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REPORT AND RECOMMENDATION

OF THE

PRESIDENT OF THE

INTERNATIONAL DEVELOPMENT ASSOCIATION

TO THE

EXECUTIVE DIRECTORS

ON A

FINANCIAL SECTOR ADJUSTMENT CREDIT

IN THE AMOUNT OF SDR 12 MILLION (US$15 MILLION EQUIVALENT)

TO

ALBANIA

May 23, 2002

Currency Equivalents

(Exchange Rate Effective April 30, 2002)

Currency Unit	= Lek
Lek 1	= US$0.007
US$1	= Lek 147

Government Fiscal Year

January 1 – December 31

Weights and Measures

Metric system

Abbreviations and Acronyms

AISC	-	**Albanian Insurance Supervision Commission**
BART	-	**Bank Asset Resolution Trust (ATK)**
BoA	-	**Bank of Albania**
CAMEL	-	**Capital, Assets, Management, Earnings, Liabilities**
CAS	-	**Country Assistance Strategy**
DIA	-	**Deposit Insurance Agency**
EBRD	-	**European Bank for Reconstruction and Development**
ECSPF	-	**Europe and Central Asia Private and Financial Sector Development Unit**
EU	-	**European Union**
FSAC	-	**Financial Sector Adjustment Credit**
FSIBTA	-	**Financial Sector Institution Building Technical Assistance Project**
GDP	-	**Gross Domestic Product**
GPRS	-	**Growth and Poverty Reduction Strategy**
IAIS	-	**International Association of Insurance Supervisors**
IAS	-	**International Accounting Standards**
IDA	-	**International Development Association**
IFC	-	**International Finance Corporation**
IMF	-	**International Monetary Fund**
INSIG	-	**Insurance Institute of Albania**
ISA	-	**International Standards on Auditing**
MAE	-	**Monetary Exchange and Affairs Department**
MoF	-	**Ministry of Finance**
MoJ	-	**Ministry of Justice**
NCB	-	**National Commercial Bank**
PRGF	-	**Poverty Reduction and Growth Facility**
PRSP	-	**Poverty Reduction Strategy Paper**
RCB	-	**Rural Commercial Bank**
RPTA	-	**Recovery Program Technical Assistance Project**
RTGS	-	**Real-Time Gross Settlement**
SvB	-	**Savings Bank**
TA	-	**Technical Assistance**
USAID	-	**United States Agency for International Development**

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ALBANIA
PROPOSED FINANCIAL SECTOR ADJUSTMENT CREDIT

CREDIT SUMMARY

Borrower:	Albania
Amount:	SDR 12 million (US$15 million equivalent)
Terms:	The Credit would have a 40-year maturity, including a 10-year grace period.
Objectives and Description:	The objective of the proposed credit is to support the Government of Albania's program to consolidate and take reforms in the financial sector beyond achievements to date to foster better engagement of the financial sector in the development of the Albanian economy. The proposed program will consist of three broad components: (i) continued reform of the banking sector including the privatization of the Savings Bank (SvB) and further strengthening of the banking regulation and supervision, (ii) enhancement of the bankruptcy and debt resolution framework, and (iii) reform of the non-bank financial sector, including further development of the regulatory and supervisory framework for the insurance sector and the privatization of the Insurance Institute of Albania (INSIG).
Benefits:	The reform actions sought under the proposed credit will help consolidate and take the reforms in the financial sector beyond achievements to date to foster better engagement of the financial sector in the growth and development of the Albanian economy. Privatization of SvB to a fit and proper international bank will end the engagement of the Albanian State in banking sector. This, together with further strengthening of the banking regulation and supervision capacities of BoA, will, in the medium-term, help create a well-regulated competitive banking environment. With improvements in the legal framework for bankruptcy and secured financing and enforcement of creditors' rights, it is hoped that, in the medium to long-term, the banks will become active participants in financing the enterprise sector and contribute to the long-term sustainable economic development of Albania. Implementation of the non-bank financial sector reforms, particularly the privatization of INSIG and development of the regulatory and supervisory framework for the insurance sector and improvements in financial reporting, will help the long-term development of a more mature financial market.

Risks: The risks to the proposed FSAC could arise from the political and macroeconomic situation, as well as the absorptive capacity. Albania remains vulnerable to domestic or regional instability that could derail the efforts to achieve the FSAC objectives. This could be both in terms of delays due to political infighting, such as the confrontation between the prime minister and the head of the Social Party (at end-2001 and early 2002) which led to a slowdown in the implementation of the legislative agenda of Parliament. To help mitigate these risks, the FSAC has been designed to ensure that key legislation is passed prior to Board presentation.

Albania's objective to sign an Associate Membership with the European Union, its recent agreement with the IMF and the substantial reliance of the country on concessional donor financing imply strong commitment to implement a stable medium-term macro-economic program. Nevertheless, Albania faces a major threat to its macroeconomic program due to the continued energy crisis. Steps, however, are being taken with assistance from IDA and other donors to remedy the situation. The weak international financial markets could impact SvB and INSIG privatization. But this risk is modest, due to the advanced stage of SvB privatization, and IFC's agreement in principle to proceed with a pre-privatization investment in INSIG.

Finally, implementation of the reforms could be undermined by the weak institutional capacity in the country. To mitigate this risk substantial technical assistance is being provided aimed at implementation of capacity building programs in all three areas being supported under the FSAC. Nevertheless, this risk should not be underestimated.

Schedule of Disbursements: The proposed credit would be disbursed in two equal tranches of SDR 6 million (US$7.5 million equivalent).

Poverty Category: Not applicable

Rate of Return: Not applicable

Project ID Number: PE-P057818

The team for this operation consists of Hormoz Aghdaey (team leader), Rochelle Hilton (banking privatization), Laura Ard (bank regulation and supervision), Michael Gascoyne (accounting and auditing framework and financial management), Rodney Lester (insurance sector restructuring), Silvia Minotti (bank supervision), Greta Minxhozi (banking resolution and country coordination), and Svitlana Lewis. Ahmed Jehani and Junko Funahashi provided legal support. Rohit Mehta is the Disbursement Officer. Andrew Lovegrove (debt resolution) and Yair Baranes (bankruptcy framework) supported the Government preparatory work with PHRD funding. Gordon Johnson provided Bank guidance for this work. Peter Kyle was the peer reviewer.

REPORT AND RECOMMENDATION OF THE PRESIDENT OF THE INTERNATIONAL DEVELOPMENT ASSOCIATION TO THE EXECUTIVE DIRECTORS ON A PROPOSED FINANCIAL SECTOR ADJUSTMENT CREDIT TO ALBANIA

Table of Contents

ANNEXES:

REPORT AND RECOMMEDATION OF THE PRESIDENT OF THE INTERNATIONAL DEVELOPMENT ASSOCIATION TO THE EXECUTIVE DIRECTORS ON A PROPOSED FINANCIAL SECTOR ADJUSTMENT CREDIT TO ALBANIA

1. I submit for your approval the following Report and Recommendation on a proposed Financial Sector Adjustment Credit (FSAC) to Albania for SDR 12 million (US$15 million equivalent) to support the Government's financial sector reform program. The proposed credit would be on standard IDA terms with a maturity of 40 years including 10 years of grace. The credit would be disbursed in two equal tranches of SDR 6 million (US$7.5 million equivalent).

2. This Report should be read in conjunction with the "Growth and Poverty Reduction Strategy (GPRS),"[1] which the Government launched in November 2001, and the June 2002 Country Assistance Strategy (CAS), which is based on the GPRS. The Albania Interim Poverty Reduction Strategy Paper (IPRSP) was discussed at the Board on June 8, 2000 (Document #IDA/SecM2000-263). These documents emphasize the importance of continued implementation the structural reforms for the achievement of the country's long-term growth and poverty reduction goals. Both the GPRS and the CAS are scheduled to be discussed by the Board concurrently with this operation.

I. OVERVIEW

3. Although the democratic and economic transformation in Albania began later than in other Central and Eastern European countries, the implementation of the initial phase of reforms was rapid and impressive. GDP grew at about 9 percent per annum in real terms from 1993 to 1996, inflation was brought down substantially and both the current account balance and the fiscal deficit improved significantly (Table 1).[2] Reforms in the public administration and financial sectors, however, advanced at a much slower pace. By early 1996, it was clear that many problems had not been resolved, and others were emerging. Structural reforms had stalled, especially in the critical area of banking, evident by the lack of progress in resolution of the problems in the state-owned banks, and in further development and enforcement of banking regulation and supervision.

4. Despite some initial efforts at reforms, the institutional and financial infrastructure was unable to adequately support sound credit practices and the effective functioning of

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[1] *National Strategy for Socio-Economic Development (GPRS)*, Republic of Albania, Council of Ministers, November 2001. The title Growth and Poverty Reduction Strategy was used during preparation of the document, which was then publicly launched as the National Strategy for Socio-Economic Development.

[2] For a detailed discussion of the Albanian economy during the early years of transition, see "*Albania Beyond the Crisis,*" Country Economic Memorandum, December 1998.

the market. The legal system remained underdeveloped and could not effectively enforce contracts. Comprehensive and well-defined accounting principles based on International Accounting Standards (IAS) were not introduced and, hence, accurate and transparent information on the financial performance of banks and enterprises was not available. The existing paper-based payments system was functioning very inefficiently.

5. Due to the weakness of the regulatory and institutional framework, there was insufficient information on which to base credit and investment decisions. Effective systems for internal risk management and control, with strict accountability to owners, directors and senior management, were not fully developed and enforced. Financial institutions were not adequately supervised and even the most basic regulations such as those ensuring adequacy of risk capital were not enforced. At the same time, the supervisory and regulatory authorities did not have adequate skills, resources and independence from political interference to perform their functions.

6. The inadequacy of the financial system, especially its regulatory and supervisory framework, led to the proliferation of informal financial arrangements including pyramid schemes, the collapse of which triggered the civil crisis of 1997. Civil unrest broke out in February 1997, and spread quickly across Albania, causing the fall of the government and precipitating new elections. The economic fallout from the crisis was severe, with GDP contracting by 7 percent and inflation increasing to over 40 percent in 1997. The Government, which took office after the elections of July 1997, quickly re-established macroeconomic control and, in late 1997, started the implementation of a broad-based program of reforms in the public administration and financial sectors, including institution-building, civil sector reform, and divestiture/privatization of state-owned banks. Successive governments have maintained this commitment to macroeconomic stability and structural reforms, with support from the international donor community led by IDA and the IMF.

7. In mid-2001, Albania held parliamentary elections, monitored by international observers. These elections were won by the Socialist Party resulting in the reappointment of the Prime Minister, but late in 2001, internal disagreement within the ruling Socialist Party led to the resignation of four key ministers including those of finance and privatization. A compromise was reached and a new government was formed at end-February 2002. The new Government has confirmed its intention to proceed with the implementation of the previously agreed reform program.

II. RECENT ECONOMIC PERFORMANCE [3]

A. Stabilization Efforts Since 1997

8. Economic performance has been strong in the aftermath of the 1997 crisis, with growth averaging about 7 percent a year and inflation at low levels. This includes 1999, when the influx of Kosovo refugees put a heavy strain on Albania's economic and administrative capacity. The Government and the Bank of Albania (BoA) have been successfully implementing the program of macroeconomic and structural reforms. The domestically financed fiscal deficit decreased significantly during 1998-2000, as expenditures were contained and revenue collection improved. The current account deficit also improved and foreign exchange reserves were maintained at about four months of imports. By the end of the 1990s, Albania had roughly regained its end-1980s' GDP level. The private sector accounted for over 85 percent of GDP and over 80 percent of employment. Agriculture had become the dominant sector, accounting for over 50 percent of GDP, followed by services and construction.

9. Albania's strong macroeconomic performance continued in 2001. The current account deficit stayed at around 6.3 percent of GDP. The overall fiscal deficit further declined to about 8.5 percent of GDP and domestic bank financing of the fiscal deficit was contained at about 3.1 percent of GDP. Inflation was about 3.5 percent and output growth 6.5 percent for the year as a whole. Economic performance during the first quarter of 2002 has been mostly favorable despite weak agricultural growth and the worsening electricity situation.

Table 1: Macroeconomic Indicators, 1991-2001
(annual averages, percent)

	1991-92	1993-96	1997	1998-2000	2001
Real GDP growth	-17.6	9.3	-7.0	7.7	6.5
Inflation	170.5	17.5	42.1	4.0	3.5
Current account deficit (% GDP)	-61.1	-15.1	-12.1	-6.8	-6.3
Fiscal deficit (% GDP)	-25.8	-11.4	-12.9	-10.3	-8.5

Source: Ministry of Finance; staff estimates

10. Despite a relatively liberal regime adopted by the Government, in 1999 FDI amounted to only US$51 million (about 1.5 percent of GDP), almost the 1997 level. FDI figures were substantially higher in 2000 (US$143 million) and 2001 (US$204 million), mainly due to receipts from the privatization of Albanian Mobile Communication (AMC) and the National Commercial Bank (NCB), as well as from the sale of the second mobile communications license. [4]

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[3] The macroeconomic performance is discussed more fully in the President's Report for the proposed Poverty Reduction Strategy Credit.

[4] The FDI situation should improve in 2002 due to privatization receipts from SvB and possibly INSIG.

