Ex post evaluation of MFA operations in Albania

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List of abbreviations

AE news	Albanian Economy news
AECH	Albanian Electronic Clearing House
AIPS	Automated Interbank Payment System
ARMO	Albanian Refining and Marketing Oil
AMC	Albanian Mobile Communication
AFSA	Albanian Financial Supervision Authority
ATM	Accounting Treasury Management system
BoA	Bank of Albania
BoP	Balance of Payments
BERIS	Business Environment Reform and Institutional Strengthening
CARDS	Community Assistance for Reconstruction, Development and Stability in the Balkans (European Union assistance programme to the western Balkans)
CAS	Country Assistance Strategy
CCMIS	Computerised Case Management and Information System
CPI	Consumer Price Index
CPIA	Country Policy and Institutional Assessment
CFT	Consultative Task Force
DG ECFIN	Directorate General for Economic and Financial Affairs
DG ENLARGEMENT	Directorate General for Enlargement
DG RELEX	Directorate General for External Relations
DPL	Development Policy Loan
EBRD	European Bank for Reconstruction and Development
EC	European Commission
EFC	Economic and Financial Committee
EFF	Extended Fund Facility
ESAF	Enhanced Structural Adjustment Facility
EU	European Union
EURALIUS	European Assistance mission to the Albanian Justice System
FDI	Foreign Direct Investment
FIAS	Foreign Investment Advisory Sector
FSAC	Financial Sector Adjustment Credit
FSSA	Financial System Stability Assessment
FSVC	Financial Services Volunteer Corps
GSM	Global System for Mobile Communications
GDP	Gross Domestic Product
GNI	Gross National Income
IBRD	International Bank for Reconstruction and Development

IDA	International Development Association (World Bank, concessional)
IFC	Institute For Contemporary Studies
IFI	International Financial Institution
IFS	International Financial Statistics
INSIG	Albanian Insurance Company
IMF	International Monetary Fund
MEFP	Memorandum of Economic and Financial Policies
MFA	Macro Financial Assistance (EC)
MIGA	Multilateral Investment Guarantee Agency
MoU	Memorandum of Understanding
NPAL-SAA	National Action Plan for the Approximation of Legislation and SAA implementation
NPV	Net Present Value
NSDI	National Strategy for Development and Integration
NSSED	National Strategy for Socio-Economic Development
OA	Operational Assessment
OECD	Organisation for Economic Cooperation and Development
OeNB	Österreichische Nationalbank
PACTA	World Bank Albania Public Administration Reform Project (2000-2006)
PHARE	Poland and Hungary Assistance for Restructuring of their Economics
PRGF	Poverty Reduction and Growth Facility
PRSP	Poverty Reduction Strategy Paper
PRSC	Poverty Reduction Strategy Credit
PIFC	Policy Paper on Public Finance Control
QFD	Quasi Fiscal Debt
SAA	Stabilisation and Association Agreement
SAP	Stabilisation and Association Process
SB	Structural Benchmark
SDP	Supervisory Development Plan
SDR	Special Drawing Rights
SERVCOM	Service Company of Oil and Gas
SIGMA	Support to the Improvement of Governance and Management
SITC	Standard International Trade Classification
SMART	Specific Measurable Achievable Realistic and Timely
SMOU	Supplement Memorandum of Understanding
TPL	Third Party Liability Insurance
USD	United States Dollar
WB	World Bank

Preface

This report has been prepared by a team of a consortium led by ECORYS Netherlands in association with CASE - Center for Social and Economic Research (Poland) and Economisti Associati (Italy). The ECORYS consortium has been contracted to conduct an ex-post evaluation of EC Macro Financial Assistance (MFA) provided to Albania in the period from April 2004 to July 2006.

This report includes the results of desk research, the work undertaken during one mission to the International Financial Institutions in Washington DC (September 2007), and two field missions to Tirana, which were conducted in October and December 2007, respectively.

We would like to express our special gratitude to all officials in Tirana and other resource persons in the country, to staff members of the IMF and World Bank in Washington and Tirana, EC officials in Brussels and Tirana for their cooperation and willingness to contribute to this evaluation by providing us with a good understanding of the facts and events at the time of the MFA operation.

We would also like to thank the Steering Committee for its constructive comments.
Responsibility for the opinions presented in this report rests exclusively with the authors and should not be attributed to the Government of Albania, the European Commission or the IFIs.

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Executive summary

Background

1. This report presents the results of the evaluation of Macro Financial Assistance (MFA) provided by the European Commission to Albania in the period from April 2004 to July 2006. The MFA consisted of a loan of EUR 9 million and a grant of EUR 16 million that was disbursed in two tranches.

2. The main goals of the MFA were to help to ease the country's external financial constraints, support the balance of payments and secure the position of the reserves. It also referred to the residual financing gap remaining to be covered after International Monetary Fund (IMF) and World Bank (WB) financing to support the policy objectives attached to the authorities' reform efforts.

3. Immediately after the Council decided to grant MFA (April 2004) Albania's balance of payments situation improved substantially due to the proceeds of the Savings Bank privatisation. The inflow of FDI of EUR 103 million filled the financing gap in the year 2004. Therefore, MFA disbursements were postponed until 2005 when a new financing gap was identified. The grant part of the first tranche amounted to EUR 3 million, and was released in November 2005. The loan part of the first tranche amounted to EUR 9 million and was released in March 2006. The loan was held up, because of a delay in Parliamentary approval. The first tranche was conditional upon the fulfilment of two prior administrative actions, a satisfactory track record under the IMF programme, and the signing of the MoU. The second tranche (a grant of EUR 13 million) was released in July 2006 after the conditionalities agreed in the MoU were deemed to have been fulfilled.

4. In 2006, the MFA accounted for about 15 percent of the total financial assistance for Albania, and roughly 1/3 of EC assistance for that year.

Evaluation objectives and approach

5. The main objectives of this ex-post evaluation of MFA are to (a) assess the effects of the MFA operation in Albania and (b) to learn key lessons, which can be applied to future interventions and/or the possible need for a reorientation of the present approach.

6. The evaluation focused on three core areas of effects: (i) macroeconomic stabilisation; (ii) sustainability of the fiscal and external financial situation; and (iii) structural reforms. In addition, the implications of the design and implementation of the MFA operation were considered.

7. The evaluation employed seven instruments: (i) data collection and analysis; (ii) a literature review; (iii) a preparatory questionnaire to prepare for the structured interviews; (iv) structured interviews with key informants; (v) macroeconomic modelling; (vi) case studies; and (vii) a 'Delphi technique' questionnaire to verify and support the findings from the interviews. The evaluation was based on the triangulation of all the findings resulting from the application of all the evaluation instruments.

Macroeconomic stabilisation

8. Albania ensured macroeconomic stabilisation in the period 2004-2007. Annual growth performance was around 5 percent; and the Bank of Albania has been successful in keeping inflation within its 3 ± 1 percent target range, despite the energy crisis. Exchange rates and interest rates stabilised in the period 2004-2007. The Repo rate came down from 8 percent in 2003 to a fairly stable rate of between 5 and 6 percent in 2007. The Lek real exchange rate against the EURO was broadly stable.

9. Key fiscal indicators also show stability in the period 2004-2007. Fiscal deficit came down from 5 percent of GDP in 2004 to a projected level of about 4 percent of GDP in 2007(dd November 2007)[1]. The reduction of the fiscal deficit, in combination with the proceeds of privatisation, enabled a reduction in public debt from close to 57 percent of GDP in 2005 to a projected debt of just above 54 percent in 2007.

10. A strongly negative trade balance was largely balanced by a 15 percent GDP inflow of remittances, resulting in modest current account deficits. In combination with a positive balance of the capital account, the overall BoP remained positive and relatively stable throughout the period, hovering around 2 percent of GDP. The capital balance has been stable, with the exception of positive outliers for 2004 and 2007 as the result of privatisations. Furthermore, the reserve position of the Bank of Albania has been above the IMF target of 4 months of imports during the entire period.

11. Due to a mix of domestic and external factors, macroeconomic performance in the year 2008 seems to be moving away from the trend of previous years. A global increase in food prices underlies an increase in the inflation rate just above the target range. The energy crisis adds additional inflationary pressure, as do the planned increases in government expenditures. The overall balance at the BoP

[1] Preliminary estimates of the Ministry of Finance (dd March 2007) even predict a small budget surplus for 2007.

remains largely unaffected, as the deterioration of the trade balance due to increased energy imports is compensated by the inflow of capital.

External sustainability

12. Overall, the external financial position of Albania remained sustainable in the period 2004-2007. The public debt and foreign-currency-denominated debt to GDP ratios both declined. Moreover, most foreign-currency-denominated debt was on concessional terms, with an average interest rate between 1 and 1.5 percent. The public debt service to fiscal revenue ratio also decreased. Debt service in relation to exports hovered at around 5 percent. This ratio is very low and is well below any risk level

13. The domestic energy sector (financial situation of KESH) and a possibility of a continuation (and deterioration) of the energy sector crisis should be considered an important risk factor threatening external sustainability. A deterioration of the current crisis could have a negative impact on inflation, economic growth, as well as a destabilising impact on the Albanian balance of payments and fiscal situation. A second cause for concern is the low export base. Despite a gradual improvement, this constitutes a substantial risk factor for external sustainability. Continued and accelerated development in export sectors is a necessary condition for ensuring macroeconomic stability in the longer term. External political instability (instability in the region), as well as internal political instability resulting in higher budget deficits due to shifts in political priorities are also seen as important factors affecting the external sustainability of the country.

14. External sustainability projections from the IMF (July 2007) do not signal any problems until 2010. Current account deficit is expected to widen during 2007-2008, but by 2010 the current account deficit will have been brought down again, anticipating improvements in the energy sector, as well as export growth. External debt is expected to gradually decline up to 2010. Domestic public debt, while relatively high for a country like Albania, is also expected to gradually decline.

Structural reforms

15. The MFA operation included a total of 14 conditionalities. Of these conditionalities, two were administrative prior actions linked to the first tranche. These prior actions were drawn from the Operational Assessment. The other twelve conditionalities were agreed in a separate Memorandum of Understanding (MoU) and were linked to the second tranche. The conditionalities covered four reform areas: (1) public finance management; (2) the fight against corruption and public administration reform; (3) financial sector reform; and (4) the business environment. Their relevance to the domestic reform process was assured by their presence in the National Action Plan for the Approximation and SAA implementation. However, from the point of view of the Albanian authorities, the

two prior actions were not seen as particularly relevant to the reform agenda. The prior actions focussed on the formalisation of processes which were already standing practices.

16. Concrete synergies between MFA and CARDS assistance was hardly possible, due to the mismatch between the long preparation period of CARDS programming and the short anticipated duration of MFA. However, some unexpected synergies were achieved when a EURALIUS project continued World Bank assistance in judicial reforms.

17. All conditionalities were formally fulfilled, whereby the conditionality on the law on judicial delays was replaced by a set of other measures. In most of the reform areas for which conditionalities were formulated, real structural reform progress has been made.

18. Two conditionalities have led to unexpected effects. MFA considered the measure on channelling public wages through the banking system as an indirect anti-corruption measure, and part of a broader public administration reform. However, this measure contributed to a strengthening of the banking system and its credit base. In addition, the conditionality on reinsurance regulation has had unintended negative effects on the balance of payments. Because of prudent requirements, Albanian insurance companies had to seek reinsurance agreements with foreign companies, which led to an estimated import of services of EUR 1 million per year.

Net impact of MFA

19. The most likely scenario of a situation without a MFA operation in Albania includes: (1) no change in arrangements of the EC and from other donors; (2) no increase in the fiscal deficit; (3) lower public expenditures in 2006, 2007, and 2008; and (4) slower expansion of credit facilities due to the slower implementation of channelling public wages through the banking sector.

20. In the counterfactual, all structural reforms would have been implemented except for the prior actions. However, this does not affect the counterfactual, since the prior actions referred to formalising standing practice. For five out of 14 MFA conditionalities, we have identified a verifiable speeding up of reform implementation (operational reinforcing effect). Some stakeholders indicated a more general reinforcing effect of the MFA instrument related to IMF and WB interventions. However, this evaluation could not make this effect explicit.

21. The net impact on macroeconomic stabilisation originated from a direct effect stemming from an increase of budgetary funds in 2006 and 2007, and an indirect effect resulting from channelling public wages through the banking sector which led to an increase in credit facilities. The accumulative effect on GDP growth in the period 2004-2008 is expected to be between 0.1 and 0.6 percent. This is

accompanied by a slightly higher inflation and marginally weaker Lek exchange rate.

22. MFA had a very limited but positive impact on the medium and long-term external sustainability prospects of Albania. Some positive effects can be attributed to a small direct effect on economic growth in the period 2004-2008. The MFA impact on other aspects of external sustainability has been negligible.

Design and implementation of MFA

23. Some specific aspects of the operation's design and implementation have been identified that conditioned the performance of the MFA in Albania. With regard to the objectives and basic design of the operation, we conclude that the multi-faceted formulation of the objectives complicates the assessment of the MFA design - especially where the timing, selection and formulation of structural condititionalities and the size of MFA operation are concerned. From a BoP perspective, EUR 25 million over a two-year period is considered to be of relatively minor importance, even for a small economy such as Albania. The relatively low amount of assistance justified that its phasing should be restricted to two tranches. In addition, it proved to be an effective design choice to make the second tranche a 100 percent grant tranche. If more tranches were used, financial assistance per tranche would probably not be an incentive for compliance. At the end of the operation, this provided more incentives to fulfil conditionalities compared to a loan tranche. Most experts agree that the mix of loan and grants was appropriate for Albania, although the 1/3 loan – 2/3 grant division seemed to be based more on a political rather than an economic rationale.

    The conditionalities were mostly in line with the SMART criteria (Specific Measurable Achievable Realistic and Timely), and in most cases the conditions could be fulfilled within one to two years. The reform areas are in line with the objective of the MFA as a balance of payment short-term assistance instrument, with the exception of the reform area governing the fight against corruption and administrative reform. This reform area also clearly had a medium-term perspective, although the MFA conditionalities were formulated with a shorter timescale. The conditionality on reinsurance regulation has had unintended negative side effects on the balance of payments (BoP) of EUR 1 million per year. Notwithstanding the importance of reforms for the stabilisation of the insurance sector, and thus decreasing the risk of financial instability; the condition had a marginally negative effect on the primary objective of the MFA instrument - that of strengthening the BoP.

    The MFA operation was effectively managed. In 2004, DG ECFIN reacted promptly and adequately with the postponement of the operation in light of the new financial situation.

24. The evaluation of the operation in Albania confirmed a number of recommendations drawn from previous evaluations of other MFA operations. None of these previous recommendations have been rejected. We have drawn three additional recommendations. Firstly, we recommend that DG ECFIN develop capacity in order to assess the (country-specific) residual financing gap analysis made by the IMF. The IMF is, and will be, the leading international organisation in identifying such financing gaps. The Albanian BoP situation - with the large number of errors and omissions - required understanding of the possible effects of IMF assumptions. EC officials confirmed that there was insufficient capacity available to closely follow the calculations or to assess possible implications for the MFA operation at the start of the operation. Secondly, we recommend using prior actions, focusing on administrative requirements in line with the short-term character of the MFA instrument. These prior actions should be used selectively and drafted with care, as they have relatively high exposure. Thirdly, we recommend that effective fulfilment of the conditionalities should be the responsibility of the government of the country receiving the support. If there is the option to select from a range of conditionalities, we suggest selecting conditionalities that do not hinge on the cooperation of authorities that are constitutionally independent of the government.

Résumé

Contexte

1. Le présent rapport présente les résultats de l'évaluation de l'aide macrofinancière (AMF) fournie par la Commission européenne à l'Albanie d'avril 2004 à juillet 2006. L'AMF se composait d'un prêt de 9 millions d'euros et d'un don de 16 millions d'euros versé en deux tranches.

2. Les principaux objectifs visés par l'AMF étaient de participer à l'assouplissement des contraintes financières extérieures du pays, de soutenir la balance des paiements et de sécuriser la position des réserves. Cette aide devait également servir à combler le déficit de financement qui subsistait après le financement offert par le Fonds monétaire international (FMI) et la Banque mondiale (BM) en vue de soutenir les objectifs politiques liés aux efforts de réforme des autorités.

3. Dès après que le Conseil avait décidé d'octroyer l'AMF (avril 2004), la balance des paiements de l'Albanie s'est sensiblement améliorée grâce aux produits de la privatisation de la Banque d'Epargne. L'apport d'IDE à hauteur de 103 millions d'euros a comblé l'écart de financement en 2004. C'est pourquoi les décaissements AMF ont été reportés en 2005, lorsqu'un nouvel écart de financement a été identifié. Le volet « don » de la première tranche s'élevait à 3 millions d'euros. Il a été mis à disposition en novembre 2005. Le volet « prêt » de la première tranche s'élevait à 9 millions d'euros. Il a été mis à disposition en mars 2006. Le prêt a été bloqué, en raison d'un retard dans l'approbation par le Parlement. La première tranche était conditionnée par l'approbation de deux actions administratives préalables, des antécédents satisfaisants dans le cadre du programme du FMI et la signature du protocole d'accord. La seconde tranche (un don de 13 millions d'euros) a été débloquée en juillet 2006 une fois que les conditions convenues dans le protocole d'accord ont été jugées remplies.

4. En 2006, l'AMF a représenté quelque 15 pour cent de l'assistance financière totale dont a bénéficiée l'Albanie et environ 1/3 de l'assistance de la CE pour cette année.

Objectifs et approche de l'évaluation

5. Les principaux objectifs de cette évaluation ex-post de l'AMF sont (a) d'évaluer les effets de l'opération AMF en Albanie et (b) de tirer les enseignements clés

susceptibles de s'appliquer à des interventions futures et/ou à la nécessité éventuelle d'une réorientation de la présente approche.

6. L'évaluation s'est concentrée sur trois grands types d'effets: (i) la stabilisation macroéconomique; (ii) la pérennité de la situation financière extérieure et fiscale; et (iii) les réformes structurelles. Par ailleurs, les implications de la formulation et de la mise en œuvre de l'opération AMF ont été prises en considération.

7. L'évaluation a fait appel à sept instruments: (i) collecte et analyse de données ; (ii) analyse de la littérature; (iii) un questionnaire préparatoire aux entretiens structurés; (iv) des entretiens structurés avec des informateurs clés; (v) une modélisation macroéconomique; (vi) des études de cas; et (vii) un questionnaire suivant la méthode Delphi en vue de vérifier et d'appuyer les conclusions des entretiens. L'évaluation reposait sur la triangulation de toutes les conclusions tirées après application de l'ensemble des instruments d'évaluation.

Stabilisation macroéconomique

8. L'Albanie a assuré sa stabilisation macroéconomique au cours de la période 2004-2007. La croissance annuelle s'élevait à quelque 5 pour cent et la Banque d'Albanie est parvenue à respecter son objectif de 3 ± 1 pour cent d'inflation, malgré la crise énergétique. Les taux de change et d'intérêt se sont stabilisés au cours de la période 2004-2007. Le taux Repo est passé de 8 pour cent en 2003 à un taux relativement stable compris entre 5 et 6 pour cent en 2007. Globalement, le taux de change réel du lek par rapport à l'euro a été stable.

9. De même, les principaux indicateurs fiscaux affichent une certaine stabilité dans la période 2004-2007. Le déficit fiscal est passé de 5 pour cent du PIB en 2004 à une projection de quelque 4 pour cent du PIB en 2007 (estimation du novembre 2007)[2]. La réduction du déficit fiscal, combinée aux produits de la privatisation, ont permis une réduction de la dette publique qui est passée de près de 57 pour cent du PIB en 2005 à une projection d'un peu plus de 54 pour cent en 2007.

10. Une balance commerciale fortement négative a été largement compensée par un apport financier de 15 pour cent du PIB sous la forme des transferts privés de l'étranger (remittances), permettant de limiter le déficit du compte courant à un niveau modeste. En combinaison avec un solde positif du compte de capital, la BdP globale est restée positive et relativement stable tout au long de la période, aux environs de 2 pour cent du PIB. Le solde des capitaux a été stable, à l'exception de poussées positives en 2004 et 2007 à la suite de privatisations. Par ailleurs, la situation des réserves de la Banque d'Albanie a été supérieure à l'objectif du FMI de 4 mois d'importations pendant toute la période.

[2] Des estimations preliminaries du Ministère des finances (mars 2007) prévoient même un léger surplus budgétaire pour 2007.

11. En raison d'un ensemble de facteurs domestiques et extérieurs, la performance macroéconomique en 2008 semble s'éloigner de la tendance des années précédentes. Une augmentation globale des prix de l'alimentaire entraîne une augmentation du taux d'inflation juste au-dessus de la fourchette cible. La crise énergétique ajoute une pression inflationniste supplémentaire, de même que les augmentations prévues des dépenses gouvernementales. Le solde général de la BdP n'est globalement pas affecté, puisque la détérioration de la balance commerciale en raison des importations accrues d'énergie est compensée par l'afflux de capitaux.

Pérennité extérieure

12. Globalement, la situation financière extérieure de l'Albanie s'est maintenue à un niveau durable au cours de la période 2004-2004. La dette publique et le rapport dette-PIB libellé en monnaie étrangère ont tous les deux baissés. En outre, la majeure partie de la dette libellée en monnaie étrangère avait été octroyée à des conditions avantageuses, avec un taux d'intérêt moyen compris entre 1 et 1,5 pour cent. Le rapport service de la dette-recettes fiscales a également reculé. Le service de la dette relatif aux exportations a avoisiné les 5 pour cent. Ce ratio très faible est loin en dessous de tout niveau de risque.

13. Le secteur énergétique domestique (situation financière de KESH) et la possibilité d'une poursuite (et d'une détérioration) de la crise du secteur énergétique devraient être considérés comme des facteurs de risque importants menaçant la pérennité extérieure. Une détérioration de la crise actuelle pourrait avoir un impact négatif sur l'inflation, la croissance économique et pourrait déstabiliser la balance des paiements et la situation fiscale albanaise. Une deuxième cause d'inquiétude est la faible base d'exportation. Malgré une amélioration progressive, il s'agit d'un facteur de risque substantiel pour la pérennité extérieure. Le développement permanent et accéléré dans les secteurs d'exportation est une condition sine qua non pour garantir la stabilité macroéconomique à plus long terme. L'instabilité politique extérieure (instabilité dans la région), ainsi que l'instabilité politique intérieure entraînant une hausse des déficits budgétaires à cause de glissements dans les priorités politiques sont également considérées comme des facteurs majeurs affectant la pérennité extérieure du pays.

14. Les projections du FMI en termes de pérennité extérieure (juillet 2007) n'anticipent aucun problème jusqu'en 2010. Le déficit du compte courant devrait augmenter en 2007-2008, mais d'ici 2010, il aura été ramenée à des valeurs inférieures, anticipant des améliorations dans le secteur énergétique ainsi qu'une croissance des exportations. La dette extérieure devrait diminuer progressivement jusqu'en 2010. La dette publique domestique, si elle est relativement élevée pour un pays comme l'Albanie, devrait elle aussi diminuer progressivement.

Réformes structurelles

15. L'opération AMF était assortie de 14 conditions. Parmi celles-ci, deux étaient des actions administratives préalables liées à la première tranche. Ces actions préalables étaient extraites de l'Evaluation opérationnelle. Les douze autres conditions ont été convenues dans un protocole d'accord distinct et étaient liées à la seconde tranche. Elles couvraient quatre domaines de réforme: (1) la gestion des finances publiques; (2) la lutte contre la corruption et la réforme de l'administration publique; (3) la réforme du secteur financier; et (4) le climat d'affaires. Leur pertinence par rapport au processus de réforme domestique était assurée par leur présence dans le Plan d'action national pour le rapprochement et la mise en œuvre de l'ASA. Toutefois, les autorités albanaises n'ont pas considéré les deux actions préalables comme particulièrement pertinentes par rapport à l'agenda de la réforme. Elles visaient la formalisation de processus qui étaient déjà des pratiques bien ancrées.

16. Des synergies concrètes entre l'AMF et le programme CARDS n'ont pratiquement pas été possibles en raison du décalage entre la longue période de préparation du programme CARDS et la courte durée anticipée de l'AMF. Néanmoins, des synergies inattendues ont été obtenues à travers un projet EURALIUS qui a poursuivi l'assistance de la Banque mondiale au niveau de réformes judiciaires.

17. Toutes les conditions ont été officiellement remplies et la condition relative à la législation et à l'arriéré judiciaire a été remplacée par une série d'autres mesures. Dans la plupart des domaines de réforme pour lesquels des conditions avaient été formulées, de réels progrès ont été enregistrés dans la réforme structurelle.

18. Deux conditions ont eu des effets inattendus. L'AMF a considéré la mesure sur la canalisation des salaires publics par le système bancaire comme une mesure indirecte de lutte contre la corruption et s'inscrivant dans le cadre plus large d'une réforme de l'administration publique. Toutefois, cette mesure a contribué à renforcer le système bancaire et sa base de crédit. En outre, la condition relative à la réglementation sur la réassurance a eu des effets négatifs inattendus sur la balance des paiements. En raison d'exigences prudentes, les compagnies d'assurances albanaises ont dû conclure des polices de réassurance avec des compagnies étrangères, ce qui s'est traduit par une importation estimée de services à hauteur de 1 million d'euros par an.

