient; and there is virtually no maintenance and totally inadequate cost recovery. There is massive leakage throughout the water distribution network, pressure cannot be maintained, and the only way to conserve drinking water is to limit pumping of water to the distribution network to a maximum of three or four hours per day. Of major concern is that fluctuating pressure in the water supply network may cause contamination of the water supply by sewage leaking from the poorly maintained sewerage network. Taking into account that only spasmodic chlorination of drinking water is effected, this could have disastrous consequences on health.

217. *Irrigation*. With annual rainfall concentrated in the April-September period and highly variable from one year to the next, irrigation is crucial for the development of agriculture. On a countrywide basis, less than 20 percent of total annual precipitation occurs in this six-month period April to September, with very little rainfall in the three months of June, July, and August. The crop water deficit

during these three months ranges between 400 and 500 mm and irrigation is thus necessary for crop growth. The inter-annual variability of water resources of Albania is significant; in the dry years, there might be up to three times less water available than in the normal hydrologic years. The quality of the water is naturally good; industry, particularly mining, is however causing serious pollution of some rivers and lakes that supply water for irrigation. The rivers mainly polluted include the Shkumbin, Seman, Goanica, Mat, and Kiri. The continuous use of such water for irrigation could cause the progressive of chemical compounds in the soil with long-term harmful effects on the fertility and production potential of the soils. In addition, many drains are polluted by urban effluent as water treatment plants are insufficient. As irrigation return flow is mixed with drainage water and often reused for irrigation of lower reaches in the command area, low water quality can be a health hazard, particularly during the dry season. A policy must be adopted to require an initial reduction of polluting agents entering the water bodies with an objective to significantly decrease pollution of water in the long term.

Table 4.3: Use of Water Resources in Albania

Water Users	Volume Used ($10^9 m^3$)	Volume Consumed ($10^9 m^3$)
Hydropower	13.97	0
Irrigation		
from reservoirs	0.56	0.28
from rivers and lakes	0.45[a]	0.22
from groundwater	0.003	0.002
Subtotal	1.01	0.50
Public/Industrial Water Supply	0.2	0.18
Total	15.18	0.68

[a] A small portion included under hydropower.
[b] Assuming a return flow of 50 percent.

218. *Hydro-electricity*. Hydroelectricity accounts for 90 percent of Albania's electricity generation and 23 percent of export earnings. Albania has substantial undeveloped hydropower potential, but studies suggest that there is limited need for additional capacity over the medium term, despite the recent growth of domestic household consumption which was mainly due to the low administered price of electricity relative to other sources of energy. Furthermore, in 1992, the export price of electricity was only half of production costs, partly due to low productivity.[37] It is unlikely that Albania will be able to get a much higher export price in the medium term. New export-oriented hydro-electricity stations should not be built unless there is assurance, e.g., through long-term contracts, that investment and all recurrent costs will be covered. Investments in new hydropower plants are therefore *not* required over the coming years. In the longer run productivity gains can be expected to reduce production costs substantially and Albania may start exporting again. Since unexploited sites are distributed over a few large cascade schemes and a diversity of small schemes, such projects will have a major impact on the availability of water. Studies on the potential for electricity exports, the impact of new power stations on the availability of water, and on the environmental impact will have to be launched before new projects can be started. New generating capacity will not, however, be needed to meet domestic demand before 2000.

37/ Including capital costs.

Water Resources Development and Management

219. *Institutional framework*. The investments required by water management and development will be, for the most part, included in the comprehensive framework provided by PIP. Responsibilities are, however, fragmented amongst ministries and agencies. The Ministry of Agriculture and Food is responsible for irrigation--by far the largest water user; the Ministry of Construction deals with all matters concerning domestic water supply and sewerage; the Ministry of Industry, Mineral Resources and Energy is responsible for industrial usage and supervises the operation of hydropower, which is planned by the National Energy Committee. Even more striking is the fact that surface water is monitored by the Institute of Hydro-Meteorology within the Academy of Sciences, whilst groundwater exploration, development and monitoring is assigned to the Hydro-Geological Enterprise of the Ministry of Industry. The pervasive problems of surface and groundwater pollution are handled by the Ministry of Health and Environment Protection. This *fragmentation problem* is becoming more complex with the move towards decentralization and the proposed realignment of Districts into Prefectures, none of which is designed to coincide with river basins or other water locations/sources.

220. The Government recognizes that there is an urgent *need to coordinate water activities*. Upon request of the Council of Ministers, the Ministry of Construction has established a technical team, consisting of members of its own staff and some from other institutes, to address the coordination issue. The team has proposed a National Water Council with a National Water Committee reporting to it. The proposed roles and responsibilities of these bodies are currently being clarified.

221. For better coordination of water activities, the Government needs to clarify the institutional framework. It is important that strategy development and monitoring, the role of the *National Water Committee*, be separate from implementation and control--the role of the *National Water Council*, ministries, and appropriate regional and local administration. The National Water Committee should be an independent entity, placed under the authority of the Council of Ministers. Its role would consist of:

(a) preparing a national strategy and policy proposals;

(b) preparing appropriate legislation and regulations; and

(c) maintaining a data base on water development, utilization, and protection.

The National Water Committee should include representatives from the Water User Associations created in the context of the rehabilitation of the irrigation network. The National Water Council, chaired by a deputy prime minister, would review recommendations from the National Water Committee and make appropriate policy and strategy decisions. Importantly, it would endorse annually the water investment program included in the Public Investment Program.

222. *National Water Strategy*. The first task of the National Water Committee would be the preparation of a national water strategy. This strategy would set out policies for the efficient management and protection of water, draft and revise laws to support the policies, establish criteria for evaluating investment programs, and identify investment projects. The strategy would focus on the interaction between water uses in different sectors and their effect on sustainable development. As such, the national water strategy would be the most important planning and management tool for the entire water sector of the economy.

E. Tourism

223. With its location on the Mediterranean, Albania has a large and as yet untapped potential for developing international tourism which could contribute to the diversification and growth of its economy. Albania has an extensive coast line with sandy beaches on the Adriatic and Aeonian shorelines, a good climate, an attractive inland scenery, historical and archeological sites, and the lore of a little-known Balkan culture.

Potential for Tourism

224. Albania represents a unique opportunity in Europe to develop environmentally sound tourism, taking advantage of its attractions while preserving its rich natural resources and biodiversity. The country offers excellent beaches, freshwater lagoons, vast lakes, archeological sites, and cultural and religious diversity. The country has about 320 km of coastline on the Adriatic characterized by long shallow beaches with medium quality sand and about 150 km coastline on the Aeonian which is a more rugged area with fine white sand beaches. The inland is mountainous and has three large natural lakes supporting original ecosystems with a large number of endemic species. Lagoons and salt marshes also present a high environmental diversity and are very important feeding and breeding sites for several bird species, including the Dalmatian pelican, an endangered specie. Rich biodiversity is also found along the coastlines, where the narrow virgin beaches provide one of the last few egg-laying sites for the loggerhead turtle. Forests in the high mountain ranges also support an abundant and varied wildlife. Against this background, the Government has identified as a major objective the development of eco-tourism, targeted at individuals or small groups with interest in the outdoors and the environment.

225. The culture and history of Albania are also likely to be attractive to tourists. Albanians are descendants of the ancient Illyrian tribes that settled in this part of the Balkans in the seventh century B.C. The country has had a history characterized by various invasions and foreign occupations which lasted, off and on, right up until the 1940s. The country as it is known today came into existence in 1912 with the collapse of the Ottoman Empire. The communist regime took control in 1944 and until the late 1980s, the country was virtually isolated from the rest of the world. This long history of invasions and foreign occupations has supported a diversity of cultural characteristics and three main religious groups (about 70% Muslim, 20 percent Christian Orthodox, and 10 percent Catholic), which have traditionally coexisted in an atmosphere of mutual tolerance. Furthermore, there are numerous archeological sites including Illyrian, Roman, Greek, and Byzantine relics, and much is not yet fully excavated.

Challenges for Tourism Development

226. Tourism development in Albania is reliant upon development of accommodations, airports, and roads, as well as improvement in water, electricity, sanitation, and telecommunication services. Given the limited domestic expertise and capital base, foreign investment is likely to be essential for the development of the sector.

227. Through joint ventures with foreign investors, the Government is attempting to upgrade some of the existing accommodations and transport terminals (both air and sea). At the same time, foreign investment in new facilities is at least partially reliant upon the development of tourism infrastructure, and the extensive rehabilitation of services such as water supply, sanitation, electricity, and telecommunications. As in other sectors of the economy, international investors are likely to require clarification of property rights and other issues of the legal framework for investment, which is presently

under preparation. Furthermore, the current regional political instability can serve as a deterrent to potential investors and tourists alike. Finally, the Albanian tourism industry will be faced with strong competition from well-developed tourism in neighboring Greece, Turkey and FYR Macedonia. In the longer run, however, as infrastructure improves and the political situation in the region settles, tourism could be become an important source of growth, provided that Albania in the meantime preserves its natural and cultural endowment.

STATISTICAL APPENDIX

Albania - Country Economic Memorandum Statistical Appendix

The numbers included in this Appendix have to be examined with extreme caution. Pre-1992 numbers reflect the shortcomings of the system of national accounts under central planning as well as the lack of openness and accountability of the statistical institutions under communism. Post-1992 numbers reflect the breakdown of the old statistical apparatus: state enterprises stopped filing records with the statistical institute. Furthermore, with the development of private enterprises, a large proportion of which belong to the informal sector, new, survey based methods of collecting and processing information have to be developed.

Such an effort is already underway: the Institute of Statistics has been recently established as an independent entity and has started to implement a well articulated development plan, with the support of the international community. Nevertheless, the 1991-92 data remain, for the most part, an educated guess by Fund and Bank staff. Such an educated guess was, however, felt to be useful as it supplied the statistical basis on which to build an illustrative quantitative framework for the policies discussed in this report.

This Appendix should therefore be looked at keeping the above limitations in mind.