B. The Medium-term Macroeconomic Framework

11. Albania's prospects for growth, development and poverty reduction are good, especially in view of a more favorable political climate in parts of Southeastern Europe and enhanced prospects for a closer association with the European Union, as well as the Government's intention to continue with structural reforms. In the medium term, economic growth is projected to remain strong, with GDP growing by about 6-7 percent a year (Table 2). An increase in exports and private sector activities is expected to lead growth during this period. The implementation of structural reforms, particularly in the enterprise and financial sectors, will be a crucial element in fostering private sector activities, which will boost this growth. Reforms in the energy sector, that are expected to significantly reduce the current gap between demand and supply, are a necessary precondition for this performance. Albania's strong growth outlook should provide the country with resources to meet its pressing needs in education, health and infrastructure, and should also contribute to attracting investment, creating employment opportunities and reducing poverty.

12. Exports and private remittances are projected to continue to play an important role in supporting growth, given Albania's proximity to the rest of Europe and its low cost labor force. Export growth is expected to strengthen following the transfer of key enterprises to strategic foreign investors (e.g., copper, chromium) as well as increases in exports of shoes and textiles. The openness of the economy has contributed to improved domestic production and is expected to lead to increased exports. Imports are projected to grow, reflecting a higher demand for capital equipment associated with stronger investment activities, but at a slower pace than exports. As a result, the current account deficit as a percentage of GDP is projected to decline and stabilize at more sustainable levels in the first half of this decade. Albania's recent accession to the World Trade Organization is expected to strengthen its trade policy and provide further incentives for increased investment.

Table 2: Macroeconomic Framework, 2000-2005 (in percent)

	2000	2001	2002	2003	2004	2005
Real GDP growth	7.8	6.5	6.0	7.0	7.0	6 5
Inflation	4.2	3 5	3.9	3 0	3.0	3.0
Current account balance (% of GDP)	-7 2	-6.3	-8.2	-7.1	-6.2	-5.4
Fiscal balance	-9.1	-8.5	-8.1	-7.2	-6.5	-6.0

Sources: Ministry of Finance and staff projections.

13. Consolidating and deepening the implementation of key reform measures will be needed to improve the overall climate for growth and private sector development. Public expenditure management reform has to be a key element of the Government program. In particular, capacities for policy development need to be strengthened, closer linkages between policy objectives and expenditures and better intergovernmental fiscal relations need to be developed. Service delivery needs to be improved and policy monitoring and evaluation needs to be strengthened. In addition, accountability mechanisms need to be

enhanced to allow Albania to fight corruption, encourage high levels of investment—particularly foreign direct investment—maintain fiscal discipline, and ensure that resources are used efficiently and transparently. Attainment of these objectives would be crucial not only to sustain growth and reduce poverty but also to facilitate integration with the European economy.

14. A major internal threat to macroeconomic stability continues to be the electricity shortage. The targets for improving the financial position of KESH, the electricity company, have been broadly met, and the authorities have taken concrete steps to introduce a viable tariff system. However, in spite of the authorities' efforts to ensure that planned imports are realized in a timely manner, serious electricity shortages continued throughout the severe winter. IDA is working closely with the authorities to alleviate this situation through technical advice and funding. Subsidies for electricity imports are expected to be a maximum of Lek 3.7 billion in 2002.

III. THE GOVERNMENT REFORM PROGRAM

15. The reform program of the Government has been formulated as part of its GPRS. The far-reaching goals of the strategy are transition to a market economy, long-term sustainability and European integration. As part of the transition towards a market economy, the most important objectives include: (i) completion of the privatization process of industrial enterprises, public services, and financial institutions; (ii) consolidation of reforms in the banking system and establishment of a capital market; (iii) deepening of market institutionalization, including property rights' consolidation, promotion of competition, and consumer protection; and (iv) deepening reform and modernization of state institutions according to the standards of a democratic society and a market-oriented economy. With regard to the financial sector, the GPRS reflects a continuation of the strategy which the Government adopted and has been implementing since late 1997, with support from IDA and the international donor community.[5]

Financial Sector Reform

16. A major component of the Government's program is financial sector reform, with a view to the divestiture of the State from the banking and insurance sectors and the establishment of sound governance structures in the financial institutions. Its first priority has been the revival of banking sector reforms, which are now well underway. Results to date have been uneven but generally encouraging. These achievements have required substantial coordination efforts by the MoF and the BoA and the provision of donor-financed technical assistance (TA). Implementation of the Government's reform strategy

[5] Due to Albania's agrarian nature and demographics, extension of rural and urban micro credits have been a key factor in the IDA's and other donors' assistance strategy for intermediation to private individuals and small business.

(following the collapse of the pyramid schemes in 1997), together with macroeconomic stability and growth, has contributed to the restoration of confidence in the banking system. Aggregate household deposits have increased substantially. In addition, although the state-owned banks have been under a lending moratorium, the aggregate intermediation levels have increased, due to more active lending policies adopted by the private commercial banks and a gradual increase in competition. In 2000, the rate of growth for total assets, deposits and Treasury-bills (T-bills) for the private banks far exceeded that of the Savings Bank (SvB) and the newly privatized NCB. New regulations approved in 1999 to develop a liquid Treasury-bill market have increased the demand of T-bills by market participants despite the decreasing interest rates.

Table 3: Structure of the Albanian Banking System (June 2001)

	SvB	NCB	Tirana Bank	Others	Total
Number of Banks				10	13
Total Assets (Lek million)	175,921	27,910	17,608	65,502	286,941
Total Assets (%)	61.3	9.7	6.1	22.9	100
T-Bills (Lek million)	126,882	13,668	7,295	8,851	156,696
T-Bills (% of total)	81.0	8.7	4.7	5.6	100
Total Equity (Lek million)	5,570	1,800	1,539	10,797	19,706
Total Deposits (Lek million)	165,840	25,348	13,286	46,405	250,879
Of which household deposits:					
Lek million	147,929	16,881	9,047	34,372	208,229
Percentage	71.0	8.1	4.4	16.5	100
Majority Ownership	State	Private	Private	Private	-

Table 4: Albanian Banking System (in Lek millions)

	DEPOSITS			ASSETS			T-BILLS		
	1999	2000	change	1999	2000	change	1999	2000	change
State banks	171,965	173,772	1.1%	187,291	192,015	2.5%	105,801	105,519	2.6%
Private banks	28,469	47,055	65.3%	42,311	68,557	62.0%	3,505	9,983	184.8
System	200,434	220,827	10.2%	229,603	260,572	13.5%	109,306	118,502	8.4%

State-owned banks include the Savings Bank and the National Commercial Bank.

17. Although SvB still has a dominant position, its share in the deposit market declined from 75 percent in 1999 to 66.1 percent in June 2001, and that in the T-bill market from 92 percent in 1999 to 81 percent in June 2001. SvB's total assets (as a percentage of the system total assets) decreased from 72 percent in 1998 to 61.3 percent in 2001.

18. In 1997, there were three state-owned banks in Albania, which together accounted for about 90 percent of the banking system assets and same percent of deposits. All three were insolvent due to their large problem portfolios caused by poor lending practices

exacerbated by political interference. Purchase of T-Bills to finance the budget, the main function of all three banks at that time, was a loss-making activity at the margin.[6] The system additionally included five small foreign or joint venture banks with no branch network.[7] These banks focused mainly on providing high-end corporate services to their clients. Financial intermediation to the private sector was very low at about 1 percent of GDP per year (at the end of 1996, the stock of outstanding loans to the private sector was about 4 percent of GDP).

19. Shortly after taking office in 1997, the Government adopted, in consultation with IDA and the IMF, an ambitious program to cease all lending activities of the state-owned banks, and to divest itself from the banking sector. In line with this program, it immediately liquidated the Rural Commercial Bank (RCB), undertook to offer the National Commercial Bank (NCB) for privatization within a one year time-frame and put SvB under a tight governance contract with a view to its privatization by the end of 2000. This timetable proved to be overoptimistic and did not adequately take into account the inherent delays in privatization transactions and the Government's implementation capacity. Nevertheless, the authorities have made substantial progress in implementing this element of their program and their commitment to the overall objective remains unchanged. RCB was liquidated in December 1997; privatization of NCB was concluded in October 2000; and SvB was until recently under a governance contract which prohibited it from lending and prescribed steps to be followed in preparing the bank for privatization.[8] The cost of financial restructuring of the banks in preparation for divestiture has amounted to about Lek 24.6 billion and implementation of this program has required substantial technical assistance. Two IDA credits (the Recovery Program Technical Assistance Project–RPTA–and the Financial Sector Institution Building Technical Assistance Project–FSIBTA) have financed, and continue to finance, these efforts.

20. Going forward, the financial sector reform has the following components: (i) continued reform of the banking sector, including privatization of SvB and further strengthening of banking regulation and supervision; (ii) enhancement of the bankruptcy and debt resolution framework; (iii) reform of the non-bank financial sector, including further development of the legal, regulatory and supervisory frameworks for the insurance sector and privatization of the Insurance Institute of Albania (INSIG).[9]

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[6] In September 1997, the BoA had a mandatory floor interest rate of 37 percent on savings deposits for the three state-owned banks, with a reserve requirement of 10 percent; the rate for 3-month T-Bills was 35 percent.

[7] There are now 13 banks.

[8] Although the SvB is not currently under a governance contract, it continues to operate under this agreement, including a full lending moratorium.

[9] Micro-credit programs, another important element of the Government's strategy, are among the most successful in the region. Over the last ten years, over 20,000 small farmers and urban micro-entrepreneurs in Albania have received micro-loans. Repayment rates have been high—over 90%—and micro-credit has

A. Continued Reform of the Banking Sector

21. **Privatization of SvB.** SvB remains the largest bank in Albania and the only one with a network of branches and agencies covering the entire country. The bank was offered for privatization in July 2001. Successful conclusion of this privatization will mark the State's exit from any substantial ownership in the banking system. Prior to this offering, the bank underwent substantial restructuring under a governance contract implemented with technical assistance from foreign consultants. These efforts included the reduction of SvB's staff from some 2,500 to about 1,600 over about 2 years, modernization of operations in key branches, implementation of IAS, and, in mid-2001, transfer of the problem portfolio (gross value of about Lek 7.0 billion) to the Bank Asset Resolution Trust (BART). During this entire period, there was a moratorium on the bank's lending. Prior to the launch of privatization, the fiscal agent role of the bank, its dominance in the household deposit market (about 71 percent), and its almost monopolistic status in the T-bill market were analyzed to ensure that an unsustainable imbalance in the system would not be created by the privatization.

Bank Divestiture to Date

RCB was liquidated in December 1997. Its banking license was revoked, the deposits on its books along with all its liquid assets were transferred to SvB (merger and acquisition), and the remaining assets and liabilities were transferred to the newly created BART. The total cost of the operation to the MoF was Lek 4.3 billion to cover the net negative value of the transfer operation to SvB. This was covered by issuance of an equal amount of T-Bills. The total gross value of assets transferred to BART was Lek 3.6 billion.

NCB sale was concluded in October 2000. The bank was sold to a consortium of strategic investors: Kentbank of Turkey with 60 percent of share capital, and IFC and EBRD, with 20 percent each. Prior to its privatization, the entire lending portfolio of the NCB (Lek 10.4 billion) was transferred to BART. Immediately following the purchase of the bank, the new owners started implementing a program of restructuring which encompassed three key elements: (i) reorganization and introduction of new internal procedures; (ii) renovation of the head office and branches; and (iii) IT installation and implementation. Following Turkey's financial crisis, Kentbank was taken over by the Turkish Bank Regulatory and Supervisory Agency, in mid-2001. This had no negative impact on NCB or the Albanian banking system, but it slowed down NCB's plans to start aggressive banking activities. Kentbank's share in NCB has recently been offered for sale. IFC and EBRD are closely involved with this sale.

22. Only two potentially attractive responses to the announcement for SvB's privatization were received by the original deadline. In order to attract additional potential investors, the authorities, following feedback from potential interested strategic investors, and in consultation with the privatization advisers, the Bank, IFC and the IMF, delayed the deadline to April 18, 2002. However, in the end, only two reputable

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proven an effective tool to reduce poverty and develop the small private sector. In recent years, the Government is supporting the development of Savings and Credit Associations, which could be the basis for a sustainable rural credit system. These efforts have been substantially supported through IDA and other donor support, including the Microcredit Project approved in FY99.

European banks submitted their expressions of interest. Both banks were pre-qualified and have been invited to submit offers for purchase of at least 60 percent of the bank. IFC and EBRD are expected to take up to 40 percent equity participation in the bank. *Finalization of the sale of SvB to a private strategic investor(s), including signing of the sale's contract(s), is a condition of the second tranche release.*

23. **Strengthening Banking Regulation and Supervision.** Since 1997, the BoA with the assistance from the IMF-MAE and USAID, has made considerable progress in developing the regulatory framework for the banking sector. The Law on the Bank of Albania and the Banking Law[10] were enacted and supporting regulations were approved by the Supervisory Council of the BoA. The Albanian banking regulatory framework reflects many of the international and regional standards currently considered as "best practices" and is generally adequate for the existing level of banking activities. Prudential requirements generally adhere to Basle Committee recommendations and EU norms.[11] However, the BoA recognizes that the existence of a relatively comprehensive banking regulatory framework does not imply that the individual financial institutions and the overall banking system will be safe and sound. Consequently, it has indicated its commitment to improving the effectiveness of the banking regulatory and supervisory framework to help foster efficient banking intermediation as well as to ensure that the risks of individual banks and the system as a whole are being properly identified, measured, monitored and managed.