Impact net de l'AMF

19. Le scénario le plus probable d'une situation sans opération AMF en Albanie est le suivant : (1) pas de changement dans les arrangements de la CE et d'autres donateurs ; (2) pas d'augmentation du déficit fiscal ; (3) baisse des dépenses publiques en 2006, 2007 et 2008 ; et (4) une expansion plus lente des facilités de crédit en raison d'une mise en œuvre moins raide de la canalisation des salaires publics à travers le secteur bancaire.

20. Dans le cas hypothétique contraire, toutes les réformes structurelles auraient été mises en œuvre, à l'exception des actions préalables. Néanmoins, le raisonnement hypothétique contraire ne s'en trouve pas affecté puisque les actions préalables portaient sur la formalisation de pratiques déjà bien ancrées. Pour cinq des 14 conditions de l'AFM, nous avons identifié une accélération quantifiable de la mise en œuvre des réformes (renforcement de l'effet opérationnel). Certains intervenants ont souligné un effet de renforcement plus général de l'instrument AMF, lié aux interventions du FMI et de la BM. Toutefois, cette évaluation n'a pas permis de décrire cet effet de manière explicite.

21. L'impact net sur la stabilisation macroéconomique provenait d'un effet direct découlant d'une augmentation des fonds budgétaires en 2006 et 2007 et d'un effet indirect résultant de la canalisation des salaires publics à travers le secteur bancaire qui a entraîné une augmentation des facilités de crédit. L'effet cumulé sur la croissance du PIB au cours de la période 2004-2008 devrait se situer entre 0,1 et 0,6 pour cent. Il s'accompagne d'une inflation légèrement supérieure et, dans une mesure négligeable, d'un taux de change du lek plus faible.

22. L'AMF a eu une incidence très limitée mais positive sur les perspectives de l'Albanie en ce qui concerne la pérennité extérieure à moyen et long terme. Certains effets positifs peuvent être attribués à un léger effet direct sur la croissance économique au cours de la période 2004-2008. L'impact de l'AMF sur d'autres aspects de la pérennité extérieure a été négligeable.

Conception et mise en œuvre de l'AMF

23. Certains aspects spécifiques liés à la conception et à la mise en œuvre de l'opération ont été identifiés comme conditionnant la performance de l'AMF en Albanie. En ce qui concerne les objectifs et la formulation de base de l'opération, nous concluons que les objectifs à multiples facettes compliquent l'évaluation de la formulation de l'AMF, tout particulièrement en ce que le calendrier, la sélection et la formulation de conditions structurelles ainsi que l'ampleur de l'opération AMF sont concernés. Du point de vue de la BdP, un montant de 25 millions d'euros sur deux ans est considéré comme un montant d'une importance relativement mineure, même pour une petite économie comme l'Albanie. Le montant relativement faible de l'aide a justifié le fait que son échelonnement soit limité à deux tranches. En outre, le choix de formulation de faire de la deuxième tranche un don à 100% s'est avéré payante. Si plus de tranches avaient été utilisées, l'aide financière par tranche n'aurait probablement pas encouragé à se mettre en conformité. A la fin de l'opération, ce choix a davantage encouragé à respecter les conditions qu'une tranche « prêt » ne l'aurait fait. La plupart des experts s'accordent sur le fait que le mélange prêts-dons était adapté à l'Albanie, bien que la répartition 1/3 prêts et 2/3 dons ait semblé davantage fondée sur des raisons politiques qu'économiques.

Les conditions étaient globalement conformes aux critères SMART (spécifié, mesurable, acceptable, réaliste, situé dans le temps) et dans la plupart des cas, les conditions pouvaient être remplies dans un délai d'un à deux ans. Les domaines de réforme sont conformes à l'objectif de l'AMF en tant qu'instrument d'aide à court terme pour la balance des paiements, à l'exception du domaine de réforme régissant la lutte contre la corruption et la réforme administrative. Ce domaine de réforme présentait aussi clairement une perspective à moyen terme, bien que les conditions de l'AMF aient été formulées dans une perspective temporelle plus courte. La condition relative à la réglementation sur la réassurance a eu des effets connexes négatifs inattendus sur la balance des paiements (BdP) à hauteur d'un million d'euros par an. Malgré l'importance des réformes pour la stabilisation du secteur de l'assurance ce qu'a entraîné une diminution du risque d'instabilité financière, la condition a eu un effet marginal négatif sur l'objectif premier de l'instrument de l'AMF, à savoir le renforcement de la BdP.

L'opération AMF a été gérée efficacement. En 2004, la DG ECFIN a réagi promptement et comme il se devait en reportant l'opération à la lumière de la nouvelle situation financière.

24. L'évaluation de l'opération en Albanie a confirmé une série de recommandations faites à l'occasion d'évaluations antérieures d'autres opérations AMF. Aucune de ces recommandations antérieures n'a été rejetée. Nous avons tiré trois recommandations supplémentaires. Tout d'abord, nous recommandons à la DG ECFIN qu'elle développe sa capacité à évaluer l'analyse du déficit de financement résiduel (spécifique au pays) réalisée par le FMI. Le FMI est et restera l'organisation internationale de pointe pour identifier de tels déficits de financement. La situation de la BdP albanaise, caractérisée par un nombre élevé d'erreurs et d'omissions, nécessitait la compréhension des effets possibles des hypothèses formulées par le FMI. Des représentants de la CE ont confirmé qu'ils ne possédaient pas suffisamment de capacités pour suivre étroitement les calculs ou évaluer les implications possibles de l'opération AMF à ses débuts. Ensuite, nous recommandons l'utilisation d'actions préalables, axées sur des exigences administratives conformes au caractère à court terme de l'instrument AMF. Ces actions préalables devraient être utilisées avec parcimonie et élaborées avec soin, puisqu'elles présentent une visibilité relativement élevée. Enfin, nous recommandons que le respect effectif des conditions soit du ressort du gouvernement du pays bénéficiant de l'aide. S'il est possible de choisir parmi un éventail de conditions, nous suggérons de sélectionner des conditions qui ne dépendent pas de la coopération d'autorités qui soient constitutionnellement indépendantes du gouvernement.

1 Introduction

This report presents the ex-post evaluation of Macro Financial Assistance (MFA) to Albania in the period from April 2004 to July 2006. The objective of this evaluation is to provide an overview of the observed macroeconomic and structural effects of the MFA operation In addition, it provides recommendations as input for a future meta-evaluation of the MFA instrument. This report follows closely the evaluation questions of the Guidelines for the Ex-Post Evaluation of MFA Operations of the Directorate General for Economic and Financial Affairs (DG ECFIN).

This report is structured as follows:
- Chapter 2 outlines evaluation objectives and methods;
- Chapter 3 presents basic information about the MFA operation;
- Chapter 4 describes macroeconomic stabilisation;
- Chapter 5 describes external sustainability;
- Chapter 6 describes structural reforms;
- Chapter 7 presents the net impact of the MFA operation;
- Chapter 8 comments on design and implementation of the MFA operation.

Appendices document data sources (Appendix I), elaborate on case studies of two specific structural conditionalities (Appendix II), provide a list of people interviewed (Appendix III), explain the macroeconomic model used to quantify the net macroeconomic impact of MFA (Appendix IV), present the applied methods for acquiring quantitative effects of structural reforms (Appendix V), provide the results of the Delphi questionnaire (Appendix VI), present a historical overview of events relevant to the MFA operation (Appendix VII), give information on IMF and WB programmes (Appendix VIII and IX), and provide an overview of recommendations of previous MFA evaluations and their relevance for the Albanian MFA operation (Appendix X).

2 Evaluation objective and approach

2.1 Objective of the evaluation

Under its Financial Regulations (Article 27.4), the EC is legally obliged to evaluate its main programmes, including MFA. The main objectives of this ex-post evaluation of MFA is to (a) assess the effects of the MFA operation in Albania, and (b) to learn key lessons, which can then be applied to future interventions and/or the possible need for a reorientation of the present approach. The evaluation will therefore not be merely backward-looking in nature, but will also be forward-looking, so as to enable the EC to draw key lessons for the future.

2.2 Evaluation approach and method

Guidelines for the ex post evaluation of the MFA operations

The starting point of the evaluation approach is the Terms of Reference and the *Guidelines for the Ex Post Evaluation of MFA Operations.* Table 2.1 contains the main evaluation questions as stated in these documents.

Table 2.1 Generic evaluation questions from the Guidelines

No.	Evaluation Question
Q1	To what extent has the MFA been effective in terms of the short-term macroeconomic stabilisation of the country concerned?
Q2	To what extent has the MFA been effective in terms of supporting structural reform?
Q3	What have been the indirect and/or unexpected effects of the MFA?
Q4	To what extent has the MFA contributed to returning the external financial situation of the country concerned to a sustainable path over the medium to long-term?
Q5	How has the way in which the MFA operation was designed and implemented shaped its effectiveness and efficiency?

The evaluation questions broadly focus on three core areas of effects. Each area focuses on the effects over a specific timescale:

1. Macroeconomic stabilisation: assessment of short-term effects (up to 2 years after disbursement);
2. Sustainability of the external financial situation: assessment of medium to long-term effects (3 years or more after disbursement);
3. Structural reforms: assessment on the economy and institutions on short and medium-term effects (up to 4 years after disbursement).

Since the MFA operation in Albania ended in July 2006, our analysis of expected macroeconomic effects, external financial sustainability and structural effects are based on projections and expectations.

Methodology
At the core of this evaluation lies the identification of the causal relations underlying the developments in the three areas: macroeconomic stabilisation, external sustainability and structural reforms. This analysis of causality aims to identify which parts of the overall developments can be attributed to the MFA operation.

For the attribution of effects to the MFA operation, we follow a three-step approach in accordance with the Guidelines for ex post evaluation of MFA. The **first step** is to identify the types of short-term macroeconomic effects, short and medium-term structural effects on the economy and institutions; and to identify plausible cause and effect relationships between assistance and subsequent developments. The **second step** is to establish a counterfactual situation. It should be noted that at the time of writing this report (December 2007), no data is available on the developments of macroeconomic indicators after the completion of the MFA operation. Going beyond 2006, this forces us to compare the forecasts made on the assumption that MFA has taken place with another set of forecasts made on the assumption that a counterfactual scenario was realised up until 2006. The **third step** involves the determination of effects of the operation, which for both macroeconomic issues and structural issues amounts to the difference between observed developments and the counterfactual situation. Unexpected and indirect effects, as well as consequences of programme design and implementation will also be analysed.

Two case studies - one on banking law and one on privatisation - have been elaborated to understand in-depth the cause effect relations between the structural conditions and the observed structural developments.

Evaluation instruments
This evaluation employs seven **main evaluation instruments**:
- data collection and analysis;
- literature review;
- preparatory questionnaires to prepare for the interviews;
- interviews with key informants;
- macroeconomic modelling;
- case studies;
- ‘Delphi technique’ questionnaires to verify and support the findings from the interviews.

Overall approach
Table 2.2 summarises our overall approach. The table shows the three core areas of the evaluation and the way these are linked to the evaluation component, the sub-evaluation questions from the Guidelines and the evaluation instruments employed.

Table 2.2 The core areas of evaluation, the time horizons, suggested approach and the evaluation components

Core areas	Time horizon	Instruments	Evaluation components	Guideline questions
Macroeconomic stabilisation	Short-term (up to 2 years after last disbursement)	Mainly quantitatively, Modelling	• Objectives • Actual development • Counterfactual objectives • Counterfactual outcomes • Net effect • Indirect effects • Unexpected effects • Instrument design	• Q 1.1 • Q 1.2 • Q 0.1 • Q 0.2 • Q 1.3 • Q 3.1 • Q 3.2 • Q 5.1
External sustainability	Medium term (3 or more years after last disbursement)	Qualitative (assessment of future risks), if possible quantitative assessment	• Actual development • Main factors • Indirect effects • Net effect	• Q 4.1 • Q 4.2 • Q 4.3 • Q.4.4
Structural reforms	Short and medium term (up to 4 years after last disbursement)	Mainly qualitative, supported by assessment of indicators	• Objectives • Relevance • Actual development • Counterfactual objectives • Counterfactual outcome • Net effect • Unexpected effects • Instrument design	• Q 2.1 • Q 2.2 • Q 2.2 • Q 0.1 • Q 0.2 • Q 2.4 • Q 2.5 • Q 5.1

3 MFA operation in Albania

3.1 Economic and political context

Political context

The 1992 elections ended the Communist and isolationist one-party state regime that had ruled in Albania since the Second World War. The transition to democracy has proven cumbersome, as successive governments have tried to deal with high unemployment, widespread corruption, a dilapidated infrastructure, powerful organised crime networks and a disruptive political environment. In 1997, the crisis brought on by the collapse of pyramid investment schemes led to financial collapse, which sparked anti-government riots and brought down the government. A new constitution was adopted by referendum and came into force on 28 November 1998. The Kosovo conflict in 1999 led to nearly 500,000 ethnic Albanian refugees moving from Kosovo to Albania, which imposed an additional burden on Albania's fragile economy.

International observers judged parliamentary elections in 2001 and local elections in 2003 to be a step towards democratic development, despite major shortcomings. Most of these shortcomings were addressed, and the conduct of parliamentary elections in July 2005 showed considerable improvement. A new President was elected in July 2007.

Macroeconomic context

The stabilisation of the political situation has created the conditions for the solid macroeconomic performance of the Albanian economy. Since 2003, GDP growth has been sustained at about 5-6 percent, and inflation has generally been remained within the 2 to 4 percent range, in line with the 3 percent inflation target. The Albanian currency (Lek) has experienced a trend appreciation, reflecting increased confidence, as well as substantial remittances from Albanians working in EU countries. Unemployment, although declining, remains high at well above 13 percent. Regarding fiscal policy, the overall deficit (including grants) hovered at around 4 percent of GDP. Since 2002, public debt has declined by about 15 percentage points of GDP, to 55 percent of GDP by the end of 2007, and is projected to decline further (see Chapter 5). On the external side, the overall balance has been positive and relatively stable within a range of between 0 and 4 percent of GDP. The substantial negative balance on the trade account has been outweighed by a large flow of remittances from Albanian migrants and a positive balance on the capital account. Notwithstanding gains in the tourism sector, the trade deficit is expected to increase in 2007 and is likely to stay high in 2008 due to the higher imports of energy.

3.2 MFA Council Decision

In April 2004, the Council approved the fourth MFA to Albania for an amount of up to EUR 25 million (Council Decision 2004/580/EC). The Council Decision explicitly stated that MFA is an appropriate measure to help ease the country's external financial constraints, support the balance of payments and secure the reserve position. Furthermore, it referred to the residual financing gap that remained to be covered (after financing from the IMF and the World Bank) to support the policy objectives attached to the authorities' reform efforts. It was also agreed that financial assistance should be instrumental in bringing Albania closer to the Community.

This fourth MFA comprised a loan element of EUR 9 million and a grant element of EUR 16 million. MFA was disbursed in two tranches (see Table 3.1).

Table 3.1 The two tranches of the MFA operation Albania approved in April 2004

Tranche	Date of disbursement	Loan/Grant	Condition
1st tranche	November 2005 March 2006	€ 3 million grant € 9 million loan	• Prior actions met • Satisfactory track record of the macroeconomic programme under the IMF's Poverty Reduction and Growth Facility • Signing of MoU
2nd tranche	July 2006	€ 13 million grant	• Conditions of the MoU fulfilled

The **first tranche** was released in two instalments. The grant of EUR 3 million was disbursed in November 2005, while the loan of EUR 9 million followed in March 2006. The disbursement of the first tranche followed compliance with two prior actions: the signing of a Memorandum of Understanding (MoU) in May 2005 and the positive appraisal of the Poverty Reduction and Growth Facility (PRGF) by the IMF.[3]

The **second tranche** was released in July 2006 and consisted of a grant of EUR 13 million. This second tranche was disbursed after the conditions in the MoU were deemed to have been fulfilled. Two conditions dominated the discussion;

- approval by the government of legislation to limit delays in the judicial process. The Commission decided that the conditions were met de facto through an alternative plan of administrative measures, even without the envisaged law,;
- approval by the government of the new law governing the banking sector. The condition was expected to be met in full shortly.

The Commission decided to release the second tranche when the new Banking Law was to be approved by the government. This happened in June and disbursement of the second tranche followed a few days before the MFA operation was due to expire.

[3] IMF Country Report No. 05/267: Sixth Review Under the Extended Arrangement Under the Poverty Reduction and Growth Facility, August 2005.

3.3 Overview of MFA implementation and dynamics of events

Previous MFA operations in Albania

In 1992 (first MFA operation) and in 1994 (second MFA operation), the EC provided Albania with grant macro-financial assistance of EUR 70 million and EUR 35 million, respectively. Within the context of its IMF-supported stabilisation and reform programme. In April 1999, the Council decided to provide Albania with a third MFA facility of up to EUR 20 million. The third MFA operation was in the form of a loan, since it was on top of grant support to the budget (some EUR 20 million through PHARE and the EC food security programmes) and additional exceptional grant budgetary support of EUR 33 million to help the country cope with the costs linked to the refugees as result of the Kosovo crisis. Ultimately the Kosovo crisis was relatively short, refugees returned home relatively quickly and the balance of payments position was better than expected. The Albanian authorities did not request the release of this loan assistance.

Start of the fourth MFA operation

In June/July 2002, the IMF approved a second PRGF 3-year programme for the sum of about USD 36 million covering the period from June 2002-June 2005. The main priorities were ensuring fiscal sustainability, promoting private sector development, and supporting the development of the energy sector. During the July 2003 review of the programme, the IMF identified for 2004 a residual external financing gap of USD 46 million after taking into account the interventions of the International Financial Institutions[4]. At the end of 2003, the Minister of Finance of Albania officially requested MFA, although the third MFA facility was outstanding. The Council agreed to assist Albania with MFA in April 2004 in order to contribute to covering the residual external financing gap in 2004, and to facilitate and encourage the efforts of the Albanian government in implementing reforms for the Stabilisation and Association Agreement (SAA) process. This Council Decision simultaneously provided for the cancellation of the 1999 MFA Council Decision.

Immediately after the Council decided to grant MFA, Albania's balance of payments situation improved substantially due to the privatisation of the Savings Bank, resulting in privatisation proceeds. The inflow of FDI of EUR 103 million filled the external financing gap for 2004. Therefore, MFA disbursements were postponed until 2005 and 2006. In those years, a residual financing gap had once again been identified by the IMF.

Memorandum of Understanding

In October 2004, the structural conditions for the second tranche were agreed and eventually signed in May 2005. The structural conditions focussed on four areas:

1. Measures to enhance the security and reliability of financial circuits, and administrative controls and to improve public finance management;
2. Measures to improve the functioning of public administration and the fight against corruption;
3. Financial sector reform;
4. Measures to improve the business environment and accelerate private sector development.

[4] The IMF did not take account of possible proceeds from privatisations when calculating the financing gap, due to a prudent calculation methodology.

Upon the fulfilment of the related conditions for the first tranche (satisfactory track record of the macroeconomic programme under the IMF's PRGF, signing of MoU and fulfilment of two prior actions) the grant component of EUR 3 million was disbursed in November 2005 and the loan component of EUR 9 million was disbursed in March 2006.

In November 2005, the first review mission of the second tranche conditions was carried out. The mission concluded that several conditions under the MoU had not yet been met. Therefore, the second tranche could not be disbursed. Also, in November 2005 the Commission issued a new Enlargement Strategy Paper.

European Partnership and SAA

In December 2005, the European Council adopted a revised European Partnership for Albania. The European Partnership identifies short and medium-term priorities which Albania should address. Progress in implementing these priorities is monitored regularly by the European Commission, notably through the annual Progress Reports; and through the other structures set up under the SAP, in particular the Consultative Task Force (CTF).[5]

After the successful conclusion of the IMF three-year PRGF programme (2002-2005), in January 2006 the IMF Board approved a new IMF PRGF programme (2006-2009), amounting to about EUR 20 million. In April 2006, a second review of the MoU conditionality was undertaken. The mission found that 10 specific conditions had been met. However, two conditions remained a cause of concern:

- approval by government of the new law on the banking sector;
- approval by government of legislative measures to limit delays in the judicial process.

During the IMF assessment of the budget for the second half of 2006 in May/June 2006, the IMF estimated a residual balance of payments needs for 2006 of EUR 41 million.

On 12 June 2006 the Stabilisation and Association Agreement (SAA) was signed in Luxembourg. The SAA will come into force following its ratification, which is expected to take about two years. In July 2006, a draft law on the banking sector was submitted for approval by the Council of Ministers and the government announced measures to further intensify progress in limiting delays in the judicial process. The Commission concluded that all conditions had been met and disbursed the second tranche of the MFA. With the second tranche of EUR 13 million together with the loan component of the first tranche (EUR 9 million, also disbursed in 2006), the EC covered about 54 percent of the EUR 41 million estimated residual financing needs in 2006 by the IMF.
Appendix VII presents a table with an overview of political, economic, and other events indirectly or directly relevant for the MFA operations.

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[5] The EU/Albania Consultative Task Force (CTF) is an ad-hoc Council/Commission forum set up with Albania. It is co-chaired by the Council Presidency/Commission and the Albanian Minister for European Integration. CTF meetings are a key instrument for monitoring Albania's reform progress, in particular in relation to politics and justice, freedom and security, and are held several times a year.

3.4 Relative importance of MFA

Table 3.2 gives an overview of all financial assistance to Albania in the period from 2002 to 2007. It shows that MFA assistance in 2006 was relatively important, as it accounted for almost 15 percent of the total financial assistance.

Table 3.2 Share of Macro Financial Assistance of the total financial assistance for Albania (in millions of EURO)

	2002	2003	2004	2005	2006 Estimate	2007 Projection
New borrowing	**123**	**101**	**100**	**98**	**116**	**152**
• Multilateral loans	84	75	72	73	82	88
○ World Bank	52	36	37	32	36	39
○ EBRD	8	13	13	15	19	20
○ Other	24	25	23	25	27	29
• Bilateral loans	38	26	28	26	35	64
Grants	**-**	**20**	**18**	**48**	**36**	**31**[6]
Total grants + borrowing	**-**	**121**	**118**	**146**	**152**	**183**
EU MFA (2004/580/EC)	**-**	**-**	**-**	**3**	**22**	**-**
• Loan	-	-	-	-	9	-
• Grant	-	-	-	3	13	-
EU MFA as % of total	**-**	**-**	**-**	**2%**	**15%**	**-**

Source: IMF Country Report No. 07/75, February 2007, IMF Country Report No. 07/244, July 2007.

EC support

Table 3.3 presents an overview of total EU assistance to Albania in the period from 2001-2006. The figures illustrate that MFA amounted on average to about one fifth of total EC assistance in the years of disbursement. The main CARDS priorities have been justice and home affairs, administrative capacity-building, economic and social development, environment and natural resources, and democratic stabilisation.

Table 3.3 Total EC assistance in Albania during the period from 2001 to 2006 (in millions of EURO)

Assistance	2001	2002	2003	2004	2005	2006
CARDS	37.6	44.9	46.5	63.5	44.2	46.8
MFA					3	22
Total	**37.6**	**44.9**	**46.5**	**63.5**	**47.2**	**68.8**
MFA as % of total EC assistance	**-**	**-**	**-**	**-**	**6%**	**32%**

Source: EU delegation website, Albania + different sources to make corrections

6 Estimate is based on the exchange rate of March 2007.

3.5 IMF and World Bank support to Albania

IMF support

In 1991, Albania joined the International Monetary Fund (IMF). Since then the IMF has disbursed a total of SDR 133 million (Special Drawing Rights). These loans are disbursed via three-year arrangements under the Poverty Reduction and Growth Facility (PRGF). For the period June 2002 to November 2005, a three-year PRGF arrangement of about SDR 28 million (USD 36 million) was active.

In January 2006, a new three-year PRGF/EFF (Extended Fund Facility) programme was agreed for around 17 million SDR (about USD 24.7 million). Half of this programme will be supported through the concessional PRGF; half through the non-concessional EFF. This operation is intended to reduce economic vulnerabilities, enhance growth potential, strengthen government solvency, protect priority spending, improve governance, and further develop the financial system. Table 3.4 summarises the IMF programmes and the disbursements.