Table 1.1: Albania: Population Structure
(In Thousands)

	1970	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991e	1992e
Total Population	2135.6	2670.5	2723.7	2780.3	2838.1	2896.7	2957.4	3016.2	3076.1	3138.1	3199.2	3255.6	3319.0	3384.0
Male	1096.6	1378.0	1405.4	1434.6	1464.5	1494.7	1526.0	1556.3	1584.2	1616.1	1646.3	1671.5	NA	NA
Female	1039.0	1292.5	1318.3	1345.7	1373.6	1402.0	1431.4	1459.9	1491.9	1522.0	1552.9	1584.1	NA	NA
Urban	679.7	897.3	920.6	948.0	973.5	999.4	1029.2	1055.7	1082.8	1111.4	1146.5	1175.0	NA	NA
Rural	1455.9	1773.2	1803.1	1832.3	1864.6	1897.3	1928.2	1960.5	1990.3	2026.7	2052.7	2080.6	NA	NA
Percentage Distribution (%)														
Total Population	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	NA	NA
Male	51.3	51.6	51.6	51.6	51.6	51.6	51.6	51.6	51.5	51.5	51.5	51.3	NA	NA
Female	48.7	48.4	48.4	48.4	48.4	48.4	48.4	48.4	48.5	48.5	48.5	48.7	NA	NA
Urban	31.8	33.6	33.8	34.1	34.3	34.5	34.8	35.0	35.2	35.4	35.8	36.1	NA	NA
Rural	68.2	66.4	66.2	65.9	65.7	65.5	65.2	65.0	64.7	64.6	64.2	63.9	NA	NA
Annual Growth Rate (%)														
Total Population		2.3	2.0	2.1	2.1	2.1	2.1	2.0	2.0	2.0	1.9	1.8	1.9	2.0
Male		2.3	2.0	2.1	2.1	2.1	2.1	2.0	1.8	2.0	1.9	1.9	NA	NA
Female		2.2	2.0	2.1	2.1	2.1	2.1	2.0	2.2	2.0	2.0	2.0	NA	NA
Urban		2.8	2.6	3.0	2.7	2.7	3.0	2.6	2.6	2.6	3.2	2.7	NA	NA
Rural		2.0	1.7	1.6	1.8	1.8	1.6	1.7	1.5	1.8	1.3	1.4	NA	NA

Source: Government of Albania and World Bank and IMF staff estimates for 1991 and 1992.

Table 1.2: Albania: Labor Force and Employment
(In Thousands)

	1970	1975	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991e	1992e
Total Population	2135.6	2400.8	2670.5	2723.7	2780.3	2838.1	2896.7	2957.4	3016.2	3076.1	3138.1	3199.2	3255.6	3319.0	3384.0
Male	1096.6	1239.6	1378.0	1405.4	1434.6	1464.5	1494.7	1526.0	1556.3	1584.2	1616.1	1646.3	1671.5		
Female	1039.0	1161.2	1292.5	1318.3	1345.7	1373.6	1402.0	1431.4	1459.9	1491.9	1522.0	1552.9	1584.1		
Nonworking Age Population	1084.6	1139.8	1199.8	1210.1	1226.9	1239.7	1250.7	1269.3	1286.9	1309.6	1328.2	1355.9	1369.3	1400.0	1417.0
Male	531.9	561.5	588.4	593.1	602.5	607.8	612.8	618.0	625.6	635.3	644.8	661.8	671.3		
Female	552.7	578.3	611.4	617.0	624.4	631.9	637.9	651.3	661.3	674.3	683.4	694.1	698.0		
Working Age Population a/	1051.0	1261.0	1470.7	1513.6	1553.4	1598.4	1646.0	1688.1	1729.3	1766.5	1809.9	1843.3	1886.3	1919.0	1967.0
Male	564.7	678.1	789.6	812.3	832.1	856.7	881.9	908.0	930.7	948.9	971.3	984.5	1000.2		
Female	486.3	582.9	681.1	701.3	721.3	741.7	764.1	780.1	798.6	817.6	838.6	858.8	886.1		
Labor Force	NA	973.5	1181.4	1212.2	1252.1	1295.2	1338.0	1378.7	1418.0	1456.2	1495.2	1534.1	1567.0	1600.0	1680.0
Male	NA	NA	617.8	633.1	653.8	677.2	699.9	721.9	740.5	757.9	777.9	798.1	812.0		
Female	NA	NA	563.6	579.1	598.3	618.0	638.1	656.8	677.5	698.3	717.3	736.0	755.0		
Inactive & Dependent b/	NA	287.4	289.3	301.4	301.3	303.2	308.0	309.4	311.3	310.3	314.7	309.2	319.3	319.0	287.0
Male	NA	NA	171.8	179.2	178.3	179.5	182.0	186.1	190.2	191.0	193.4	186.4	188.2		
Female	NA	NA	117.5	122.2	123.0	123.7	126.0	123.3	121.1	119.3	121.3	122.8	131.1		
Total Employment	NA	893.0	1122.0	1161.0	1216.0	1252.0	1279.0	1298.0	1341.0	1381.0	1405.0	1431.0	1434.0	1370.0	1247.0
State Sector c/	NA	503.0	655.0	676.0	709.0	735.0	757.0	769.0	800.0	830.0	852.0	881.0	905.0	833.0	728.0
Cooperative Sector d/	NA	390.0	467.0	485.0	507.0	517.0	522.0	529.0	541.0	551.0	553.0	550.0	529.0	512.0	481.0
Non-Agricultural Private Sector														25.0	38.0
Labor Force minus Employment		80.5	59.4	51.2	36.1	43.2	59.0	80.7	77.0	75.2	90.2	103.1	133.0	230.0	433.0
Registered Unemployment e/		16.5	19.5	21.5	17.4	21.2	25.5	30.9	37.1	30.3	30.3	28.7	33.2	55.0	109.0
Male		3.0	4.6	5.6	5.0	5.6	7.1	10.4	12.9	10.4	10.1	10.9	13.6	NA	NA
Female		13.5	14.7	15.9	12.4	15.4	18.4	20.5	24.2	19.9	20.2	17.8	19.6	NA	NA
Memo:															
Unemployment Rate		8.3	5.0	4.2	2.9	3.3	4.4	5.9	5.4	5.2	6.0	6.7	8.5	14.4	25.8
Unemployment Growth Rate				-13.8	-31.3	22.7	36.6	36.8	-4.6	-2.3	19.9	14.3	29.0	72.9	88.3

Source: Albanian Ministry of Economy, Statistics Bureau, and IMF and World Bank staff estimates for 1991 and 1992.

a/ Working age is 15-59 years for men, and 15-54 years for women.
b/ Includes disabled, pupils 15 years and older, students, and military forces.
c/ Includes Budgetary workers, employees of state enterprises and farms.
d/ Includes employees of agricultural cooperatives and recently privatized farms/cooperatives.
e/ Represents those receiving benefits.

Note: In 1990, 48.7 percent of unemployed were between 15 and 24 years of age, 29.3 percent between 25 and 35 years of age, and 22 percent over 36 years of age.

Table 1.2a: Albania: Labor Force and Employment

Table 2.1: Albania - Gross Domestic Product by Sector of Origin

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991e	1992e	1993
(Millions of Current Leks)														
Net Material Product	12862	13264	13625	13697	13300	13602	14013	13699	13631	15223	13122	12870	35909	81776
Industry	5782	5704	5968	5928	5848	5886	6196	6276	6310	6822	5491	4695	6122	11307
Agriculture	4319	4292	4314	4665	4399	4703	4768	4550	4296	4919	4716	5055	19442	45649
Construction	891	935	1041	1070	1065	979	936	879	891	989	841	793	2714	7324
Transportation	372	375	446	457	461	446	480	479	498	517	434	412	1074	2491
Other Services	1498	1954	1856	1577	1527	1588	1633	1515	1636	1976	1642	1916	6557	15005
GDP/NMP ratio	1.21	1.21	1.21	1.22	1.24	1.24	1.24	1.26	1.25	1.23	1.28	1.28	1.35	1.35
GDP	15538	16073	16544	16724	16510	16863	17390	17253	17008	18681	16813	16474	48477	110398
(Millions of 1990 Leks)														
Net Material Product	12199	12929	13281	13351	12964	13200	14013	13699	13631	15223	13122	9497	8129	9020
Industry	5224	5463	5715	5677	5600	5637	6196	6276	6310	6822	5491	3465	1386	1247
Agriculture	4091	4292	4314	4665	4399	4645	4768	4550	4296	4919	4716	3730	4401	5035
Construction	814	912	1011	1039	1035	951	936	879	851	989	841	585	614	808
Transportation	377	370	440	451	455	440	480	479	498	517	434	304	243	275
Other Services	1693	1892	1801	1519	1475	1527	1633	1515	1636	1976	1642	1414	1484	1655
GDP/NMP ratio	1.22	1.22	1.22	1.23	1.25	1.25	1.24	1.26	1.25	1.23	1.28	1.28	1.35	1.35
GDP	14881	15736	16200	16379	16174	16462	17390	17253	17008	18681	16813	12156	10974	12177
Growth Rates (%)														
Net Material Product		6.0	2.7	0.5	-2.9	1.8	6.2	-2.2	-0.5	11.7	-13.8	-27.6	-14.4	11.0
Industry		4.6	4.6	-0.7	-1.4	0.7	9.9	1.3	0.5	8.1	-19.6	-36.9	-60.0	-10.0
Agriculture		4.9	0.5	8.1	-5.7	5.6	2.6	-4.6	-5.6	14.5	-4.4	-20.9	18.0	14.4
Construction		12.0	10.9	2.8	-0.4	-8.1	-1.6	-6.1	1.4	11.0	-14.6	-30.4	5.0	31.5
Transportation		-1.9	18.9	2.5	0.9	-3.3	9.1	-0.2	4.0	3.8	-15.9	-29.9	-20.0	13.0
Other Services		11.8	-4.8	-15.7	-2.9	3.5	6.9	-7.2	8.0	20.8	-16.4	-13.9	5.0	11.5
GDP		5.7	2.9	1.1	-1.3	1.8	5.6	-0.8	-1.4	9.8	-10.0	-27.7	-9.7	11.0
Share of NMP in 1986 Leks (%)														
Net Material Product	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Industry	42.8	42.3	43.0	42.5	43.2	42.7	44.2	45.8	46.3	44.8	41.8	36.5	17.0	13.8
Agriculture	33.5	33.2	32.5	34.9	33.9	35.2	34.0	33.2	31.5	32.3	35.9	39.3	54.1	55.8
Construction	6.7	7.1	7.6	7.8	8.0	7.2	6.7	6.4	6.5	6.5	6.4	6.2	7.6	9.0
Transportation	3.1	2.9	3.3	3.4	3.5	3.3	3.4	3.5	3.7	3.4	3.3	3.2	3.0	3.0
Other Services	13.9	14.6	13.6	11.4	11.4	11.6	11.7	11.1	12.0	13.0	12.5	14.9	18.3	18.3
Memorandum Items:														
Consumer Price Index	104	102	102	102	102	102	100	100	100	100	100	136	442	818
Inflation Rate		-2.2	0.0	0.0	0.0	0.4	-2.4	0.0	0.0	0.0	0.0	35.5	226.0	85.1
GDP Deflator											100	136	442	907
Change in GDP Deflator											0.0	35.5	226.0	105.2
Exchange Rate, p.a. (Lek/US$	9.5	8.6	8.6	8.6	8.6	8.6	8.0	8.0	8.0	8.0	8.0	14.6	70.1	100.6
Exchange Rate, e.o.p. (Lek/US$)								8.0	8.0	8.0	8.0	..	103.1	109.0
Atlas Conversion Factor							#DIV/0!	#DIV/0!	#DIV/0!	7.7	7.7	11.7	49.4	102.3
GDP ($ Mln)	1635.6	1873.3	1928.2	1949.2	1924.2	1965.4	2173.8	2156.6	2126.0	2335.1	2101.6	1128.3	691.5	1097.4
GNP (Leks Mln)	15568	16165	16660	16782	16538	16875	17391	17256	17009	18680	16787	16107	46514	106776
GNP ($ Mln)	1639.0	1883.9	1941.6	1955.8	1927.4	1966.7	2173.8	2157.0	2126.1	2335.0	2098.3	1103.2	663.5	1061.4
Population	2670.5	2723.7	2780.3	2838.1	2896.7	2957.4	3016.2	3076.1	3138.1	3199.2	3255.6	3319.0	3384.0	3450.0
GDP per capita ($)	612.5	687.8	693.5	686.8	664.3	664.6	720.7	701.1	677.5	729.9	645.5	340.0	204.4	318.1
GNP per capita ($)	613.7	691.7	698.3	689.1	665.4	665.0	720.7	701.2	677.5	729.9	644.5	332.4	196.1	307.6
Atlas Methodology GDP per capita ($)								..	..	757.6	671.9	425.7	289.9	312.7
Atlas Methodology GNP per capita ($)										757.6	670.9	416.3	278.2	302.4
% Nom GDP: Agriculture	33.6	32.4	31.7	34.1	33.1	34.6	34.0	33.2	31.5	32.3	35.9	39.3	54.1	55.8
% Nom GDP: Industry	45.0	43.0	43.8	43.3	44.0	43.3	44.2	45.8	46.3	44.8	41.8	36.5	17.0	13.8
% Nom GDP: Services (Resid	21.5	24.6	24.5	22.7	23.0	22.2	21.8	21.0	22.2	22.9	22.2	24.2	28.8	30.4