24. The Law on the Bank of Albania establishes the BoA as an independent legal entity, headed by a Governor, with powers to direct monetary policy as well as with independence in licensing, issuing regulations and supervising financial institutions. However, institutional independence of the BoA needs further refinement. To address this issue, amendments to the BoA Law have been submitted to Parliament to increase the independence of the Governor and prohibit members of BoA's Supervisory Council from being employed directly or indirectly in the banking business. Parliament is expected to approve these amendments in 2002. Another area which needs to be improved is the licensing requirements as specified in the Banking Law. Existing legislation should be amended to include more stringent requirements for bank shareholders and managers, and a more careful evaluation of the managers' technical ability to oversee day-to-day banking operations and risk management. Finally, commercial bank corporate governance needs to be strengthened, including the power of the banks' supervisory boards. To this end, the Government intends to secure parliamentary adoption of the necessary amendments to the Banking Law, in the near future.

25. A money laundering law, prepared with IMF assistance, currently exists. Steps are also underway, at the MoF level, with assistance from US Treasury, to institute

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[10] Laws No. 8269, dated 23.12.1997, and No. 8365, dated 02.07.1998, respectively.

[11] A comprehensive evaluation of bank supervision based on Basle Committee 25 Core Principles for an Effective Banking Supervision was carried out by the IMF-MAE in late-1999.

procedures to detect and respond to identified situations, including reviewing the adequacy of laws, prevention activities, and training needs. BoA, with IDA support, is also cooperating in the anti-money laundering efforts through attention to regulations and supervision. To this end, BoA has prepared, with IDA input, draft regulations on "the Prevention of Money Laundering." The next step for BoA will be the adoption of regulations and development and implementation of procedures for the identification, documentation and referral of suspicious activity. Regulations concerning concentration of lending and credits to shareholders should also be further strengthened to reduce the risk of insider abuse.

26. In light of the dominant role of the banking sector in the Albanian financial market and in view of an expected dynamic private banking environment, with IDA support,[12] the BoA has developed and adopted a long-term strategy and institutional development program for banking supervision (SDP), identifying the required technical assistance for its implementation. The IMF is funding a resident advisor to support this implementation.

27. Substantial progress has been made in setting up, with USAID assistance, formalized supervisory processes that more closely reflect international standards. A comprehensive CAMELS rating framework has been introduced, a manual for on-site inspections has been drafted, and steps have been taken to establish an Early Warning System (EWS) function. BoA has also made efforts to strengthen its supervisory capability,[13] both with regard to on-site inspection and off-site monitoring and has established an annual on-site examination cycle. Training programs covering several important areas of supervision, such as the evaluation of credit risk and procedures, and the management of liquidity, interest and exchange rate risks, have been introduced. In spite of this progress, supervisory skills remain weak and staff retention is an issue. This contributes to the generally weak effectiveness of the supervisory system in performing its functions.

28. Given the current state of the banking system and the relatively low level of credit risk on the banks' balance sheets, this is an opportune time to firmly establish bank supervision, as well as to introduce and reinforce a strong compliance culture with sound operating practices. However, efforts would be wasted if BoA is unable to retain adequate human resources. Improvements in the level of remuneration, introduction of different personnel levels reflecting different levels of skills, together with the adoption of

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[12] IDA support was provided through an assessment of banking regulatory and supervisory framework and effectiveness, focused on the following pillars of the supervision system: (i) regulation relating to banking and its supervision; (ii) the supervisory process; and (iii) the accounting and auditing guidelines and practices for the banks.

[13] The supervisory function of the BoA is currently organized into two units: (i) licensing and methodology, and (ii) on-site and off-site. The staff total 26, 14 of which are on-site examiners, 3 are located in the off-site section, and the other 9 are dedicated to the methodology and licensing unit.

a Code of Ethics for all supervisory staff, addressing any potential conflict of interests, could reduce the turnover as well as improve the effectiveness of the supervisory process. The SDP, adopted in March 2002, contains a set of monitorable indicators and targets to assess the achievement of short-term goals in strengthening the supervisory process and skills and refinement of banking legislation. *Satisfactory progress in the implementation of the SDP is a condition of the second tranche release.*

29. **Development of a Deposit Insurance System**. As an effective supervisory system is a prerequisite for the establishment of a deposit insurance scheme, careful consideration should be given to the timing of its introduction. Although the Albanian supervisory system still needs to be strengthened, it is appropriate to implement this scheme at this time, now that the banking system is well capitalized, has very low risk assets, and SvB privatization process is sufficiently advanced. Over the recent past, BoA has made considerable progress towards developing a deposit insurance scheme in line with EU standards, in preparation for its introduction. A new law, prepared with the assistance of the IMF-MAE, was adopted by Parliament on March 29, 2002. The new law provides, inter alia, for the insurance scheme funding and administration. To ensure long-term sustainability of the system, the Government intends to make arrangements to establish a Deposit Insurance Agency (DIA) and develop a financing plan to ensure its long-term solvency. These efforts will be supported by the IMF and USAID. *Establishment of the DIA and satisfactory progress in implementing the DIA financing program is a condition of the second tranche release.*

30. **Development of an Efficient Payment System**. The current interbank payments system (clearing and settlement services) is not adequate to meet the needs and support the development of the private sector. Payments through the system, which is operated by BoA, are carried out by the physical exchange of documents and payment settlements are handled manually. This results in high operating costs for the banks, slow processing of payment instructions, and long execution times for payments. As such, the system is highly exposed to risks and lacks the confidence of banks and other users. BoA has developed and adopted a strategy for modernizing the payments system, introducing automated systems for both large and low value payments. It has made substantial progress, to date, in implementing this strategy, with IMF-MAE and IDA support.

31. For the large interbank payments and settlement system to support the development of financial markets and the private sector, BoA is establishing an automated Real Time Gross Settlement (RTGS) system, which will be in line with international standards. The main objectives of the RTGS system are to: (i) achieve real-time settlement of payments between the commercial banks on their books with the BoA and facilitate the timely settlement of monetary transactions; (ii) increase the efficiency of daily liquidity management by the banks (with an integrated system for settlement account information); (iii) minimize the payment system risk; (iv) improve the inter-bank communication infrastructure; and (v) set up the supporting infrastructure for future developments in the payments and financial systems. The procurement of the RTGS system (supported with funding from the IDA Credit for the FSIBTA) is at an advanced

stage. The BoA expects the RTGS system to be in place and operating, with connection to the system of not less than 5 banks, within one year. As a subsequent phase, the Government Securities Book-entry System and the Monetary Operations Department will also be linked with the RTGS system. BoA has evaluated bids for the RTGS system and further actions are under consideration.

32. In conjunction with the development of the RTGS system, the BoA is also in the process of implementing an integrated accounting/management system (with funding from the FSIBTA), which will interface with the RTGS system. As a next phase, it has already started working on the bulk clearing and settlement system for retail (low value) payments. It plans for this system to come on-stream shortly after the RTGS system. BoA intends to establish of the necessary legislative framework for the operations of the small-value clearing and settlement system before this system comes on-stream

33. **Enhancing Banking Competition**. The Government is committed to improving the environment in Albania to encourage banking competition. Divestiture of the State from banks is a cornerstone of this objective. The Government is also committed creating a level playing field for private banks to conduct their business. This includes supporting infrastructure improvements (such as a modern payments system, deposit insurance scheme, credit information facility) as well as outsourcing its own banking needs, based on transparent competitive procedures. This will be important, given that in the foreseeable future the Government will remain the largest client of the system. To this end, the Government has taken steps to improve the auctioning procedures to allow the general public to more easily purchase Treasury Bills. In addition, it has auctioned out its fiscal functions in Elbasan and Durres (major cities) to private banks and is holding similar auctions in other municipalities. Furthermore, the Government has encouraged state-owned enterprises to seek banking with private banks, on a competitive basis. In the medium to long-term, the above actions are expected to contribute to a reduction in SvB's dominant position in the sector.

B. Enhancement of the Bankruptcy and Debt Resolution Framework.

34. **Bankruptcy Framework and Collateral Enforcement.** The bankruptcy framework (comprising a set of bankruptcy rules and procedures as well as the infrastructure of judges, specialized professionals, and information systems) is a major vehicle for enterprise restructuring in mature market economies as well as an essential building block towards good governance. Improving this framework, together with other legislation to protect creditors' rights, is another fundamental element of Government's reform program. Although an Albanian insolvency law is in force, the bankruptcy system as a whole remains largely inoperative. The existing law is complex and cumbersome and the capacity of the court system and qualifications of staff are inadequate. As a result, there is a general mistrust in using the system and not a single case has been processed under the existing bankruptcy legislation.

35. The Government is in the process of reforming the bankruptcy framework to address these shortcomings. This includes overhauling the existing legislation, as well as implementing a capacity building program in order to make the system effective. The MoF has prepared a new insolvency law with support from GtZ in consultation with multilateral donors, including IDA and the IMF. This law, which was adopted by Parliament in May 2002, is substantially in harmony with relevant EU legislation and in line with international best practices as reflected in the World Bank's *Principles and Guidelines for Insolvency and Creditor Rights Systems*. It is also in conformity with the legal system in Albania. The law reflects the Government's policy of increasing financial intermediation, by providing adequate and much needed protection for secured creditors.

36. A major consideration in the preparation of this legislation was to establish a strong protective mechanism for possible rehabilitation of insolvent but viable business organizations without undermining the efficient and consistent enforcement of creditors' rights against collateral by placing significant restrictions on their actions. These principles are designed to promote maximum certainty in risk management and resolution practices. In the context of liquidation, administrators should be entitled to dispose of collateral in a commercially reasonable manner, if the property is not essential to the sale of a business as a going concern. In reorganization proceedings, the process should favor rehabilitation of the enterprise swiftly and with minimum possible impact on secured creditors' rights, except to the extent necessary to achieve the reorganization. Where collateral is unnecessary to the reorganization, a creditor should have the ability to request that the collateral be relinquished.

37. As part of the efforts to create a legal framework which would foster financial intermediation, the *Law on Securing Charges* became effective in January 2001, and the Registry of Securing Charges has been operating satisfactorily since early 2001, with over 2,000 registrations. Although the initial operations of the Registry were largely donor-funded, the Government has now in place arrangements to ensure the operational and financial viability, and long-term sustainability, of this system. After consideration of various alternatives, this has been done by incorporating the Registry into the civil service, making it a department of the MoF. Although the Registry needs budgetary support for its operations in the short-run, it is expected to eventually become self-financing.

38. In addition to improving legislation, the Government's program will focus on strengthening implementation of the bankruptcy and collateral enforcement framework. As part of the overall program and to develop a working system, which in the long-run will help financial intermediation and turn the bankruptcy system into an efficient vehicle for enterprise restructuring and liquidation, a team of legal experts from the MoJ, the MoF and private sector practitioners has formulated an Institutional Development Program (IDP) for Insolvency and Secured Financing Enforcement. The major components of the program comprise: (i) improvement of the judicial infrastructure, including introducing licensing requirements for professional insolvency practitioners; (ii) deepening the capacity for the court application of detailed rules of bankruptcy and

secured financing procedures; and (iii) elaboration and provision of an education and public awareness campaign of the bankruptcy and secured financing system. The program includes monitorable indicators to assess its successful implementation. The IDP has been approved jointly by the Ministers of Finance and Justice. *Satisfactory implementation of the program is a condition for the second tranche release.*

39. **BART Debt Workout.** An additional element of the Government's banking sector reform program is the resolution of the bad loan portfolios of the state-owned banks. BART was created in 1998 for the purpose of working out the bad debt, initially of RCB. BART is mandated to renegotiate its claims with debtors and, in cases where it failed, to enforce the claims through the courts. According to its management reports, BART has renegotiated loans for about Lek 820 million of which about Lek 395 has been fully repaid and the balance are current in their payments. In addition, BART is pursuing claims of about Lek 2.5 billion through litigation and has received decisions on about Lek 250 million to date.

40. The authorities have recently begun to question these results and believe that BART has not functioned effectively as an aggressive liquidator of these assets. This has in part been driven by a lack of clarity in BART's mandate. Its operation has also been significantly hampered by the lack of an effective legal framework for the enforcement of creditor rights. An additional concern is that BART lacks the controls and governance structures required to support activities. These problems have become more of a concern with the transfer of the problem portfolios of the NCB and SvB, which have increased the value of BART's assets about fivefold. The Government contracted an extended audit of BART[14] to obtain a better assessment of its performance. The audit confirmed that BART management's reporting of results were overstated and identified serious institutional weaknesses.

41. BART's failure to work out claims and enforce its rights as a creditor has a negative impact on the banking system by preventing otherwise creditworthy borrowers from establishing relationships with privately owned banks and, by failing to enforce its creditor rights, encourages a lack of creditor discipline. To improve the capacity of BART to implement its expanded mandate, the authorities prepared (with PHRD-funded assistance) a new BART law. The new law, which was adopted by Parliament in May 2002,[15] will fundamentally transform BART as an institution and give it a clear mandate to achieve the objective of resolving its portfolio (by transparent sales or transfer to private sector management) by the end of 2005. The governance of BART will simultaneously be restructured by significantly strengthening the oversight role of the

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[14] This extended audit (including an audit of operations) of 2000 as well as up to September 2001 was financed from the IDA Credit for the FSIBTA.

[15] Law on ATK, Law No. 8894 of May 5, 2002.

Supervisory Board, by establishing a Management Board with clear responsibility and accountability, and by introducing an Investment Board to provide independent advice and review regarding BART's operations and work out activities.

42. The authorities have also drafted (with PHRD-funded assistance) terms of reference for a strategic and business plan to be prepared by BART management. The plan, which is expected to be adopted by end-September 2002, will focus BART on the following key objectives: (a) to transfer ownership of BART's assets to the private sector, to the extent possible; (b) to maximize the use of private sector skills in the management of BART's assets; (c) to maximize the present value of cash recoveries for the benefit of the State; (d) to ensure that all BART's activities are carried out in a way which meets international standards for transparency and accountability; and (e) to reinforce the rule of law and strengthen the framework for creditor rights by ensuring that debtors honor their obligations.