Table 3.4 IMF arrangements and disbursements from 2002 to present [7]

<table>
<tr><th>Facility</th><th colspan="2">Date of arrangement</th><th colspan="2">Date of expiration</th><th>Amount
(in million SDR)</th><th>Drawn
(in million SDR)</th></tr>
<tr><td>PRGF</td><td colspan="2">21June 2002</td><td colspan="2">20 November 2005</td><td>28.00</td><td>28.00</td></tr>
<tr><td>PRGF</td><td colspan="2">01 February2006</td><td colspan="2">31 January 2009</td><td>8.52</td><td>3.65</td></tr>
<tr><td>EFF</td><td colspan="2">01 February2006</td><td colspan="2">31 January 2009</td><td>8.52</td><td>3.65</td></tr>
<tr><td colspan="3">IMF disbursements (in million SDR)</td><td></td><td></td><td></td><td></td></tr>
<tr><td></td><td>2002</td><td>2003</td><td>2004</td><td>2005</td><td>2006</td><td>2007</td></tr>
<tr><td>IMF</td><td>4</td><td>8</td><td>8</td><td>8</td><td>4.9</td><td>2.4</td></tr>
<tr><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
</table>

Source: www.imf.org

Appendix VIII presents an overview of all review missions that took place under the IMF PRGF June 2002 programme and the IMF PRGF/EFF February 2006 Programme. All in all, Albania has managed to achieve progress in reforms, and maintain macroeconomic stability throughout the 2002-2007 period. The IMF programmes were kept on track.

World Bank support

The Republic of Albania became a member of the World Bank in 1991. Since then, the World Bank Group has extended a total of 65 loans (mostly on IDA terms), totalling about USD 840 million, plus USD 100 million in commitments from the IFC and guarantees of USD 9 million from MIGA (Multilateral Investment Guarantee Agency). World Bank activities are designed in line with a three-year Country Assistance Strategy (CAS). The latest CAS was approved by the World Bank's Board of Directors in January 2006. The fourth CAS outlines a programme with support of USD 86 million in IDA terms, as well as the International Bank for Reconstruction and Development (IBRD) financing of up to USD 110 million.

[7] 30 June 2007

The CAS programme seeks to support Albania's efforts to improve governance while focusing on two core areas:
1. promoting economic growth through support to private sector development;
2. improving public services delivery, particularly in the social sectors.

Table 3.5 presents an overview of the most relevant World Bank adjustment related programmes in the period 2002-2007. Appendix IX provides background information on the different World Bank programmes.

Table 3.5 Overview of the most relevant World Bank adjustment-related programmes in the period 2002-2007

Project description	Amounts in million US$			Approval date	Closing date
	Principal	Available	Disbursed		
Public Administration Reform Project (PACTA)	8.5	0	8.8	21 Jan 2000	15 Dec 2006
Financial Sector Adjustment Credit (FSAC)	15	0	17.2	20 June 2002	31 Dec 2004
Poverty Reduction Strategy Credit (PRSC-1)	20	0	21.2	20 June 2002	30 June 2003
Poverty Reduction Strategy Credit 2 (PRSC-2)	18	0	18.9	10 July 2003	31 Dec 2004
Poverty Reduction Strategy Credit 3 (PRSC-3)	10	0	10.6	7 Dec 2004	31 Dec 2005
Business Environment Reform and Institutional Strengthening (BERIS)	5.6 3.7	5.4 3.5	5.4 0.3	26 Oct 2006	15 Jan 11
Development Policy Loan (DPL)	10	10.3	0	29 Mar 2007	31 Dec 2007

Source: www.worldbank.org

4 Macroeconomic stabilisation

4.1 Introduction

In this chapter we assess the macroeconomic objectives of the operation and the extent to which these objectives have been achieved (actual macroeconomic development). Table 4.1 lists the evaluation questions that we address in this chapter.

Table 4.1 Evaluation questions for analysing the impact on macroeconomic stabilisation

	Impact on macroeconomic stabilisation
1	What are the short and medium-term macroeconomic objectives of the assistance? (Q1.1)
2	To what extent have the short and medium-term macroeconomic objectives of the assistance been achieved? (Q1.2)
3	Has the assistance given rise to any unexpected short or medium-term macroeconomic effects? What were these and how did they occur? (Q3.2)

4.2 Macroeconomic objectives of intervention

1. What are the short and medium-term macroeconomic objectives of the assistance?

General objectives

The Council Decision states that "*Community macro-financial assistance is an appropriate measure to help the country meet its external financing needs, including through a reinforcement of its reserves and budget support*".

From this statement, three objectives of macroeconomic stabilisation in the short and medium term can be distinguished:

1. To help the country meet its external financing needs;
2. To reinforce its reserves;
3. To reinforce the budget.

Specific objectives

In addition to the general objectives, the MoU lists a number of specific conditions linked to the MFA. These conditions coincide with the quantitative performance criteria stipulated under the IMF's PRGF arrangement (Poverty Reduction and Growth Facility). The quantitative performance criteria comprise:

- a quarterly ceiling on net domestic assets of the Bank of Albania (BoA);
- a quarterly ceiling on net credit of the banking system to the consolidated general government;

- quarterly indicative total tax revenue targets;
- a quarterly floor for net international reserves of the BoA;
- a quarterly ceiling on contracting or guaranteeing of public and publicly-guaranteed non-concessional external debt.

4.3 Gross impact – actual macroeconomic outcomes

2. To what extent have the short and medium-term macroeconomic objectives of the assistance been achieved?

To answer this question, we describe the actual macroeconomic developments related to general and specific objectives.

4.3.1 General objectives

This section presents some basic data and analysis of macroeconomic development in Albania during the period 1999-2006, and, if available, preliminary estimates for 2007 and projections for 2008. Table 4.2 contains the macroeconomic indicators that are used to assess the progress in achieving macroeconomic stabilisation.

Table 4.2 Macroeconomic indicators

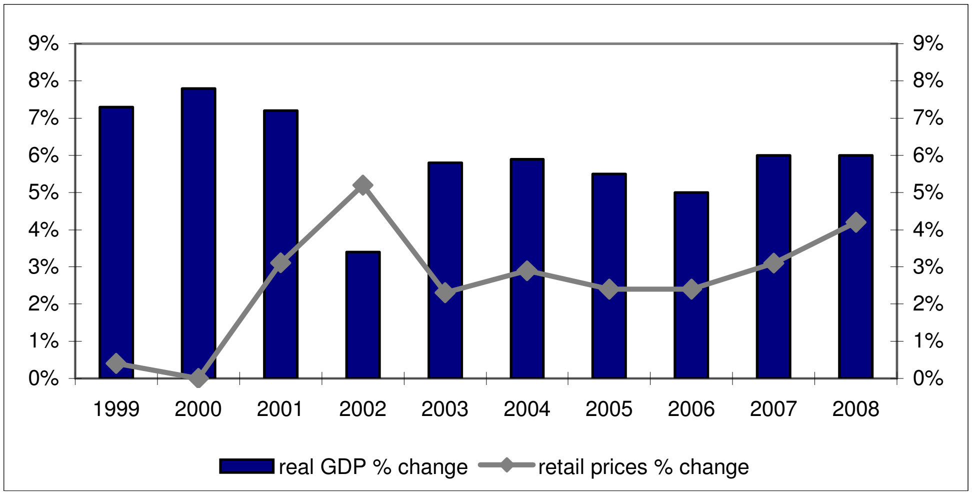
Domain	Effect indicators
Macro-economy	Growth rates in GDP and components, inflation, interest rate Exchange rate
Fiscal sector: Public finance	Level of government revenue, level of government expenditure Deficit, financing of the deficit and the debt, existence of quasi-fiscal operations
External sector: Balance of payments	Net balance of payments, components of current account, components of capital account, international reserves

4.3.2 Macro economy

Gross domestic product (GDP)

Figure 4.1 presents real GDP growth for the period 1999-2008. The figure shows strong and stable real GDP growth. Except for a dip in 2002, the annual rate of growth is above 5 percent.

Figure 4.1 Real GDP growth rate and average Consumer Price Index (CPI) 1999-2008



Note: 2006 is an estimate; 2007 - 2008 are projections

Source: IMF Country Reports 03/218, 05/267, preliminary estimates (dd January 2008) fourth review (forthcoming, Spring 2008)

With regard to GDP growth, the outlook for 2007 and 2008 is similarly positive. Although the country has faced a shortage of energy in 2007 that is likely to endure until 2009, productivity growth has remained unaffected. The Albanian government has successfully shielded the main industrial sectors as well as the main tourist centres from the energy outages. Furthermore, Albanian government, by means of the state-owned energy company KESH, has substantially increased its energy imports in 2007 with negative consequences for the financial position of KESH and the balance of payments (see the sections on the fiscal and the external sector).

Inflation

Figure 4.1 also depicts the development of the average Consumer Price Index (CPI). The figure shows that in the period 2004-2007 the Bank of Albania (BoA) had been successful in keeping the inflation within its 3 ± 1 percent target range.[8] In 2008, inflation is expected to exceed the target range slightly, with a projected rate of 4.2 percent (IMF, 2008). An analysis of the factors underlying this increase in inflation shows that the excessive inflation is not likely to endure. The global increase of food prices is considered to be the major determinant of inflation followed by more expensive energy imports (BoA, 2007). Both developments give rise to expected one-off effects on the price level. Consequently, from 2009 onwards, the inflation is expected to be within the target boundaries (IMF, 2008).

Other threats for price stability are the increase in private credit and the expansionary government budget for 2008. The first factor - growth of private credit - is played down by the IMF and the BoA. These institutions concur that the strengthening of financial infrastructure, banking regulation and supervision, as well as monetary policy tightening

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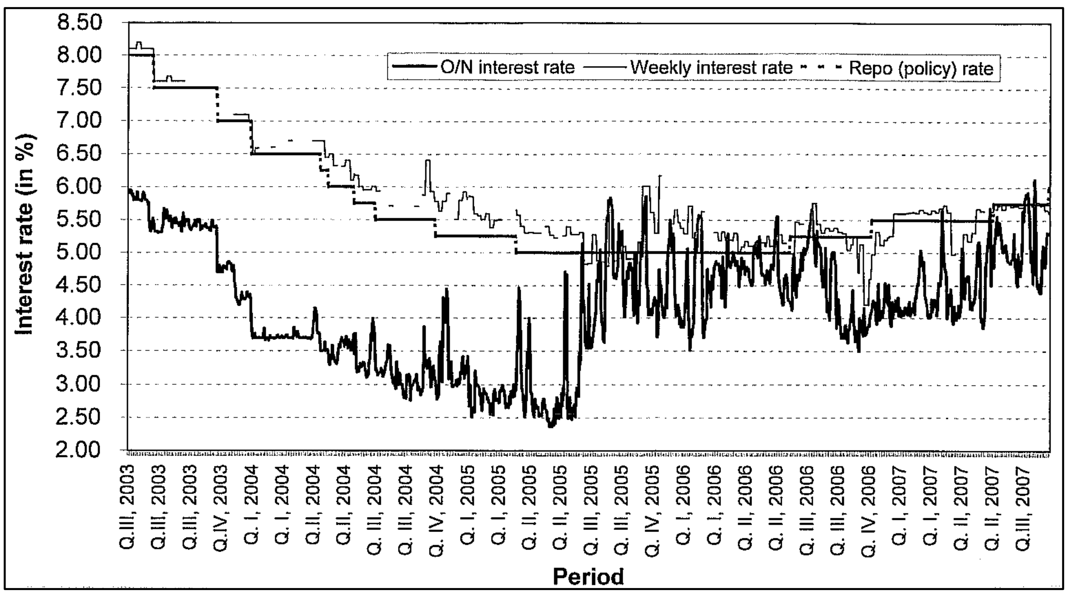
8 Albania — Letter of Intent, Supplemental Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding, Tirana, January 9, 2004; also Bank of Albania, Round Table Inflation Targeting 2, 7-8 Dec 2006, Tirana, Albania.

has been an appropriate response to the credit boom. In their view, credit growth is necessary to finance private investment to foster future growth. In this respect, the credit growth compares well with similar transition countries; and reflects a catching-up of Albania's economy. The second factor - expansive government expenditure - refers to the recent approval of the 2008 budget, which includes a significant increase of government expenditures. On the following pages, under the heading of the fiscal sector, this development is discussed in more detail.

Interest rates

Figure 4.2 shows the development of the major interest rates in the inter-bank market. The narrowing of the spread between overnight and weekly rates, and their position close to the repo-rate indicates further stabilisation of Albania's financial markets. In absolute terms, the key interest rate, the repo (policy) rate, came down from around 8 percent in 2003 to a fairly stable rate between 5 and 6 percent in the period 2005 and 2007. Recently (November 2007), the BoA raised the repo-rate by 0.25 percent to 6.25 percent to counteract inflationary pressures in the Albanian economy.

Figure 4.2 Development of the primary inter-bank interest rates 2003 – 2007



Source: Bank of Albania

Exchange rate

Another indicator reflecting macroeconomic stabilisation is the development of the Albanian currency (Lek). Albania follows an independently floating exchange rate regime — although the monetary authorities occasionally intervene in the foreign exchange market with the aim of smoothing out temporary fluctuations. Figure 4.3 shows the nominal exchange rate towards both the US dollar and the euro. The Lek has significantly appreciated against the USD, while the nominal exchange rate against the euro has remained more stable. In general, this development reflects a depreciation of the dollar against the euro. Traditionally, the Lek was more oriented to the USD. However, in recent years, this orientation has shifted towards the euro. Albanian inflation was only slightly higher than in the Eurozone, implying a stable real exchange rate of the Lek against the euro.

Figure 4.3 Development of the exchange rate of the Albanian Lek (against the euro and USD) 2000- 2007

Source: http://www.chartflow.com/ozforex/historybasic.asp

4.3.3 Fiscal sector

Fiscal deficit

Table 4.3 provides an overview of key fiscal indicators. It shows the development of Albania towards a stable and sustainable fiscal situation. Supported by a slight decrease of public expenditures to about 29 percent of GDP, and a substantial increase of total tax revenues (from 18.9 percent in 2000 to 23.1 percent in 2006); the fiscal deficit has come down from 7.9 percent of GDP in 2000 to 3.3 percent of GDP in 2006. The fiscal deficit is expected to increase in 2007, resulting from - among others factors - an increased government subsidy to the state-owned energy company KESH (to the tune of 0.5 percent of GDP) that is deemed necessary to mitigate the economic consequences of the unanticipated energy crisis. Nevertheless, projected at 4.2 percent of GDP (dd November 2007), the fiscal deficit remained under control in 2007[9].

The reduction of the fiscal deficit, in combination with the proceeds of enterprise privatisation and nominal GDP growth, enabled the Albanian government to lower its public debt from 72.8 percent of GDP in 2000 to below 55 percent in 2007.[10]

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9 Preliminary estimates from the Ministry of Finance (dd March 2008) even seem to suggest a small budget surplus for 2007.

10 The Albanian authorities, in concurrence with the IMF, have committed themselves to discharges the public debt with 50% of all its privatisation receipts.

Table 4.3 Developments in the fiscal sector in the period 2000-2008 (expressed as a percentage of GDP)

	2000	2001	2002	2003	2004	2005	2006*	2007*	2008*
Total revenue and grants	22.9	23,6	24.5	24.1	24.6	24.9	25.5	26.9	26.3
Tax revenue	18.9	19.7	20.5	20.9	22.1	22.4	23.1	24.3	24.4
Total expenditure	30.7	31.6	31.1	28.5	29.8	28.6	28.7	31.0	31.5
Overall balance (incl. grants)	-7.9	-7.9	-6.6	-4.5	-5.2	-3.7	-3.3	-4.2	-5.2
Public and publicly guaranteed debt	72.8	67.6	65.0	60.7	57.7	57.8	56.2	54.7	54.6

Note: 2006 is an estimate; 2007 - 2008 are projections;

Source: IMF Country Reports 03/218, 05/267, preliminary estimates (dd January 2008) fourth review (forthcoming, Spring 2008)

Two comments need to be made on the positive description of the fiscal development above. Firstly, the fiscal situation in 2008 projects a departure from the fiscal trend of the last 8 years. The Albanian parliament has approved the 2008 budget which results in a deficit of 8 percent due to increased government expenditures. The rise in expenditures should allow for an ambitious investment plan to realise a new road infrastructure from Albania to Kosovo. The actual fiscal deficit will depend on whether the Albanian government is capable of executing the entire budget. Based on past experience, reflecting difficulties of the Albanian authorities to timely execute investment plans; the IMF estimates that the fiscal deficit for 2008 will not exceed 5.2 percent. They hold the view that a fiscal deficit at this level would *"allow for a temporary acceleration of spending on critical transport infrastructure while maintaining macroeconomic stability, safeguarding continued fiscal consolidation and providing sufficient financing for other medium-term public investment objectives"* (Statement of IMF mission, November 2007).

Secondly, the fiscal indicators of Table 4.3 do not capture the entire public sector deficit. A full picture should also account for quasi-fiscal deficits (QFD) of state-owned companies. Of particular importance in this regard is the Albanian power sector, which is controlled by the state-owned company KESH. In this sector, the QFD is defined as the difference between 'the electricity consumption at the consumer level, including non-technical losses, valued at the long-run marginal cost' and 'actual collected revenue'. Although the World Bank acknowledges the improvement in the period 2001-2004, it still observes that revenues collected from household consumers are a small proportion of the true cost - which results in their uneconomic use of electricity. This also deprives the power sector of resources needed for rehabilitation and expansion. In 2005, the QFD - arising from suboptimal tariffs and low collections - was estimated at around 2.5 percent of GDP (World Bank, 2006). Although collection rates have further improved since 2005, the increase of energy imports has damaged the financial position of KESH.

Financing sources

Table 4.4 shows the sources of financing the fiscal deficit and the public debt. The large shares of privatisation in 2004 and 2007 reflect the privatisation of the Savings Bank and Albtelekom, respectively. The increase of foreign sources to finance the fiscal deficit in 2008 reflects the private credit acquired by the Albanian government to finance the planned road infrastructure investments.

In general, the table shows the relatively heavy reliance on domestic sources to finance its deficit and debt. The reliance on domestic financing sources relates to a relatively short-term maturity of the debt structure - which makes Albania's debt financing vulnerable to shocks on the domestic financial market. In collaboration with the IMF, the Albanian government has started to improve the debt management capacity of the Ministry of Finance; and has also managed to lengthen the average maturity term of domestic debt.

Table 4.4 Sources of finance, 1999 – 2008

	2000	2001	2002	2003	2004	2005	2006*	2007*	2008*
Fiscal deficit									
Financed by: • *% Domestic borrowing*	39.2	39.2	48.5	64.4	44.2	73.0	69.7	42.9	32.7
• *% Privatisation*	20.2	27.8	1.5	2.2	36.5	2.7	6.0	42.9	7.6
• *% Foreign financing*	40.6	32.9	50.0	31.1	19.2	21.6	18.2	14.3	61.5
	100%	100%	100%	100%	100%	100%	100%	100%	100%
Public debt									
% Domestic	57.3	61.4	63.9	66.7	68.1	69.0	69.9	70.0	65.9
• *% External*	42.7	38.6	36.1	33.3	31.9	31.0	30.1	30.0	34.1
	100%	100%	100%	100%	100%	100%	100%	100%	100%

Note: 2006 is estimate; 2007 - 2008 are projections

Source: Based on own calculations of data from IMF Country Reports 03/218, 05/267 and preliminary estimates (dd January 2008) fourth review (forthcoming, spring 2008)

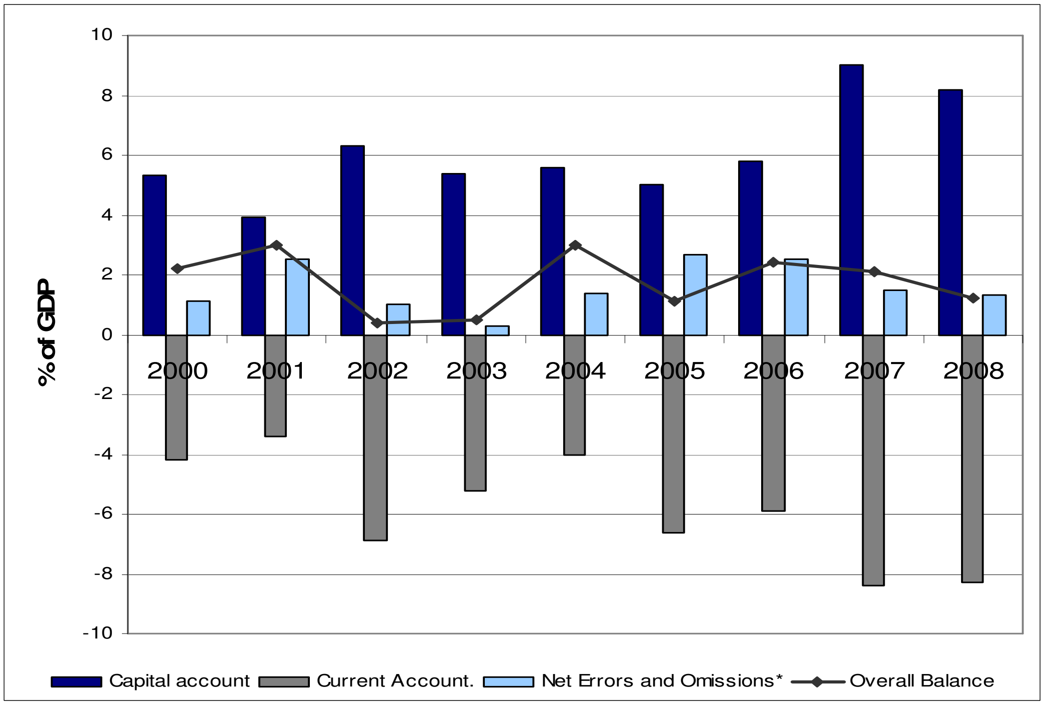
In order to lower the reliance on domestic financing sources, the Albanian government has to enter the international capital markets. To this end, the country has requested an assessment of its creditworthiness by the international rating agency Moody's. In June 2007, the country received its first credit rating from Moody's. Albania received a rating Ba1 for its foreign-currency bonds. According to Moody's, the rating reflects Albania's transition from an isolated, administered economy, and from a very low per capita income level to a market economy. It states that: "*The macro economy suffers from a weak export performance, a shortage of energy, poorly defined and enforced property rights, including an absence of a comprehensive land title registry, a court system that is sub-optimal, and a generally cumbersome business environment*". Furthermore, "*because of its underdeveloped capital markets, Albania has an unfavourable debt maturity structure. However, the overall level of government debt in relation to gross domestic production will probably not grow significantly over the medium term.*" On the positive side, Moody's comments that: "*Albania benefits greatly from a political elite that is pro-business. There are no major differences between political parties in the realm of economic or foreign policy, as all participants tend to be pro-EU, pro-NATO, and very much in favour of the cautious economic policy recommendations received from the International Monetary Fund and the World Bank.*"

4.3.4 External sector

Balance of Payments

Figure 4.4 presents the current account, the capital account and the overall balance in the period from 2000 to 2008. The figure shows that for the entire period, the negative balance on the current account has been outweighed by positive balance on the capital account and the category 'net errors and omissions'.[11] Consequently, the overall balance has been positive and relatively stable in a range between 0 and 4 percent of GDP.

Figure 4.4 Development of the Balance of Payments 2000-2008 (expressed as a percentage of GDP)



Note: 2006 is estimate; 2007 - 2008 are projections

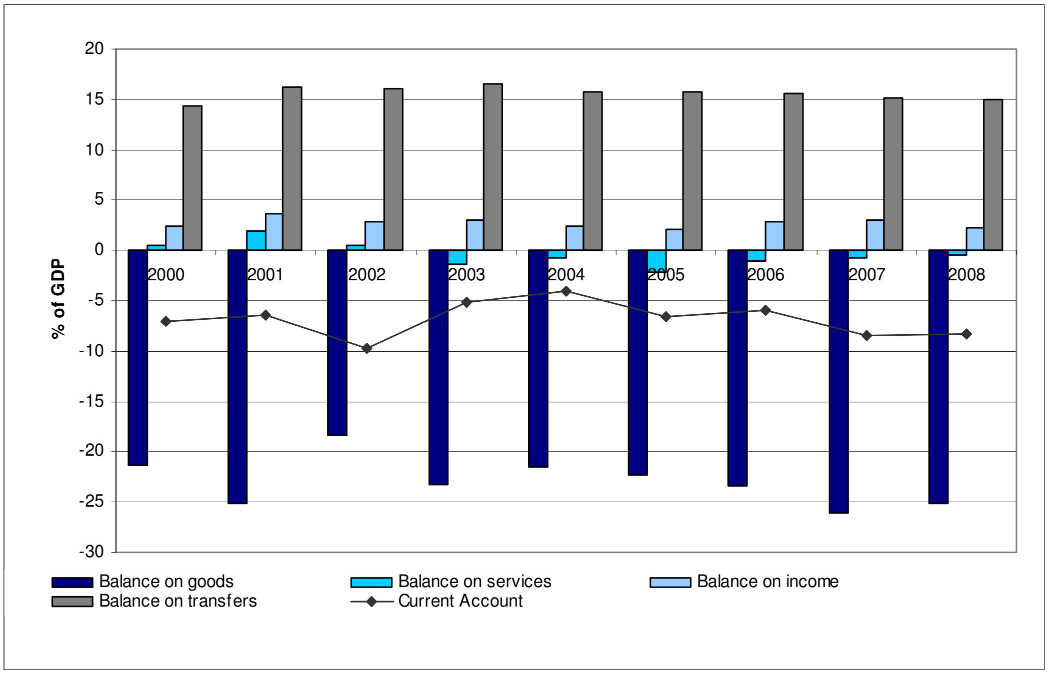
Source: IMF Country Reports 03/218, 05/267 and preliminary estimates (dd January 2008) fourth review (forthcoming, Spring 2008)

Current account

Figure 4.5 takes a closer look at the current account of Albania for the period 2000-2008. It shows that the current account deficit was relatively stable in a range between 6 and 8 percent of GDP; with the years 2002 and 2004 as, respectively, negative and positive outliers. The deficit in the current account is caused by the imbalance of exports versus imports (balance of goods). This imbalance is expected to increase in the years 2007 and 2008 due to the need to import more energy. Counterbalancing the deficit in the balance of goods is the large flow of remittances from Albanian migrants. Although the export base is estimated to expand over the coming years, the need to import more expensive electricity (projected by 1¼ percent of GDP in 2007) hinders further significant improvements in the balance of goods in the forthcoming years.