Source: Albanian Ministry of Finance and Economy, and World Bank staff estimates for 1991-1993.

Table 2.2: Albania: GDP by Expenditure Category
(Millions of Current Leks)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991e	1992e
Gross Domestic Product	15538.0	16073.0	16544.0	16724.0	16510.0	16863.0	17390.0	17253.0	17008.0	18681.0	16813.0	16473.8	48476.8
Resource Balance	63.1	235.9	-744.9	-436.8	-324.2	-373.4	-71.3	-16.6	-482.2	-518.2	-1339.2	-3388.7	-39115.8
Exports, GNFS	3591.7	3694.0	3205.4	3043.2	2874.9	2737.8	2618.5	2668.4	2786.3	3351.4	2541.1	1201.6	5608.0
Imports, GNFS	3528.6	3458.1	3950.3	3480.1	3199.2	3111.2	2689.8	2685.0	3268.6	3869.6	3880.3	4590.2	44723.8
Total Expenditures	15474.9	15837.1	17288.9	17160.8	16834.2	17236.4	17461.3	17269.6	17490.2	19199.2	18152.2	19862.5	87592.6
Consumption	10669.9	10433.1	11299.9	11465.8	11911.2	12102.4	12086.3	12366.6	12574.2	13273.2	13286.3	18855.5	82567.6
Private Sector a/	9284.9	9073.1	9892.9	10010.8	10375.2	10551.4	10473.3	10702.6	10965.2	11627.2	11633.9	15233.5	72092.2
Statistical Discrepancy	-49.1	-161.9	540.9	135.8	194.2	257.4	122.3	-88.4	195.2	0.0	0.0	0.0	0.0
Government	1385.0	1360.0	1407.C	1455.0	1536.0	1551.0	1613.0	1664.0	1609.0	1646.0	1652.5	3622.0	10475.4
Gross Domestic Investment	4805.0	5404.0	5989.0	5695.0	4923.0	5134.0	5375.0	4903.0	4916.0	5926.0	4865.8	1007.0	5025.0
Gross Fixed Capital Formation	4712.0	4778.0	5261.0	5590.0	5746.0	5060.0	5385.0	5588.0	5363.0	5854.0	5198.8	1007.0	5025.0
Public												1007.0	2025.0
Private												0.0	3000.0
Increases in Stocks	93.0	626.0	728.0	105.0	-823.0	74.0	-10.0	-685.0	-447.0	72.0	-333.0	0.0	0.0
Gross Domestic Savings	4819.0	5478.0	5785.0	5394.0	4793.0	5018.0	5426.0	4798.0	4433.8	5407.8	3526.6	-2381.7	-34090.8
Net factor Income	29.7	92.0	116.3	57.6	27.9	11.5	0.6	2.9	1.2	-0.7	-26.4	-366.5	-1962.8
Current Transfers	50.5	61.3	56.5	51.9	56.2	49.6	45.5	55.3	55.8	84.4	120.0	1303.8	33641.0
Gross National Savings	4899.2	5631.3	5957.7	5503.5	4877.0	5079.1	5472.2	4856.1	4490.8	5491.5	3620.2	-1444.3	-2412.6
Gross National Product	15567.7	16165.0	16660.3	16781.6	16537.8	16874.5	17390.7	17255.8	17009.2	18680.3	16786.6	16107.4	46514.0
Memorandum Items:													
IFS Exchange Rate (Lek/US$)	8.7	8.7	8.7	8.7	8.7	8.7	8.0	8.0	8.0	8.0	8.0	14.6	70.1
GDP ($ Mln)	1786.0	1847.5	1901.6	1922.3	1897.7	1938.3	2173.8	2156.6	2126.0	2335.1	2101.6	1128.3	691.5

Source. Albanian Ministry of Finance and Economy, and World Bank staff estimates for 1991 and 1992.

a/ Private sector consumption taken as residual from 1988.

Table 2.3: Albania: GDP by Expenditure Category
(Millions of 1986 Leks)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991e	1992e
Gross Domestic Product	14881.0	15736.0	16200.0	16379.0	16174.0	16462.0	17390.0	17253.0	17008.0	18681.0	16813.0	12156.3	10974.2
Resource Balance	60.4	231.0	-729.4	-427.8	-317.6	-364.5	-71.3	-16.6	-482.2	-518.2	-1339.2	-2500.5	-8855.1
Exports, GNFS	3439.8	3616.5	3138.8	2980.5	2816.4	2672.7	2618.5	2668.4	2786.3	3351.4	2541.1	886.7	1269.5
Imports, GNFS	3379.4	3385.6	3868.2	3408.3	3134.1	3037.2	2689.8	2685.0	3268.6	3869.6	3880.3	3387.2	10124.6
Total Expenditures	14820.6	15505.0	16929.4	16806.8	16491.6	16826.5	17461.3	17269.6	17490.2	19199.2	18152.2	14656.8	19829.3
Consumption	10218.7	10214.4	11064.9	11229.3	11668.8	11814.6	12086.3	12366.6	12574.2	13273.2	13286.3	13913.8	18691.7
Private Sector a/	8892.3	8882.9	9687.2	9804.3	10164.1	10300.5	10473.3	10702.6	10965.2	11627.2	11633.9	11241.0	16320.3
Statistical Discrepancy	-47.0	-158.5	529.7	133.0	190.2	251.3	122.3	-88.4	195.2	0.0	0.0	0.0	0.0
Government	1326.4	1331.5	1377.7	1425.0	1504.7	1514.1	1613.0	1664.0	1609.0	1646.0	1652.5	2672.7	2371.4
Gross Domestic Investment	4601.8	5290.7	5864.5	5577.5	4822.8	5011.9	5375.0	4903.0	4916.0	5926.0	4865.8	743.1	1137.6
Gross Fixed Capital Formation	4512.8	4677.6	5151.6	5474.7	5629.1	4939.7	5385.0	5588.0	5363.0	5854.0	5198.8	743.1	1137.6
Public	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	743.1	458.4
Private	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	679.1
Increases in Stocks	89.1	612.9	712.9	102.8	-806.3	72.2	-10.0	-685.0	-447.0	72.0	-333.0	0.0	0.0
Gross Domestic Savings	4615.2	5363.2	5664.7	5282.7	4695.4	4898.7	5426.0	4798.0	4433.8	5407.8	3526.6	-1757.5	-7717.5
Net factor Income	28.5	90.1	113.9	56.4	27.3	11.3	0.6	2.9	1.2	-0.7	-26.4	-270.4	-444.3
Current Transfers	48.3	60.0	55.3	50.9	55.1	48.4	45.5	55.3	55.8	84.4	120.0	962.1	7615.7
Cross National Savings	4692.1	5513.3	5833.9	5390.0	4777.8	4958.3	5472.2	4856.1	4490.8	5491.5	3620.2	-1065.8	-546.2
Gross National Product	14909.5	15826.1	16313.9	16435.4	16201.3	16473.3	17390.7	17255.8	17009.2	18680.3	16786.6	11885.9	10529.9

Source: Albanian Ministry of Finance and Economy, and World Bank staff estimates for 1991 and 1992.

a/ Private sector consumption taken as residual from 1988.