43. The plan, which will establish time-bound targets, will be closely monitored by the Supervisory Board. At a minimum, BART will resolve not less than 15 percent by value and 10 percent by number of its assets by end-June 2003; no less than 50 percent by value and 50 percent by number of its assets by mid-2004; and, not less than 90 percent by value and 75 percent by number of its assets by mid-2005. Any assets remaining on BART's books at end-2005 will be transformed into State claims and transferred to the MoF for future resolution. BART will cease to exist as an institution at the same time. *Satisfactory implementation of the Strategic and Business Plan, including resolution of at least 15 percent of BART's portfolio in value is a condition of the second tranche release.*

44. **Improvement of Financial Reporting.** The current Law on Accounting, which was published in 1993, describes the methods by which accounting records are to be maintained and provides an outline of the contents of the annual financial statements. Recognition and valuation principles for assets and liabilities are described only in broad terms; the detailed rules are contained in two accounting manuals, one for banks and one for all other commercial enterprises. The accounting manuals prescribe the compulsory chart of accounts to be used by banks and other enterprises and provide step-by-step instructions for posting transactions to the relevant accounts.

45. The Trade Company Law of 1992 mandates the annual audit of the financial statements of all companies which exceed certain income and asset size criteria. An amendment to the Law in 1995 brought about the creation of an institute of auditors (IEKA). IEKA has received substantial technical assistance since its inception including assistance in the development of an auditing manual compliant with International Standards on Auditing (ISA). IEKA is currently preparing a full translation of the ISA which, subject to the approval of the membership, will be adopted as the standards of the institute. To ensure enforcement of the ISA, the Trade Company Law should be amended to stipulate that all statutory audits be performed in accordance with ISA. The Government intends to mandate the use of International Standards on Auditing.

46. In 1998, the BoA issued a new chart of accounts and accounting manual, developed with financial and technical support from the EU Phare. The new chart of accounts and the accompanying instructions are substantially in conformity with IAS. All banks have now implemented the new uniform chart of accounts. The BoA mandates the preparation of IAS financial statements for all banks, which causes some contradictions with the current Accounting Law. To that end, a new Accounting Law should be introduced in order to provide for full application of International Standards in the area of bank accounting; this would remove the inconsistency and effectively mandate the BoA to maintain its reporting requirements in line with developments in IAS. In addition, the Banking Law and other relevant legislation should be reviewed in order to identify changes needed and accordingly amended. This, together with the adoption of ISA, would enhance the transparency and quality of regulatory reporting from banks and provide the supervisory function with a more reliable independent assessment of banks' financial conditions. This is particularly important as the supervisory function is still in the embryonic stage of development. The MoF has completed drafting a new Accounting Law and plans to submit it to Parliament (together with satisfactory amendments to other relevant legislation) with is view to its adoption by end-2002.

47. There is currently no specific guidance in any of the accounting legislation which might assist the nascent insurance market; insurance companies are required to prepare financial statements in the same format as general trading companies. The overwhelming majority of current business is auto insurance but, as the life products market begins to develop, it will be necessary for the public to be able to obtain some comfort that their long-term savings are secure and that they will be able to draw on life assurance policies when they mature; again some comfort can be gained by ensuring that insurance companies make adequate financial disclosures. The Albanian Insurance Supervision Commission (IASC) is currently working on a standard specifically for insurance companies and this would therefore be an opportune time for the new Accounting Law to mandate the publication of IAS financial statements by insurance companies. Full implementation of International Accounting Standards for insurance companies and any other entities which have a public trust obligation is expected prior to the second tranche release.

48. The corporate sector in Albania comprises predominantly small and micro enterprises; less than 0.3 percent of enterprises have a reported turnover exceeding US$1.4 million. The majority of firms are owner managed and a large volume of transactions are settled in cash, increasing the risk that financial performance will be misstated (typically profits are understated to avoid taxation). In such an environment, financial institutions will lend only to connected companies (about which they have inside information) or against collateral. However, as the informal economy shrinks and the corporate sector develops, the banks will need to migrate from pure collateral-based lending to cash-flow based lending, which will require companies to produce accurate and reliable financial information. The Albanian General Accounting Standards (the Law on Accounting plus the accounting manual for non-bank companies) are based on the French model and, although they are not fully IAS compliant, form a reasonable

accounting framework for the majority of the existing corporate sector. However, as companies increase in size or begin to form group structures, the current framework may prove inadequate. Therefore the new Law on Accounting should define size criteria for companies, above which they are required to produce full IAS financial statements. Albania currently has no operating securities market and, with its history of collapsed pyramid schemes, it will be essential for any securities market which might develop to be effectively regulated so as to quickly build the trust of the investing public. One aspect of securities market regulation is the enforcement of adequate financial disclosure on those companies wishing to list their securities. Full implementation of International Accounting Standards for corporations which exceed a minimum size criteria and for corporations which issue their securities to the public and mandatory use of an appropriate chart of accounts by such corporations are expected by second tranche of the credit.

49. The Government is aware that amending only accounting and auditing legislation is not sufficient to introduce standards for transparency and good governance for corporations. Revision of the commercial code, securities legislation, and other appropriate legislation is needed in order to establish penalties for falsification of financial information and reporting, appropriate incentives and responsibility of corporate owners, managers and supervisory boards. Completion of the review of the relevant legislation is expected by second tranche of the credit.

C. Reform of the Non-Bank Financial Sector

50. **INSIG Privatization.** INSIG was created on 31 July, 1991, as Albania's monopoly insurer. In March 1996, INSIG became a wholly state-owned joint stock company. It has grown strongly during the past few years[16] and has proved to be a conservative investor, as the vast majority of the assets are held in cash or cash equivalents. INSIG's product range consists of three broad categories: motor vehicle insurance; property insurance; and, life, accident and health insurance. Currently three other (private) insurance companies operate in Albania, but INSIG remains the dominant force in non-life insurance (with a market share of around 60 percent at end 2001), and is the only licensed life insurance company.

51. In February 2000, the Government adopted a decision to prepare INSIG for privatization. Although initially the Government indicated an ambitious deadline of end-2001 for this undertaking and much preparatory work has been done, this deadline was clearly unattainable and a more realistic target would be early 2003. INSIG, with the

[16] Net premiums have grown by 60 percent and profits have increased by 132 percent, since 1996. With total shareholders' equity of 2.4 billion Lek, INSIG is well capitalized. The major factors for this growth record have been: taking advantage of opportunities such as the regional expansion into Kosovo; taking advantage of economies of scale, thereby reducing costs; and aggressive restructuring: during the year 2000, INSIG reduced its workforce by 280 staff, or 41 percent, while at the same time continuing to expand its business.

assistance of a short-term advisor (funded from the FSIBTA Credit), has prepared two key policy documents: "INSIG Draft Strategic Plan 2001-2003" and "INSIG Proposed Framework for Privatization". The privatization framework document addresses a number of topics including pre-privatization steps that could be taken to make INSIG more attractive to potential investors, and recommendations for changes to the legal framework in order to increase the appeal of investing in the financial services industry in Albania.

52. The privatization framework document provided the Government with three options for sale of INSIG: (i) a traditional sales process, seeking bids in the same way as that undertaken for the Savings Bank; (ii) a two-step process, commencing with a "pre-privatization sale", to be followed by a complete divestiture in the medium-term; and (iii) fast-track privatization. After considering the various options, the Government decided to privatize INSIG through a three-phase process, which is generally consistent with the two-step approach. This process would include: (i) a pre-privatization sale of up to 40 percent to international financial institutions (IFC and EBRD) by negotiations; and (ii) the subsequent privatization which would have two phases: 12 months after this sale, to offer by international tender no less than an additional 40 percent of the shares to strategic investor(s); and, within 5 years of the pre-privatization, to sell the remaining government shares to private Albanian banks and credit institutions through a public offering. This strategy is incorporated in the INSIG Privatization Law which was adopted by Parliament in May 2002. The Government is well advanced in its discussions with the IFC and EBRD for the pre-privatization equity sale. Under this arrangement, they would then help with the continued pre-privatization restructuring and the eventual sale of the company to strategic investors. The Government has indicated its intention to retain professional advice for the implementation of this strategy to help ensure the transparency and integrity of the process. Privatization efforts are being supported by IFC and by technical assistance funded from the IDA Credit for the FSIBTA.

53. **Insurance Regulation and Supervision.** Privatization of the insurance sector in turn requires development of an adequate regulatory and supervisory framework designed to stimulate healthy competition in the market. The MoF and the Albanian Insurance Supervision Commission (AISC) have developed, with assistance from IFC, recommendations for improvements in the insurance legislation and in the operations of the AISC. To this end, they have prepared a package of legislation including: (i) draft amendments to the Insurance Law; and (ii) draft regulations on basic financial and statistical reports required by AISC from insurance companies operating in Albania. The draft amendments to the Insurance Law are expected to be submitted to Parliament later this year, with a view to their early adoption. Additionally, the authorities plan to prepare amendments to the 1992 TPL law in their efforts to move toward international standards. These amendments are expected to be adopted by Parliament by early-2003. As an immediate step to reduce the risk in the insurance market, the MoF has approved regulations setting premium and reserve requirements for third party liability insurance. *Enactment of satisfactory insurance legislation is a condition for the second tranche release.*

54. The Government is also fully committed to migrating the AISC toward an independent status and by end-2002 will take steps in this regard by providing AISC with budgetary and operational independence in substantial compliance with the core principles of the International Association of Insurance Supervisors (IAIS). To help the long-term development of AISC, the MoF and the management of AISC are currently preparing an institutional strengthening plan which they intend implement through securing technical assistance from bilateral and multilateral donors. *Establishment of an insurance regulatory agency with budgetary and operational independence acceptable to IDA is a condition for the second tranche release of the credit.*

IV. THE PROPOSED CREDIT

A. Rationale for IDA Involvement

55. The IDA assistance strategy (Country Assistance Strategy—CAS—May 2002) will be presented to the Board concurrently with this operation. The CAS is designed to support Albania in implementing the GPRS. The GPRS confirms the validity of the broad objectives of the 1998 CAS and the 2000 CAS Progress Report. Therefore, the objectives of the FY03-05 CAS are largely the same as those of the previous CAS, namely: (i) improving governance and strengthening institutions (building efficient and inclusive public institutions; increasing transparency and accountability at all levels; strengthening monitoring and evaluation; and using community-based approaches that build institutions from the bottom up); (ii) promoting sustainable private sector growth (maintaining macroeconomic stability in conjunction with the IMF program; continuing financial sector reform and enterprise privatization; improving the environment for private investment; sustaining agricultural growth and fostering broad-based rural growth; improving infrastructure and creating institutional environments conducive to infrastructure sustainability, especially through community or private sector participation; and promoting environmental sustainability); and (iii) fostering human development (education, health and social protection).

56. Poverty reduction is the overarching objective of the Bank's assistance strategy.[17] The Bank will continue the efforts started in 1998 to deepen the cross-sectoral focus on poverty alleviation—consistent with the GPRS. The GPRS, together with the Bank-IMF Joint Staff Assessment, and the CAS, all emphasize the importance of continued implementation of the structural reforms for the achievement of the Government's long-term growth and poverty reduction strategy. The GPRS outlines the following structural reforms as most important in deepening the transition process: "(a) completion of the

[17] The need to increase efforts to reduce poverty was also the overarching objective of the strategy presented in the CAS Progress Report and Interim PRSP (presented to the Board in March and June 2000, respectively).

privatization process of industrial enterprises, public services, and financial institutions, which are still under State ownership; (b) consolidation of reforms in the banking system and establishment of the capital market; (c) deepening of market institutionalization, including property right consolidation, promotion of competition, consumer protection; (d) deepening of reformation and modernization of State institutions according to the standards of a democratic society and a market-oriented economy."

57. The proposed operation plays a prominent role in the Bank's assistance strategy and in achieving the objectives of the GPRS, as presented in the CAS. The reform program supported under the FSAC will help the design and implementation of the Government's final phase of divestiture from the financial sector. With this exit, the Government's role will shift from that of an owner to that of a regulator. The proposed operation supports the Government's effort in this transition by focusing on improving the legal and institutional framework necessary for functioning of a market-based financial sector, which is critical for sustaining the long-term impact of the structural reforms and growth.

58. Since late-1997, the Bank, through its policy dialogue, has been instrumental in helping the Government formulate its banking sector reform strategy. Funding for preparation and implementation has been provided through two IDA credits (the RPTA and the FSIBTA). The RPTA (approved in FY98) supported the initial phase of banking sector reform, focusing on divestiture of RCB and NCB. This project is substantially completed. The FSIBTA (approved FY00) provides follow up assistance focusing on SvB and the non-bank financial sector, particularly the insurance sector. These operations, together with the Judicial and Legal Reform Project (approved FY00), will help ensure that resources are available to provide the technical assistance needed to implement the program supported by the FSAC. Donor funding from a PHRD grant and from IFC has also been used to support preparation of this program.

59. IFC is making a significant contribution to the Government's financial sector privatization efforts. They have invested, together with the EBRD, in NCB. They are also planning to make an equity investment in SvB and are providing substantial support in the marketing of the bank. Finally, IFC is expected to make a pre-privatization investment in INSIG and help in its future privatization.