[11] An important constituent of the category 'net errors and omissions' is the flow of informal remittances which enter the country via the 'pockets' of Albanian workers abroad. The formal remittances that pass through the banking system are included in the current account category of 'private transfers'.

Figure 4.5 Development of the Current account 2000-2008 (in percentage of GDP)



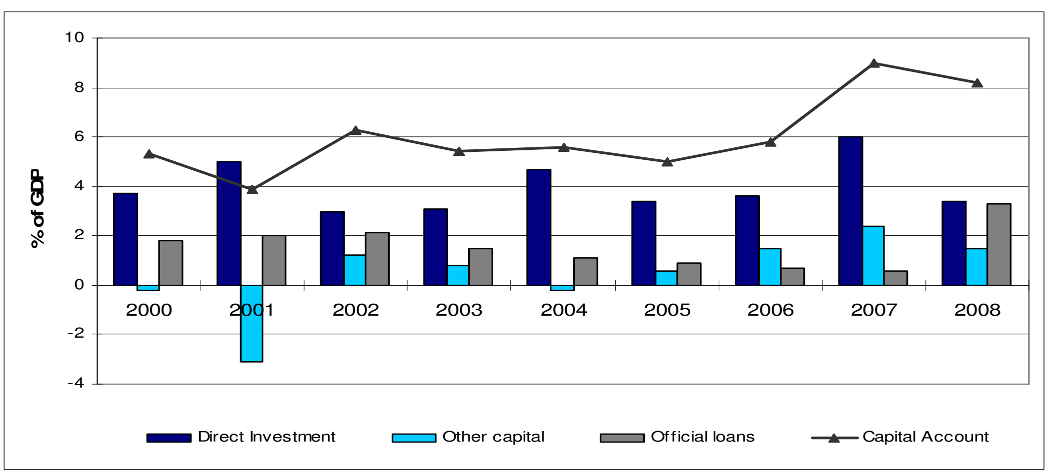
Note: 2006 is estimate; 2007 - 2008 are projections

Source: IMF Country Reports 03/218, 05/267 and preliminary estimates (dd January 2008) fourth review (forthcoming, Spring 2008)

Capital account

Figure 4.6 shows the development of the Capital account of Albania for the period 2000-2008.

Figure 4.6 Development of the Capital Account 2000-2008 (expressed as a percentage of GDP)



Note: 2006 is estimate; 2007 - 2008 are projections

Source: IMF Country Reports 03/218, 05/267 and preliminary estimates (dd January 2008) fourth review (forthcoming, spring 2008)

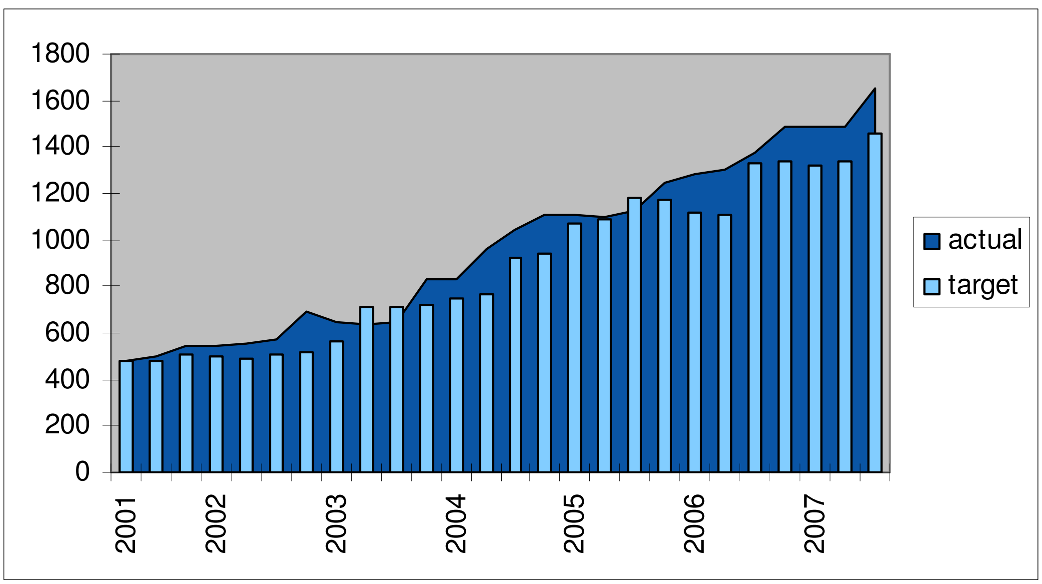
Figure 4.6 shows a relatively stable positive capital balance which is primarily supported by Foreign Direct Investment. The positive outliers in 2004 and 2007 are caused by the large scale privatisations of respectively the Savings Bank and Albtelekom. As the number of large scale privatisations has run dry, the continuation of the positive capital balance depends on the country's capacity to attract greenfield investments. The quality of the business environment is a crucial prerequisite. In recent years, the Albanian government has implemented various reforms in order to improve the business environment. Nevertheless, these attempts have so far been only partly successful (see Chapter 6 on structural reforms).

In 2008, the capital balance is expected to be substantially supported by the inflow of foreign capital through official loans. This sudden projected increase in 2008 reflects the private credit acquired by the Albanian government to finance the planned investments in road infrastructure.

International reserves

Figure 4.5 presents the development of the reserve position of the BoA for the period from 2000 to 2007. The table shows that the reserve position in the entire period has been above the IMF target level, which corresponds to level of 4 months of imports. In line with IMF requirements, the reserve position is registered in US dollars. A substantial part of the increase in the reserve position can be attributed to the depreciation of the US dollar, as the majority of the reserve portfolio is held in euro.

Figure 4.7 Development of Net International Reserves of the BoA (in million USD) in relation to IMF target (2001-2007)



Source: Bank of Albania, December 2007

4.3.5 MFA specific objectives

The specific macroeconomic objectives coincide with the IMF quantitative performance criteria of its arrangement under the Poverty Reduction and Growth Facility (PRGF). The implementation of the MFA concurred with the three-year programme from 2002-2005 and 2006-2009. Table 4.6 shows the assessment of these criteria by the IMF. It concludes that during the implementation of MFA, Albania performed on each criterion in accordance with the set benchmarks.

Table 4.5 Performance of Albania on the quantitative performance criteria in the period 2004 - 2006 (end of March benchmarks)

Objective	2004		2005		2006		IMF assessment
	Prog	Actual	Prog	Actual	Prog	Actual	
Ceiling on net domestic credit of the banking system to the consolidated general government (in billions of Lek)	6	6	6	2	8	-6	Met
Ceiling on accumulation of net domestic assets of the BoA (in billions of Lek)	-7	-24	-13	-19	3	-20	Met
Indicative total tax revenue targets (in millions of Lek)	36	36	199	199	41	45	Met
Floor for net international reserves of the BoA (in millions of US dollars)	57	104	240	275	22	120	Met
Ceiling on contracting or guaranteeing of public and publicly-guaranteed non-concessional external debt (in millions of euro)	120	19	240	126	70	45	Met

Source: IMF Country Reports 03/218, 05/267 and preliminary estimates (dd January 2008) fourth review (forthcoming, Spring 2008)

4.3.6 Conclusions

From the description of the development of the macroeconomic development in general, and the fiscal and the external sector in particular; it is concluded that the objectives have been achieved in the period up to 2007:
- the general macroeconomic development of Albania is positive and stable;
- the budget deficit is relatively small and is under control;
- the balance of payments does not give rise to urgent concerns about the country's ability to meet its external financing needs;
- the development of the financial reserves is sufficient and in line with the increase of imports.

Due to a mix of domestic and external factors, macroeconomic performance in the year 2008 seems to depart in various ways from the trend of previous years. A global increase in food prices underlies an increase in the inflation rate. The energy crisis adds additional inflationary pressure, as well as the planned increase of government expenditures. Another related factor is the inflow of capital for the road investment, which compensates for the deterioration of the trade balance due to increased energy imports; leaving the balance of payments largely unaffected.

4.4 Unexpected macroeconomic results

3. Has the assistance given rise to any unexpected short or medium-term macroeconomic effects? What were these and how did they occur?

We identified unexpected macroeconomic effects of two structural reforms: (1) channelling public sector wages through banks; and (2) reinsurance regulation. Both are explained in more detail in Section 6.6. This effect resulting from channelling the public wages through the banking system has been included in the counterfactual analysis.

5 External sustainability

5.1 Introduction

Table 5.1 presents the second group of evaluation questions, which analyses the external financial sustainability position of Albania. This chapter briefly reviews key information that is relevant from the perspective of external sustainability.

Table 5.1 Evaluation questions on the MFA's contribution to external sustainability

	Q4 To what extent has the MFA contributed to returning the external financial situation of the recipient country to a sustainable path over the medium to longer term?
1	How did the external financial situation of the recipient country evolve prior to and during the MFA operation? (Q.4.1)
2	What are the main internal and external factors upon which the current trend in the country's external financial situation and its prolongation into the future are based? (Q.4.2)
3	How is the country's external financial situation likely to evolve in the five years following the final disbursement, given the likelihood of changes to current conditions? (Q.4.3)

5.2 Gross impact – actual evolution of external sustainability indicators

1. How did the external financial situation of the recipient country evolve prior to and during the MFA operation?

Developments to the Current account were primarily shaped by the dynamics of exports, imports and remittances. All three major items of the Current account have been steadily growing in recent years.

Between 2002 and 2006, exports denominated in euro expanded at an average annual pace of 16 percent, with a slower rise of imports – 12 percent annually, but from a much higher base. Relative to the GDP, trade balance has been fluctuating in recent years; declining from a deficit of almost 26 percent of GDP in 2002 to less than 22 percent in 2004; to subsequently rise to around 24 percent during 2005-2006. This is a large trade deficit by international standards, and suggests problems with export performance (see Section 5.3).

In absolute (euro) terms trade imbalance widened somewhat between 2002 and 2006. Developments of the Current account deficit were similar: a decline from above 7 percent of GDP in 2002 to below 4 percent in 2003, followed by an increase to around 6 percent of GDP in 2005-2006. In contrast to the size of the trade imbalance, the Current account deficit is in line with the levels seen in several other countries at a similar level of development.

Officially recorded remittances have been growing fast over the last few years. It is worth noting that remittance inflows (as recorded in the balance of payments under the heading of 'private transfers') are substantially higher than commodity exports, and are comparable to exports of services[12]. This size of remittances grew at an average annual rate of 14 percent between 2002 and 2006. There is some disagreement over the exact size of the remittances flow. On the one hand, some of our interviewees believe that the 'errors and omissions' category of the balance of payment may mask additional remittances. On the other hand, the IMF has expressed its reservations on the methodologies used for calculating transfers in the Albanian balance of payments; and microeconomic evidence suggests a lower level of remittances inflows[13].

Debt sustainability

Public debt in Albania stood at a high level of above 75 percent of GDP in 1997. Foreign-currency-denominated debt was estimated at 38 percent of GDP[14]. Table 5.2 presents a selection of public sector and external debt indicators for the period 1998-2006.

Table 5.2 Selected public sector and external debt indicators, 1998-2006

Public sector and external debt sustainability framework: selected indicators under a baseline scenario (in % of GDP if not otherwise indicated)	**1998**	**2002**	**2003**	**2004**	**2005**	**2006***
Total public sector debt	68.5	65.3	61.7	56.6	56.7	55.7
of which: foreign-currency-denominated	32.3	23.5	20.6	18	17.5	17.1
Public debt service to revenue ratio (%)	37.6	17.7	19.3	17	14.4	14.2
Average nominal interest rate on forex public debt (%)	0.7	1.5	1.1	1.2	1.3	2.1
Average real interest rate on domestic currency public debt (%)	13.8	5.8	7.2	3.3	4.5	4.9
External debt (nominal, % GDP)	34.3	25.3	22.2	20.4	20.5	19.8
External debt to service to exports ratio (%)	8.9	6.8	5.3	4.5	4.5	6.1
Effective interest rate on external debt (%)	1.7	1.6	1.8	1.6	2.0	2.9

Note: 2006 data are projections.

Source: IMF, Albania: Second Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, Review Under Extended Arrangement, and Financing Assurances Review - Staff Report, Country Report 07/75 and Albania: Third Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, Review Under Extended Arrangement, and Financing Assurances Review - Staff Report, IMF Country Report 07/224.

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12 The reliability of balance of payment data on remittances may be questionable. Some microeconomic surveys suggested lower inflows of remittances than were recorded in the balance of payments. See IMF, Albania: Selected Issues; IMF Country Report no. 06/285.

13 See the discussion in the IMF, Albania: Selected Issues, IMF Country Report No. 06/285.

14 The figures reported in this paragraph and subsequent paragraph are derived from the IMF Albania country reports no. 07/75 and 07/224.

A gradual improvement of these indicators during 1998-1999 was reversed in 2000, when public debt to GDP ratio hit almost 73 percent. Since 2000, a combination of robust economic growth, exchange and interest rate changes, and relatively constrained fiscal policy resulted in a gradual decline in public debt to GDP ratio. In 2003, it declined to 61.7 percent; stabilising at around 56 percent of GDP during 2004-2006. Foreign-currency-denominated debt has continued to decline relative to the GDP; falling from 30.2 percent in 2000 to 20.6 percent in 2003, 18 percent in 2004, and an estimated 17.1 percent in 2006. It is worth noting that foreign-currency-denominated debt is, for the in most part on concessional terms with the average nominal interest rate at under 1 percent until around 2001; rising to between 1 and 1.5 percent during 2002-2005. The average real interest rate on domestic currency-denominated debt was very high in late-1990s (above 10 percent); subsequently declining to 4.5-7 percent in 2001-2006 (with a low of 3.3 percent in 2004).

Another, potentially more important indicator is provided by the public debt service to the fiscal revenues ratio[15]. It shows the portion of all budget spending that has to be devoted to servicing of public debt, and so cannot finance any public goods or services. This indicator has substantially improved over the last decade. It recorded the worst results in 1998, when it stood at worrying 37.6 percent; declining to 18.9 percent by 2001. After fluctuating between 17 and 19 percent during 2002-2004, it dropped to 14.4 percent in 2005 and down to an estimated 14.2 percent in 2006.

The external debt of Albania was only slightly larger than the foreign-currency-denominated part of the public debt, because so far private Albanian entities have hardly borrowed externally. After hitting a high of around 40 percent in 1997, the external debt began a gradual decline; reaching 18.5 percent in 2001, 20.4 percent in 2004, and just below 20 percent in 2006.

Debt service in relation to exports also reached its highest level in 1997 (at 12.8 percent); later falling to just above 4 percent in 1999-2001. Since 2002 it has fluctuated in the range between 4.5 and 6.1 percent. This low level is well below levels signalling any risks. This results from the overall low level of foreign indebtedness, and also from the concessional character of the bulk of this borrowing. As discussed above, the effective interest rate on foreign debt has been very low for the last few years. Interest payments are set to increase over the coming years as the new borrowing will increasingly be on commercial terms.

Overall, the risk of external debt distress can be evaluated as low in 2007. Somewhat higher risks are associated with domestic public debt, which contains a high proportion of short-maturity debt, despite a continued increase in the average maturity.

15 Debt service is defined as the sum of interest and amortisation of medium and long-term debt and fiscal revenues, including grants.

5.3 Identification of major risks

2. What are the main internal and external factors on which the current trend in the country's external financial situation and its prolongation into the future are conditional?

In this section, we present our analysis of the key risk factors to external sustainability. These findings are based on the analysis of statistical data and interviews with officials from the Albanian authorities, international financial institutions, as well as independent experts. The following potential sources of risk have been identified:

- the energy crisis;
- credit growth;
- political instability;
- narrow export base;
- high share of short term-public debt;
- remittances.

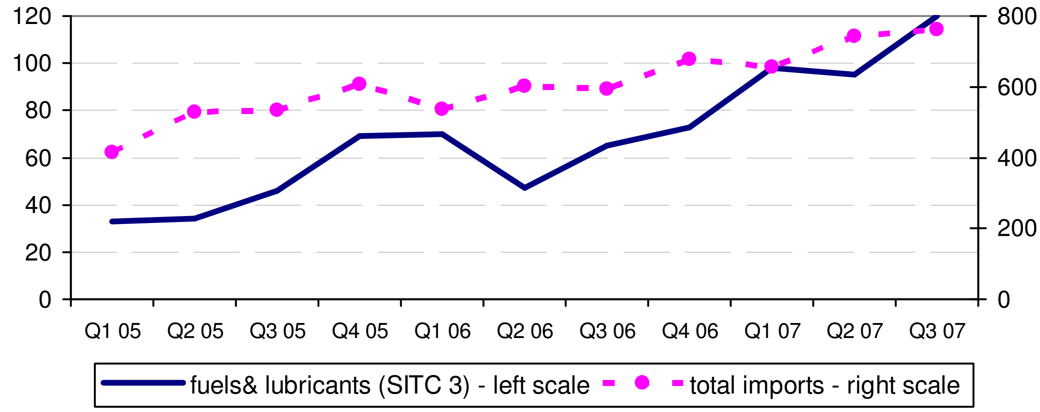
Energy crisis

The interviews with informants - particularly during the missions - have confirmed that the current state of the domestic energy sector (production and transport capacity) and a possibility of continuation (and deterioration) of the energy crisis should be considered an important risk factor. Given the drought (reducing hydropower generation possibility), the problem of non-payment for electricity, and mixed reform record related to the sector; the current, very difficult situation is likely to continue into 2008.

A limited and unreliable electricity supply will adversely affect the external financial situation. Firstly, the Current account is negatively affected by the surging energy import bill. Between 2005 and 2006, imports of fuels and lubricant (Standard International Trade Classification code 3) increased by over 40 percent (in euro terms) compared to a 16 percent growth in total imports. In 2007, these trends intensified further, as KESH has imported much more energy than was permitted by the KESH Action Plan. In the second and third quarters of 2007, energy imports rose on an annual basis by 102 percent and 85 percent, respectively[16]. In the third quarter of 2007, energy imports (more precisely, imports classified under SITC 3) were close to 16 percent of total imports - almost double the share from the third quarter 2005 (see also Figure 5.1).

[16] The figures presented are actually likely to underestimate the dynamics of energy imports, as they relate to the whole of the SITC 3 category (a more detailed breakdown of the import structure was not available on quarterly basis).

Figure 5.1 Dynamics of energy imports and total imports, 2005-2007, (quarterly data, EUR million)



Source: Bank of Albania.

Continued disruptions to the energy supply could reduce economic growth. However, so far, industrial production, as well as tourism has to a large extent been shielded from the outages. Furthermore, the quality of the functioning of public institutions would be adversely affected (e.g. directly affected as a result of reduced office hours in the public administration).

Finally, taking a more long-term view, the current situation of the energy sector is not sustainable from the fiscal perspective. The privatisation of KESH, increases of energy tariffs, further improvements in tariff collection, and efficient reduction of losses (mainly due to leakages and theft) appear necessary. Potential defaulting on these difficult reforms in an environment of high regional energy prices and constrained energy supply could have destabilising impact on the Albanian balance of payments and the country's fiscal situation.

Credit growth

The continuing credit boom can also be listed among the potential risk factors, although the likelihood of problems related to this can be assessed as low. Rapid growth of credit in the economy has been observed in most emerging European economies where low base (very low ratio of credit extended to the private sector as a percentage of GDP), positive growth prospects, macroeconomic stabilisation and favourable global interest rate conditions have added to the credit boom. The planned strengthening of the institutional framework for the monitoring and supervision of the credit portfolios (e.g. a credit information bureau) should further limit the related risks. Solving the remaining problems pertaining to the property rights may be an important factor supporting the growth of mortgage credit.

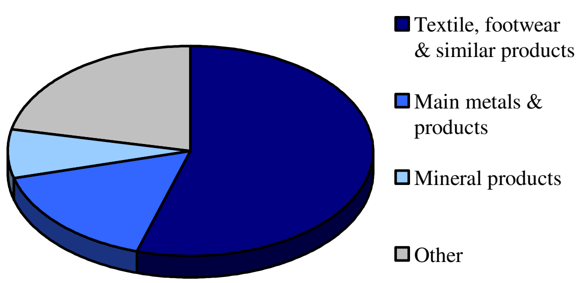
Political instability

Most interviewees consider political instability to be an important factor affecting the external sustainability of the country. Political issues in Albania and the region are constantly looming, which is affecting economic expectations. In addition, most interviewees also referred to the risk of higher budget deficits as a result of a shift in political priorities.

Narrow export base

Low exports, and particularly exports of goods, indicate problems in the business environment - especially with regard to domestic competitiveness. Despite a gradual improvement, this constitutes a substantial risk factor. A continued and accelerated development of export sectors is a necessary condition for ensuring macroeconomic stability in the longer term. Exports of services, tourism in particular, may react strongly to unexpected domestic or external policy developments - e.g. affecting perceived security in the country. The current structure of commodity exports can be seen as vulnerable (see Figure 5.2). Textiles, clothing and footwear (55 percent of total goods exports in 2006; down from 67 percent in 2002) are precisely the sectors where competition from Asian producers (notably China) is very strong. This is expected to limit the growth prospects for Albanian companies. The high geographical concentration of Albanian exports is also a concern. With around 83 percent of commodity exports going to just two countries – Italy and Greece (2006 data), any swings in domestic demand in these countries may have a strong impact on Albanian external balance.

Figure 5.2 Commodity structure of exports in 2006, (% shares in total exports of goods)



Source: Albanian Centre for International Trade.

High share of short term public debt

A relatively high share of short-term public debt could create problems with regard to changes in investor sentiment, e.g. due to political factors. Additionally, a high rate of domestic credit growth (from a low base) could become a potentially destabilising factor unless the quality of bank portfolios is adequately monitored.

Remittances

The inflow of remittances, currently playing important macroeconomic a microeconomic roles, is expected to remain stable in the short to medium term (see text box, below). The longer-term prospects will hinge on a combination of factors, mainly related to conditions affecting legal and illegal labour migrations. While the risks of a significant decline in remittances inflows can be assessed as low; the potential consequences could be substantial.

Text box: Remittances

Remittances refers to money that migrants have sent to related people (family and friends) or have deposited in personal (bank) accounts from the migration destination (host country) to the place of origin (home country). Remittances are small private sum transfers, mostly for food, education, health care or housing. However, the aggregate of these small sums has been very considerable from the macroeconomic perspective, significantly impacting economic development of Albania.

Size of remittance flows

In 2004, Albania was number 10 in the top 10 of remittance-receiving countries in the world. On average, the remittance flow is approximately 13.5 percent of GDP. For 2006, it is expected to exceed the EUR 1 billion mark. At this amount, remittances were three times higher than net foreign direct investment, double the official development aid received by Albania, and almost as large as exports. Remittances are expected to amount to approximately 20 percent of household expenditure. Table 5.3 provides private transfer data and forecasts from the IMF which includes estimates for unrecorded inflows.

Table 5.3 Remittances 2002-2005, estimate for 2006 and projections up to 2012

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Private transfers (million EUR)	612	706	826	969	1024	1095	1177	1262	1351	1440	1535
Private transfers (as % GDP)	13.0	14.2	13.7	14.4	14.1	13.8	13.6	13.4	13.2	12.9	12.6

Source: IMF Country Reports

International literature suggests that in most cases, remittances form a persistent and relatively stable flow. There are no indications why this would be different in the case of Albania.

Migration

This large flow of remittances is the result of continuous labour migration. In the period from 1989 to 2003 in Albania, almost 25 percent of the total population migrated. Migration peaked closely after the collapse of the pyramid scheme collapse in 1997 and 1998. Greece and Italy are the most preferred destination countries for Albanians. Official statistics for Albania in 2004 show that approximately 60 percent of remittance inflows were from Greece; 30 percent from Italy; and the remaining remittances were from the USA, Germany and other European countries. The migrants were either highly educated or unskilled. Highly educated Albanians migrated to the United States, while unskilled migrants tended to migrate to Greece or Italy.