Table 2.4: Albania: GDP by Expenditure Category
(As Share of GDP)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991e	1992e
Gross Domestic Product	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Resource Balance (GNFS)	0.4	1.5	-4.5	-2.6	-2.0	-2.2	-0.4	-0.1	-2.8	-2.8	-8.0	-20.6	-80.7
Exports, GNFS	23.1	23.0	19.4	18.2	17.4	16.2	15.1	15.5	16.4	17.9	15.1	7.3	11.6
Imports, GNFS	22.7	21.5	23.9	20.8	19.4	18.4	15.5	15.6	19.2	20.7	23.1	27.9	92.3
Total Expenditures	99.6	98.5	104.5	102.6	102.0	102.2	100.4	100.1	102.8	102.8	108.0	120.6	180.7
Consumption	68.7	64.9	68.3	68.6	72.1	71.8	69.5	71.7	73.9	71.1	79.0	114.5	170.3
Private Sector a/	59.8	56.4	59.8	59.9	62.8	62.6	60.2	62.0	64.5	62.2	69.2	92.5	148.7
Statistical Discrepancy	-0.3	-1.0	3.3	0.8	1.2	1.5	0.7	-0.5	1.1	0.0	0.0	0.0	0.0
Government	8.9	8.5	8.5	8.7	9.3	9.2	9.3	9.6	9.5	8.8	9.8	22.0	21.6
Gross Domestic Investment	30.9	33.6	36.2	34.1	29.8	30.4	30.9	28.4	28.9	31.7	28.9	6.1	10.4
Gross Fixed Capital Formation	30.3	29.7	31.8	33.4	34.8	30.0	31.0	32.4	31.5	31.3	30.9	6.1	10.4
Public	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	6.1	4.2
Private	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	6.2
Increases in Stocks	0.6	3.9	4.4	0.6	-5.0	0.4	-0.1	-4.0	-2.6	0.4	-2.0	0.0	0.0
Gross Domestic Savings	31.0	34.1	35.0	32.3	29.0	29.8	31.2	27.8	26.1	28.9	21.0	-14.5	-70.3
Net factor Income	0.2	0.6	0.7	0.3	0.2	0.1	0.0	0.0	0.0	0.0	-0.2	-2.2	-4.0
Current Transfers	0.3	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.5	0.7	7.9	69.4
Gross National Savings	31.5	35.0	36.0	32.9	29.5	30.1	31.5	28.1	26.4	29.4	21.5	-8.8	-5.0
Gross National Product	100.2	100.6	100.7	100.3	100.2	100.1	100.0	100.0	100.0	100.0	99.8	97.8	96.0

Source: Albanian Ministry of Finance and Economy, and World Bank staff estimates for 1991 and 1992.

a/ Private sector consumption taken as residual from 1988.

Table 2.5: Albania - Agricultural Production

	1975	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
In millions of current Leks													
Total Gross Agricultural Product	6338	6894	7012	7291	7975	7535	7821	8402	8441	7921	8772	8171	6961
Crop Production	3714	3940	4153	4477	4844	4465	4696	5080	4995	4423	4795	4202	2614
Grains	1073	1176	1124	1206	1347	1229	1363	1303	1341	1440	1373	1373	684
Maize	428	593	653	717	751	671	577	748	633	485	519	467	283
Rice	45	38	44	38	39	37	39	35	34	28	27	18	7
Potatoes	124	109	131	111	148	115	94	121	99	66	104	92	172
Vegetables	518	584	618	648	668	618	610	627	642	525	649	661	688
Kidney Beans a/	81	45	60	40	81	36	66	101	75	74	100	60	90
Tobacco	220	165	221	219	196	234	259	341	355	191	238	201	98
Sunflower Seeds	108	101	126	131	215	132	146	132	97	71	96	67	19
Cotton	119	85	118	119	89	112	152	164	144	87	100	70	7
Sugar Beets	62	83	91	96	96	75	69	58	58	38	79	51	19
Other b/	936	961	967	1102	1214	1206	1321	1450	1517	1418	1510	1142	547
Fruits and Olives, o/w:	532	565	589	611	691	556	578	539	572	537	602	530	444
Apples, Pears, Peaches, Figs	108	137	174	157	178	141	118	140	122	117	150	112	79
Grapes	132	139	141	160	161	158	163	127	155	150	158	183	150
Olives	73	58	51	38	108	17	72	38	81	50	66	22	89
Livestock	1790	2069	1971	1960	2117	2186	2204	2456	2571	2616	2807	2957	3484
Meat	515	672	679	579	590	661	682	877	925	874	862	944	1043
Milk	727	892	806	778	845	890	907	933	991	1066	1195	1276	1642
Eggs	97	119	126	143	159	175	177	189	210	212	240	255	244
Other c/	451	386	360	460	523	460	438	457	445	464	510	482	555
Forestry & Related Activ.	302	320	299	293	323	328	343	327	303	345	568	482	419
In millions of 1986 Leks													
Total Gross Agricultural Product	6420	6987	7245	7533	8240	7785	8081	8402	8441	7921	8772	8171	6076
Crop Production	3722	3946	4278	4562	4992	4597	4837	5080	4995	4423	4795	4202	2402
Grains	1045	1146	1124	1206	1347	1229	1363	1303	1341	1440	1373	1373	672
Maize	430	596	653	717	751	671	577	748	633	485	519	467	270
Rice	46	39	44	38	39	37	39	35	34	28	27	18	7
Potatoes	124	109	131	111	148	115	94	121	99	66	104	92	95
Vegetables	530	598	618	648	668	618	610	627	642	525	649	661	616
Kidney Beans	81	45	60	40	81	36	66	101	75	74	100	60	54
Tobacco	281	211	283	280	251	294	259	341	355	191	238	201	98
Sunflower Seeds	124	116	126	131	215	132	146	132	97	71	96	67	19
Cotton	136	96	124	125	94	118	162	164	144	87	100	70	7
Sugar Beets	62	83	91	96	96	75	69	58	58	38	79	51	17
Other a/	863	907	1024	1170	1302	1272	1452	1450	1517	1418	1510	1142	547
Fruits and Olives, o/w:	516	548	589	611	691	556	578	539	572	537	602	530	383
Apples, Pears, Peaches, Figs	102	129	174	157	178	141	118	140	122	117	150	112	67
Grapes	126	132	141	160	161	158	163	127	155	150	158	183	116
Olives	73	58	51	38	108	17	72	38	81	50	66	22	76
Livestock	1887	2180	2079	2067	2234	2304	2323	2456	2571	2616	2807	2957	2872
Meat	531	598	707	609	616	702	818	877	925	874	862	944	801
Milk	727	892	806	778	845	890	907	933	991	1066	1195	1276	1316
Eggs	102	132	126	143	159	175	177	189	210	212	240	255	200
Other c/	527	558	440	537	614	537	421	457	445	464	510	482	555
Forestry & Related Activ.	295	313	299	293	323	328	343	327	303	345	568	482	419
Real Value Increase													
Total Gross Agricultural Product			3.7	4.0	9.4	-5.5	3.8	4.0	0.5	-6.2	10.7	-6.9	-25.6
Crop Production			8.4	6.6	9.4	-7.9	5.2	5.0	-1.7	-11.5	8.4	-12.4	-42.8
Grains			-1.9	7.3	11.7	-8.8	10.9	-4.4	2.9	7.4	-4.7	0.0	-51.1
Maize			9.6	9.8	4.7	-10.7	-14.0	29.6	-15.4	-23.4	7.0	-10.0	-42.2
Rice			12.8	-13.6	2.6	-5.1	5.4	-10.3	-2.9	-17.6	-3.6	-33.3	-61.1
Potatoes			20.2	-15.3	33.3	-22.3	-18.3	28.7	-18.2	-33.3	57.6	-11.5	3.3
Vegetables			3.3	4.9	3.1	-7.5	-1.3	2.8	2.4	-18.2	23.6	1.8	-6.8
Kidney Beans			33.3	-33.3	102.5	-55.6	83.3	53.0	-25.7	-1.3	35.1	-40.0	-10.0
Tobacco			34.1	-1.1	-10.4	17.1	-11.9	31.7	4.1	-46.2	24.6	-15.5	-51.2
Sunflower Seeds			8.6	4.0	64.1	-38.6	10.6	-9.6	-26.5	-26.8	35.2	-30.2	-71.6
Cotton			29.2	0.8	-24.8	25.5	37.3	1.2	-12.2	-39.6	14.9	-30.0	-90.0
Sugar Beets			9.6	5.5	0.0	-21.9	-8.0	-15.9	0.0	-34.5	107.9	-35.4	-66.7
Other a/			12.9	14.3	11.3	-2.3	14.2	-0.1	4.6	-6.5	6.5	-24.4	-52.1
Fruits and Olives, o/w:			7.5	3.7	13.1	-19.5	4.0	-6.7	6.1	-6.1	12.1	-12.0	-27.7
Apples, Pears, Peaches, Figs			34.9	-9.8	13.4	-20.8	-16.3	18.6	-12.9	-4.1	28.2	-25.3	-40.2
Grapes			6.8	13.5	0.6	-1.9	3.2	-22.1	22.0	-3.2	5.3	15.8	-36.6
Olives			-12.1	-25.5	184.2	-84.3	323.5	-47.2	113.2	-38.3	32.0	-66.7	245.5
Livestock			-4.6	-0.6	8.1	3.1	0.8	6.7	4.7	1.8	7.3	5.3	-2.9
Meat			18.2	-13.9	1.1	14.0	16.5	7.2	5.5	-5.5	-1.4	9.5	-15.1
Milk			-9.6	-3.5	8.6	5.3	1.9	2.9	6.2	7.6	12.1	6.8	3.1
Eggs			-4.5	13.5	11.2	10.1	1.1	6.8	11.1	1.0	13.2	6.3	-21.6
Other c/			-21.1	22.0	14.3	-12.5	-21.6	8.6	-2.6	4.3	9.9	-5.5	15.1
Forestry & Related Activ.			-4.5	-2.0	10.2	1.6	4.6	-4.7	-7.3	13.9	64.6	-15.1	-13.1

Source: Statistics Department, Ministry of Agriculture and World Bank staff estimates for 1990-1991.