B. Coordination with the IMF and other Donors

60. IDA and the IMF have been closely coordinating their efforts in support of Albania's financial sector reforms. In fact, the previous Poverty Reduction and Growth Facility (PRGF) program,[18] which ended in July 2001, provided a policy umbrella for the

[18] The IMF is supporting the Government's commitment to stability and structural reforms, formulated as part of the GPRS, through the PRGF, which is expected to be renewed in June 2002 for 3 years.

structural measures which were designed with the assistance of IDA. Implementation was supported by the two above-mentioned IDA credits. Other donors, including USAID, US Treasury, the Government of Japan (through the PHRD grant for the FSAC) and GtZ, have provided and continue to provide technical and financial support to the preparation and implementation of financial sector and bankruptcy reforms. The Bank has coordinated its efforts with all donors both in Washington and in Tirana.

C. Credit Amount and Borrower

61. The proposed IDA credit, in the amount of SDR 12 million (US$15 million equivalent), will be made to Albania. The proposed credit would be based on standard IDA terms with a maturity of 40 years including 10 years of grace and an expected disbursement of 1-2 years. The credit would be disbursed in two equal tranches of SDR 6 million (US$7.5 million equivalent).

D. Credit Design

62. The principle objective of the proposed credit is to provide timely and responsive support to Albania's efforts to implement effective reform of its banking and insurance sectors as well as its bankruptcy framework. The credit would provide fast-disbursing funds for balance of payments support. The Government, in cooperation with the Bank and the IMF (through a PRGF to be presented to the IMF Board in June 2002), would aim at maintaining a stable macroeconomic framework essential for the successful implementation of the structural reforms.

63. The main elements of the reform program are:

- *Continued Reform of the Banking Sector* focusing on the conclusion of efforts towards the privatization of SvB and improvement of the institutional, regulatory, and supervisory framework for banking;

- *Enhancement of the Bankruptcy and Debt Resolution Framework* focusing on the adoption of the new insolvency legislation and capacity building for and implementation of the insolvency and secured financing framework, and debt workout activities of BART; and

- *Reform of the Non-Bank Financial Sector* focusing on further development of the regulatory and supervisory framework for the insurance sector and the privatization of INSIG.

64. The focus of the design of the credit is on capacity building, implementation of which is medium to long-term in nature. Hence, although the credit is expected to fully disburse in a period of 1-2 years, the long-term nature of the reforms have been considered in the design of the capacity building plans and are expected to be supported through IDA and other donor financing.

E. Board Conditions, Tranche Triggers and Supervision

65. Conditions for Board presentation have been met:

- Short-listing of strategic investors for the sale of SvB;
- Adoption of an agreed SDP by BoA;
- Approval of an agreed IDP for bankruptcy and secured financing;
- Adoption of a new satisfactory insolvency law;
- Adoption of a new BART law;
- Adoption of a privatization law for INSIG; and
- Completion of draft new legislation for the insurance sector.

66. Conditions for the second tranche release include:

- Finalization of SvB's sale by signing a contract for the sale of not less than 50 percent plus one of SvB's shares;
- Establishment of a Deposit Insurance Agency (DIA) and satisfactory progress in implementing its financing program;
- Satisfactory implementation by BoA of the SDP;
- Satisfactory progress in implementation of the IDP for bankruptcy and secured financing enforcement;
- Satisfactory implementation of the Strategic and Business Plan for BART, including resolution of 15 percent of its portfolio value;
- Enactment of satisfactory insurance legislation; and
- Establishment of an insurance regulatory agency with budgetary and operational independence.

67. The MoF and BoA will be responsible for the supervision and implementation of the program. IDA will monitor the implementation of the program through periodic reviews. Monitorable indicators have been agreed with the authorities to be able to objectively assess the progress in the implementation of the reforms. Monitorable indicators are provided in the attached matrix, for both tranche release conditions and for the overall implementation of the Government's program for financial sector reform.

E. Implementation

68. The proposed FSAC will be implemented in accordance with standard IDA procedures for adjustment credits. The financial sector program will be implemented by the MoF and the BoA. Upon notification by IDA of credit effectiveness, the proceeds of the credit will be deposited by IDA into the designated Deposit Account at the request of the Borrower. In accordance with the Operational Directive on the Simplification of Disbursement Rules under Structural Adjustment and Adjustment Credits (February 8, 1996), disbursement will not be linked to specific purchases. Therefore, there will be no procurement requirements.

F. Financial Arrangements

69. The MoF will have in place an adequate accounting and financial management reporting system for Deposit Account. The MoF will maintain records of all transactions under the credit in accordance with sound accounting practices. The Government will submit to IDA a monthly receipts of all payment account showing the transactions on the Deposit Account, starting with the receipt of IDA funds and ending when the balance on the Deposit Account has been reduced to nil. The Borrower shall: (a) have the Deposit Account audited in accordance with appropriate auditing principles consistently applied by independent auditors acceptable to IDA; (b) furnish to IDA as soon as available but in any case no later than four months after the date of IDA's request for such audit, a certified copy of the report of such audit by said auditors of such scope and in such details as IDA shall have reasonably required; and (c) furnish to IDA such other information concerning the Deposit Account and the audit thereof as IDA shall have reasonably requested.

70. The audit will be carried out at semi-annual intervals as agreed with IDA, calculated from the date of first tranche release, with suitable adjustments of timing depending on the date of subsequent tranche release and the funds left in the Deposit Account at any point in time. The terms of reference for the audit will be agreed between IDA and the Borrower. Audits would end once all funds have been transferred from the Deposit Account. In addition to the above, IDA may request that its own staff (or a specialist contractor working on its behalf) carry out special reviews of the Deposit Account. If, after deposit into the Deposit Account, the proceeds of the credit are used for ineligible purposes, IDA will require the Borrower to either: (i) return that amount to the account for use for eligible purposes, or (ii) refund the amount directly to IDA.

G. Environmental Impact

71. In accordance with the Bank's Operational Directive on Environmental Assessment (OD 4.01), the proposed operation has been placed in category "C" and does not require an environmental assessment.

H. Benefits and Risks

72. The reform actions sought under the proposed credit will help consolidate and take the reforms in the financial sector beyond achievements to date to foster better engagement of the financial sector in the growth and development of the Albanian economy. Privatization of SvB to a fit and proper international bank will end the engagement of the Albanian State in banking sector. This, together with further strengthening of the banking regulation and supervision capacities of the BoA, will in the medium-term help create a well regulated competitive banking environment. With improvements in the legal framework for bankruptcy and secured financing and enforcement of creditors' rights, it is hoped that, in the medium to long-term, the banks

will become active participants in financing the enterprise sector and contribute to the long-term sustainable economic development of Albania. Implementation of the non-bank financial sector reforms, particularly the privatization of INSIG, development of the regulatory and supervisory framework for the insurance sector and improvements in the financial reporting, will, in the short-term, help in the provision of better services to the population and, in the long-run, the development of a more mature financial market in Albania (see Table 5 for Key Outcomes).

Table 5: KEY OUTCOMES		
	NEAR-TERM	MEDIUM- TO LONG-TERM
Banking Sector Reform	▪ Privatization of the Savings Bank. ▪ Outsourcing of budgetary and fiscal functions to private banks through open auctions in major towns.	▪ Increase of public trust in the banking sector through increased levels of savings and utilization of banking services by the public. ▪ Increased competition in the banking sector leading to increased and better quality services to clients and population as a whole. ▪ Reduction in SvB's share in the market. ▪ Ensuring prudent market-based banking practices, through improved governance, regulation, and supervision. ▪ Reduction in transaction costs and payment system risks. ▪ Formation of a core of competent bank supervisors.
Enhancement of the Bankruptcy and Debt Resolution Framework	▪ Adoption of the new legislation for the bankruptcy framework. ▪ Training and licensing of pilot group of bankruptcy professionals in accordance with criteria based on the new bankruptcy framework.	▪ Improvement of lending environment and trust in the bankruptcy system. ▪ Improvement in transparency of bankruptcy enforcement mechanism. ▪ Increase in bank lending. ▪ Improvement of credit discipline.
Reform of the Non-bank Financial Sector	▪ Adoption of the new legislation for the insurance sector. ▪ Privatization of INSIG. ▪ Strengthening of the insurance sector supervision and bringing it closer to EU standards.	▪ Increase in competition in the insurance sector. ▪ Creation of sound and enabling regulatory environment for the development of the insurance sector.

73. The risks to the proposed FSAC could be grouped into *political, macroeconomic, and absorptive capacity risks.*

- *Political Risk.* Although Albania's political stability and domestic security have improved since 1997, both major political parties have serious internal divisions. Regionally, the Stability Pact and the prospect of closer ties with European structures are major incentives for reform and political consolidation and will help mitigate this risk, although the 2001 outbreak of ethnic conflict in Macedonia underscores the region's continued instability. Albania remains vulnerable to domestic or regional instability that could derail the efforts to achieve the FSAC objectives. This could be both in terms of delays due to political infighting, such as the recent confrontation between the prime minister and the head of the Socialist Party which led to a slow down in the implementation of the legislative agenda of Parliament, and the use of key elements of the reform for populist politics, such as the privatization of the Savings Bank and that of INSIG. It must be noted, however, that to date, despite major debates in the papers on the future of SvB, no one has yet seriously questioned the merits of privatization. To help further mitigate this risk, the FSAC has been designed to ensure that key (and irreversible) steps are taken prior to Board presentation.

- *Macroeconomic Risk.* The implementation of reforms could be undermined by risks of internal and external macroeconomic imbalances. The Government has agreed with the IMF on the implementation of a stabilization program based on continued cautious fiscal and monetary policies as well as efforts to increase exports and contain the current account deficit. In addition, Albania's objective to sign an Associate Membership with the European Union implies a commitment with the European Commission to implement a stable medium-term macroeconomic program. Nevertheless, Albania faces a major threat to its macroeconomic program due to the continued energy crisis. Reliable electricity is essential for private sector development and sustainable growth. Continued reliance on Government-subsidized energy imports could undermine further fiscal consolidation and the government's ability to fully finance its economic priority actions. Lack of availability of reliable electricity could lead to reduced interest by potential foreign strategic investors in Albania, as well as to the departure of businesses already present in the country, as well as contribute to social unrest and political instability. Steps, however, are being taken with assistance from IDA and other donors to remedy the situation. These include investments in non-hydro power generation capacities and better management of electricity distribution. Another macroeconomic factor that could impact the privatization of SvB and INSIG is the current weak international financial markets. In the case of SvB, this is minimal as the MoF has already identified and invited potential (serious) strategic investors to bid on SvB. In the case of INSIG, IFC is advanced in its consideration of a pre-privatization investment, which will insulate the process from the financial markets situation in the short-term.

- *Absorptive Capacity Risk.* Implementation of the reforms could be substantially undermined by the weak institutional capacity in the country. The risk that this will impact the implementation of the objectives of the FSAC is mitigated by a number of technical assistance initiatives that are well under way. Technical assistance has been provided through different IDA-financed projects (FSIBTA, Judicial and Public Administration Reform projects) and other donors' programs. These measures would support the implementation of the reforms sought under the proposed operation and help build sustainable capacities in the country, particularly in areas of banking supervision, bankruptcy/secured transactions framework and insurance regulation and supervision. These efforts are being pursued in closed coordination with other bilateral and multilateral donors.

V. RECOMMENDATION

74. I am satisfied that the proposed credit will comply with the Articles of Agreement of the International Development Association and recommend that the Executive Directors approve it.

James D. Wolfensohn
President

By: Shengman Zhang

Washington D.C.
May 23, 2002

ANNEX 1

REPUBLIC OF ALBANIA
MINISTRY OF FINANCE

REPUBLIC OF ALBANIA
BANK OF ALBANIA

No. 3539 Prot

Tirana, 2002

Letter of Development Policy

FINANCIAL SECTOR ADJUSTMENT CREDIT

Dear Mr. President:

1. We are writing this letter on behalf of the Government of the Republic of Albania and the Bank of Albania (BoA). Since early 1990's, Albania has made significant progress towards the institutional and structural reforms required for the establishment of a functioning market economy and macroeconomic stability has now been achieved. This progress has been made despite the serious problems experienced due to the near-collapse of civil society and the state as a result of the breakdown of the pyramid schemes in 1997 and, in 1999, the outbreak of the Kosovo crisis which placed heavy fiscal strains on the economy due to the costs of supporting refugees.

2. Since the collapse of the pyramid schemes in mid-1997 significant progress has been made in the implementation of measures to reform the financial sector. In 1997 a new banking law was adopted and a bank privatization strategy was developed. Under the bank privatization strategy, the Rural Commercial Bank (RCB) was closed and its assets transferred to the Bank Assets Resolution Trust (BART/ATK) which was created to centrally work out the problem loan portfolios of the state-owned banks. This was followed by the operational restructuring of the National Commercial Bank (NCB) and, in 2000, its sale to foreign and multilateral strategic investors. The privatization process for the Savings Bank (SvB) is now well advanced, and we expect to finalize the sale by the end of 2002. The privatization process for the Albanian Insurance Company (INSIG) is now starting. The privatization of INSIG, which should be completed in 2003, will mark the final exit of the State from any major ownership role in the financial sector.

3. Since the renewal of our Government's mandate, in the elections held in June 2001, we have reviewed the progress made in the financial sector as well as the framework for bankruptcy and debt resolution. From our review of the financial sector we have identified a number of areas where further progress needs to be made to strengthen supervision and regulation of the banking system, deepen financial markets, and complete the privatization process for SvB and INSIG. The privatization of the

banking system now underway has reinforced the need for an effective system of bank regulation and supervision. In this regard, we have identified a number of areas for improvement, particularly with respect to strengthening the supervision function and the need to bring accounting standards and practices into line with international norms. We must address major weaknesses which continue to exist in the governance of banks and in the accountability of bank management and supervisory boards. To encourage mobilization of deposits, and thus provide much-needed resources, from which credit can be prudently provided to the real sector, Parliament has adopted legislation to establish a deposit insurance scheme. We develop an associated financing plan to ensure its long-term solvency. In the insurance sector, in addition to moving forward with the privatization of INSIG, we will prepare an appropriate legal and institutional framework to regulate the industry and provide it with adequate supervision.