Transfer channels

At the beginning of the 1990s, remittances were mostly transferred through informal channels (cash carrying). In 1994 it was estimated that approximately 10 percent of all transfers were through formal channels. For the year 2001, experts estimated that 40 percent of all remittances were transferred through the formal sector; whereas today they assess this figure about 50 percent. Nowadays, Money Transfer Operators (MTOs) dominate the formal market for money transfers to Albania (about 80 percent of the market). Other formal intermediaries, such as banks and the post office play a small but increasingly significant role.

Economic impact

Remittances are one of the defining factors of exchange rate dynamics in small open economies. To illustrate, Lucas (2005) observed that from 1992 to 2002, the Albanian Lek depreciated by 7.6 percent on average per year against the USD. Taking into account inflation developments, in the period from 1997 to 2002 there was even a real appreciation of the Albanian Lek against the USD, at more than 7 percent on average. No doubt exports would have been stronger in the absence of this real appreciation.

Remittances can be a significant source of foreign exchange through which creditworthiness and access to international capital markets can be improved. Remittances can provide financial institutions with access to better financing than might otherwise be available.

Almost 70 percent of remittances received in Albania go to the poor rural areas in the north of the country. This is the region were most migrants originate from. Remittances have a large impact on poverty reduction, especially in this region.

5.4 Projections for external sustainability

3. How is the country's external financial situation likely to evolve in the five years following the final disbursement, given the likelihood of changes to current conditions?

IMF projections

This section provides analysis of the external sustainability based on the most recent available data. The major source is the IMF external and public debt sustainability analysis. Its recent update appeared in the IMF Country Report 07/244 published in July 2007. The IMF framework provides a consistent set of medium-term projections, allowing for the presentation of developments of several sustainability indicators. The key results are presented in Table 5.4.

Several observations should be made with regard to these forecasted data. Firstly, external debt is low and is expected to gradually decline over the 5 years following the disbursement of the final MFA tranche in 2006. This is also true for the Net Present Value (NPV) of debt. Secondly, net external debt is actually negative over the projection period, suggesting a very safe debt level relative to international reserves. Debt service ratios, while gradually increasing over the projection period (reflecting the gradual phasing out of grace periods on concessional borrowing) remain well within internationally-accepted safety limits (see below). Domestic public debt, while relatively high for a country like Albania, is nevertheless set for a gradual decline.

Table 5.4 Medium-term public and external debt sustainability framework, 2005-2011

Public sector and external debt sustainability framework: selected indicators under baseline scenario (expressed as a percentage of GDP if not otherwise indicated)	2005	2006	2007	2008	2009	2010	2011
Total public sector debt	56.7	55.7	54.4	53.4	52.3	51.1	49.8
of which: domestic	39.1	38.9	37.5	36.5	35.6	34.7	33.9
of which: external	17.6	16.8	16.9	16.8	16.7	16.4	15.9
Nominal external debt	20.5	19.8	19.9	19.8	19.7	19.1	..
of which: public & publicly guaranteed (PPG)	18.7	18.1	17.9	17.9	17.6	17	..
of which: private	1.8	1.6	2	1.9	2.1	2.1	..
Identified net debt-creating flows	2.1	2.1	1.9	1.1	0.5	-0.3	..
Deficit in balance of goods and services	24	24	25.1	23.5	22.6	21.6	..
Net current transfers (negative = inflow)	-14.4	-14.1	-13.8	-13.6	-13.4	-13.2	..
Other current account flows (negative = net inflow)	-2.3	-3.3	-3.3	-3	-2.9	-2.8	..
Net FDI (negative = inflow)	-3.3	-3.5	-5.2	-4.9	-4.9	-5	..
Official transfers (negative = inflow)	-1.2	-1.4	-1.2	-1.1	-1	-0.9	..
Net external debt *	-7.7	-8.9	-6.6	-5.9	-5.1	-6.2	..
NPV of external debt **	16.4	16.2	16.3	16.1	16.2	16.2	..
as a percentage of exports	75.1	64.1	62.6	61.5	61.7	60.4	..
NPV of PPG external debt	14.7	14.2	14.3	14.2	14.3	14.2	..
as a percentage of exports	67	56.4	54.4	53.1	53.2	52.2	..
Debt service-to-exports ratio (in percent)	4.5	4.5	6.1	6.1	7.4	7.7	..
PPG debt service-to-exports ratio (in percent)	4.1	4.1	5.1	5.5	5.8	5.9	..
Total gross financing need (in EUR billions)	0.2	0.4	0.3	0.4	0.5	0.5	..

Notes: Data for 2006 is estimated; for 2007 to 2010 the data is projected.
* Net external debt is defined as the stock of debt less international reserves of the banking system.
** Net present value (NPV) calculations assume that NPV of private sector debt is equivalent to its face value.

Source: Albania: Third Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, Review Under Extended Arrangement, and Financing Assurances Review - Staff Report, IMF Country Report 07/224.

An analysis of factors determining projected debt levels and flows indicates that persistent negative trade balance will continue to act as a debt-creating flow, while remittances inflows and FDI inflows will be among the strongest countervailing forces.

Assessment based on the CPIA benchmark

In order to support the positive assessment on the level and dynamics of debt indicators from Table 5.4, additional benchmarks should be used. One of the most commonly used approaches is the one proposed by the IMF and World Bank staff paper of March 2005.[17] It defines the relevant debt thresholds depending on the quality of policies in the countries

17 IMF and IDA (2005) *Operational framework for debt sustainability assessment in low-income countries – further considerations*, 28 March.

analysed. This is motivated by an intuitive observation that worse economic policies may call for a much more cautious approach in assessing external sustainability compared to countries with established records of responsible macroeconomic policy-making.

The quality of policies is proxied by the World Bank's Country Policy and Institutional Assessment (CPIA). These assessments are made annually and have been available to the public since June 2006, when the 2005 ratings were released for the first time. The CPIA ranking is used to classify low-income countries into three groups; with weak, medium and strong policies, respectively. The dividing for this classification have been set at CPIA 3.25 (between weak and medium) and 3.75 (between medium and strong). (Another version has suggested 3 as a dividing value between weak and medium policies, and 3.9 separating strong from medium policies.) In the next step, for each classification group of countries, the indicative sustainable debt thresholds are defined in terms of relationships between the NPV of debt stock and debt service to GDP, exports and budget revenues excluding grants. These debt thresholds (using the 'preferred' version of CPIA dividing points) are presented in Table 5.5.

Table 5.5 Debt-burden thresholds in the option preferred by IMF staff

	NPV of debt as a % of exports	NPV of debt as a % of GDP	NPV of debt as a % of revenues	Debt service as a % of exports	Debt service as a % of revenues
Weak policy (CPIA ≤ 3.25)	100	30	200	15	25
Medium policy (CPIA 3.25< to < 3.75)	150	40	250	20	30
Strong policy (CPIA 3.75≤)	200	50	300	25	35

Source: IMF and IDA (2005) *Operational framework for debt sustainability assessment in low-income countries – further considerations*, 28 March.

The table above confirms that during the projection period, Albania is well within any of the debt thresholds - even if it may have a weaker policy record. In fact, Albania scores positively in the CPIA, with an average of 3.7 in 2006.

Balance of payments, international reserves

Current account deficit is expected to widen during 2007-2008, mainly on the back of higher energy imports. Export growth is expected to remain strong over the coming years. This, together with an expected improvement in the energy situation after 2008, is forecast to bring a gradual narrowing of the trade balance (although it is likely to stay high in international comparison). This will also bring Current account deficit down to around 5 percent of GDP - or even lower - by around 2010. This can be considered a safe and sustainable level for a country at the level of development of Albania that is catching-up with Europe. International reserves in number of months of imports are also forecast to be maintained at the current safe level of four months of imports in the period between now and 2010.

5.5 Conclusion

The external financial position of Albania has remained sustainable in the period 2004-2007. The public debt and foreign-currency-denominated debt to GDP ratios both declined. Moreover, most foreign-currency-denominated debt was on concessional terms, with an average interest rate of between 1 and 1.5 percent. The ratio of public debt service to fiscal revenue also decreased. Debt service in relation to exports hovered at around 5 percent, which is a very low ratio - well below levels signalling any risk.

The domestic energy sector (the financial situation of KESH) and a possibility of a continuation and deterioration of the energy sector crisis should be considered an important risk factor threatening external sustainability. Deterioration of the current crisis could have a negative impact on inflation, economic growth, as well as a destabilising impact on the Albanian balance of payment and fiscal situation. The second cause for concern is the low export base. Despite a gradual improvement, this constitutes a substantial risk factor for external sustainability. Continued and accelerated development in export sectors is a necessary condition for ensuring macroeconomic stability in the longer term.

External sustainability projections from the IMF (July 2007) do not signal any problems until 2010. Current account deficit is expected to widen during 2007-2008, but by 2010 the Current account deficit will be brought down again, anticipating improvements in the energy sector and export growth. External debt is expected to gradually decline up to 2010. Domestic public debt, while relatively high for a country like Albania, is also expected to gradually decline.

6 Structural reforms

6.1 Introduction

This chapter addresses the evaluation questions on structural reforms (see Table 6.1 below). Firstly, the rationale behind the selection of conditionalities will be described; and its relevance to domestic needs evaluated. This chapter will then move on to a review of the gross impact of conditionalities. Complementarities between MFA and other EU and IFI instruments will be reviewed, and possible unexpected structural effects identified.

Table 6.1 Relevant evaluation questions for analysing the impact of structural reforms

	Impact of structural reforms
1	What are the expected short and medium-term expected structural effects of the assistance (in the context of the recipient country's reform programme)? (Q2.1)
2	How relevant are the expected short and medium-term structural effects of the assistance to the needs of the recipient country? (Q2.2.)
3	To what extent have the short and medium-term structural effects of the assistance (in the context of the recipient country's reform programme) occurred as envisaged? (Q2.3)
4	To what extent have structural effects been enhanced, if at all, by complementarities between the MFA and other EU instruments? (Q2.5)
5	Has the assistance given rise to any unexpected short and medium-term structural effects? What were these and how did they occur? (Q3.2)

6.2 Structural objectives of the intervention

1. What are the expected short and medium-term structural effects of the assistance (in the context of the recipient country's reform programme)?

The MFA operation in Albania included a total of 14 conditionalities (Table 6.2 below). The two conditionalities attached to the *first tranche* are of a fairly technical and procedural nature, and are drawn from the Operational Assessment (OA). In this respect, they can be regarded as 'administrative' prior actions to make disbursement possible under the EU financial rules. The remaining twelve conditionalities were agreed in a separate Memorandum of Understanding; and were conceived to allow relatively quick disbursement over a maximum one-year period. These are more policy-oriented, and come from a combination of different sources: reinforcement of existing WB and IMF conditionalities, European Partnership priorities, suggestions from the MFA operational assessment itself, and the results of the DG ECFIN fact-finding missions. They can be broadly grouped into four main policy areas:

1. public finance reform;
2. the fight against corruption and public administration reform;
3. financial sector reform;
4. business environment.

Table 6.2 Structural conditionalities in Albania and their source and underlying rationale

Sector	Conditionalities listed in the MoU	Source and rationale
	Public finance reform	
1. Segregation of duty (first tranche)	At the Treasury, clarification and formalisation of the delegation of authority by level and proper segregation of duty in place: staff performing payments should not be given the duty of approving payments or reconciling accounts	Recommendation from the Operational Assessment Report
2. Double signature rule (first tranche)	Apply double signature rule for payments at the Treasury	Recommendation from the Operational Assessment Report
3. Internal audit reports	Quarterly submission by the Ministry of Finance to the Council of Ministries of internal audit reports of line ministries, together with recommendations for remedial actions in identified areas.	A specification of two World Bank PRSC 3 conditions, and linked to a parallel EU-sponsored TA project
4. Policy Paper on public finance control	Adoption of a Policy Paper on Internal Control of Public Finance	Included in the NPAL-SAA and related to a parallel EU-sponsored TA project . Also broadly related to the World Bank PRSC 3
5. Treasury IT system	Progress with the introduction of a new integrated IT system to support the core activities of the Treasury. In particular, launch of the operation in the Tirana district	A weakness highlighted in the OA. Also part of the objective of World Bank PACTA 2000
	Fight against corruption and public administration reform	
6. Channel public sector wages through banks	Processing the payment of at least 50% of public sector wages through the banking system.	Performance criteria for the fourth review IMF PRGF. Idea also included in NPAL-SAA
7. Legal framework for conflict of interest	Approval by the Government of the legal framework on conflicts of interest.	Initiative resulted from a Council of Europe study and was included in NPAL-SAA. Also indirectly related to World Bank PRSC 3 conditionality (accountability of public officials)
8. Delays in judicial processes	Approval by the Government of legislative measures to limit delays in judicial processes	Included in NPAL-SAA. Broadly related to the WB judicial and legal reform project
	Financial sector reform	
9. New law in the banking sector	Approval by the Government of the new law in the Banking Sector.	Included in NPAL-SAA, it is the continuation of the WB-led banking supervisory development plan

Sector	Conditionalities listed in the MoU	Source and rationale
		under FSAC.
10. Bank of Albania IT system	Introduction of an integrated IT software system at the Bank of Albania and implementation throughout 2005 of the Plan on Banking Supervision.	OA-detected weakness (first part of the conditionality). Extension of an expired World Bank FSAC loan conditionality (second part of conditionality).
11. By-laws on (re) insurance	Adoption of secondary legislation on insurance/reinsurance, including prudential rules with regard to reinsurance	A follow-up of an IMF PRGF January 2004 SMOU commitment to have a new insurance law approved. Strictly related to WB FSAC assistance.
Business environment		
12. Action Plan on administrative barriers	Approval of the new Action Plan on administrative barriers.	A follow-up of a previous FIAS plan and WB conditionality.. Structural benchmark of the IMF PRGF fifth review
13. Law on Commercial Registration	Approval of the New Law on Commercial Registration with the aim of facilitating market entry.	Agreed with IMF in PRGF SMOU as a part of the 2004 fiscal package, but not formally a conditionality.
14. Tender for the Privatisation of Albtelekom +ARMO	Offer for the sale (final tender) of Albtelekom and ARMO	Idea included in the NPAL-SAA and agreed with IMF in PRGF SMoU for 2004. Also structural benchmark for the fifth PRGF review.

The rationale behind selection of conditionalities was mainly driven by the need to ensure a reasonably quick disbursement of funds and a combination with a number of other factors, namely:

- some conditionalities - mainly in the field of public finance reform - were either taken from the OA or conceived to reinforce the expected results of existing EU projects;
- most conditionalities in the financial sector reform are extensions / reinforcements of results achieved by previous or parallel WB projects. One condition in the area of public finance reform was *de facto* selected to support a WB project (PACTA), which experienced problems. The review of this programme was being carried out at the time when MFA negotiations were ongoing;
- the bulk of conditionalities in the public administration area are more specifically MFA-related, and were taken from the European Partnership process and the NPAL-SAA;
- conditionalities in the field of business environment were mainly taken from IMF conditions, or were to reinforce IMF conditions of the PRGF being agreed upon those days.

The Government had drafted its own action plan to address the European Partnership priorities. The existence of this document made the selection of MFA conditionalities a relatively easy exercise. In addition, the well-identified actions in this document made the MFA specific, rather than referring to general policies or broad objectives.

6.3 Relevance of MFA structural objectives

2. How relevant are the expected short and medium-term structural effects of the assistance to the needs of the recipient country?

Ownership of most of the proposed reforms and therefore their relevance to Albanian needs was broadly ensured by their presence in the NPAL-SAA agenda. The only exception was the represented priorities drawn from the OA. Most interviewees agreed that the selected conditionalities were relevant to the policy agenda at that time (see also Appendix VI). The Government employed the MFA to further strengthen its case for including in the policy agenda matters of concern to independent third-party authorities (the Central Bank, the Judiciary), or to overcome foreseeable resistances. This was reportedly the case of the new law on the banking sector and of the proposed legislation on judicial delays.

Most interviewees agreed that reforms such as internal audit procedures, public administration reform and improvement of the business environment were at the top of the reform agenda.

Some disagreement existed over whether judicial reforms (more specifically, limit judicial delay) were really top structural reform issues. Some interviewees maintained that judicial delays *per se* were a limited problem when compared to the more fundamental difficulties faced by the Albanian judiciary in terms of the quality of services provided. Judicial delays were certainly not the major factor for businesses to have wide recourse to arbitration procedures and other modalities of dispute settlement[18].

Some experts stated that financial sector reform was not a priority. This can partly be explained by the fact that a functional and satisfactory banking law had already been adopted in 1997 and amended in 1998. Nevertheless, most experts were of the opinion that the new Banking Law would bring relatively marginal operational improvements related to the process of formal harmonisation with EU directives. In the same vein, WB sources stated that reinforcing insurance supervision was not only a matter of a lack of proper legislation. The lack of (qualitative) capacity with the Insurance Supervision Authority (ISA) was probably a bigger bottleneck at that time.

Disagreement exists over whether the two administrative “prior actions” (double signature and segregation of duty) were relevant reforms. Albanian counterparts familiar with the issue agreed that double signature and segregation of duty were not substantial matters, since these procedures had been in place for long, but merely lacked formalisation. The prevailing view was that these prior actions resulted from a misunderstanding by the consultants responsible for the assessment; such that this

[18] A major indicator of this phenomenon is the fact that the total number of official insolvency procedures before courts in the country was barely more than a couple of cases.

misunderstanding had been variously attributed to a "*linguistic misunderstanding*", a *"quid pro quo"* or *"a lack of formalisation intelligible to outsiders of an existing practice"*.

In retrospect another conditionality that was not fully clear was the *"introduction of an integrated IT system at the Bank of Albania",* which was also drawn from an OA recommendation. An automated Treasury/MIS system at the BoA had been in place from November 2002;[19] and the Bank itself had supported the establishment of the interbank settlement system that had become operational in January 2004. When the MFA was negotiated, it was unclear what was meant by the term "integrated" IT system[20]. A fully-fledged bulk clearing system for retail payments (the Albanian clearing house system) would be completed in mid-2005, but it was not clear whether this was meant by an "integrated IT system".

With the benefit of hindsight, some interviewees stated that conditionalities in the area of civil servant status could have been useful. Civil servant status has become a highly controversial and divisive point in Albanian politics and a longstanding matter of disagreement. When the law was approved, the largest opposition party at that time claimed it had not been sufficiently involved in the law-making process. They considered this law as a "majority" law that was subject to strong attacks once the former opposition party came to power. The dismissal of hundreds of civil servants after September 2005 led to some concerns about the sustainability of the reform. Nevertheless, it is doubtful whether an MFA conditionality could have made the civil service reform process more stable, as some interviewees had hinted. The law and civil sector reform were already World Bank and IMF conditions, but this did not appear to have made a clear difference. In addition, it is questionable whether such conditions would have been in line with the short-term balance of payments character of the MFA operation.

6.4 Gross impact – actual structural reform outcomes

3. To what extent have the expected short and medium-term structural effects of the assistance (in the context of the recipient country's reform programme) occurred as envisaged?

[20] The operational assessment report never mentioned the lack of an integrated IT system, but did mention the fact that the IT system was underused for internal audit purposes (and this conflicted with World Bank report stating exactly the opposite and claiming the system was used for that purpose). However, the link with the audit aspect was lost during the negotiation process, and the phrasing of the conditionality - while mirroring that of the Treasury - became unclear and slightly ambiguous. The Albanian authorities were uncertain as to how they could prove compliance with this structural condition, but were willing to prove progress in the level of automation of bank operations - quoting all IT systems put in place within the bank, including also those that had been there before conditionalities had been negotiated and finally agreed.

Area I: Public finance reform

Conditionality 1 and 2: Segregation of duty and double signature. The procedure has now been duly formalised in line with Western standards, although most interviewees agree a substantial issue was not really present. According to one interviewee, the resulting "formalisation" of the procedure resulted in 'problems' with the local governments who objected to any national government authority on the issue on grounds of local autonomy. However, nowadays there are no longer transactions (even at the local level) that do not comply with these procedural standards. Moreover, formalisation of the double signature gave the Ministry of Finance more authority vis-à-vis local governments.

Conditionality 3: Internal audit reports. An internal audit department was established in 2003 and since February 2004, quarterly audit reports are transmitted to the Council of Ministers. In line with the MFA conditionality starting from 2005, the focus of these audit reports has increasingly moved from findings to recommendations. So far, more than 2000 recommendations have been formulated mainly in the fields of: 1) tax and customs, 2) public procurement legislation, 3) legislation on circulation of legal documents, and 4) the monitoring of cash transactions. Over 90 percent of these recommendations have reportedly been implemented, and more than 1000 ministerial orders have been issued as a result. Information about the quantification of related benefits is not available.

The World Bank scored the results of the parallel PRSC3 project as satisfactory in the field of public financial accountability; and considered as notable achievements the enactment of the Law on Internal Audit in 2003 and its subsequent implementation in areas such as the adoption of internal audit standards, development by the Ministry of Finance of a comprehensive audit manual, and the establishment of a "functional" audit process.

Conditionality 4: Policy Paper on Public Finance Control. This PIFC Policy Paper was approved in June 2005 and was supported by an Action Plan with 25 actions. Of these 25 points, 15 – mostly related to the development of the internal audit function within the Albanian administration – have been wholly or partly implemented. Outstanding issues concern secondary legislation on financial management and accounting. When the present government came into office, it endorsed the Policy Paper but reassessed its priorities, including the introduction of a new Organic Budget Law and an Internal Audit Law. A revised Policy Paper and Action Plan are expected to be approved by the Council of Ministers by the end of 2007 to reflect the priorities. It should also include an action plan set out in the Albanian Public Finance Sector Strategy for 2007-2013, which was prepared at the end of 2006 in order to meet the requirements of the IMF.

In June 2006, the World Bank rated the effectiveness of internal controls as a B (on a scale from A to D with A being the best)[21]. The effectiveness of the internal audit was rated as a C+, while that of recording and management of cash balances, debt and

[21] For the exact meaning of the WB ratings on the effectiveness of internal controls, please read World Bank (2005), "Public Expenditure and Financial Accountability – PEFA; PFM Performance Measurement Framework", PEFA secretariat, Washington DC.

guarantees rated as a B. The World Bank deemed the overall progress achieved in public financial accountability as satisfactory; while public expenditure management in general was scored as moderately satisfactory.

Conditionality 5: Treasury IT system. After a long and troublesome implementation process, the World Bank project for the implementation of the Treasury IT system was accomplished by the end of 2006. The delay did not result from a lack of political commitment, but was mainly related to contractual problems between the Albanian government and the WB contractor, and the technical complexities of the assignment. On paper, all the 36 District Treasury Offices are connected to this IT system; and it was pilot tested in line ministries and local governments. Software was developed, hardware installed and a nationwide communication network completed, although the quality of the lines available is far from the standards that such a complex IT system would require.

Currently, the IT network is still in a trial phase and its full impact on budget implementation has not been fully materialised. For the time being it has accrued costs because the Ministry of Finance is running the new system in parallel to the existing system. Furthermore, the information gathered by the new system is not fully accurate and cannot be used for reporting purposes. The system was expected to be fully operational in January 2008, but the energy crisis caused some additional delays, as all districts had to buy generators. Moreover, there is not enough trained staff and the new system is also not yet running in compliance with those of the private banks or the BoA. At present, with the available information, it is unclear whether the project can be made a successful tool for expenditure management in the near future.

Both the Albanian government and the World Bank are not yet satisfied[22] with the results of this project because it has not achieved yet the expected benefits. In particular, slow progress in automation has hindered the anticipated gains, such as sending of daily payment data by District Treasury Offices to the Central Treasury (data is sent on a weekly basis). The reconciliation between the transaction data from the Treasury system and the cash balance at the BoA is done on a monthly basis.

Area II: The fight against corruption and public administration reform

Conditionality 6: Public wages channelled through banks. The issue of transferring wages through the banking sector was mainly part of a dialogue with the IMF. Table 6.3 below presents an overview of when targets were agreed between the IMF and the Albanian authorities, and when these targets were met. In February 2005, Albania agreed the targets with the IMF to “increase the total number of public employees paid in this manner to 25,000 by the end ofMarch 2005 (PC) and to 50,000 by the end ofJune 2005”. In August 2005, the target was increased to 70,000.

[22] World Bank (2006), ‘Implementation completion report on a credit in the amount of SDR 6.9 million to the Republic of Albania for a third poverty reduction support credit’.

Table 6.3 Overview of quantitative goals for channelling public wages through the private sector and dates of realisation

When goal set?	Goal (# of employees)?	When to realise?	When result measured?	Target met?	*Source*
Feb 05	25,000	end of March 05	end of March 05	yes	*Aug 05 Report jo. Jan 05 rep.*
Feb 05	50,000	end of June 2005	end of June 05	yes	*Aug* 05 Report jo. Jan 05 rep.
Aug 05	70,000	end of Sept 2005	end of Sept 2005	yes	*Aug* 05 Report jo. IMF Country Report No. 06/54 feb. 06

Source: IMF

The MoU of the MFA operation officially came into force in May 2005. This was in between the first and second target agreed with the IMF. However, the target of 50 percent had already been negotiated in October 2004

The February 2005 target of 50,000 was met in June 2005. The August 2005 deadline of 70,000 was met in September 2005. Now the vast majority of public wages reportedly go through the banking system.