Table 2.6: Albania: Industrial Production
(Millions of Current Leks)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
Energy											
Electricity	922.0	719.0	676.0	557.0	619.0	567.0	594.0	543.0	527.0	543.0	463.0
Oil	1146.0	1093.0	1018.0	808.0	810.0	770.0	880.0	842.0	844.0	851.0	804.0
Mining											
Coal	187.0	203.0	219.0	235.0	256.0	265.0	263.0	263.0	274.0	276.0	261.0
Chromium	222.0	235.0	260.0	250.0	272.0	234.0	307.0	281.0	326.0	340.0	265.0
Copper	722.0	832.0	924.0	952.0	1097.0	1034.0	1304.0	1370.0	1461.0	1525.0	1134.0
Iron-Nickel	275.0	518.0	480.0	612.0	578.0	518.0	486.0	528.0	622.0	671.0	521.0
Manufacturing											
Chemical and Rubber	655.0	737.0	864.0	833.0	835.0	909.0	888.0	937.0	965.0	1017.0	857.0
Building Materials	1199.0	1116.0	1160.0	1154.0	1173.0	1029.0	1023.0	1008.0	983.0	996.0	879.0
Wood Processing	722.0	708.0	735.0	754.0	765.0	779.0	758.0	729.0	708.0	742.0	662.0
Paper	141.0	153.0	156.0	154.0	153.0	165.0	161.0	153.0	144.0	165.0	152.0
Machinery & Equipment	430.0	440.0	501.0	553.0	594.0	549.0	495.0	513.0	496.0	486.0	369.0
Spare Parts	420.0	433.0	462.0	493.0	498.0	503.0	466.0	485.0	493.0	513.0	482.0
Electrotechn. & Metalworks	1167.0	1276.0	1398.0	1451.0	1515.0	1535.0	1367.0	1396.0	1409.0	1490.0	1492.0
Glass and Ceramics	143.0	152.0	162.0	153.0	169.0	149.0	139.0	125.0	139.0	152.0	142.0
Other Minerals	89.0	100.0	102.0	105.0	117.0	103.0	109.0	110.0	108.0	115.0	116.0
Textile	0.0	778.0	771.0	815.0	741.0	822.0	793.0	778.0	778.0	795.0	713.0
Clothing	0.0	862.0	923.0	950.0	911.0	957.0	866.0	883.0	956.0	1146.0	1318.0
Leather Processing	0.0	301.0	320.0	325.0	345.0	326.0	317.0	350.0	385.0	412.0	432.0
Other Light Industry	2348.0	530.0	580.0	612.0	567.0	646.0	641.0	569.0	570.0	616.0	596.0
Tobacco Products	0.0	175.0	192.0	181.0	192.0	184.0	171.0	164.0	163.0	195.0	158.0
Fishery	0.0	42.0	52.0	45.0	48.0	61.0	58.0	66.0	74.0	66.0	78.0
Flour, Bread	0.0	1402.0	1412.0	1447.0	1511.0	1555.0	1543.0	1608.0	1635.0	1676.0	1720.0
Other Food & Beverages	4358.0	2843.0	2945.0	2992.0	3098.0	3003.0	3031.0	3153.0	3144.0	3273.0	3089.0
Print	113.0	117.0	118.0	120.0	118.0	121.0	121.0	123.0	120.0	130.0	124.0
Other	55.0	77.0	86.0	99.0	100.0	106.0	110.0	164.0	173.0	179.0	169.0
Total Gross Output	15314.0	15842.0	16516.0	16650.0	17082.0	16890.0	16891.0	17141.0	17497.0	18370.0	16996.0
Capital Goods	9796.0	10227.0	10560.0	10553.0	10950.0	10773.0	10951.0	10956.0	11177.0	11574.0	10237.0
Consumer Goods	5518.0	5615.0	5956.0	6097.0	6132.0	6117.0	5940.0	6185.0	6320.0	6796.0	6759.0
Turnover Taxes	3083.0	2750.0	2985.0	2894.0	2752.0	2847.0	3237.0	3350.0	3324.0	3325.0	4276.0
Social Production a/	18397.0	18592.0	19501.0	19544.0	19834.0	19737.0	20128.0	20491.0	20821.0	21695.0	21272.0
Material Inputs	12615.0	12888.0	13533.0	13616.0	13986.0	13851.0	13932.0	14215.0	14511.0	14873.0	15185.0
Net Material Production	5782.0	5704.0	5968.0	5928.0	5848.0	5886.0	6196.0	6276.0	6310.0	6822.0	6486.0

Source: Albanian Ministry of Heavy Industry, Mining and Energy.

a/ Turnover taxes account for the difference between gross output and social production.

Table 2.7: Albania: Industrial Production
(Millions of 1986 Leks)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
Energy											
Electricity	486.0	557.0	524.0	432.0	480.0	439.0	594.0	543.0	527.0	543.0	463.0
Oil	1214.0	1181.0	1115.0	880.0	879.0	837.0	880.0	842.0	844.0	851.0	804.0
Mining											
Coal	182.0	197.0	212.0	229.0	248.0	257.0	263.0	263.0	274.0	276.0	261.0
Chromium	230.0	250.0	235.0	257.0	278.0	256.0	307.0	281.0	326.0	340.0	265.0
Copper	852.0	935.0	1042.0	1071.0	1234.0	1162.0	1304.0	1370.0	1461.0	1525.0	1134.0
Iron-Nickel	397.0	511.0	474.0	602.0	570.0	512.0	486.0	528.0	622.0	671.0	521.0
Manufacturing											
Chemical and Rubber	625.0	678.0	799.0	770.0	772.0	841.0	888.0	937.0	965.0	1017.0	857.0
Building Materials	1045.0	1071.0	1111.0	1106.0	1123.0	985.0	1023.0	1008.0	983.0	996.0	879.0
Wood Processing	655.0	669.0	695.0	712.0	723.0	736.0	758.0	729.0	708.0	742.0	662.0
Paper	123.0	133.0	136.0	134.0	133.0	144.0	161.0	153.0	144.0	165.0	152.0
Machinery & Equipment	350.0	372.0	425.0	468.0	503.0	465.0	495.0	513.0	496.0	486.0	369.0
Spare Parts	327.0	350.0	374.0	399.0	404.0	407.0	466.0	485.0	493.0	513.0	482.0
Electrotechn. & Metalworks	990.0	1129.0	1234.0	1283.0	1337.0	1356.0	1367.0	1396.0	1409.0	1490.0	1492.0
Glass and Ceramics	118.0	132.0	140.0	132.0	146.0	131.0	139.0	125.0	139.0	152.0	142.0
Other Minerals	86.0	105.0	107.0	110.0	124.0	109.0	109.0	110.0	108.0	115.0	116.0
Textile	700.0	736.0	729.0	771.0	701.0	778.0	793.0	778.0	778.0	795.0	713.0
Clothing	812.0	829.0	887.0	914.0	878.0	922.0	866.0	883.0	956.0	1146.0	1318.0
Leather Processing	265.0	279.0	298.0	302.0	319.0	302.0	317.0	350.0	385.0	412.0	432.0
Other Light Industry	288.0	389.0	431.0	455.0	420.0	484.0	641.0	569.0	570.0	616.0	586.0
Tobacco Products	145.0	150.0	165.0	155.0	165.0	158.0	171.0	164.0	163.0	195.0	158.0
Fishery	38.0	42.0	52.0	45.0	48.0	61.0	58.0	66.0	74.0	66.0	78.0
Flour, Bread	1348.0	1390.0	1400.0	1435.0	1499.0	1543.0	1543.0	1608.0	1635.0	1676.0	1720.0
Other Food & Beverages	2712.0	2820.0	2920.0	2965.0	3069.0	2976.0	3031.0	3153.0	3144.0	3273.0	3089.0
Print	105.0	111.0	113.0	114.0	112.0	116.0	121.0	123.0	120.0	130.0	124.0
Other	52.0	59.0	76.0	110.0	97.0	105.0	110.0	164.0	173.0	179.0	169.0
Total Gross Output	14145.0	15085.0	15724.0	15851.0	16262.0	16082.0	16891.0	17141.0	17497.0	18370.0	16996.0
Capital Goods	9024.0	9705.0	10014.0	10015.0	10387.0	10224.0	10951.0	10956.0	11177.0	11574.0	10237.0
Consumer Goods	5121.0	5380.0	5710.0	5836.0	5875.0	5858.0	5940.0	6185.0	6320.0	6796.0	6759.0
Turnover Taxes	2956.0	3011.0	3255.0	3180.0	3042.0	3128.0	3237.0	3350.0	3324.0	3325.0	4276.0
Social Production a/	17101.0	18096.0	18979.0	19031.0	19304.0	19210.0	20128.0	20491.0	20821.0	21695.0	21272.0
Material Inputs	11877.0	12633.0	13264.0	13354.0	13704.0	13573.0	13932.0	14215.0	14511.0	14873.0	15185.0
Net Material Production	5224.0	5463.0	5715.0	5677.0	5600.0	5637.0	6196.0	6276.0	6310.0	6822.0	5486.0

Source: Albanian Ministry of Heavy Industry, Mining and Energy.

a/ Turnover taxes account for the difference between gross output and social production.