4. Although the mechanism for resolution of the bad assets of the state-owned banks was created in 1998, to date, little progress has been made by BART/ATK in resolving the portfolios of these assets. Successful resolution of these claims is important not only to provide some recovery of the costs of bank restructuring but also to instill creditor discipline, thereby creating a better environment for bank lending. Our review of the framework for bankruptcy and debt resolution, along with a detailed review of BART/ATK's operations, has helped to identify those weaknesses in the framework for the enforcement of creditor rights which pose obstacles not only to the resolution of BART/ATK's assets but also to the availability of all types of credit. Accordingly, our program to reform the framework for bankruptcy and debt enforcement incorporates both overall improvements to the legal and institutional framework, centered on improvements to the bankruptcy and collateral regimes, and specific measures designed to give BART/ATK the mandate and ability to clear up the large backlog of non-performing claims for which it is responsible.

5. We are aware that, while the completion of the privatization of the financial sector will provide support for the long-term growth of output and employment, the full benefits of reform will not occur until an adequate regulatory and supervisory framework for the financial sector is in place and significant progress has been made in developing a framework for protection of creditors' rights. Accordingly, we intend to push forward with an ambitious program of further reforms with the intent of completing the required measures within two years.

6. The Government of Albania's overall reform program has been formulated as part of the Growth and Poverty Reduction Strategy (GPRS) which was agreed with IDA in early 2002. The GPRS groups the "3-year growth strategy" into three broad categories: transition towards a market economy; long-term sustainable development policies; and European integration. As part of the transition towards a market economy, the most important objectives include: (i) completion of the privatization process of industrial enterprises, public services, and financial institutions; (ii) consolidation of reforms in the banking system and establishment of a capital market; (iii) deepening of market institutionalization, including property rights consolidation, promotion of competition, and consumer protection; and (iv) deepening reform and modernization of State

institutions according to the standards of a democratic society and a market-oriented economy. In regard to the financial sector, the GPRS reflects a continuation of the strategy which our Government adopted and has been implementing since 1998. To support these reforms we request the assistance of the International Development Association through a Financial Sector Adjustment Credit.

Macroeconomic Framework

7. We will continue to strive for the macroeconomic stability required for economic growth through the PRGF program now agreed with the International Monetary Fund. The objective of this program, which was recently renewed for a further 3 years, is to help maintain the annual rate of inflation below 4 percent, maintain the momentum of growth, and keep our foreign exchange reserves at about four months of imports. These objectives will be achieved through continued tight fiscal and monetary policies and through efforts to increase exports and contain the current account deficit. The domestically financed fiscal deficit is targeted to decline from 3 percent in 2001 to 3.0 percent in 2002 and 2.5 percent in 2003, leading to an increase in Government savings and releasing resources to sustain long-term growth of the economy. Deficit reduction will be achieved through a combination of improved tax collection and increased efficiency in public spending through better prioritization, particularly of current expenditures. Inflation is expected to remain under control between 2 and 4 percent between 2002-2004. Despite expected increases in imports, improvements in domestic savings should permit a reduction in the current account deficit from 8.5 percent in 2001 to 8.0 percent in 2002 and 7.2 percent in 2003.

Financial Sector Reform

8. The pervasive presence of the State in the banking system has had a negative impact on the development of the economy as a whole by distorting the allocation of scarce credit resources. Failure to rapidly work out the non-performing assets of the state-owned banks encouraged a culture of non-payment on the part of debtors. Weaknesses in the mechanisms for the enforcement of creditor rights and a failure to rapidly address issues raised by the deliberate destruction of bank documents during the disturbances in 1997 have further degraded the creditor environment.

9. Although we have taken many steps to date to address the above issues, we are now aiming to implement further measures to consolidate the achievements and to foster better engagement of the financial sector in the development of the Albanian economy. To this end, the program will focus on continued divestiture of the State from the financial sector and on further improvement of both the legal and institutional frameworks necessary for the functioning of a market economy. The core elements of our program can be grouped into three main categories: (i) continued reform of the banking sector; (ii) enhancement of the bankruptcy and debt resolution framework; and (iii) reform of the non-bank financial sector.

(i) Continued reform of the banking sector

10. This component would support the conclusion of efforts towards the privatization of the last remaining state-owned bank. With this privatization, the sector will be comprised of private banks which are expected to conduct their business prudently, based on market principles and incentives. We realize that in such a private banking environment, the need for robust banking regulation and supervision will be increased. Although BoA has a functioning bank supervision program, including an on-site inspection cycle of 12 months, we plan to substantially strengthen the banking regulatory and supervisory framework. Finally, measures are being undertaken to enhance banking competition.

Privatization of State-Owned Banks

11. As mentioned previously, the process of restructuring and privatization of the state-owned banks commenced in late 1997 with a decision to close RCB and merge its performing assets and liabilities into SvB. A total of Lek 3.6 billion of RCB's non-performing assets, consisting largely of small agricultural loans, were transferred to BART/ATK at that time. The second phase of the process was the restructuring and privatization of NCB. This was accomplished by means of substantial technical assistance to rationalize and modernize NCB's operations. In 2000, a total of Lek 10.4 billion of non-performing assets of NCB were transferred to BART/ATK and the bank was recapitalized and sold to a consortium of multilateral and private investors. The third phase of the program, the privatization of SvB, is now moving forward. The bank has completed its operational restructuring (again with substantial technical assistance), and Lek 7.0 billion of its non-performing assets have been transferred to BART/ATK in mid-2001. The bank is being offered for sale through invitation for international tender to pre-selected number of strategic investors. We will select a strategic investor and initiate negotiations for SvB by the end of June 2002. In addition to IDA, we are receiving substantial assistance from IFC and EBRD (which will also take equity shares in SvB) in this endeavor. We expect this privatization to be completed by the end of 2002.

Improvement of Bank Regulation and Supervision

12. The fundamental framework for bank regulation and supervision has been established. However, the near-completion of the privatization process for the state-owned banks has reinforced the importance of further strengthening bank regulation and particularly, supervision. We view prudent operation of the banking system as critical given the devastating social and economic impacts of the collapse of the pyramid schemes in 1997. We have reviewed existing legislation, regulations, and supervisory practices and have identified a number of areas for improvement.

13. The Bank of Albania has enjoyed complete independence in the recent past. The Law on the Bank of Albania establishes this independence, but it could be revised to further strengthen BoA's institutional position. To this end, amendments to the Bank of

Albania Law have been submitted to the Parliament to increase the independence of the Governor and to prohibit members of BoA Supervisory Council form being employed directly or indirectly in the banking business. These amendments were adopted by Parliament on May 14 2002. This will help guard against interference through legal gaps, which could undermine public confidence in the banking system. In addition, these amendments will prescribe clear prohibitions against conflicts of interest on the part of BoA Supervisory Council members both during and after their tenure.

14. We are currently preparing changes to the Banking Law and BoA regulations which tighten standards for bank licensing (to include inter alia more stringent screening criteria for bank owners and managers and a more careful evaluation of the managers' technical ability to oversee banking operations and risk management), for licensing additional banking activities, and to better define restrictions on transactions between banks and connected parties. At the same time, BoA intends to prepare regulations which better define the scope of asset classification requirements, fully develop rules related to the calculation and reporting of large credit exposures, and require accurate recognition of losses and earnings in bank financial reports. We plan to submit the changes to the Banking Law to Parliament view to their adoption by end-2002, and concurrently will introduce the associated regulation.

15. As part of our international obligations and cooperation, BoA has recently adopted modern regulations on the prevention of money laundering and is working closely with the Ministry of Finance in enhancing the enforcement of money laundering legislation in Albania with assistance from the US Treasury and IFIs.

16. With donor assistance, progress has been made to improve the supervisory process. A comprehensive CAMELS rating framework has been introduced, a manual for on-site inspections has been drafted, and steps have been taken to establish an Early Warning System (EWS) function. BoA has also made efforts to strengthen its supervisory capability, both with regard to on-site inspection and off-site monitoring and has established an annual on-site examination cycle. Training programs have covered several important areas of supervision such as the evaluation of credit risk and procedures, and the management of liquidity, interest and exchange rate risks. In spite of this progress, supervisory skills remain weak, and retention of qualified and experienced staff is an issue. Human resource concerns and the lack of rigorous application of the existing banking law and regulations, together, result in a generally weak system of bank oversight and supervision.

17. Given the relatively recent operational restructuring and recapitalization of the largest banks in the system, this is an opportune time to take decisive steps to further build a rigorous regulatory and bank supervision program, as well as to introduce and reinforce a strong bank compliance culture with sound operating practices. To begin with, since efforts would be lost if BoA were unable to retain adequate human resources, improvements are being made to adjust the level of remuneration and to introduce different personnel levels reflecting different levels of skills. We also plan to revise the Code of Ethics for all supervisory staff to address, inter alia, potential conflicts of

interests. We will also expand the dialog with the external audit industry and raise the level of expectations for banks' external audit processes and the accuracy and integrity of audit results, thereby helping to supplement our own supervisory efforts. We will institute a type of «quality assurance» process which will provide at least two pre-identified benefits: (i) help to communicate to senior and executive BoA management the progress and effectiveness of regulatory and supervisory activities, and (ii) communicate additional bank-specific issues which may not be raised through the regular management reporting process. Additional plans exist to more actively enforce bank regulation and supervisory practices, improve the on- and off-site supervisory functions, and enhance licensing practices, through additional technical assistance and advisory oversight. The above steps are all reflected in a Supervisory Development Plan agreed with IDA and which was adopted by BoA's Supervisory Council in March 2002. We hope to substantially improve the effectiveness of the supervisory process with the implementation of SDP. The Plan incorporates specific measures and steps, including improvements in BoA regulations for supervision of banks (as agreed with IDA). We are fully committed to the implementation of the SDP.

18. Strengthening of the supervisory system is a prerequisite for the establishment of a deposit insurance scheme. We recognize that a well-designed deposit insurance scheme provides a useful tool to increase confidence in the banking system and to encourage deposit mobilization. The increase in the flow of financial resources into the banking system will contribute to improved intermediation between savers and borrowers. We believe that it is appropriate to implement this scheme now that the banking system is well capitalized, has very low risk assets, and the Savings Bank privatization process is sufficiently advanced. Accordingly, Parliament adopted a deposit insurance law and we intend to establish a Deposit Insurance Agency based on the law. We plan to develop in the coming year a financial program to ensure the solvency of the deposit insurance agency and to make satisfactory progress in the implementation of this program (which will be assessed jointly with IDA during 2003).

Enhancing Competition

19. Development of capital markets and the banking sector as a whole is now inhibited by limited competition in the Treasury Bill market, the lack of an efficient interbank settlement system, and the lack of an efficient system for low value payments. In order to increase banking competition in the Treasury Bill market and in the provision of financial services for the Government, we have already improved procedures to allow the general public to more easily purchase Treasury Bills. In 2002, we held open auctions based on which we contracted government fiscal functions out in Durres and Elbasan. We intend to continue these efforts. In addition, we are actively encouraging state-owned enterprises to seek banking with private banks, based on best services provided. In order to improve the interbank settlement system, we intend to complete three steps by early 2003: first, the real time gross settlement system (RTGS), for which procurement is underway, will become operational; second, not less than five banks will be connected to RTGS; and, third, we intend to develop a small value clearing and settlement system (the objective of BoA is to have this scheme come on-stream at about

the same time as the RTGS) and to ensure that the appropriate legal framework is in place for its operation.

(ii) Enhancement of the bankruptcy and debt resolution framework

20. This part of our program will build on the efforts undertaken to date and focus particularly on improving implementation and enforcement of the bankruptcy and secured charges legislation. It is hoped that with the improvements in the bankruptcy and secured charges framework, and creditors rights, the banking sector will engage more proactively in crediting the economy and hence help further the growth of the enterprise sector.

21. A related key area of reforms is improvement in the framework for the work out of bad debt. This includes the redefinition of the role of BART/ATK in the resolution of its inherited portfolio through adoption of the new BART/ATK law and the Strategy and Business Plan. A major focus will also be on the divestiture of assets held by BART/ATK and its closure at the sunset time.

22. Improvements to the framework for bankruptcy and debt recovery are essential if the newly privatized banking sector is to be able to fulfill its function of providing credit to the economy efficiently. The current inability of creditors to enforce their rights is a major obstacle to the provision of financing and has resulted in an extremely low level of bank lending. Separately, the large backlog of non-performing debts transferred from the state-owned banks to BART/ATK must be quickly resolved in order to restore needed discipline to the system which has been undermined by the widespread failure of borrowers to repay debts to the state-owned banks

Reform of the Legal and Institutional Framework for Bankruptcy and Debt Recovery

23. We have made progress recently in improving the legal framework for secured lending through the enactment of the Law on Securing Charges. The Registry for Securing Charges commenced operations in 2001 and to date over 2000 secured loans had been registered. In early 2002 we enacted regulations to ensure the long-term financial and operational viability of the Registry by incorporating the Registry as an integral budgetary responsibility of the Ministry of Finance.