There is consensus among most interviewees (see also Appendix VI) that the channelling of wages through the banking system, along with financial reform (excluding reinsurance), has been one of the most successful reform areas. However, the underdeveloped banking network in certain parts of the country is still a constraint.

Conditionality 7: Legal framework on conflict of interest. A new Conflict of Interest Law, broadly inspired by the OECD toolkit principles, was approved in April 2005. Some amendments on politically controversial aspects were made in February 2006 after the new government took office. The approval of the Law, although formally outside the loan conditions, was one key factor which convinced the World Bank to assess the progress on accountability under PRSC 3 as satisfactory. Practical implementation of the law requires a massive training effort among civil servants who have poor familiarity with the underlying basic concepts. So far the impact of the Law has been mainly preventive and has materialised in less than a dozen concrete cases across all government services. However, it is believed that this Law has played a role in the public perception of corruption.

Conditionality 8: Delays in judicial processes. In 2005, the newly-appointed government changed its approach to judicial delays. They considered that approving the draft law that had been prepared by their predecessors would be of little help in coping with delays. Furthermore, they saw this draft law more as a burden to the budget, because of the financial compensations envisaged. After initially considering this conditionality as unmet, the Commission agreed with the Albanian government that the law would be replaced by package of organisational / administrative measures, including: 1) the reorganisation of the judicial districts, 2) computerisation of offices, 3) the inclusion of duration of cases in the judges performance evaluation grid, 4) disciplinary measures when a judge makes a case more protracted (the case can be taken to the High Court) as included in the newly-approved law on the organisation of the judicial process.

Progress was made last year regarding the computerisation of offices, especially compared with previous years (as was concluded in an assessment made by the World Bank in 2006). After massive EU-sponsored training efforts, the system was expected to become fully operational in January 2008 in 80 percent of the courts, although the way it has been used in some Courts of Appeal is far from being considered European best practice, and may lead to a substantial underestimation of the actual duration of cases. Results of the reorganisation of judicial districts are mixed, because the process also led to the dismissal of some judges, as well as to time-consuming and reportedly inefficient management of some newly created Court branches. Little can be said on the impact of career evaluation and disciplinary procedures, because these have been in place for only a short period. All in all, available evidence points to a geographically fairly diversified situation, with increasing backlogs in the main courts of Tirana and Durres mainly due to shortage of judges. In the other regions of the country, the situation appears to be improving and is more under control.

Area III: Financial sector reform

Conditionality 9: Reform of the Banking Law. As part of the stabilisation and association process, the authorities decided to prepare a new law on banks in Albania. The law was intended to work in harmony with EU directives and the Basel Principles. The Law replaced the July 1998 law and was a top priority for the Albanian authorities.

The new Law “On Banks in the Republic of Albania” was approved by Parliament on 18 December 2006, and came into force on 1 June 2007. The Law was prepared by the BoA with IMF technical assistance in close consultation with the Bank Association and the business community. The new Law strengthens the BoA’s supervisory functions. It also provides the BoA with the adequate means to monitor the banking sector. Although the new Law brought further harmonisation, it led to minor adjustments in BoA monitoring and supervision. Most experts state that the 1998 law was already considered to be of high quality.

As of 2006, the banking system now consists of 17 banks (3 Albanian-owned and 14 foreign-owned or joint ventures). Foreign capital continues to dominate over domestic capital, accounting for about 85 percent of the capital. In the last few years an increase in financial intermediary services led to rapid credit growth. Credit as a percentage of GDP is expected to rise up to 30 percent by the end of 2007. However, Albania’s stock of credit relative to its income level remains low by transition economy standards. In addition, large parts of the credit were used for investment purposes rather than consumption. In general, the development of the Albanian banking sector appears to be sound.

The World Bank has been the leading donor agency to support financial sector reform in general, in close cooperation with the IMF and the EC. The MFA conditionality on the approval of the new law on banks is closely linked to the World Bank Financial Sector Adjustment Credit (FSAC), which was successfully completed in 2004. In 2004, the NPAL-SAA also mentioned the need to amend the law on banks in order to harmonise with EC directives and Basel Principles. This was repeated in the NPAL-SAA of 2005, this time with a clear deadline. The new Law was also part of the IMF EEF/PRGF of 2006.

This conditionality is one of the case studies in this evaluation. For further analyses, see Appendix II.

Conditionality 10: Bank of Albania IT system and supervision. The BoA IT system is composed of the following three components:

- Accounting and Treasury Management System – ATM;
- Automated Interbank Payment System – AIPS;
- Electronic Clearing House – AECH.

The internal ATM system began operating in November 2002 and automated all BoA operations, thereby allowing a more accurate supervision of the banking sector, and improving of the reserve management and the management of the liquidity. AIPS began operating in January 2004. This system is in line with the best international standards and practices, and involves all the second-level banks of Albania; ensuring a better monitoring of the liquidity of all participants, as well as a quick electronic settlement of the high value payments between banks. It also provides the BoA with an effective tool with which to assess systematic risk. Finally, AECH began operating in July 2005, executing the settlement of all small value payments on a net basis. AECH implementation has decreased banking costs and provided a further tool with which to monitor credit and liquidity risks. The BoA has regularly continued the implementation of the Supervisory Development Plan for Banking Supervision prepared by the World Bank. Recently the BoA established the Department for Financial Stability.

In 2005, the World Bank assessed the progress achieved in the field of banking reform and supervision strategies as highly satisfactory. Strategies were deemed increasingly robust and more risk-based; with improvements in the quality and comprehensiveness of the risk analysis, management evaluations and supervisory plans. Interviewees agree unanimously that this has remained the case in the last two years. Support for banking supervision and the regulatory framework has been mainly provided by the IMF and USAID, through its FSVC programme. The World Bank assessed the BoA's progress in the field of IT automation as high in terms of institutional development; and substantial in terms of management aspects.

Conditionality 11: By-laws on reinsurance. A new Law on Insurance, Reinsurance and Insurance Supervision was approved by the Albanian parliament in September 2004, and subsequently amended to ensure compliance with minimum international standards. To remedy poor compliance with regulations and further strengthen supervision, the Minister of Finance issued by-laws to enforce prudent reinsurance practices - especially in the areas of compulsory Third Party Liability Insurance (TPL) car insurance and border green cards. These insurances still represent over 2/3 of the total Albanian insurance market. The purpose of these by-laws was to ensure sound and prudent financial management of the provision according to which 10 percent of insurance premiums should be reinsured. In 2006, the World Bank assessed progress achieved in insurance regulation as marginally satisfactory. This assessment depended on the reinsurance regulations that had been used as a substitute for an effective regulatory agency in stabilising the system. If this regulation had not been there, the assessment would have probably been more negative.

Later in 2006, the insurance supervision system was completely restructured. The Albanian Financial Supervision Authority (AFSA) was created, an authority responsible for supervising the entire non-banking system. One of its first activities was to issue new guidelines on reinsurance, on order to remedy some perceived weaknesses and lack of clarity of the previous regulation. With World Bank assistance, AFSA is considering a thorough reform of the reinsurance market through the establishment of a domestic reinsurance pool mechanism broadly inspired by the Turkish model; or considering sponsoring a sufficiently capitalised domestic leading reinsurance company. At the moment, there are no real domestic reinsurance companies active in Albania, and the market is fully dependent on external operators (see Section 6.8 below),

Area IV: Business environment

Conditionality 12: Action Plan on administrative barriers. This Action Plan was adopted by the Council of Ministers in August 2003 The Action Plan was amended in February 2004 and continuously implemented[23] in the period 2004-2005. From October 2005, implementation of this Action Plan was managed through an inter-ministerial task force attached to the Prime Minister's office. Although a new Action Plan was not formally approved at the beginning of 2005, the IMF deemed the parallel PRGF structural benchmark to have met due to the progress reached with the 2004 self-assessment, which also included recommendations for action.

Since the appointment of the new government (September 2005), the concept of administrative barriers has been replaced by a more encompassing overall regulatory reform concept in line with OECD regulatory best practice. In 2006, 24 unnecessary licences and regulations were cut from a total of 135 by-laws; and administrative requirements were reduced by between 30 and 40 percent. For the time being, there is little information available on concrete results achieved in the overall period. However, most interviewees assessed progress in the business environment reform area positively (see also Appendix VI).

Conditionality 13: New Law on Commercial Registration. In mid-February 2006, the Government approved a law reducing the maximum time required to register a business in Court to 8 days, and this law was ratified by Parliament in May 2006[24]. The Court registration, however, was just one of the various steps required for starting up a business.

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23 At the end of 2004, of the 99 measures envisaged; 52 had already been implemented; 37 were being implemented; 8 were postponed until 2005, and only 2 had been cancelled.

24 This was not the simplified registration procedure for the small business tax that was agreed with IMF as part of the 2004 fiscal package and then postponed to early 2005; rather it was the original content of the conditionality. The measure was intended to have an updated registry of small businesses at the time when social contribution collections from small businesses are transferred to the GDT; and therefore also had fiscal implications that the 2006 regulation did not have.

Table 6.4 below shows that according to World Bank Doing Business statistics[25] the difficulties related to starting a business have actually been decreasing over the period, both in terms of time required (-10 percent) and total related costs.

Table 6.4 Main indicators for starting a business in Albania

Year	Starting a business				
	Rank	Procedures (number)	Time (days)	Cost (% of GNI per capita)	Min. capital (% of GNI per capita)
2005	..	11	41	31.1	39.9
2006	124	11	39	22.4	36.7
2007	123	10	36	20.9	34.4

Source: World Bank Doing Business database

This 2006 reform has been superseded by a new law on Commercial Registration that was finally approved in May 2007 and had become operational in September 2007. The Law represents a joint and simultaneous registration process covering both judicial and administrative aspects. The approach is to have a one-stop shop facility registering a business within 24 hours. It is too early to assess impact of this ambitious new reform, as some operational difficulties still have to be overcome[26].

Conditionality 14: Albtelekom and ARMO privatisation. Albtelekom is the only fixed-line telephone company in Albania. This company holds the third licence to exploit a mobile network (after Vodafone and AMC). In 2001, the Albanian authorities made their first attempt to privatise Albtelekom (selling 76 percent of the shares).The attempt was unsuccessful due to the weak global market after 9/11. The authorities made a second attempt in November 2004. Eleven companies expressed interest, and four of them were shortlisted. Following the process of due diligence, three companies informed the Albanian government that they no longer intended to make an offer. The only bidder appeared to be the Turkish consortium of Calik Enerji and Turk Telekom. In June 2005, the Council of Ministers signed the contract with the Turkish consortium for EUR 120 million. However, in October 2005, the new Parliament, installed in September 2005, rejected the draft law on ratification of the contract. Issues of contention were the status of Turk Telekom in the consortium, the inclusion of the GSM licence in the contract, and the inclusion of roaming rights in the agreement. A committee, installed by the Council of Ministers, hired an independent consultant (April 2006) and reviewed the entire tender procedure. This led to renegotiations with the Turkish consortium in November 2006. On 20 June 2007, the Government sold 76 percent of the shares (EUR 120 million). Pursuant to the agreement with the IMF, 50 percent of the proceeds are used for debt reduction; and the other 50 percent for priority investments. The sale has significantly increased the

25 Some Albanian authorities have reservations about the accuracy of the underlying methodology and its ability to adequately reflect real-life conditions in Albania.

26 For instance, the new registration system was conceived to have 29 branches in all the municipalities. However, not all branches have been established, there is a lack of trained staff. Resources have to be found, IT has to be in place and electricity has to be working, etc. The old system based on local courts was abolished, so now all Albanians have to travel to Tirana for their applications.

flow of FDI in 2007, and had therefore a positive one-off effect on the BoP. In the coming years, additional investments of the Turkish owners totalling around EUR 30 million are expected.

ARMO (Albanian Refining and Marketing Oil), one of Albania's major industrial companies, refines crude oil and gas and conducts the wholesale trade of fuel, gas and their products. The framework law on the privatisation of ARMO (sale of 76 percent of the shares) dates from July 2003. In the autumn of 2004, Albania called for expressions of interest. Initially nine companies showed an interest, but only one offer was submitted. This offer was not in compliance with tender requirements. The privatisation process began again in 2007, both for the retail and refinement activities of ARMO.

Since 2002, the IMF has referred to the privatisation of Albtelekom and ARMO in its PRGF programmes. The World Bank supported the privatisation process in Albania with technical assistance financed through a Structural Adjustment Credit (USD 45 million) granted in 1999, followed by a Poverty Reduction Support Credit granted in 2004. Besides the MFA, the EC also referred to privatisation in general, and Albtelekom and ARMO in particular in the European Partnership Agreements of 2004 and 2005.

This conditionality is one of the case studies in this evaluation. For further analyses, see Appendix II.

6.4.1 Conclusions

The degree of fulfilment[27] of the conditionalities and the short-term and medium-term progress in various areas are summarised in the Table 6.5 below. All conditionalities were formally fulfilled. The law on judicial delays (Conditionality 8) was considered fulfilled, since the conditionality was replaced by a set of other measures. In the majority of reform areas for which conditionalities were formulated, real structural reform progress has been made; while in other cases it is simply too early to make a final judgement.

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[27] A distinction has been made between conditionalities fully fulfilled, and conditionalities fulfilled. Conditionalities fulfilled are defined as those with a different timing than that which was envisaged, or with slightly different terms than those originally anticipated. Short-term impact is defined as the immediate positive effect of actual fulfilment of the conditionality; whereas medium-term impact is defined as the broader contribution to progress in the related reform area.

Table 6.5 Actual reform progress in the areas of MFA-conditionalities

Conditionality	Degree of fulfilment	Short–term	Medium-term
Public finance reform			
1. Segregation of duty	Formally fulfilled	Better formalisation of a practice already largely in place	-
2. Double signature	Formally fulfilled	Reportedly a formal aspect with no real operational consequences	-
3. Internal audit reports	Fully fulfilled	Substantial	Very likely, but to be confirmed in a new legal framework
4. Policy paper on Public Finance control	Fully fulfilled	Substantial. Related Action Plan mostly implemented and progress achieved	An updated policy paper is in process of being prepared, so as to reflect changes in the broader legal framework
5. IT automation of Treasury operations	Fulfilled	Very limited. No real improvement as far as debt and liquidity management is concerned	Unclear because the system is not yet in operation
Fight against corruption and public administration reform			
6. Public wages through banks	Fully fulfilled	Substantial. Measure implemented well beyond what was originally expected	Spill-over effects extended to the private sector that is now increasingly required to channel their transactions with the State through banks.
7. Legislation on conflict of interest	Fully fulfilled	Substantial. Legal framework is in place and independent authority is in charge of implementation	Still requires substantial training to be fully understood in Government day-to-day practice. Number of cases still limited
8. Delays in judicial processes	Replaced by alternative implementation modalities	Some progress achieved through computerisation of case management. But overall picture is mixed.	Unclear, as it depends on a number of factors.
Financial sector reform			
9. New Banking Law	Fully fulfilled	Good. Banking Law brought more into line with European harmonisation requirements.	Good. Reform appears sustainable and capable of steering the banking development process for a long time to come.
10. IT system and supervision	Fulfilled, although original meaning unclear	Substantial progress achieved in the computerisation of the clearing system.	Very good. The information structure of Central Bank operations maintains a high momentum and is strongly embedded in management culture
11. Reinsurance by-laws	Fully fulfilled	Good. Important stabilisation role played in an underdeveloped market.	Will have to be superseded by a deeper reform fully restructuring the sector

Conditionality	Degree of fulfilment	Short–term	Medium-term
Business environment			
12. Removal of administrative barriers	Fulfilled	Substantial. Consensus on some improvement of business environment climate.	Reform maintains momentum and remains a Government priority
13. New Law on Commercial Registration	Fulfilled	Some limited progress achieved in the time required to register a business.	New much more ambitious reform recently put in place. Too early to assess its final impact.
14. Privatisation of Albtelekom and ARMO	Fulfilled	Limited Privatisation brought onto the Government agenda but then stopped by Parliament. Privatisation of ARMO has yet to fully materialise.	Mixed: Privatisation receipts of Albtelekom entered the budget in 2007 and sector was liberalised. The privatisation of ARMO is still at its initial stage.

6.5 Impact of complementarity with other EU instruments

4. To what extent have structural effects been enhanced, if at all, by complementarities between the MFA and other EU instruments?

The start of MFA broadly coincided with the Thessaloniki agenda of June 2003, and could therefore benefit from resulting policy developments of the European Partnership process. Moreover, Albania, in particular, responded to the European Partnership document by producing a national Action Plan with a timetable and implementation details about how it intended to address European Partnership's priorities (NPAL-SAA). This NPAL-SAA was extensively used for MFA preparation. Table 6.6 presents an overview of how MFA is linked to the NPAL-SAA.

Table 6.6 MFA conditionalities included in the September 2004 Action Plan for Partnership Implementation and related synergies

Conditionality	Included	Institution responsible	Deadline envisaged	Donor partner originally envisaged
Public finance reform				
1 and 2. Segregation of duty and double signature	No			
3. Internal audit reports	Yes	Ministry of Finance	October 2004	None
Comment	*CARDS twinning in place provided assistance*			
4. Policy paper on Internal control	Yes	Ministry of Finance	Sept – Dec. 2005	SIGMA (financed through CARDS)
Comment	*SIGMA was hired expressly for the purpose but co-operated with CARDS twinning*			
5. IT automation of Treasury operations	No			
Fight against corruption and public administration reform				
6. Public wages through banks	No			
7. Legislation on conflict of interests	Yes	Council of Ministers HIDCA	March 2005	
Comment	*Substantial assistance from USAID, WB and Council of Europe*			
8. Delays in the judicial process	Yes	Ministry of Justice + High Court	September 2005	
Comment	*Government-proposed alternative measures partly supported by EU-Euralius project*			
Financial Sector Reform				
9. New Banking Law	Yes	Bank of Albania	December 2004	IMF, WB
Comment	*IMF provided TA*			
10. IT system for supervision	Yes	Bank of Albania	December 2005	WB
	Process entirely followed and supervised by WB. USAID also provided assistance			
11. Reinsurance by-laws	No			
Comment	*TA provided by WB that still follows the process*			
Business Environment				
12. Removal of administrative barriers	Yes	Various ministries	First quarter 2005	
Comment	*FIAS involvement*			
New Law on Commercial Registration	Yes	Various ministries	Second quarter 2005	
14. Privatisation of Albtelekom and ARMO	Yes	Ministry of Economy and Telecommunications	First and second quarter 2005	
Comment	*World Bank*			

CARDS

Until 2007, CARDS was the main EC assistance instrument for Albania (see also Table 3.3 in Section 3.4). CARDS support priorities focused on the judicial system and police ("The fight against corruption and administration reform"), but also in the areas of "Public finance reform" and "Business sector reform". In general, in three out of four reform areas for which MFA formulated conditionalities, CARDS was extremely active; and this is understandable also in the light of the common European Partnership priorities. However, the longer preparation period required for CARDS programming contrasted with the shorter implementation period anticipated for the MFA. Therefore, support through CARDS to complement specific MFA conditionalities proved virtually impossible, with the exception of one case.

The EU supported the reform of Public Internal financial control and internal audit through CARDS. Under this programme, the Ministry of Finance's General Directorate for Internal Audit has been renovated and refurbished. The EU has also provided IT and office equipment, including audit software for internal audit units across all line ministries. These components were complementary to an EU Twinning project on Public Internal Financial Control (PIFC) implemented by the UK's National Audit Office, as well as the Dutch Ministry of Finance that happened to be there during the period of conditionality fulfilment; and were therefore able to provide some assistance.

However, in the original government programme, it was envisaged that the EU would support conditionality fulfilment mainly through technical expertise provided by the joint CARDS-funded OECD SIGMA Programme that was invoked for the drafting and finalisation of a policy paper and action plan on public internal financial control.

Unintended synergies were achieved when a EURALIUS mission became involved in the issue of judicial delays; and subsequently when CARDS supported the sustainability of judicial computerisation.

European Partnership

In late 2005, after the Albanian elections, a second European Partnership with Albania was approved. The Table 6.7 below summarises the main MFA-relevant provisions included in the two texts, and highlights the main differences. In both documents, a distinction was made between short-term priorities - which are expected to be accomplished in one to two years - and medium-term priorities - which are expected to be achieved within three to four years. It is worth noting that there are few instances of discrepancies in the prioritisation of actions between MFA and the Partnership Agreements. In particular, the 2004 document classifies the fight against corruption as a medium-term priority and, as such, deals also with the privatisation of Albtelekom and ARMO. Moreover, only the second Partnership Agreement includes some generic provisions on financial sector monitoring and supervision.

Table 6.7 MFA-relevant provisions included in the first and second Partnership Agreements with Albania

First Partnership Agreement (2004)	Second Partnership Agreement (2006/54/EC)
Public finance reform	
Maintain a stable macroeconomic framework in the context of the IMF programme and demonstrate compliance with IFIs recommendations. *short term*	Maintain macroeconomic stability by accelerating fiscal reforms, in particular regarding the budget process, expenditure management and public sector pay reform *short term*
Enforce the law on internal audit *short term*.	Further strengthen external audit, financial control management and internal audit *medium term*
Develop a comprehensive public internal financial control strategy paper, taking into account EU requirements *short term*	Establish procedures to detect irregularities affecting national and international funds *medium term*
The fight against corruption and public administration reform	
Achieve significant results in the fight against corruption, and implement GRECO recommendations *medium tem*	Implement and update the 2004 and 2005 anti-corruption Action Plan also in the light of Council of Europe evaluation reports (GRECO) *short term*
Achieve a continuous increase in the execution rate of court sentences *short term*	Achieve a continuous increase in the rate of execution of court rulings *short term*
Substantially reduce the current backlog, and ensure the timely execution of sentences *medium term*	Take further measures to reduce the use of cash in the economy *short term*
Financial sector reform	
	Improve the prudent monitoring of the financial sector *short term*
Business environment	
Improve the business environment *short term*	
Implement the Action Plan for the removal of administrative barriers to investment, and the removal of administrative procedures *short term*	
Complete the privatisation process by privatising Albtelecom and ARMO *medium term*	

From 2004 onwards, the support provided through CARDS focused mainly on the European Partnership priorities through four main areas of support, namely: 1) democratic stabilisation; 2) good governance and institutional building; 3) economic and social development, and 4) the launch of community programmes.

6.6 Unexpected impact on structural reforms

5. Has the assistance given rise to any unexpected short and medium-term structural effects? What were these and how did they occur?

The major unexpected structural effect of MFA is related to the measure on public wages channelled through the banking system. The MFA considered it an indirect anti-corruption measure, and part of the broad public administration reform; while the IMF dealt with its parallel conditionality as a macroeconomic performance indicator. There is broad consensus among interviewees that one of the most notable consequences of this measure was the strengthening of the banking system and its credit basis.

The conditionality on reinsurance regulation has had unintended negative side effects on the balance of payments. Because of the stringently prudent requirements enforced through that regulation and subsequent amendments, Albanian insurance companies have to seek reinsurance agreements with major foreign reinsurance companies. Due to the fragmented nature of the Albanian market[28] and the growing rates charged in the reinsurance market, these agreements can easily come at a cost exceeding 20 percent to 25 percent of the related premium basis[29]. The share of the latter is conservatively estimated at around EUR 4 million. Notwithstanding the importance of reforms for the stabilisation of the insurance sector, and thus the decreasing the risk of financial instability; the total negative contribution of reinsurance regulation to the balance of payments can be roughly estimated at roughly EUR 1 million annually and keeps growing year on year together with the overall growth of the underlying domestic insurance market (valued at present a total of EUR 40 million).

28 There are 10 insurance companies presently active in Albania and none of them is fully foreign-owned. IFC and EBRD invested in Insig, the former state-owned company IFC and EBRD, but has not been privatised yet. The American-Albanian Fund invested in Sigal, a domestic venture.Some of these domestic companies are reportedly building a wider regional dimension through subsidiaries in Kosovo, FYROM, and Montenegro.

29 In fact, the regulation is a major factor in shaping the market. For instance, in 2006, a company's licence to operate in the TPL and green card markets was withdrawn because of its failure to comply with reinsurance provisions.

7 Net impact of MFA

7.1 Introduction

This chapter provides the assessment of the net impact of the MFA operation, both on macroeconomic stabilisation, structural reforms and external sustainability. Table 7.1 presents the evaluation questions for this net impact analysis.