Table 3.1: Albania - Consolidated Balance of Payments a/
(Millions of US$)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991e	1992e
Current Account Balance	15.9	45.1	-67.0	-38.3	-28.1	-36.5	-3.1	5.2	-53.1	-54.3	-155.7	-167.9	-108.1
CAB Excluding Official Transfers	15.9	45.1	-67.0	-38.3	-28.1	-36.5	-3.1	5.2	-53.1	-55.8	-155.7	-249.1	-438.0
Trade Balance	13.3	35.9	-77.9	-41.9	-34.1	-40.7	-5.3	-4.4	-63.7	-77.1	-169.8	-207.9	-454.0
Exports, fob	367.2	416.8	360.4	341.6	319.7	304.1	311.3	311.2	318.6	378.7	286.1	73.1	70.0
Imports, fob	353.9	383.7	438.3	383.5	353.8	344.7	316.6	315.6	382.3	455.8	455.9	281.0	524.0
Non-Factor Services	-8.7	-7.5	-8.9	-9.0	-3.7	-2.9	-3.7	2.4	3.5	12.3	2.4	-24.2	-104.0
Receipts	10.9	11.9	13.2	13.1	15.4	15.0	16.0	22.4	29.7	40.2	31.5	9.2	10.0
Shipment & Oth Trans	5.1	5.7	6.2	5.9	7.2	6.2	6.8	7.6	7.3	8.8	7.0	2.5	
Travel	0.7	1.0	0.5	0.5	0.6	0.6	1.1	2.0	3.0	3.3	3.5	0.1	
Other	5.2	5.2	6.5	6.6	7.6	6.2	8.1	12.7	19.3	28.1	21.0	6.6	10.0
Expenditures	17.5	19.4	22.1	22.1	19.1	17.9	19.7	20.0	26.2	27.9	29.[illegible]	33.4	114.0
Shipment & Oth Trans	6.5	6.8	10.6	10.7	7.6	5.5	7.3	5.9	10.1	10.2	8.5	5.6	
Travel & Insurance	1.6	1.8	2.1	1.9	1.7	1.7	1.6	1.6	1.9	2.3	2.2	0.5	
Other	7.2	8.8	9.2	9.5	9.7	10.6	10.8	12.5	14.2	15.4	18.4	27.3	114.0
Factor Services	3.4	10.6	13.4	6.6	3.2	1.3	0.1	0.4	0.2	-0.1	-3.3	-25.1	-28.0
Interest Receipts	7.4	12.9	14.7	7.7	4.3	2.3	0.8	1.1	0.9	0.4	0.0	0.8	2.0
Net Others													
Interest Expenditures	3.9	1.6	1.3	1.1	1.1	0.9	0.7	0.7	0.7	0.5	3.3	25.9	30.0
Unrequitted Transfers, Net	5.8	7.1	6.5	6.0	6.5	5.7	5.7	6.9	7.0	10.6	15.0	89.3	479.9
Private	5.8	7.1	6.5	6.0	6.5	5.7	5.7	6.9	7.0	9.1	15.0	8.1	148.0
Receipts	5.8	7.1	6.5	6.0	6.5	5.7	5.7	6.9	7.0	9.1	15.0	8.1	148.0
Payments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Official	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.5	0.0	81.2	331.9
Capital Account	-17.9	-57.4	35.6	-29.1	8.3	12.6	-0.5	-2.0	37.8	-10.2	123.3	50.6	95.1
Direct Foreign Investment													21.0
MLT Net Disbursements	-9.7	-3.5	-3.5	-2.6	-2.8	-2.7	-2.1	-2.0	-2.0	-1.9	27.1	21.4	78.1
Short-Term Capital, net	-8.2	-53.9	39.3	-26.3	11.1	15.3	1.6	0.0	39.8	-8.3	96.2	29.2	5.0
Other Capital												0.0	-9.0
Errors and Omissions	-10.7	20.3	-1.7	26.4	7.9	6.2	3.6	10.9	20.6	4.7	3.4	-34.3	-176.6
Overall Balance	-12.7	8.0	-32.8	-41.0	-12.0	-17.6	0.0	14.1	5.5	-59.8	-29.0	-184.2	-24.6
Financing of Overall Balance	12.7	-8.0	32.6	41.0	12.0	17.6	0.0	-14.1	-5.5	59.8	29.0	184.2	24.6
Change in Reserves (-=Inc.)	-3.2	-28.0	13.3	41.4	11.7	17.4	1.4	-11.8	-127.0	-263.9	194.2	223.8	-27.0
Memorandum Items:													
Exchange Rate (Leks/US$)	9.5	8.6	8.6	8.6	8.6	8.6	8.0	8.0	8.0	8.0	8.0	14.8	70.1
Resource Balance	6.6	27.5	-86.8	-50.9	-37.8	-43.5	-8.9	-2.1	-60.3	-64.6	-167.4	-232.1	-558.0
Exports, GNFS	378.1	430.5	373.6	354.7	335.1	319.1	327.3	333.6	348.3	416.9	317.6	82.3	80.0
Imports, GNFS	371.4	403.0	460.4	405.6	372.9	362.6	336.2	335.6	408.6	483.7	485.0	314.4	638.0

Source: Albanian Ministry of Finance and Economy and staff calculations.

a/ Includes balance of payments in non-convertible currencies.
Note: 1991 and 1992 based on World Bank and IMF staff estimates.

Table 4.1: Monetary Survey
(Million Leks, end-of-period)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991e	1992e
Net Foreign Assets	473.5	448.9	498.1	434.4	405.2	451.2	487.5	497.7	150.2	-769.7	-2490.0	-13873.0	-37368.0
Foreign Assets	630.5	708.1	666.9	546.0	513.5	529.5	630.8	720.6	1540.2	3645.2	1620.0	806.0	8841.0
Foreign Liabilities a/	157.0	259.2	168.8	111.6	108.3	78.3	143.3	222.8	1390.0	4414.9	4110.0	14679.0	46209.0
Total Domestic Credit	3836.1	4341.2	4551.4	5130.3	5139.7	5505.2	5696.5	6428.4	6381.4	7754.0	9452.9	18915.0	31772.6
To Government (Net)	-3951.4	-3895.0	-4014.3	-3345.9	-2968.0	-2559.7	-2523.1	-2274.8	-2246.4	-1336.3	-651.2	7662.2	20234.0
To the Economy	7787.5	8236.3	8565.6	8476.3	8107.7	8064.9	8219.5	8703.3	8627.8	9090.3	10104.1	11252.8	11538.6
State Enterprises	5865.0	6168.0	6438.9	6377.2	5901.4	5873.1	5626.1	5926.4	5711.2	6000.0	6671.2	6876.6	6818.6
State Farms	689.0	677.0	710.0	712.0	765.0	800.0	993.0	1085.0	1175.0	1317.0	1538.0	1945.8	3344.6
Cooperatives	1127.0	1284.0	1306.0	1271.0	1318.0	1260.0	1458.0	1536.0	1573.0	1590.0	1700.0	1942.3	0.0
Households	106.5	107.3	110.6	116.1	123.2	131.8	142.5	155.9	168.6	183.4	194.9	488.1	175.2
Private Sector													1200.2
Broad Money (M2)	2670.2	2703.6	2688.2	2960.0	3045.0	3173.0	3403.4	3646.9	3931.3	4514.4	5570.0	11383.6	28369.0
Currency in Circulation	703.3	757.3	800.2	911.2	944.5	967.1	1035.2	1162.4	1233.9	1241.7	1694.9	4439.2	9897.1
Deposits b/	1966.9	1946.3	1888.0	2068.8	2100.5	2205.9	2368.2	2484.5	2697.4	3272.7	3874.9	6944.9	18874.3
Domestic Currency Deposits	1966.9	1946.3	1888.0	2068.8	2100.5	2205.9	2368.2	2484.5	2696.7	3270.5	3758.9	6792.9	12030.9
State Enterprises	1000.9	894.3	752.0	817.8	785.5	704.9	834.2	777.5	879.7	1278.5	1588.9	2936.0	5330.0
State Farms	62.0	69.0	73.0	96.0	75.0	69.0	65.0	78.0	83.0	76.0	104.0	167.0	0.0
Cooperatives	204.0	248.0	275.0	264.0	255.0	361.0	286.0	300.0	256.0	349.0	359.0	96.7	0.0
Private Business													606.7
Household Demand Deposits	405.0	415.0	445.0	507.0	558.0	606.0	670.0	755.0	832.0	864.0	917.0	2230.6	1330.2
Household Time Deposits	295.0	320.0	343.0	384.0	427.0	465.0	513.0	574.0	646.0	703.0	790.0	1362.6	4362.1
Other Time Deposits													401.9
Foreign Currency Deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.7	2.2	116.0	152.0	6843.4
Other Items (Net)	2167.9	2472.6	2509.9	2665.0	2568.5	2840.4	2863.1	2690.8	2554.2	3202.5	1392.9	-6341.6	-33964.4
Memorandum Items:													
Narrow Money c/	1108.3	1172.3	1245.2	1418.2	1502.5	1573.1	1705.2	1917.4	2065.9	2105.7	2611.9	6669.[illegible]	17163.5
Velocity of Broad Money (M2)	5.8	5.9	6.2	5.6	5.4	5.3	5.1	4.7	4.3	4.1	3.0	1.4	1.7
GDP at Market Prices	15538.0	16073.0	16544.0	16724.0	16510.0	16863.0	17390.0	17253.0	17006.0	16681.0	16813.0	16473.6	48476.8

Source: Albanian Ministry of Finance; World Bank and IMF Staff estimates for 1991 and 1992.

a/ Including arrears.
b/ Time and demand deposits of state enterprises, state farms and cooperatives cannot be separated on the basis of information available. Their liquidity is, de facto, constrained, and not comparable to international standards.
c/ Sum of currency in circulation and household demand deposits. Since the liquidity of household demand deposits is limited, the definition of narrow money adopted is not comparable to international standards.

Table 4.2: Monetary Survey
(As Percent of GDP)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991e	1992e
Net Foreign Assets	3.0	2.8	3.0	2.6	2.5	2.7	2.8	2.9	0.9	-4.1	-14.8	-84.2	-77.1
Foreign Assets	4.1	4.4	4.0	3.3	3.1	3.1	3.6	4.2	9.1	19.5	9.6	4.9	18.2
Foreign Liabilities a/	1.0	1.6	1.0	0.7	0.7	0.5	0.8	1.3	8.2	23.6	24.4	89.1	95.3
Total Domestic Credit	24.7	27.0	27.5	30.7	31.1	32.6	32.8	37.3	37.5	41.5	56.2	114.8	65.5
To Government (Net)	-25.4	-24.2	-24.3	-20.0	-18.0	-15.2	-14.5	-13.2	-13.2	-7.2	-3.9	46.5	41.7
To the Economy	50.1	51.2	51.8	50.7	49.1	47.8	47.3	50.4	50.7	48.7	60.1	68.3	23.8
State Enterprises	37.7	38.4	38.9	38.1	35.7	34.8	32.4	34.4	33.6	32.1	39.7	41.7	14.1
State Farms	4.4	4.2	4.3	4.3	4.[illegible]	4.7	5.7	6.3	6.9	7.0	9.1	11.8	6.9
Cooperatives	7.3	8.0	7.9	7.6	8.0	7.5	8.4	8.9	9.2	8.5	10.1	11.8	0.0
Households	0.7	0.7	0.7	0.7	0.7	0.8	0.8	0.9	1.0	1.0	1.2	3.0	0.4
Private Sector	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	2.5
Broad Money (M2)	17.2	16.8	16.2	17.8	18.4	18.8	19.6	21.1	23.1	24.2	33.1	69.1	58.5
Currency in Circulation	4.5	4.7	4.8	5.4	5.7	5.7	6.0	6.7	7.3	6.6	10.1	26.9	20.4
Deposits b/	12.7	12.1	11.4	12.4	12.7	13.1	13.6	14.4	15.9	17.5	23.0	42.2	38.9
Domestic Currency Deposits	12.7	12.1	11.4	12.4	12.7	13.1	13.6	14.4	15.9	17.5	22.4	41.2	24.8
State Enterprises	6.4	5.6	4.5	4.9	4.8	4.2	4.8	4.5	5.2	6.8	9.5	17.8	11.0
State Farms	0.4	0.4	0.4	0.6	0.5	0.4	0.4	0.5	0.5	0.4	0.6	1.0	0.0
Cooperatives	1.3	1.5	1.7	1.6	1.5	2.1	1.6	1.7	1.5	1.9	2.1	0.6	0.0
Private Business	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.3
Household Demand Deposits	2.6	2.6	2.7	3.0	3.4	3.6	3.9	4.4	4.9	4.6	5.5	13.5	2.7
Household Time Deposits	1.9	2.0	2.1	2.3	2.6	2.8	2.9	3.3	3.8	3.8	4.7	8.3	9.0
Foreign Currency Deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.7	0.9	14.1
Other Items (Net)	14.0	15.4	15.2	15.9	15.6	16.8	16.5	15.6	15.0	17.1	8.3	-38.5	-70.1
Memorandum Items:													
Narrow Money c/	7.1	7.3	7.5	8.5	9.1	9.3	9.8	11.1	12.1	11.3	15.5	40.5	35.4
GDP at Market Prices	15538.0	16073.0	16544.0	16724.0	16510.0	16863.0	17390.0	17253.0	17008.0	18681.0	16813.0	16473.8	48476.8

Source: Albanian Ministry of Finance and World Bank and IMF Staff estimates.

a/ Including arrears.

b/ Time and demand deposits of state enterprises, state farms and cooperatives cannot be separated on the basis of information available. Their liquidity is, de facto, constrained, and not comparable to international standards.

c/ Sum of currency in circulation and household demand deposits. Since the liquidity of household demand deposits is limited, the definition of narrow money adopted is not comparable to international standards.