24. The second pillar of the creditor framework, a functioning bankruptcy and insolvency system, does not yet exist. While legislation has been enacted in the past, no Albanian court has ever handled a case of insolvency or bankruptcy. In addressing this problem we have also recognized that the interaction between insolvency and bankruptcy law and the new Law on Securing Charges must be well designed and free of conflicts. In particular, bankruptcy should not provide debtors with a means to prevent the seizure of collateral registered under the Law on Securing Charges.

25. As part of our efforts to improve the creditors rights, the Council of Ministers approved on April 13, 2002, a new insolvency law substantially in line with the EU legislation and in line with the World Bank's Principles and Guidelines for Insolvency and Creditor Rights Systems. The insolvency law, that was adopted by the Parliament in May 22, 2002. This law will provide a satisfactory regulatory framework for insolvency. In order to enable satisfactory implementation and enforcement of the new framework, the Ministry of Finance and the Ministry of Justice have jointly approved an Institutional Development Program to support the process of insolvency and secured financing enforcement. The implementation of the program will be funded from already identified bilateral and multilateral sources, including existing IDA credits. We are fully committed to the implementation of this program as agreed with IDA and by mid 2003 we will have completed not less than three pilot cases to test the operation of the reformed insolvency framework.

Reform of BART/ATK

26. Since its formation in 1997, BART/ATK has enjoyed only very limited success in working out the assets transferred to it from the banks. BART/ATK's failure to work out claims and enforce its rights as a creditor has a negative impact on the banking system by preventing otherwise creditworthy borrowers from establishing relationships with privately owned banks and, simultaneously, by failing to enforce its creditor rights (particularly against debtors whose credit files were destroyed in the disturbances in 1997) encourages a lack of creditor discipline. In addition, the recently completed KPMG diagnostic audit of BART/ATK indicates very serious institutional weaknesses and reinforces the case that a drastic restructuring of it is now required. We have already taken steps to restructure and strengthen BART/ATK's management and will take further steps to strengthen the management team if this is required. We, in conjunction with the conclusions of the diagnostic audit, have identified three key weaknesses of BART/ATK: first, it lacks a clear mandate to aggressively work out assets and transfer them to the private sector within a defined period of time. Second, it lacks the governance and controls appropriate for an institution entrusted with a substantial portfolio of state assets. Third, it lacks the legal tools required to effectively enforce its rights as a creditor.

27. In order to transform BART/ATK into a mechanism for speedy elimination of the stock of non-performing assets, we have embarked on an ambitious program of institutional and legal reforms, Parliament has adopted on May 14, 2002 a new Law on BART/ATK which will fundamentally transform it as an institution and give it a clear mandate to achieve the objective of resolving its portfolio (by transparent sales or transfer to private sector management) by the end of 2005. The governance of BART/ATK will be simultaneously restructured by significantly strengthening the oversight role of the Supervisory Board, by establishing a Management Board with clear responsibility and accountability, and by introducing an Investment Board to provide independent advice and review regarding BART/ATK's operations and work out activities. As a starting point towards improving its operations and better management of its portfolio, BART/ATK has signed a loan servicing agreement with SvB for back-office (servicing and bookkeeping) responsibility for loans carved out of SvB. We have also completed

tender procedures for at least two qualified international consultants (to be funded using resources provided from IDA credits) to provide assistance to BART/ATK in achieving the objectives established by its new mandate and, secure donor financing for the three members of BART/ATK's new Investment Board.

28. By the end of September 2002, BART/ATK (using the results of its extended audit by KPMG) will adopt a strategic and business plan which will establish quantitative and qualitative time bound objectives for the Management Board to achieve, and which will be closely monitored by the Supervisory Board. At a minimum, BART/ATK will achieve the objectives of resolving not less than 15 percent by value and 10 percent by number of its gross assets by the end of June 2003; and, we intend that it will resolve not less than 50 percent by value and 50 percent by number of its assets by mid-2004; and, not less than 90 percent by value and 75 percent by number of its assets by mid-2005. Any assets remaining on BART/ATK's books at the end of 2005 will be transformed into state claims and transferred to the Ministry of Finance for future resolution. BARTATK will cease to exist as an institution at the same time.

Improvements to Financial Reporting

29. The final pillar in the development of a functioning credit market is development of transparent and accurate financial reporting by corporations and improvements in their governance to protect creditors. No credit information system can function effectively if the financial information provided to it by corporations is inaccurate or incomplete and lenders must enjoy protections against fraud by corporate owners and managers. We will address these issues by means of a two-part strategy.

30. The current Law on Accounting, which was published in 1993, describes the methods by which accounting records are to be maintained and provides an outline of the contents of the annual financial statements. The Trade Company law of 1992 mandates the annual audit of the financial statements of all companies, which exceed certain income and asset size criteria. An amendment to the Law in 1995 brought about the creation of an institute of auditors (IEKA). IEKA has received substantial technical assistance since its inception including assistance in the development of an auditing manual compliant with International Standards on Auditing (ISA). We intend to mandate the use of ISA, through amendments to the Trade Company Law. In 1998, the BoA issued a new chart of accounts and accounting manual, developed with financial and technical support from the EU Phare. The new chart of accounts and the accompanying instructions are substantially in conformity with IAS. All banks have now implemented the new uniform chart of accounts. The BoA mandates the preparation of IAS financial statements for all banks, which causes some contradictions with the current Accounting Law. To that end, a new Accounting Law should be introduced in order to provide for full application of International Standards in the area of bank accounting; this would remove the inconsistency and effectively mandate the BoA to maintain its reporting requirements in line with developments in IAS. We have drafted a new Accounting Law and are currently making revisions to streamline this law and make it compliant with recognized international norms. We expect Parliamentary adoption of this law, together

with amendments to other relevant legislation by end-2002. We expect full implementation of International Accounting Standards for banks following adoption. We also plan full implementation of International Accounting Standards for insurance companies and any other entities, which have a public, trust obligations.

31. Although, Albania currently has no operating securities market, with its history of collapsed pyramid schemes, it will be essential for any securities market which might develop to be effectively regulated so as to quickly build the trust of the investing public. One aspect of securities market regulation is the enforcement of adequate financial disclosure on those companies wishing to list their securities. We, therefore, also plan to mandate implementation of IAS for corporations, which issue their securities to the public and mandatory use of an appropriate chart of accounts following adoption of the new accounting law. We are aware that amending only accounting and auditing legislation is not sufficient to introduce standards for transparency and good governance for corporations. We, therefore, intend to complete during 2002 a review of the commercial code, securities legislation, and other appropriate legislation to identify amendments needed for introduction of standards for transparency and good governance.

(iii) Reform of the non-bank financial sector

32. Our efforts in this area include further development of the regulatory and supervisory framework for the insurance sector and the privatization of INSIG. Efforts for the privatization INSIG have been supported by IDA as well as by IFC and EBRD, in collaboration with the management of INSIG. To this end and with your support, IFC is considering a pre-privatization equity investment in INSIG. The development of the regulatory and supervisory framework is being elaborated with support from the World Bank both through grant-funded technical assistance from the IFC and from the IDA-financed FSIBTA Project.

33. INSIG is the principle company offering insurance services in Albania and, although competion is increasing, it still has a major market share (about 60 percent of nonlife at end-2001). In line with the Gonverment's program of divestiture from the financial sector, we have decided to move forward with efforts to restructure and privatize INSIG. To this end, in February 2000, the Government adopted a decision to prepare INSIG for "privatization". With assistance from IDA in support of its pre-privatization efforts, INSIG has prepared two key policy documents ("INSIG Draft Strategic Plan 2001-2003", and "INSIG Proposed Framework for Privatization"). These documents addressed a number of topics including: adopting a sales process which will provide the Government with options for selling INSIG to quality investors; recommending changes to the legal framework in order to increase the appeal of investing in the financial services industry in Albania; and pre-privatization steps aimed at making INSIG more attractive to potential investors.

34. After considering the various options, we have adopted the following strategy for the privatization of INSIG. Privatization will take place through a three-phase process: (i) a pre-privatization sale of up to 40 percent to international financial institutions (IFC

and EBRD) by negotiations; (ii) 12 months after this sale, to offer by international tender no less than an additional 40 percent of the shares to strategic investor(s) and (iii) within 5 years of the pre-privatization, to sell remaining Government shares to private Albanian banks and credit institutions through public offering. This strategy is incorporated in the Privatization Law, which Parliament has adopted in May 22, 2002. We intend to retain professional advice to help with the implementation of phase (ii) of this strategy to help ensure the transparency and integrity of the process.

35. Privatization of the insurance sector in turn requires development of an adequate regulatory and supervisory framework designed to stimulate healthy competition in the market. With assistance from the International Finance Corporation we have developed recommendations for improvements in the insurance legislation and in the operations of the Albanian Insurance Supervision Commission (AISC). To this end, we have prepared a package of legislation including: (i) draft amendments to the Insurance Law; and (ii) draft regulations on basic financial and statistical reports required by AISC from insurance copmanies operating in Albania. We will approve the letter by end-2002. We plan to submit the draft amendments to the Insurance Law to Parliament later this year, with a view to the early adoption. Additionally, we plan to prepare amendments to the 1992 TPL law in our efforts to move toward international standards. We expect these amendments to be adopted by Parliament by early-2003.

36. As an immediate step to reduce the risk in the insurance market, we have adopted regulations setting premium and reserve requirements for third party liability insurance. We are fully committed to migrate the AISC toward an independent status and by end-2002 we will take steps in this regard by providing AISC with budgetary and operational independence. In order to help long-term development of AISC, we are currently preparing an institutional strengthening plan. We intend to ensure the implementation of this plan through securing technical assistance from bilateral and multilateral donors.

Sincerely.

Minister of Finance

Governor of the Bank of Albania

Annex II

Proposed Financial Sector Adjustment Credit
Draft Matrix of Key Actions[18]

I. BANKING SECTOR REFORM				
Area	**Pre-Board LDP Achievements**	**Board Conditions[2]**	**Tranche Release Conditions[2]**	**Monitorable Indicators[2]**
Banking Privatization	Solicitation of expressions of interest from strategic investors for SvB sale through international tender.	**Short listing of strategic investors.**	**Finalization of SvB sale through signature of contract for sale of not less than 50%+1 of SvB's shares.**	**Signing of sales contract with strategic investor(s).**
Banking Competition	Improvement in procedures offering T-Bills to the public.			Outsourcing of budgetary and fiscal functions to private banks through open auctions in 6 major towns. Increase in credits to private sector as percentage of GDP from current level of 4.6%. Drop in interest rate spreads. Increase in sales of T-Bills to the public.

[18] According to the Development Credit Agreement, key actions also include: (i) agreement with the IMF on a medium-term macroeconomic framework endorsed by the PRGF as a condition for the Board presentation; and (ii) satisfactory compliance with the macroeconomic framework, as assessed by the World Bank and the IMF, as a condition for the tranche release.

[2] Bolded actions depict core conditions for Board and tranche release as well as monitorable indicators that relate to tranche release conditions. Other indicators relate to the Government's own agenda and goals as set out in the LDP.

I. BANKING SECTOR REFORM				
Area	**Pre-Board LDP Achievements**	**Board Conditions**[2]	**Tranche Release Conditions**[2]	**Monitorable Indicators**[2]
Deposit Insurance	Enactment of a satisfactory deposit insurance law.		**Establishment of the DIA and satisfactory progress in implementing its financing plan.**	**Capitalization of the DIA to the levels agreed.** **Development of adequate staffing levels.** **Provision of adequate budget.** **Approval by BoA of a 3-year financing plan for the DIA**
Banking Regulation	Submission to Parliament of satisfactory amendments to the Law on the Bank of Albania.			Parliamentary adoption of of the amendments to the Banking Law and the Law on the Bank of Albania. Adoption of satisfactory regulations by the BoA.
Banking Supervision		**Adoption of agreed Supervisory Development Plan (SDP) by the BoA.**	**Satisfactory implementation of the SDP.**	**As per SDP.**
Development of an Efficient Payments System	Evaluation of bids for the RTGS system.			Establishment of the necessary legislative framework for the operations of a small value (bulk) clearing and settlement system (BCSS). Initiation of the RTGS system operations. Connection of not less than 5 banks into the RTGS.