Table 7.1 Evaluation questions for the counterfactual and net impact of the MFA operation

	Net impact of MFA
	Counterfactual
1	What arrangements would have been implemented if the MFA had not been granted? (Q0.1)
	Effects counterfactual
2	What are the structural and macroeconomic effects of the most likely implementation scenario(s)? (Q0.2)
	Net impact
3	What has been the contribution of actions resulting from the respect of structural conditionality criteria to the occurrence of expected structural effects? (Q.2.5)
4	What has been the contribution of the grants and/or loans provided by the MFA operation to the achievement of MFA objectives? (Q1.3)
5	What, if any, has been the contribution of actions arising as a result of the structural conditionality criteria to the achievement of the short and medium-term macroeconomic objectives of the assistance (i.e. the indirect effects of structural conditionality criteria)? (Q3.1)
6	What is the MFA contribution to medium and long-term external sustainability prospects? (Q.4.4)

7.2 Counterfactual

1. What arrangements would have been implemented if the MFA had not been granted?

This section presents the counterfactual for the impact analysis. In order to provide a complete assessment of the net impact of the MFA, this section also constructs counterfactuals for macroeconomic support and the structural conditionalities.

7.2.1 Counterfactual macroeconomic support

Focus on the fiscal domain

Evidence from the interviews (also supported by the results from the Delphi questionnaire, see Appendix VI) indicates that the MFA has been used to support the budget. The MFA has directly been channelled via the BoA into the budget. The interviewees also agreed that, notwithstanding the identification of a residual financing gap by the IMF; Albania faced no urgent balance of payments pressures, and the Bank of Albania had a favourable reserve position (in excess of the ceiling set by the IMF programme). In light of these findings, the counterfactual scenario concentrates on the fiscal domain.

Alternative arrangements

Based on our analysis, the most likely alternative arrangement is based on the following findings:

- in the absence of the MFA neither the IMF officials nor the Albanian authorities consider an alteration to the IMF programme as a likely scenario. The sound macroeconomic performance of Albania in the period 2004-2007 supported this view;
- consensus is also evident regarding the improbability of a larger allocation of CARDS assistance from the EU. Interviewees noted that the multi-annual CARDS programme has been fixed for the period 2004-2006, and that alterations could not have been expected;
- no increase in World Bank activities could have been expected. This finding is in line with the observation that WB programmes are fixed over a longer period. In addition, the WB pursues a strategy of gradually reducing its activities in Albania;
- all interviewees agreed that a higher budget deficit would not have been likely since the IMF deficit ceilings were reached in both 2005 and 2006. Furthermore, there appears to be broad consensus that the fiscal gap in the absence of the MFA would not have been covered by the increase of tax revenues. Instead, budget cuts were considered to be (very) likely.

In response to these findings, the consequences of a cut in the available budgetary resources by EUR 3 million in 2005 and EUR 22 million in 2006 have been explored further. Most interviewees stated that a cut in the infrastructure investments would have been the most likely scenario. Although the infrastructure was labelled as a priority sector together with the sectors health and education; a certain reduction or delay of expenditures in these categories is not unlikely. Infrastructure expenditure has been the fastest-growing expenditure category, and not all funds could be spent on designated projects. In this context, the Albanian government, in concurrence with the IMF, has allocated part of unspent budget in 2006 into a fund designated to finance land expropriation procedures (expropriation fund) in case of future infrastructural projects. This transfer of budgetary sources to the fund amounted to 2.8 billion Lek (0.3 percent of GDP) which equates to around EUR 23 million.[30] At the end of 2007[31], this money was still in the fund and had yet to be used.[32]

The budgetary sources transferred to the designated fund roughly coincided with the disbursed MFA in 2006. Government officials, as well as officials from IFIs deemed highly plausible that without MFA, the transfer of resources from the budget 2006 to the designated expropriation fund would not have taken place. Although the means in the

[30] IMF (2007), Country Report 07/75
[31] Dated 7 December 2007
[32] The IMF denied approval to the Albanian authorities upon their request for a similar transfer to the fund in 2007.

expropriation fund have not been used yet in the fiscal year 2007, it is expected that the funds will be released in 2008 on the basis of the Government's ambitious investment plans for road infrastructure in that year.

In order to quantify the effect of MFA, we have assumed that the counterfactual public investments would have been EUR 3 million lower in 2005 and in 2006. These assumptions for 2005 and 2006 reflect slightly lower realised levels as a result of lower levels of planned investments in the absence of MFA. For 2007 and 2008, investments would have been EUR 9.5 million lower annually, reflecting the postponement effect of investment due to the current nature of the expropriation fund.[33]

7.2.2 Counterfactual structural reforms

As far as structural effects are concerned, the counterfactual hypothesis is not always supported by clear evidence. Table 7.2 below reports the conclusions on counterfactuals per conditionality.

Most interviewees agreed that without MFA most reforms related to the MFA conditionalities would have been implemented, at any rate. MFA applied cross-conditionality (in most cases with the NPAL-SAA) and the Government had strong ownership of the reforms. MFA was hardly considered the driving force of reforms.

Regarding the situation without MFA, most interviewees stated that for most reforms, the Albanian government was assigned a driving role, with the exception of enhancement of IT Treasury operations and pruden rules on reinsurance - which were WB driven.

Therefore, we assume that without MFA (counterfactual) most reforms would have been implemented. However, the prior actions (Conditionalities 1 and 2) would probably not have been implemented, unless the issue had been raised by other donors, or by the Commission itself under another programme. The Albanian government did not see this as top priority, because the *de facto* segregation of duty and double signature existed. Channelling all public wages through the banking sector (Conditionality 6) would probably have been more difficult to achieve, politically; and would have taken more time. The conditionality "Channelling public sector wages through banks" seemed to have broadened the capital base of the private banks. In the counterfactual, the opportunities of banks to expand credit facilities would have been slower to materialise.

[33] The assumptions made do not affect the calculations of the overall net impact of MFA. They merely influence the distribution of the impact over time.

Table 7.2 Counterfactual assumptions per conditionality

Conditionality	Counterfactual
Public finance reform	
1. Segregation of duty **2. Double signature**	The formal issue could have been raised one day by another organisation, or by the Commission itself.
Formalisation can be entirely attributed to the MFA conditionality. The item was not perceived by Albanian counterparts as a priority, due to the fact that it was existing practice.	
3. Internal audit reports	Would have been implemented. Maybe a little bit slower and with more emphasis on Partnership Agreement.
Government already persuaded to take action. MFA reinforced the results of a parallel EU project. The item was already on the Government agenda and was just generically reinforced by a parallel WB conditionality. MFA conditionality was more specific.	
4. Policy paper on Public Finance Control	Would have been implemented a little slower + more EP emphasis.
MFA reinforced the results of a parallel EU project on an item that had been included on the Government agenda. WB parallel conditionality was much more generic.	
5. IT automation of the Treasury	Would have been implemented at any rate under WB lead.
MFA reinforced an existing WB conditionality. Operational problems were related to contractual disagreements between the Albanian government and the WB contractor.	
The fight against corruption and public administration reform	
6. Public wages through banks	Would have taken longer to implement, and with stronger political resistance.
Government used MFA leverage to go beyond the targets already agreed with IMF.	
7. Legislation on conflict of interest	Would have been implemented by Government at any rate, possibly with stronger WB role.
Conditionality already included on the Government agenda. Parallel WB conditionality much more generic, but hardly detectable MFA-related influence.	
8. Delays in judicial processes	-
MFA original conditionality was de facto replaced by an already fulfilled WB conditionality and a set of different measures autonomously conceived by Government.	
Financial sector reform	
9. New banking law	Would have taken longer to implement.
Debate on the law would have continued for a longer period.	
10. IT system and supervision	Would have been implemented by Central Bank, at any rate.
Little awareness of MFA conditionality and its real meaning within the BoA. Substantial progress achieved by internal means.	
11. Reinsurance by-laws	Would have been implemented by Government, at any rate under stronger WB conditionality.
Specific MFA conditionality helped compliance with generic WB conditionality. The World Bank would have formalised more pressure and taken over conditionality. MFA mainly had a political signalling effect. Little awareness of MFA within operational department in charge of reform implementation.	
Business environment	
12. Removal of administrative barriers	Would have been implemented by Government, at any rate and would have remained the focus of possible WB conditionalities.
MFA merely further reinforced the issue on the 2004 Government agenda. No real alternative scenario.	
13. New Law on Commercial Registration	Would have been implemented by Government, at any rate.
Little awareness of MFA conditionality reported by the department in charge. A priority on the new Government agenda	
14. Privatisation of Albtelekom/ARMO	Would have been implemented, at any rate.
Difficulties have stemmed from Parliament procedures, and proved resilient to any conditionality from no matter which source.	

7.2.3 Conclusion: most likely counterfactual scenario

The above findings conclude that the most likely counterfactual implementation scenario appears to be the following:

- no changes in the IMF macroeconomic programme;
- no increase in the World Bank structural lending;
- no shift in EU funding;
- no increase of the Albanian fiscal deficit;
- no transfer of EUR 23 million from 2006 to a designated 'expropriation' fund;
- lower public investment expenditures of EUR 3 million in 2005 and 2006, EUR 9.5 million in both 2007 and 2008;
- channelling of all public wages through the banking sector would have taken longer. The opportunities of banks to expand credit facilities would have been slower to materialise.

In short, we are of the opinion that in the counterfactual (without the MFA), there would have been no transfer of budgetary sources in 2006 to the appropriation fund. Consequently, road infrastructure investment would have been smaller in the period 2006-2008. Furthermore, credit to the private sector would have been temporarily smaller during 2005-2006.

7.3 Effects of the counterfactual scenario

2. What are the structural and macroeconomic effects of the most likely implementation scenario(s)?

Structural effects

In the counterfactual, all reforms would have been implemented except for the prior actions (Conditionalities 1 and 2). This would not affect the counterfactual, since the prior actions referred to formalising existing practice, and therefore had no real impact on segregation of duty and double signature processes.

The channelling of public wages through the banking sector would have taken comparatively longer in the counterfactual; leading to a temporarily lower level of private sector credit. For quantifying the effects we assume that in the counterfactual, in 2005 5,000-15,000 less public sector employees received their wages through the banking system; in 2006 the difference is in the range 5,000-10,000; while by 2007 the scenarios (actual and counterfactual) converge[34]. These effects are included in our estimations of the macroeconomic effects of the counterfactual in the following section.

[34] The issue of transferring wages through the banking sector was part of a dialogue with the IMF. Specifically, in the Letter of Intent, Supplementary Memorandum on Economic and Financial Policies, and Technical Memorandum of Understanding dated February 3, 2005, Albania pledged to "increase the total number of public employees paid in this manner to 25,000 by the end of March 2005 (PC); and to 50,000 by the end of June 2005". These targets were met and exceeded; and by September 2005, around 70,000 public sector employees (and over 75,000 at the turn of 2005/2006) were paid through banks. Thus, the 10,000 figure for 2005 on average lies somewhat below half of the "overshooting" of targets agreed with the IMF (70,000 – 50,000 = 20,000) to the MFA operation. This may be justified by the fact that the MFA conditionalities on this issue were agreed earlier (in the October 2004 MoU); and also that the original IMF conditions were only targeting the channelling through the banking sector of the wages of a much smaller group of public sector employees.

Macroeconomic effects

A quantitative modelling approach has been used to estimate the macroeconomic effects of the MFA operation. The counterfactual scenario was explicitly modelled, and its results are compared with the actual data. The applied macroeconomic model is broadly similar to the model employed in previous evaluations (evaluation of MFA in the Former Yugoslav Republic of Macedonia, Romania, and Tajikistan). However, several improvements and refinements have been introduced to the modelling framework to allow a more nuanced analysis of the effects of the MFA operation. The guiding principles of the model improvements were allowing the widening of the sensitivity analysis and incorporating more country-specific features that may subsequently become important in analysing the MFA operation in Albania.

The model recognises links between, and ensures consistency among four basic economic sectors: real, external, government and banking. The model has been calibrated using IMF Country Reports, IMF International Finance Statistics (IFS) and data from the Bank of Albania. More detailed information on the model and recent improvements is included in Appendix IV.

One important feature that distinguishes the modelling exercise in the case of Albania from previous evaluations of MFA operations in other countries is that disbursements took place in 2005-2006. Consequently, at the time of writing this report (2007), no data is available on the developments of macroeconomic indicators after the completion of the MFA. In going beyond the 2005-2006 perspective, it forces us to compare the forecasts made on the assumption that MFA has taken place with another set of forecasts made on the assumptions that a counterfactual scenario was realised up until 2006. Luckily, sufficiently detailed forecasts are available from the IMF (*Albania Country Report* no. 244/07) to form a basis for the actual (forecast) scenario. Still, it should be noted that the degree of uncertainty that is necessarily related to any counterfactual simulation may be higher in the case of Albania. This is due to the uncertainty surrounding macroeconomic forecasts constructed by the IMF in mid-2007 that forms the reference point for our counterfactual simulation.

The counterfactual scenario implies a tighter budget position, changes of selected balance of payments positions and – most importantly from the perspective of macroeconomic consequences – smaller streams of money flowing through the banking sector.

On the fiscal front, the absence of budget support provided by the MFA implies lower general government revenues, and – due to lack of room for manoeuvre in the widening of the deficit (see the discussion above) – adjustment of general government spending. As explained above, we ascribe the whole adjustment to the investment expenditure of the government - which is cut to keep the nominal value of the overall fiscal deficit unchanged.

In the monetary survey, an important change arises due to the lower share of the public sector wage bill going through the banking sector in the counterfactual scenario (see also Appendix V). This implies lower deposits – both saving and demand deposits. This in turn has an effect on the credit activities of banks; resulting in lower credit extended to the private sector. Ensuing lower domestic consumption and investment activities is recorded in national accounts.

Lower domestic demand also implies lower demand for imports; adding another element to the balance of payments adjustment that is also necessitated by the direct effect of lower MFA transfers. Overall, there is a visible reduction of imports that is facilitated by an exchange rate adjustment (a minor appreciation of the Lek).

The price dynamics are determined by developments in domestic demand, broad monetary aggregates and the exchange rate.

Overall, cumulative real GDP growth between 2004 and 2009 is estimated to be 0.1 – 0.6 percent lower in the counterfactual scenario.

7.4 Net impact on structural reforms

3. What has been the contribution of actions resulting from the respect of structural conditionality criteria to the occurrence of expected structural effects?

Table 7.3 summarises conclusions on the net effect of MFA. The net effect distinguishes between:

a) *political reinforcing effect*: defined as all relevant actors familiar with the MFA conditions and perceiving them as an incentive to overcome political resistance (an overall increase in the chances of them happening);
b) *operational reinforcing effect*: the reinforcing effect led to a verifiable speeding up of reform implementation (the lack of pre-emptive effects of other instruments).

We have identified clear operational reinforcing effects in five cases (Conditionalities 1-2, 3, 4, 6 and 9 – see Table 7.3, below). Political reinforcing effects are less clear-cut and can be reasonably argued in another four cases; while two additional cases remain dubious and without conclusive evidence. In a couple of cases, any MFA net impact can be ruled out based on available evidence about the factors that are really driving the implementation of reforms.

Table 7.3 MFA net impact and the most likely alternative scenario

Conditionality	Political reinforcing effect	Operational reinforcing effect	Rationale behind assessment
Public finance reform			
1. Segregation of duty **2. Double signature**	++	++	Item formally raised by MFA OA. Not on agenda. Although effect on formalisation, no real effect.
3. Internal audit reports	++	++	MFA contributed to give high profile to reform.
4. Policy paper on Public Finance control	+	+	Synergic effects with a parallel TA project
5. IT automation of Treasury operations	No	No	Events were mainly driven by relations with a WB contractor.
Fight against corruption and public administration reform			
6. Public wages through banks	++	++	MFA weakened political resistances to expand scope of measure
7. Legislation on conflict of interest	(+)	No	Law was actually approved before the MoU was signed. Government signalled its commitment to reform.
8. Delays in judicial processes	No	No	Conditionality was *de facto* waived. No MFA impact
Financial Sector Reform			
9. New banking law	++	++	MFA forced the process to be concluded in 2006, and reinforced the harmonisation message.
10. IT system and supervision	?	No	Unclear whether any political signalling effect was ever made, due to unclear formulation of conditionality, but no detectable operational consequences.
11. Reinsurance by-laws	(+)	No	Process largely driven by the World Bank. Little awareness of MFA at the operational level.
Business environment			
12. Removal of administrative barriers	(+)	No	Political signalling reinforcement effect of importance of item in 2004, but little operational effect.
13. New Law on Commercial Registration	?	No	Government speeded up the approval process in 2005, but apparently mainly for internal reasons.[35]
14. Privatisation of Albtelekom and ARMO	(+)	No	MFA played a very limited reinforcing role in putting privatisations on the Government agenda

++ :verifiable and substantial effect
+ :verifiable but small effect
(+) :not verifiable but possibly a small effect
? :no verifiable effect
No :no effect

[35] This issue had reportedly been included in the New Government 100 days Programme, and was considered as a high priority for domestic political purposes. However, this government pressure to speed up the process came to coincide with the DG ECFIN mission findings reporting a lack of progress in the area. No conclusive evidence was found on whether the main source of influence was internal or external.

General reinforcing effect on reforms

The analysis above shows the political reinforcing effect of the MFA conditions per reform area. The interviewees and the participants of the stakeholders' workshop in Tirana expressed the perception of a more general reinforcing effect of MFA at instrument level. Firstly, the IMF stated that they perceived cross-conditionality as a general additional political pressure and leverage for their conditions. Secondly, key officials in the country did not perceive MFA as a separate EC instrument, but experienced the different EC instruments and programmes (SAA, Partnership Agreement, CARDS) as one integrated package of EC support.

Some stakeholders strongly believed that this more general reinforcing effect of the MFA instrument should not be underestimated. However, this evaluation could not make this effect explicit.

7.5 Net impact on macroeconomic stabilisation

4. What has been the contribution of the grants and loans provided by the MFA operation to the achievement of MFA objectives?

5. What, if any, has been the contribution of actions resulting from the respect of structural conditionality criteria to the achievement of short and medium-term macroeconomic objectives of the assistance (i.e. the indirect effects of structural conditionality criteria)?

In this section we quantify the contribution of the MFA operation to macroeconomic stabilisation in the short and medium term. We distinguish between:

- a direct macro-economic effect of MFA, stemming from the increase of budgetary funds with, respectively, EUR 3 million in 2005, EUR 3 million in 2006, EUR 9.5 million in 2007 and 9.5 million in 2008;
- an indirect macro-economic effect of MFA stemming from the conditionality which required “Processing the payment of at least 50 percent of public sector wages through the banking system”. This seemed to have a direct macroeconomic impact through the broadening of the capital base of the private banks. This increased the opportunities of banks to expand credit facilities, which contributed to private investments.

From a quantitative point of view, the indirect macroeconomic impact of the structural reform conditionality is of similar importance as the direct macroeconomic effect resulting from the increase of budgetary funds. However, the total macroeconomic impact of the MFA is small - especially taking into account the very limited size of the operation itself (e.g. in relation to GDP or foreign trade flows).

The most important effect, that plays a role in the discussion on macroeconomic stabilisation, is the estimated effect on economic growth; such that over the 2004-2008 period, the cumulative effect was between 0.1 and 0.6 percent (see Table 7.4). This was accompanied by slightly higher inflation rate, as well as a marginally weaker Lek exchange rate resulting from the MFA. MFA allowed for higher public expenditures on infrastructure investment projects.

Table 7.4 Net impact of MFA (difference between actual and counterfactual scenarios) – annual developments in a "baseline" scenario

	2005	2006	2007	2008
General government revenues & grants (billion Lek)	0.4	2.7	0	0
General government expenditures (billion Lek)	0.4	0.4	1.2	1.2
Current account (million EUR0)	16	34	1	1
GDP growth rate (percentage per annum)	0.1	0.2	0.1	0.0
Inflation rate (percentage points)	0.1	0.0	-0.1	0.0
Exchange rate (Lek per EUR0)	0.9	1.0	2.0	2.0

Note: Only net effects without actual and counterfactual values are presented because the actual series are only partly forecasted. This does not affect modelling results. The point estimates (specific figures) presented in the table correspond to a specific baseline counterfactual scenario.
Source: Project database (IMF and Bank of Albania data, IMF forecasts) and estimations from the model (see Appendix IV).

7.6 Net impact on long-term external sustainability

6. What is the MFA contribution to medium and long-term external sustainability prospects?

This section provides a qualitative discussion of the key channels of MFA impact on medium to long-term external sustainability. Where possible, a quantitative estimate of the effects is also made.

7.6.1 Qualitative channel approach

This analysis draws on all other sections of the evaluation by selecting and discussing channels through which the MFA could have influenced external sustainability in the medium to long-term perspective. A similar approach was tested in previous evaluations (particularly in the case of Tajikistan).

The MFA could have influenced medium and long-term external sustainability through the following channels:

- direct impact on GDP level, and thus on debt to GDP indicators;
- strengthening the domestic financial sector;
- other structural reforms improving the long-term growth potential;
- other structural reforms improving the export potential of the economy;
- building up foreign exchange reserves;
- effects on the budget and debt management;
- privatisation.

Direct impact on GDP level and thus on debt to GDP indicators

The MFA operation allowed for slightly higher cumulative GDP growth (than would have been the case in the counterfactual scenario), thus marginally improving the future path of debt to GDP ratios. Based on simple calculations, the effect could be up to around 0.1 of a percentage point improvement in the external debt to GDP ratio in the projection period up to 2010. However, these quantitative estimates have significant limitations. Firstly, the applied macroeconomic model only deals with short-term effects of the MFA (of up to two years). It can illustrate the impact on the balance of payments, GDP, price levels, exchange rates, etc. during and shortly after the MFA operation. It does not allow for modelling changes in various macroeconomic indicators (e.g. exports, imports, foreign reserve position, etc.) several years after the MFA is completed. Thus, it cannot make funded estimations for the medium to long-term sustainability of the balance of payments. In addition, the projection horizon at which the external sustainability is assessed implies that the precision of any macroeconomic modelling exercise is subject to very wide margins of error. These margins of error are particularly large in relation to the magnitude of the estimated MFA effects. It should be remembered that "normal" levels of volatility of economic variables, such as exchange rates or interest rates (which can hardly be forecast with any reasonable precision over such horizons) can lead to larger changes in the external sustainability indicators over the projection period.

This similar logic cannot be applied to trade or Current account deficit to GDP ratios; as in the longer term the volumes of imports and exports can be thought to depend on GDP levels (thus, long terms paths of exports and imports cannot be considered constant between the actual and counterfactual scenarios). By the same token, no long-term impact on foreign reserve position can be identified in this manner.

Strengthening the domestic financial sector

The strength and development of the domestic financial sector by its impact on virtually all sectors of the economy can be a potentially important element ensuring long-term external sustainability. The MFA operation included conditionalities related to financial sector development (new Banking Law, IT systems and supervision, re-insurance by-laws, public wages through banks). However, our analysis suggests that the contribution of the MFA to progress in these spheres can be assessed as rather limited – at best, it speeded up some processes. Thus, this channel of MFA impact cannot be considered as having any significant role related to long-term external sustainability.

Other structural reforms improving the long-term growth potential

A stronger long-term economic development potential would be among the key elements for limiting the risk of an unsustainable balance of payments or debt position. However, in the case of Albania we have not identified any meaningful role of the MFA operation affecting the long-term development potential.

Other structural reforms improving the export potential of the economy

The relatively weak export potential of Albania constitutes one of the problems and risk factors for the external sustainability outlook. Broadening the export base and building a stronger position in new markets could thus improve the sustainability outlook for the balance of payments in the long term. However, we have not identified any meaningful role of the MFA operation affecting the long-term export potential.

Building up foreign currency reserves
The strong reserve position (relative to imports, for example) is considered an important cushion against threats to external sustainability. Thus, the building up of reserves could be considered a factor improving the external sustainability outlook. However, we have not identified any significant role of the MFA operation in affecting the foreign reserve position.

Effects on the budget process and debt management
The efficient functioning of institutions dealing with the budget process and debt management can play a positive role mitigating the risk of public debt getting out of control. Our conclusions point out to an operational reinforcing effect for some reforms in the functioning of the public finance institutions. However, these operational reinforcing effects merely refer to the formalisation of existing practice (e.g. the prior actions relating to segregation of duties and the double signature principle). Furthermore, MFA had a modest operational effect on the Policy Paper on Public Finance Control (and thus the resulting activities from this Action Plan). MFA had a limited positive effect on the budget process and debt management, but this effect was too small to argue that MFA had a positive effect on improving long-term external sustainability.

Privatisation
Efficient privatisation may contribute to long-term external sustainability through a combination of mechanisms. Firstly, privatisation proceeds could replace debt issuance needed for financing budget deficits. This has a direct impact on the level of public indebtedness. Secondly, privatised entities can be expected to act more efficiently under private ownership (e.g. increasing competitiveness in the sector, increasing profits and tax revenues, reducing the need for public subsidies, etc.) and therefore further support for long-term external sustainability.

The MFA conditionalities referred to two large privatisations; Albtelekom and Albanian Refining and Marketing Oil (ARMO) (see Chapter 6 and Appendix II for a detailed discussion). However, as explained in Section 7.4, the net effect of these privatisations cannot be attributed to the MFA operation. Thus, we cannot identify any role of MFA on long-term external sustainability working through the privatisation channel.