Table 4.3: Monetary Survey
(Percent Change)

	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991e	1992e
Net Foreign Assets	-5.2	11.0	-12.8	-6.7	11.4	8.0	2.1	-69.8	-612.5	223.5	457.1	169.4
Foreign Assets	12.3	-5.8	-18.1	-6.0	3.1	19.1	14.2	113.7	136.7	-55.6	-50.2	996.9
Foreign Liabilities a/	35.1	-34.9	-33.9	-3.0	-27.7	83.0	55.5	523.9	217.6	-6.9	257.2	214.8
Total Domestic Credit	13.2	4.8	12.7	0.2	7.1	3.5	12.8	-0.7	21.5	21.9	100.1	68.0
To Government (Net)	-1.4	3.1	-16.7	-11.3	-13.8	-1.4	-9.8	-1.2	-40.5	-51.3	-1276.6	164.1
To the Economy	5.8	4.0	-1.0	-4.3	-0.5	1.9	5.9	-0.9	5.4	11.2	11.4	2.5
State Enterprises	5.2	4.4	-1.0	-7.5	-0.5	-4.2	5.3	-3.6	5.1	11.2	3.1	-0.6
State Farms	-1.7	4.9	0.3	7.4	4.6	24.1	9.3	8.3	12.1	16.8	26.5	71.9
Cooperatives	13.9	1.7	-2.7	3.7	-4.4	15.7	5.3	2.4	1.1	6.9	14.3	-100.0
Households	0.8	3.3	4.8	6.1	7.0	8.1	9.4	8.1	8.8	6.3	150.4	-64.1
Private Sector												
Broad Money (M2)	1.3	-0.6	10.9	2.2	4.2	7.3	7.2	7.8	14.8	23.4	104.4	149.2
Currency in Circulation	7.7	5.7	13.9	3.7	2.4	7.0	12.3	6.2	0.6	36.5	161.9	122.9
Deposits b/	-1.0	-3.0	9.6	1.5	5.0	7.4	4.9	8.6	21.3	18.4	79.2	171.8
Domestic Currency Deposits	-1.0	-3.0	9.6	1.5	5.0	7.4	4.9	8.5	21.3	14.9	80.7	77.1
State Enterprises	-10.7	-15.9	8.7	-3.9	-10.3	18.3	-6.6	13.1	45.3	24.3	84.8	81.5
State Farms	11.3	5.8	31.5	-21.9	-8.0	-5.8	20.0	6.4	-8.4	36.8	60.6	-100.0
Cooperatives	21.6	10.9	-4.0	-3.4	41.6	-20.8	4.9	-14.7	36.3	2.9	-73.1	-100.0
Private Business												
Household Demand Deposits	2.5	7.2	13.9	10.1	8.6	10.6	12.7	10.2	3.8	6.1	143.2	-40.4
Household Time Deposits	8.5	7.2	12.0	11.2	8.9	10.3	11.9	12.5	8.8	12.4	72.5	220.1
Foreign Currency Deposits									214.3	5172.7	31.0	4402.2
Other Items (Net)	14.1	1.5	6.2	-3.6	10.6	0.8	-6.0	-5.1	25.4	-56.5	-555.3	435.6
Memorandum Items:												
Narrow Money c/	5.9	6.2	13.9	5.9	4.7	8.4	12.4	7.7	1.9	24.0	155.4	157.3

Source: Albanian Ministry of Finance and World Bank and IMF Staff estimates.

a/ Including arrears.
b/ Time and demand deposits of state enterprises, state farms and cooperatives cannot be separated on the basis of information available. Their liquidity is, de facto, constrained, and not comparable to international standards.
c/ Sum of currency in circulation and household demand deposits. Since the liquidity of household demand deposits is limited, the definition of narrow money adopted is not comparable to international standards.

Table 4.4: Albania - CPI and Inflation

	Index	Inflation
1991	135.5	35.5%
1st Quarter	105.3	5.3%
2nd Quarter	122.0	15.8%
3rd Quarter	140.0	14.8%
4th Quarter	174.7	24.8%
January	100.0	0.0%
February	106.0	6.0%
March	110.0	3.8%
April	115.0	4.5%
May	123.0	7.0%
June	128.0	4.1%
July	135.0	5.5%
August	140.0	3.7%
September	145.0	3.6%
October	150.0	3.4%
November	170.0	13.3%
December	204.2	20.1%
1992	441.7	226.0%
1st Quarter	255.2	46.1%
2nd Quarter	333.2	30.6%
3rd Quarter	505.0	51.6%
4th Quarter	673.5	33.4%
January	224.4	9.9%
February	256.2	14.2%
March	285.0	11.2%
April	310.6	9.0%
May	334.8	7.8%
June	354.1	5.8%
July	377.4	6.6%
August	549.7	45.7%
September	588.0	7.0%
October	655.3	11.4%
November	678.2	3.5%
December	687.1	1.3%
1993	817.6	85.1%
1st Quarter	757.1	12.4%
2nd Quarter	769.0	1.6%
3rd Quarter	847.3	10.2%
4th Quarter	896.9	5.8%
January	733.8	6.8%
February	765.3	4.3%
March	772.3	0.9%
April	771.4	-0.1%
May	767.5	-0.5%
June	768.2	0.1%
July	828.3	7.8%
August	838.8	1.3%
September	874.9	4.3%
October	891.5	1.9%
November e/	896.8	0.6%
December e/	902.2	0.6%
Memo:		
1991 Year-on-year Inflation		104.2%
1992 Year-on-year Inflation		236.5%
1993 Year-on-year Inflation		31.3%

Source: Albania Institute of Statistics.

Table 5.1: Albania: Consolidated General Government Budget Operations
(Million Leks)

	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991e	1992e
Total Revenue	8282.0	8363.0	8403.0	8533.0	8473.0	8488.0	9052.0	9003.0	7888.0	4702.0	9562.0
Current Revenue	8282.0	8363.0	8403.0	8533.0	8473.0	8488.0	9052.0	9003.0	7888.0	4702.0	9562.0
Tax Revenue	7400.0	7252.0	7463.0	7694.0	7828.0	7978.0	7707.0	8250.0	7039.0	4394.0	8453.0
Turnover Tax	3586.0	3462.0	3210.0	3321.0	3883.0	3934.0	3880.0	4224.0	3936.0	2258.0	2365.0
Profit and Income Taxes	3239.0	3145.0	2561.0	2600.0	1999.0	1972.0	1837.0	2067.0	1335.0	484.0	1587.0
State Enterprises	3128.0	3020.0	2443.0	2467.0	1870.0	1864.0	1749.0	1974.0	1273.0	481.0	--
Agricultural Coops	111.0	125.0	118.0	133.0	129.0	108.0	88.0	93.0	62.0	3.0	--
Personal											216.0
Customs Duties										94.0	1504.0
Excise Duties											1284.0
Employer Social Insurance Fund Contrib.	575.0	645.0	661.0	668.0	622.0	863.0	889.0	922.0	967.0	1433.0	1700.0
Other a/	0.0	0.0	1031.0	1105.0	1124.0	1209.0	1101.0	1037.0	852.0	124.0	33.0
Non-tax Revenue	882.0	1111.0	940.0	839.0	645.0	510.0	1345.0	753.0	778.0	308.0	1109.0
Total Expenditures	8586.6	9013.0	9147.0	8888.9	8482.0	8776.1	9255.9	10603.7	10310.5	10202.0	23432.6
Current Expenditures	3946.5	4227.9	4183.9	4417.8	4123.0	4397.0	4753.7	5162.6	7287.0	9195.0	21382.1
Wage Bill	1059.5	1092.7	1123.6	1128.7	1176.0	1209.0	1216.7	1238.0	1391.0	1854.0	5375.0
Operation & Mgmt	764.0	784.0	794.0	795.0	653.0	703.0	694.0	738.0	1723.0	1768.0	5100.4
Other	184.0	183.0	192.0	204.0	165.0	133.0	133.0	169.0	96.0	246.0	851.1
Interest Payments	34.0	32.0	31.0	30.0	25.0	26.0	25.0	70.0	0.0	0.0	650.0
Domestic	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External	34.0	32.0	31.0	30.0	25.0	26.0	25.0	70.0	0.0	0.0	650.0
Subsidies and Transfers	1905.0	2136.2	2043.1	2260.1	2104.0	2326.0	2685.0	2947.6	4077.0	5327.0	9405.6
Pensions (Soc Security)		884.0	971.0	1035.0	1106.0	1162.0	1236.0	1331.0	1440.0	1982.0	3386.0
Other Social Assistance b/											3730.6
Subsidies		1252.2	1072.1	1225.1	998.0	1164.0	1449.0	1616.6	2637.0	3345.0	2289.0
Subsidies to Enterprises		969.2	788.1	907.1	736.0	841.0	1149.0	1241.6	2334.0	2932.0	2289.0
Budgetary		629.0	543.0	592.0	635.0	486.0	396.0	508.0	257.0	744.0	2289.0
Extra-Budgetary		339.2	245.1	315.1	103.0	355.0	753.0	735.6	2077.0	2188.0	0.0
Foreign Trade Subsidies		30.0	186.0	99.0	10.0	0.0	355.0	14.0	354.0	--	0.0
Other		153.0	146.0	315.0	0.0	0.0	525.0	478.0	1350.0	--	0.0
Construction Price Subsidies		284.0	284.0	280.0	229.0	323.0	286.0	314.0	295.0	413.0	0.0
Agriculture Bank		0.0	20.0	38.0	31.0	0.0	14.0	61.0	8.0	0.0	0.0
Capital Expenditure	4630.5	4670.2	4901.3	4412.3	4440.0	4440.0	4491.3	5474.0	3162.0	1007.0	2050.5
Fixed Investment	4630.5	4670.2	5352.2	4412.3	[illegible]	4440.0	4491.3	5474.0	3162.0	1007.0	2050.5
Material Sphere	3708.0	3781.9	4370.0	3441.0	[illegible]	3418.0	3483.0	4440.0	3162.0	1007.0	2050.5
Budgetary	3708.0	3569.0	3919.0	3441.0	3429.0	3418.0	3306.0	3433.0	2880.0	1007.0	2050.5
Extra-Budgetary	0.0	212.9	451.0	0.0	0.0	0.0	177.0	1007.0	482.0	0.0	0.0
Nonmaterial Sphere	924.5	888.3	982.2	971.3	1011.0	1022.0	1008.3	1034.0			
Funds of Council of Ministers and Ministries	9.6	114.9	61.8	58.8	-61.0	-60.9	10.9	-32.9	-138.5	0.0	0.0
Overall Balance excluding Grants	-304.6	-650.0	-744.0	-355.9	-9.0	-288.1	-203.9	-1600.7	-2583.0	-5500.0	-13870.6
Grants c/										466.0	2939.0
Overall Budget Including Grants										-5034.0	-10931.6
Financing:											
Domestic	-17.4	650.0	744.0	355.9	9.0	288.1	203.9	1600.7	2556.0	4637.8	10828.6
Net Position with the SBA	47.9	453.0	722.9	653.7	-121.2	-39.5	250.6	880.5	-171.2	-686.0	0.0
Bank Credit to Government	-65.3	197.0	21.1	-297.8	130.2	327.6	-46.7	148.4	799.0	7860.2	10828.5
Domestic Arrears (to Enterprises)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	571.7	1928.2	-2556.4	200.1
Foreign	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	27.0	396.2	103.0