II. ENHANCEMENT OF THE BANKRUPTCY AND DEBT RESOLUTION FRAMEWORK				
Area	**Pre-Board LDP Achievements**	**Board Conditions**	**Tranche Release Conditions**	**Monitorable Indicators**
Bankruptcy framework		**Adoption of agreed Institutional Development Program for bankruptcy enforcement and secured financing.** **Adoption of a satisfactory insolvency law.**	**Satisfactory progress in implementation of the Institutional Development Program (IDP) for bankruptcy enforcement and secured financing.**	**Completion of no less than 3 pilot cases to test the operation of the framework.** **As per IDP.**
Collateral Enforcement	Provision of adequate arrangements for financial and operational viability of the Secured Charges Registry for 2002 and beyond.			Maintenance of at least 2 staff for the Registry.
Improvement of Financial reporting	Complete drafting a new Accounting Law.			Enactment of a satisfactory Accounting Law and of amendments to relevant legislation, mandating full implementation of IAS for banks, insurance companies, and entities with public trust obligations. Mandatory implementation of IAS for corporations issuing securities to the public and their use of an appropriate chart of accounts. Mandatory use by audit firms of ISA. Review relevant legislation to identify amendments needed for introduction of standards for transparency and good governance for corporations.
BART Debt Workout	Conclusion of the BART audit and submission of the results to IDA.	**Adoption of satisfactory BART Law.**	**Satisfactory implementation of Strategic and Business Plan, including divestiture of 15% of its portfolio value.**	**Adoption and implementation of the Strategic and Business Plan.** **Resolution of 15% of BART's portfolio value.**

III. REFORM OF NON-BANK FINANCIAL SECTOR				
Area	**Pre-Board LDP Achievements**	**Board Conditions**	**Tranche Release Conditions**	**Monitorable Indicators**
INSIG Privatization	Agreement on the privatization strategy for INSIG.	**Adoption of privatization law for INSIG.**		Signing of sales contract with a strategic investor(s) and/or IFI. Independent board and commercial management structure for INSIG. Retention by MoF of professional advise to help with the privatization program.
Insurance Regulation and Supervision	Approval by MoF of regulations on premiums and reserving for third party liability insurance (at levels agreed with IDA). Agreement on migration of AISC towards an independent status.	**Completion of drafting new legislation for the insurance sector.**	**Enactment of a satisfactory insurance legislation.** **Establishment of an insurance regulatory agency with budgetary and operational independence, acceptable to IDA.**	**Enactment of amendments to Insurance Law.** **Progress in the use of a basic set of financial and statistical reporting requirements.** **Adoption of revisions to the 1992 TPL Law.** **Independence of AISC measured against progress in meeting the essential criteria of IAIS Core Principle 1.**

Annex III

Statement of IDA Credits
ALBANIA – FINANCIAL SECTOR ADJUSTMENT CREDIT
02-May-2002

			Original Amount in US$ Millions				Difference between Expected and Actual Disbursements	
Project ID	FY	Purpose	IBRD	IDA	Cancel.	Undisb	Orig	Frm Revised
P069479	2002	FISHERY DEVT	0.00	5.60	0.00	5.51	0.00	0.00
P070078	2001	TRADE & TRANS FACIL IN SE EUR	0.00	8.10	0.00	6.70	2.60	0.00
P055383	2001	SOC SERV DEVT	0.00	10.00	0.00	9.55	-0.25	0.00
P054736	2001	AG SERVICES	0.00	9.90	0.00	9.26	0.09	0.00
P057182	2000	LEGAL/JUDICIAL REFORM	0.00	9.00	0.00	7.60	3.76	0.00
P066491	2000	WS URGENT REHAB	0.00	10.00	0.00	7.38	4 22	0.00
P068853	2000	EMERGENCY ROAD REPAIR	0.00	13.65	0.00	6.65	5.13	3.45
P069079	2000	FINANCIAL SECTOR IBTA	0.00	6.50	0.00	4.17	1.48	0.00
P069120	2000	EDUC REFORM	0.00	12.00	0.00	10.32	-0.11	0.00
P069939	2000	PUBLIC ADMIN REFORM	0 00	8.50	0.00	7.46	2.40	0.00
P043178	1999	IRRIG & DRAIN II	0.00	24.00	0.00	8.64	-1.28	0.00
P051309	1999	COMMUNITY WORKS	0 00	9.00	0.00	0.41	5 27	0.00
P051310	1999	MICROCREDIT	0.00	12.00	0.00	5.00	-0.74	0.00
P045312	1998	HEALTH RECOVERY	0 00	17.00	0.00	12.00	13.15	0.00
P054384	1998	RECOVERY PROG TA	0.00	5.00	0.00	0.46	0 48	0.54
P051602	1998	PRIVATE INDUSTRY RECOVERY	0.00	10.25	0.00	5.32	5 86	0.00
P040975	1998	LAND DEVT	0.00	10.00	0.00	6.51	5.82	0 00
P040818	1998	DURRES PORT	0.00	16.99	0.00	8.38	8.09	0.70
P034491	1996	POWER TRNSM & DIST	0 00	29.50	4.49	11.30	19.96	0.00
P036060	1996	NATL ROADS	0.00	25.00	0.00	0.69	2.33	0 00
P008271	1996	FORESTRY	0 00	8.00	0.00	1.95	2.67	-0.11
		Total:	**0.00**	**259.99**	**4.49**	**135.26**	**70.38**	**4.59**

STATEMENT OF IFC's
Held and Disbursed Portfolio
January 2002
In Millions US Dollars

		IFC Committed				IFC Disbursed			
FY Approval	**Company**	**Loan**	**Equity**	**Quasi**	**Partic**	**Loan**	**Equity**	**Quasi**	**Partic**
1998	AAP	0.00	28.50	0.00	0.00	0.00	9.15	0.00	0.00
2000	NCBank	0.00	2.00	0.00	0.00	0.00	2.00	0.00	0.00
1999	SEF Eurotech	0.90	0.00	0.00	0.00	0.90	0.00	0.00	0.00
1999	SEF FEFAD Bank	0.00	0.98	0.00	0.00	0.00	0.98	0.00	0.00
2001	Seament	15.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
	Total Portfolio:	**15.90**	**31.48**	**0.00**	**0.00**	**0.90**	**12.13**	0.00	**0.00**

Approvals Pending Commitment

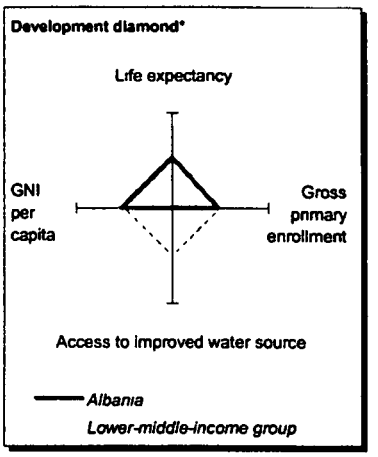
FY Approval	**Company**	**Loan**	**Equity**	**Quasi**	**Partic**
1998	Patos Marinza	30.00	0.00	0.00	50.00
2001	Pastos Marinza In	10.00	0.00	0.00	0.00
	Total Pending Commitment	40.00	0.00	0.00	50.00

Annex IV

Albania at a glance

5/14/02

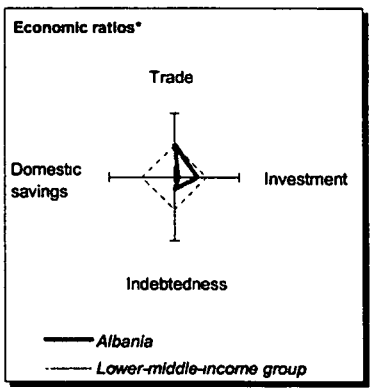
POVERTY and SOCIAL	Albania	Europe & Central Asia	Lower-middle-income
2001			
Population, mid-year *(millions)*	3 4	475	2,046
GNI per capita *(Atlas method, US$)*	1,230	2,010	1,140
GNI *(Atlas method, US$ billions)*	4 2	956	2,327
Average annual growth, 1995-01			
Population *(%)*	0 9	0 1	1 0
Labor force *(%)*	1 3	0 6	1 3
Most recent estimate (latest year available, 1995-01)			
Poverty *(% of population below national poverty line)*	.	.	.
Urban population *(% of total population)*	40	67	42
Life expectancy at birth *(years)*	74	69	69
Infant mortality *(per 1,000 live births)*	20	21	32
Child malnutrition *(% of children under 5)*	8		11
Access to an improved water source *(% of population)*	.	90	80
Illiteracy *(% of population age 15+)*	15	3	15
Gross primary enrollment *(% of school-age population)*	110	100	114
Male	109	101	116
Female	110	99	114



KEY ECONOMIC RATIOS and LONG-TERM TRENDS

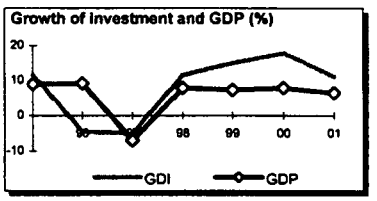
	1981	1991	2000	2001
GDP *(US$ billions)*	.	1 1	3 8	4 1
Gross domestic investment/GDP	35.1	7.3	18 6	19 4
Exports of goods and services/GDP	23 0	7 2	18 9	20 4
Gross domestic savings/GDP	36 6	-13.0	-2.9	-3 7
Gross national savings/GDP	.	-14.2	11.6	13 1
Current account balance/GDP	.	-21.6	-7.2	-6 3
Interest payments/GDP	..	0.2	0 2	0.3
Total debt/GDP		44 9	20 9	23 0
Total debt service/exports	.	3 9	2 1	2 7
Present value of debt/GDP	.	..	12 9	..
Present value of debt/exports	..	..	38 5	.

	1981-91	1991-01	2000	2001	2001-05
(average annual growth)					
GDP	-0 5	5 4	7 8	6 5	6 7
GDP per capita	-2.4	4.6	6 9	5 6	6 3
Exports of goods and services		11 7	5 8	24.8	5 5

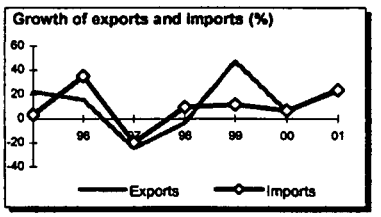


STRUCTURE of the ECONOMY

(% of GDP)	1981	1991	2000	2001
Agriculture	32 4	39 3	51 0	49 1
Industry	43 0	42 7	26 3	27 3
Manufacturing	..	36 5	11 6	11 6
Services	24.6	18.0	22 7	23 6
Private consumption	54.9	90 9	92.0	90 9
General government consumption	8 5	22 1	10 9	12 9
Imports of goods and services	21 5	27 6	40.4	43 5



(average annual growth)	1981-91	1991-01	2000	2001
Agriculture	1 0	6 1	4 0	1 4
Industry	-0.5	5.0	11 4	10 7
Manufacturing	.	-0 8	5 0	6.5
Services	-3 0	5 1	13 3	13 6
Private consumption	.	5 4	2 8	6.7
General government consumption		3 1	7 4	12.0
Gross domestic investment	-1 0	20 1	17 9	11.1
Imports of goods and services	.	11 0	6 5	23 5

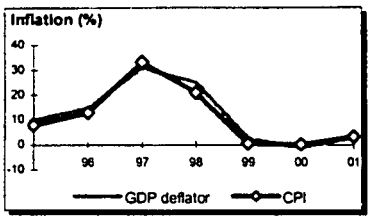


Note. 2001 data are preliminary estimates

* The diamonds show four key indicators in the country (in bold) compared with its income-group average If data are missing, the diamond will be incomplete

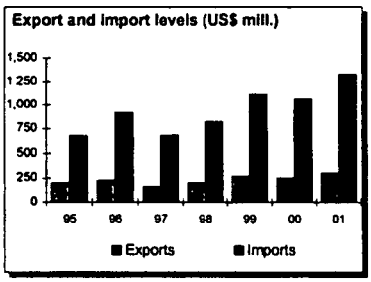
PRICES and GOVERNMENT FINANCE

	1981	1991	2000	2001
Domestic prices				
(% change)				
Consumer prices		49 4	0.1	3 1
Implicit GDP deflator	-2 2	34 5	-1 2	2 8
Government finance				
(% of GDP, includes current grants)				
Current revenue		34 3	22 4	23 0
Current budget balance	.	-21 7	-2.4	-1 2
Overall surplus/deficit	.	-27 8	-9 1	-8 5



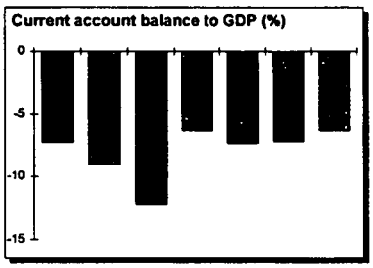
TRADE

	1981	1991	2000	2001
(US$ millions)				
Total exports (fob)	419	101	256	305
Commodity 1		.	28	
Commodity 2			14	.
Manufactures			218	
Total imports (cif)	384	409	1,070	1,332
Food	.		217	
Fuel and energy	.		71	
Capital goods	.		230	
Export price index *(1995=100)*				
Import price index *(1995=100)*	..	.	.	
Terms of trade *(1995=100)*	.	.	.	.



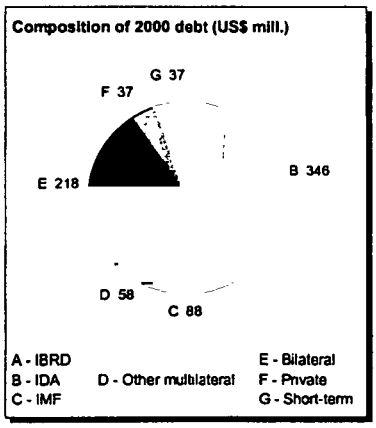
BALANCE of PAYMENTS

	1981	1991	2000	2001
(US$ millions)				
Exports of goods and services	431	82	705	840
Imports of goods and services	403	314	1,520	1,791
Resource balance	28	-232	-815	-951
Net income	11	-22	106	148
Net current transfers	.	8	439	543
Current account balance	45	-246	-270	-260
Financing items (net)	-19	24	381	391
Changes in net reserves	-28	221	-111	-131
Memo:				
Reserves including gold *(US$ millions)*	..		638	767
Conversion rate *(DEC, local/US$)*	..	14 4	143 7	143 5



EXTERNAL DEBT and RESOURCE FLOWS

	1981	1991	2000	2001
(US$ millions)				
Total debt outstanding and disbursed	..	512	784	945
IBRD		0	0	0
IDA		0	346	.
Total debt service	.	4	27	41
IBRD	..	0	0	0
IDA	.	0	2	3
Composition of net resource flows				
Official grants	..	320	161	.
Official creditors	.	20	93	
Private creditors		28	-1	
Foreign direct investment	.	0	143	
Portfolio equity	..	0	0	
World Bank program				
Commitments	.	0	54	20
Disbursements	.	0	64	34
Principal repayments	..	0	0	0
Net flows	..	0	64	34
Interest payments		0	2	3
Net transfers	.	0	62	31



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