Source: Albanian Ministry of Finance and World Bank staff estimates.

a/ Transfer of amortization through 1991; 1992 includes minor taxes.
b/ Includes unemployment benefits, rural poverty assistance, price subsidies, and political prisoner program.
c/ Represents grant counterpart sales revenue.

Table 5.2: Albania: Consolidated General Government Budget Operations
(As Percent of GDP)

	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991e	1992e
Total Revenue	50.1	50.0	50.9	50.6	48.7	49.2	53.2	48.2	46.8	28.5	19.7
Current Revenue	50.1	50.0	50.9	50.6	48.7	49.2	53.2	48.2	46.8	28.5	19.7
Tax Revenue	44.7	43.4	45.2	45.6	45.0	48.2	45.3	44.2	42.2	28.7	17.4
Turnover Tax	21.7	20.7	19.4	19.7	22.3	22.6	22.8	22.6	23.4	13.7	4.9
Profit and Income Taxes	19.6	18.8	15.5	15.4	11.5	11.4	10.8	11.1	7.9	2.9	3.3
State Enterprises	18.9	18.1	14.8	14.6	10.8	10.8	10.3	10.6	7.6	2.9	0.0
Agricultural Coops	0.7	0.7	0.7	0.8	0.7	0.6	0.5	0.5	0.4	0.0	0.0
Personal										0.0	0.4
Customs Duties										0.6	3.1
Excise Duties										0.0	2.8
Employer Social Insurance Fund Contrib.	3.5	3.9	4.0	4.0	4.7	5.0	5.2	4.9	5.8	8.7	3.5
Other a/	0.0	0.0	6.2	6.6	6.5	7.0	6.5	5.6	5.1	0.8	0.1
Non-tax Revenue	5.3	6.6	5.7	5.0	3.7	3.0	7.9	4.0	4.6	1.9	2.3
Total Expenditures	51.9	53.9	55.4	52.7	48.8	50.9	54.4	58.8	61.3	61.9	48.3
Current Expenditures	23.9	25.3	25.3	26.2	23.7	25.5	27.9	27.6	43.3	55.8	44.1
Wage Bill	6.4	6.5	6.8	6.7	6.8	7.0	7.2	6.6	8.3	11.3	11.1
Operation & Mgmt	4.6	4.7	4.8	4.7	3.8	4.1	4.1	4.0	10.2	10.7	10.5
Other	1.1	1.1	1.2	1.2	0.9	0.8	0.8	0.9	0.6	1.5	1.8
Interest Payments	0.2	0.2	0.2	0.2	0.1	0.2	0.1	0.4	0.0	0.0	1.3
Domestic	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External	0.2	0.2	0.2	0.2	0.1	0.2	0.1	0.4	0.0	0.0	1.3
Subsidies and Transfers	11.5	12.8	12.4	13.4	12.1	13.5	15.8	15.8	24.2	32.3	19.4
Pensions (Soc Security)	0.0	5.3	5.9	6.1	6.4	6.7	7.3	7.1	8.6	12.0	7.0
Other Social Assistance b/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	7.7
Subsidies	0.0	7.5	6.5	7.3	5.7	6.7	8.5	8.7	15.7	20.3	4.7
Subsidies to Enterprises	0.0	5.8	4.8	5.4	4.2	4.9	6.8	6.6	13.9	17.8	4.7
Budgetary	0.0	3.8	3.3	3.5	3.7	2.8	2.3	2.7	1.5	4.5	4.7
Extra-Budgetary	0.0	2.0	1.5	1.9	0.6	2.1	4.4	3.9	12.4	13.3	0.0
Foreign Trade Subsidies	0.0	0.2	1.1	0.6	0.1	0.0	2.1	0.1	2.1	0.0	0.0
Other	0.0	0.9	0.9	1.9	0.0	0.0	3.1	2.5	8.0	0.0	0.0
Construction Price Subsidies	0.0	1.7	1.6	1.7	1.3	1.9	1.7	1.7	1.8	2.5	0.0
Agriculture Bank	0.0	0.0	0.1	0.2	0.2	0.0	0.1	0.3	0.0	0.0	0.0
Capital Expenditure	28.0	27.9	29.7	26.2	25.5	25.7	26.4	29.3	18.8	6.1	4.2
Fixed Investment	28.0	27.9	32.4	26.2	25.5	25.7	26.4	29.3	18.8	6.1	4.2
Material Sphere	22.4	22.6	26.5	20.4	19.7	19.8	20.5	23.8	18.8	6.1	4.2
Budgetary	22.4	21.3	23.7	20.4	19.7	19.8	19.4	18.4	15.9	6.1	4.2
Extra-Budgetary	0.0	1.3	2.7	0.0	0.0	0.0	1.0	5.4	2.9	0.0	0.0
Nonmaterial Sphere	5.6	5.3	5.9	5.8	5.8	5.9	5.9	5.5	0.0	0.0	0.0
Funds of Council of Ministers and Ministries	0.1	0.7	0.4	0.3	-0.5	-0.4	0.1	-0.2	-0.8	0.0	0.0
Overall Balance	-1.8	-3.9	-4.5	-2.1	-0.1	-1.7	-1.2	-8.6	-15.4	-33.4	-28.6
Grants										2.8	6.1
Overall Budget Including Grants										-30.6	-22.6
Financing:											
Domestic	-0.1	3.9	4.5	2.1	0.1	1.7	1.2	8.6	15.2	28.2	22.3
Net Position with the SBA	0.3	2.7	4.4	3.9	-0.7	-0.2	1.5	4.7	-1.0	-4.0	0.0
Bank Credit to Government	-0.4	1.2	0.1	-1.8	0.7	1.9	-0.3	0.8	4.8	47.7	21.9
Domestic Arrears (to Enterprises)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	3.1	11.5	-15.5	0.4
Foreign	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.2	2.4	0.2
Memo:											
GDP at market prices	16544.0	16724.0	16510.0	16863.0	17360.0	17253.0	17006.0	18881.0	16813.0	16473.8	48478.8

Source: Albanian Ministry of Finance.

a/ Transfer of amortization through 1991; 1992 includes minor taxes.
b/ Includes unemployment benefits, rural poverty assistance, price subsidies, and political prisoner program.
c/ Represents grant counterpart sales revenue.

Table 6.1: Albania: External Debt
(Millions of US$, end-of-period)

	1989	1990	1991e	1992e
Total Debt a/	74.0	349.0	501.0	624.6
Medium & Long Term	0.0	36.0	76.0	112.1
Multilateral	0.0	0.0	0.0	2.0
o/w IDA	0.0	0.0	0.0	2.0
Bilateral	0.0	2.0	22.0	56.0
Private	0.0	34.0	54.0	54.1
IMF	0.0	0.0	0.0	13.5
Net Short-Term	74.0	313.0	425.0	499.0
o/w Stock of Interest Arrears on Long-Term Debt			5.0	10.0
Disbursements	0.0	33.0	49.0	61.0
Medium & Long Term	0.0	33.0	49.0	47.0
Multilateral	0.0	0.0	0.0	2.0
o/w IDA	0.0	0.0	0.0	2.0
Bilateral	0.0	2.0	20.0	42.0
Private	0.0	31.0	29.0	3.0
IMF	0.0	0.0	0.0	14.0
Amortizations	0.0	0.0	9.0	0.0
Medium & Long Term	0.0	0.0	9.0	0.0
Multilateral	0.0	0.0	0.0	0.0
o/w IDA	0.0	0.0	0.0	0.0
Bilateral	0.0	0.0	0.0	0.0
Private	0.0	0.0	9.0	0.0
IMF	0.0	0.0	0.0	0.0
Net Short Term	74.0	239.0	107.0	70.0
Increase in Interest Arrears on Long-Term Debt	0.0	0.0	5.0	5.0
Interest Payments	0.0	3.0	3.0	2.0
Medium & Long Term	0.0	3.0	3.0	2.0
Multilateral	0.0	0.0	0.0	0.0
o/w IDA	0.0	0.0	0.0	0.0
Bilateral	0.0	0.0	0.0	0.0
Private	0.0	3.0	3.0	2.0
IMF	0.0	0.0	0.0	0.0
Memo:				
Total Debt Service	0.0	3.0	12.0	2.0
Total Debt Service as % of GDP	0.0	0.1	1.1	0.3
Total Debt Service as % of Exports of GNFS	0.0	0.9	14.6	2.5

Source: Ministry of Finance, Bank of Albania, and World Bank staff estimates
a/ Differences between net disbursements and end-of-year stocks reflect exchange rate fluctuations.

IBRD 25910

The boundaries, colors, denominations and any other information shown on this map do not imply, on the part of The World Bank Group, any judgment on the legal status of any territory, or any endorsement or acceptance of such boundaries.

JULY 1994