7.6.2 Conclusion

To sum up, we conclude that the MFA has had a positive but very limited role in affecting the medium and long-term external sustainability prospects. Some positive effects can be ascribed to a small direct impact on economic growth during the period 2004-2008, and consequently affecting the debt to GDP indicators. We did not identify other aspects of external sustainability on which MFA had any meaningful impact.

8 Design and implementation of MFA

8.1 Introduction

This chapter describes the impact of the design and implementation of MFA in Albania. The assessment contains a number of observations that may also be relevant for the design and implementation of other future MFA operations. Table 8.1 below shows the fifth generic evaluation question.

Table 8.1 Evaluation question on the design and implementation effectiveness and efficiency

	How has the way in which the MFA operation was designed and implemented conditioned its effectiveness and efficiency?
1	In what way has the design and implementation of the MFA conditioned the performance of the MFA operation in respect of its cost and its objectives? (Q5.1)

Section 8.2 presents specific findings on the operation's design and implementation that conditioned the performance of MFA in Albania. Section 8.3 sets out conclusions and recommendations. These conclusions and recommendations can be seen as input for a meta-evaluation of several MFA operations, with a view to deriving more strategic lessons about the MFA instrument.

8.2 Findings and conclusions

Objectives and design consequences

The objectives underlying the provision of MFA to Albania are manifold. The Council Decision (2004/580/EC) includes the following objectives:

- To help the country meets its external financing needs;
- To support the sustainability of Albania's external financial position;
- To reinforce the country's reserve position;
- To support its budget;
- To support the policy objectives attached to the authorities' reform efforts.

The primary objective of the MFA instrument is to strengthen the balance of payments position. The objectives mentioned in the Council Decision are in line with this overarching principle. However, we conclude that the multi-faceted formulation of the objectives complicates the assessment of the quality of the MFA design and implementation - especially with regard to the timing, selection and formulation of structural conditionalities and the amount of MFA. For the effective achievement of each objective requires different approach to the design of the operation (reform areas, selection of conditionalities, short-term and/or medium-term reforms, number of tranches, etc).

Amount and tranches
The financial assistance under the MFA operation was limited. From a BoP perspective, EUR 25 million over a two-year period is considered to be of relatively minor importance - even for a small economy such as Albania. We conclude that the relatively low amount of assistance justified the restriction of the operation to two tranches. Had more tranches been used, financial assistance per tranche would probably not have been an incentive for compliance. In addition, we conclude that it proved to be an effective design choice to make the second tranche a 100 percent grant tranche. At the end of the operation, this provided more incentives to fulfil conditionalities compared to a loan tranche.

Mixture of loan and grants
The MFA operation consisted of a loan element of EUR 9 million and a grant element of EUR 16 million. In contrast to WB-IDA loans, the MFA does not have strict rules which can be applied to determine the loan component. Most experts agree that the mix of loan and grants was appropriate for Albania;although the 1/3 loan – 2/3 grant division seemed to be based more on a political rather than an economic rationale, since other countries in the Balkan region received the same mix of grant and loan assistance. The disbursement of the loan encountered some delay because the loan agreement had to be approved by Parliament shortly after the elections. However, there were no specific issues raised during parliamentary discussions. We conclude that the inclusion of a substantial grant element in the MFA operation was a prime incentive for the Albanian government to commit to the operation.

Formulation of conditionality and choice of reform areas
We conclude that the formulation of the conditionalities have been appropriate. The conditionalities have been formulated in alignment with the SMART–criteria (Specific, Measurable, Achievable, Realistic and Timely). Furthermore, with the exception of the reform area ‘the fight against corruption and administrative reform’ the reform areas are in line with the objective of the MFA, such that they are short-term support to the balance of payments.

Reaction to a changing context
At the time the MFA operation was launched, the privatisation of the Savings Bank was expected in the near future, as the privatisation procedure was ongoing. However, it was not foreseen that the deal would fall through a few days after the Council Decision. The identified residual financing gap for 2004 disappeared as a result of the privatisation proceeds. In response, the DG ECFIN postponed the operation. We conclude that the DG ECFIN reacted promptly and adequately in informing the Council that the MFA operation had to be postponed in light of the new financial situation.

The IMF forecast of the residual financing gap did not take account of the potential proceeds of privatisation. The IMF applies strict, prudent rules for calculating the financing gap - which does not allow for the inclusion of anticipated privatisation proceeds prior to the finalisation of the privatisation. During our interviews it became clear that some EC officials were aware of these prudent rules.

Residual financing gap

A residual financing gap is an essential precondition for MFA balance of payments support. In 2003, the IMF identified a financing gap for 2004. This was an immediate cause to prepare a fourth MFA operation. However, this gap was completely filled by the proceeds of the privatisation of the Savings Bank. For 2005, a financing gap was identified once again. However, a stronger than expected growth of remittances prevented problems with the balance of payments. Also for 2006, the IMF stated that a financing gap was expected but did not materialise.

Balance of Payments experts at the BoA state that identifying a residual financing gap is virtually impossible in the case of Albania. This point of view is confirmed by World Bank experts and other independent experts. Firstly, there is much uncertainty on the exact flow of remittances. A substantial part of remittances (in EURO) are directly used for the purchase of property, which is largely undetected by the BoA. Secondly, the remittances transfer market is in transition. The growth of the formal remittances market (MTOs and banks) is strong and hard to predict, making estimates based on historic data highly inaccurate. Thirdly, there is a high degree of uncertainty related to FDI. The inflow of FDI is estimated on the basis of surveys; and part of the capital flows are still cash-based. These capital cash flows are not detected by the BoA because no exchange transaction takes place. These three developments largely explain the relatively large number of 'errors and omissions' in the BoP. Therefore, the experts agree that firm statements on residual financing gap are questionable in the case of Albania.

Leaving aside these uncertainties in the measurement of the BoP, nearly all experts we interviewed stated that Albania probably did not encounter BoP challenges in the years 2004 to 2007. EC officials confirmed that the EC lacked the capacity to scrutinise the IMF calculations, or to assess possible implications for the MFA operation at the start of the operation.

Budget support

The Albanian authorities perceived MFA as a budget support instrument and did not attach much importance to its BoP effects. During the interviews, a highly positive appreciation of budgetary support in general was expressed. The interviewees expressed the view that future EC support to Albania should be more in the form of budget support.

Unexpected negative effect on the BoP

The conditionality on reinsurance regulation has had unintended negative side effects on the balance of payments. Because of prudent requirements, Albanian insurance companies have to seek reinsurance agreements with foreign companies - which has led to an estimated increase of service imports of EUR 1 million per year. Notwithstanding the importance of reforms for the stabilisation of the insurance sector, and thus decreasing the risk of financial instability; the condition had a negative effect on the primary objective of the instrument: that of strengthening of the BoP. Related to the Current account deficit of about EUR 426 million, the negative impact is marginal. However, related to the MFA operation itself (EUR 25 million disbursed over two years), the effect is not negligible. We conclude that, with the benefit of hindsight, this conditionality should not have been included in the MFA.

Short and medium-term structural reforms

In 2004, in close cooperation with the Albanian authorities, the EC drafted a European Partnership Agreement in which short-term and medium-term reform objectives were identified. Six of the 14 MFA conditionalities can be directly linked to this agreement. Some of these conditionalities had a medium-term perspective (two to three years). These medium-term conditions were mainly linked to the fight against corruption and reducing the backlog and timeliness of the execution of sentences (judicial sector). We concluded that the DG ECFIN has dealt with these medium-term conditions from the European Partnership Agreement appropriately by formulating the conditionalities with a shorter time horizon.

Defining prior actions and taking conditionalities from the OA

The MFA operation in Albania strengthened the use of the prior action concept. In addition to a satisfactory track record of the macroeconomic programme under the IMF's PRGF, and the signing of the MoU; two additional prior actions were formulated for the disbursement of the first tranche. These prior actions were drawn from the Operational Assessment and were in the area of Public finance reform. Most interviewees were aware of these prior actions, giving these two actions a relatively high exposure. However, taking conditionalities from the OA reports to comply with prudent financial regulation requirements without putting them into a broader political and operational framework can have unintended side-effects which were identified in three cases:

1. The prior actions the Commission focused on less relevant formal aspects;
2. The introduction of an integrated IT system at the BoA (Conditionality 10) caused the original meaning of the conditionality to be apparently lost during the negotiation process, and to become ambiguous.
3. The Treasury IT system (Conditionality 5) unintentionally entered an area where real progress did not depend on local political willingness or operational capacity, but on difficulties experienced with an external contractor.

Formulation of cross-conditionality

When MFA conditionality is phrased slightly differently in comparison with IMF conditions, the fulfilment of the IMF condition does not necessarily translate into the fulfilment of the MFA conditionalities. This can cause misunderstanding among recipients of the aid. This appears to have been the case with the Action Plan on the removal of administrative barriers. The IMF stated that the Government should continue to implement its Action Plan for removing administrative barriers to investment; whereas the MFA referred to the approval of a new action plan. For the Albanian government it was unclear whether the approval of the IMF conditionality also implied the approval of MFA conditionality.

Conditionalities that require the commitment of independent authorities

Most conditionalities require the Albanian government to approve new legislation. The MFA also included new regulation that, in order to be effective, required the involvement and commitment of independent authorities such as the Central Bank and the Judiciary. The Albanian experience showed that inclusion of such conditionalities may jeopardise the aim of the MFA to disburse funds over a relative short period of time. In the case of judicial reform (Conditionality 8), even though the Albanian authorities stated during the MoU negotiations that the condition was achievable; the EC identified this reform area as complex, particularly in its implementation. At the end of the MFA operation, this condition was not met and had to be waived before the disbursement of the second tranche. In the case of the banking law (Conditionality 9), the conditionality was only achieved just before the term of the operation ended.

8.3 Recommendations

The conclusions on the design and implementation of the MFA operation in Albania in the previous section confirmed a number of recommendations drawn from previous evaluations of other MFA operations. For the purposes of an overview, and to maintain consistency, we will not repeat these recommendations, but refer instead to Appendix X where the extent to which the recommendations of previous MFA operations apply to the Albanian experience.

The Albanian case also showed that certain previous recommendations were not applicable because either the Albanian MFA operation was in line with these previous recommendations, or because the recommendations were not appropriate in the Albanian context. None of the previous recommendations has been falsified. However, for one previous recommendation, the Albanian operation highlighted a difference. In previous MFA evaluations it was recommended that the conditionalities should be closely linked to the aim of short-term macroeconomic stabilisation. In Albania, notwithstanding an identified (limited) residual financing gap, the economy was stable in the short term. In this situation, it can be recommended that the conditions for structural reform should focus more on areas improvement of external sustainability (medium to long-term) with a short-term implementation horizon.

In addition to the results of previous MFA evaluation results, we have drawn the following additional conclusions from our analysis and interpretation of the MFA operation in Albania. For each conclusion, we include a recommendation to address any identified weakness and/or to reinforce any strengths identified. These conclusions and recommendations should contribute to a future meta-evaluation of the MFA instrument.

Assess residual financing gap analysis
A residual financing gap is an essential precondition for MFA support to the balance of payments. The IMF is, and will be, the leading international organisation identifying such financing gaps. However, in the case of Albania there was reason to be fully aware of the assumptions the IMF had to make to take into account the specific Albanian circumstances prior to the operation. In particular, the large share of errors and omissions made determining the residual financing gap open to interpretation. EC officials confirmed that they had insufficient capacity available to follow the assessment of the residual financing gap more closely, or to examine possible implications for the MFA operation.

Recommendation I: We suggest that the DG ECFIN develops capacity in order to assess the (country-specific) residual financing gap analysis made by the IMF.

Prior actions have high exposure

The MFA operation in Albania had two specific 'administrative' prior actions for the disbursement of the first tranche. Although not considered as the most important reforms, most stakeholders were aware of these prior actions - giving them relatively high exposure. We therefore conclude that prior actions can have value added for future MFA operations.

As stated in previous evaluations, the design of MFA should refrain from excessive recourse to prior actions, or conditions to be fulfilled for disbursement of the first tranche. In line with the short-term character of the instrument, the use of prior actions should be confined to actions related to legal pre-requirements. We recommend making use of prior actions because of the relatively high political exposure. However, because of this high political exposure, prior actions require careful selection and formulation.

Recommendation II: We recommend using prior actions, with a focus on administrative requirements in line with the short-term character of the MFA instrument. These prior actions should be used selectively, and should be drafted with care, as they have relatively high exposure.

Independent authorities

The case of Albania shows that the inclusion of conditionalities that require the involvement of institutions that are constitutionally independent from the Government, such as the Judiciary or the Central Bank, may be at odds with the MFA objective of disbursement of funds over a short time period. This is because the independent authorities may envisage a different time period for dealing with the issues that are subject of the conditionality; and may not feel fully committed to the conditionality as agreed between the EC and country's government. In such cases, it is hard to hold that government responsible if the conditionality appears not to have been fulfilled successfully, or not fulfilled in time. Although the conditionality can be formulated in such a way that it relates only to measures that are within the mandate of the governments; it should be recognised that effective implementation requires the commitment of the independent authorities - which cannot be enforced by the MFA instrument. Therefore, if there is the opportunity to make a selection from a range of conditionalities, we suggest giving preference to those directly under the control of the Government itself.

Recommendation III: We recommend that effective fulfilment of the conditionalities should be in control of the government of the country receiving the support. If there is the possibility to select from a range of conditionalities, we suggest selecting conditionalities that do not rely on the cooperation of authorities that are constitutionally independent of the government of the country concerned.

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Appendix IIStructural reforms: case studies

Introduction

We have conducted two case studies on structural reforms that have a close link with the financial sustainability of the country. These case studies have been selected because they provide insights on the beneficiary's perception of costs and benefits of proposed reforms and synergies with IFIs operations.

Case study: New law on banks in Albania

Introduction

Financial sector reform was one of the structural reforms for which conditionalities were included in the Memorandum of Understanding between the European Community and Republic of Albania signed for the Macro Financial Assistance (MFA). In this case study, we describe the development of the banking sector in Albania, and we focus on the approval of the new law No.9662 "On Banks in the Republic of Albania" approved by the Albanian parliament in 18 December, 2006, entering into force on June 1, 2007, aiming to derive the net impact of this conditionality in the MFA.

Table II.0.1 List of conditionalities in the MoU, Financial sector reform

Financial sector reform conditionalities in the MoU
Approval of the new law on the Banking Sector
At the Bank of Albania, the introduction of an integrated IT software system, and implementation throughout 2005 of the Plan of Banking Supervision
Adoption of the secondary legislation on insurance/reinsurance, including prudent rules with regard to reinsurance

Gross impact actual reform outcomes

Historical overview

Since 1991, all subsequent governments continuously had improving the banking sector as one of the objectives of their reform agendas. The first reforms in 1992 led to a two-tier banking system by dividing the old State Bank of Albania into a central bank (the Bank of Albania) and three state-owned banks, the Savings Bank- (SB), the National Commercial Bank (NCB), and the Rural Commercial Bank (RCB). The first private bank began operations in 1993.

The foreign banks, as in other transition economies, typically concentrated on servicing foreign investors and undertaking fee-based foreign transactions. In an effort to encourage the establishment of private domestic banks, in 1994, the BoA introduced clear regulations and application procedures, based on a minimum capital requirement of USD 1 million. By mid-1998, there were seven private banks, which were either wholly foreign-owned or joint-ventures.

The development of the banking sector in Albania was seriously hindered by the proliferation the pyramid schemes in Albania which caused the 1997 civil unrest in the country. With support of the IMF and WB the new government that took office in June 1997 moved aggressively to reform the banking system:

- in July 1998 a new law was approved which improved the independence of BoA;
- the Rural Commercial Bank (one of the three state-owned banks) was liquidated;
- The Government initiated the privatisation process of the two remaining state-owned banks; NBC and the Saving Bank.

NBC privatisation was concluded in October 2000, and the privatisation of the Saving Bank was concluded in 2004. The privatisation of the Savings Bank marked the exit of the State from ownership in the banking sector.

As part of the Stabilisation and Association Process (SAP) the authorities decided to prepare a new law on banks in Albania. The law aimed at harmonisation with EU directives.

The law was prepared by Bank of Albania (BoA) with IMF technical assistance, in close consultation with Bank Association and the business community. The new law No**.** 9662, dated 18.12.2006 “On Banks in the Republic of Albania” became effective as of June 1, 2007. The new Law adopted large part of provisions of the 2001/12 EC directive and the Basel Principles, strengthening the BoA’s supervisory functions, and it provides BoA with the adequate means by which to monitor the banking sector.

Gross macroeconomic impact: Performance of the banking system

In the last 10 years, the Albanian banking system has undergone substantial restructuring. State-owned banks were privatised, the number of banks increased, domestic capital banks were established; and in the last few years foreign banks have entered the Albanian market through acquisitions. As of 2006, the banking system consists of 17 banks (three Albanian banks and 14 foreign-owned or joint ventures). Of the 17 banks, 1 is quite large, 5 to 6 are medium-sized banks, and the remaining banks are considered to be small. Foreign capital continues to dominate over domestic capital; accounting for 85.7 percent of the capital of the system. Capital shares deposited by EU Member States during 2006 increased by 3.3 percent.

The banking system developments and the increased role of banks as financial intermediaries have led to a significant credit growth in recent years. The loans portfolio amounted to 21.3[36] percent of GDP at end of 2006, and was expected to reach 30 percent by the end of 2007; and it constitutes 31.3 percent of total banking system assets and

36 Data provided by Bank of Albania Annual Report 2006, May 2007

about 37.4 percent of the banking system deposits. Nonetheless, despite its rapid growth, Albania's stock of credit relative to its income level remains low by transition economy standards (see Table II.2).

Table II.0.2 Selection of transition countries stock of credit, 2000 and 2006 expressed as a percentage of GDP

Countries	2000	2006/1
Albania	**4**	**24**
Average transition countries	**24**	**48**

Source: WEO and IFS.

1/ 2005 value for Poland, Lithuania and Slovenia. March 2007 value for Albania

Table II.3 presents a number of indicators reflecting the performance of the Albanian baking system.

Table II.0.3 Banking sector indicators 2003-2006 with projections for 2008 and 2009

	Dec 2003	Dec 2004	Dec 2005	Dec 2006	Dec 2007	Dec 2008	Dec 2009
Deposits (as a % of GDP)	46.6	47.7	50.6	56.1	60.7	65.3	69.6
Return on equity (annual basis)	19.5	21.1	22.2	20.2			
Non-performing loans (% total loans)	4.6	4.2	2.3	3.1			
Total loans as a % of total assets	13.6	16.4	25.7	31.7			
Private sector credit (as a % of GDP)	7.7	9.4	14.9	21.8	28.6	34.9	40.8

Source: IMF Country Report 07/244

The table shows a significant growth of the banking system as reflected by increase in the deposits as a percentage of GDP. The combination of high returns on equity with a relatively small share of non-performing loans demonstrates the commercial viability of the sector. In general, the development of the Albanian banking system appears to be sound and prosperous. Although the high increase in the total loans and the private sector credit since 2005 has given rise to concerns, further analysis of the credit growth seems to suggest that it merely reflects Albanian need to expand its economic base. The large part of the credit is used for investment purposes rather than consumption. Corporate lending constitutes the main share of banks' portfolio, amounting to 66.5 percent of the total loans portfolio at the end of 2006. Most of the corporate loans (34.5 percent) have been used for the purchasing of machinery and equipment; while 23.2 percent of corporate loans portfolio has been used for financing investments in activity area expansion. Meanwhile, in 2006, household lending reached 7 percent of GDP (33.5 percent of the total loans portfolio). Property purchases constitute 59.3 percent of total household lending. Trade continues to be the main sector absorbing crediting from the banking system. It accounts for 22.4 percent of the total loans portfolio.

Other determining factors

In addition to the continuous efforts of subsequent Albanian governments, the donor community has also contributed to the development of the banking sector. The World Bank has been the leading donor agency supporting financial sector reform, in close cooperation with the IMF and the EC. The MFA conditionality on the approval of the new law on banks in Albania is closely linked to the World Banks FSAC, which had implementation of the Supervisory Development Plan (SDP) for banking supervision as one of its conditionalities.

World Bank

The World Bank supported financial sector reform, especially with a Financial Sector Adjustment Credit (FSAC). The FSAC supported;

- the privatisation of the Savings Bank;
- reform of the institutional, regulatory, and supervisory framework for banking;
- enhancement of the bankruptcy and debt resolution framework;
- reform of the non-bank financial sector.

Albanian governments needed to undertake several policy actions for the release of the FSAC tranches, such as the privatisation of the Savings Bank, preparation and implementation of the Supervisory Development Plan (SDP) for banking supervision, and improving banking legislation through the adoption by Parliament in 2002 of the amendments in Bank of Albania law. FSAC program was successfully closed in December 2004.

IMF

The IMF has supported and closely monitored the development of the financial sector over the last fifteen years in Albania. In 2005, the IMF and the World Bank prepared a Financial System Stability Assessment (FSSA) to assess the stability of the financial system and to identify and remedy weaknesses in Albanian financial sector structure. Some of the FSSA recommendations are included as Structural Benchmarks (SB) under the EEF/PRGF. The IMF included the approval of the new law on banks in Albania as a Structural Benchmark (SB) to be met by March 2007, under the EEF/PRGF programme (See Table II.4). IMF technical assistance for the preparation of the new law was crucial.

European Union

The 2004, NPAL-SAA mentioned the need to amend the law on banks in Albania, to harmonise it with the EC directives and Basel Principles. However, no clear deadline was set for the achievement of this objective. A deadline on the approval of a new law on the banking sector was set in the 2005 NPAL-SAA.

Table II.0.4 Timeframe for the MFA conditionality in the National Plan for approximation of legislation and SAA implementation

National measures	Technical assistance	Date of submission to the Government or Parliament	Expected date of adoption and entry into force
On some amendments to the law "On Banks in Republic of Albania"	IMF and WB	IV Quarter 2005	II Quarter 2006

Source: NPAL-SAA

Net impact of MFA conditionality

Approval of the new law on the banking sector was the top priority for the Albanian authorities. The interviews seem to suggest that cross conditionality between EC-MFA and IMF-EEF/PRGF might have speeded up the approval process of the new law by exerting additional pressure to the Albanian government (see also Appendix 6). However, the original Banking Law dating back to 1998/1999 was already considered to be a good law. The modifications included in the new Banking Law are considered to be rather minor in comparison with the former law.

We conclude that MFA had an operational effect on installing a new law on the banking sector (speeding up the implementation of the law). However, the effect of this Law in improving supervision on the banking sector is limited.

Case study: privatisation Albtelekom and ARMO

Introduction

The Memorandum of Understanding linked to the Macro Financial Assistance that was negotiated in October 2004 and signed in May 2005 included the conditionality "offer for sale (final tender) of Albtelekom and Albanian Refining and Marketing Oil (ARMO)". The motivation behind this condition was to ensure that the Albanian authorities continued with the privatisation of large state-owned enterprises. The privatisation of Albtelekom and ARMO is guided by Law No. 8306 (14 March 1998) "On the Privatisation Strategy for Sectors of Special Importance". Based on this Law, for each company operating in a strategic sector, a specific law needs to be prepared.

With the aim of deriving the net impact of the inclusion of the conditionality in the MFA-agreement, this chapter describes in detail how the developments related to this conditionality are reported.

Gross impact: actual reform outcomes

Sale of Albtelekom

Albtelekom is the only fixed-line telephone company in Albania. It serves around 250,000 customers (around 33 percent of Albania's 800,000 households, and 7 percent of the country's 3.6 million population). In addition, the company holds the third licence to exploit a mobile phone network, after Vodafone and AMC. Albtelekom created the Eagle Mobile operator, but it never began offering its services due to a lack of resources to invest in the new network.

In 2001, the Albanian authorities made its first attempt at privatising Albtelekom. However, the tender was not successful due to the weak global market following international turmoil following the terrorist attacks on 9/11.

The Albanian authorities conducted a second privatisation attempt in November 2004. An invitation for expressions of interest in the sale of a 76 percent stake was published. Following the advertisement in international newspapers / magazines, as well as a roadshow in various European capitals, 11 companies expressed interest. Based on a qualitative assessment of their eligibility, four of them were shortlisted. These companies were allowed full access, in order to conduct a due diligence of Albtelekom and to prepare their respective offers. The shortlist comprised:

- Korean Telecom Consortium / Samsung (Korea);
- Turk Telekom Consortium / Calik Enerji Telekomunikasyon (Turkey);
- MTC / Mohamed Abdul Mohsen Al-Kharafi & Sons (MTC Albania Consortium) (Kuwait);
- Telekom Slovenije (Slovenia).

Following the process of due diligence, three companies informed the Albanian authorities that they were no longer intending to issue an offer. Due to the strict rules of confidentiality associated with the tender (in accordance with the rules of the Paris Chamber of Commerce), this information was not made public. The only bidder appeared to be the Turkish consortium of Calik Enerji and Turk Telekom. Their offer of EUR 120 million was well above the net asset value of the company, which according to the assessment by the independent American investment bank Millar, was valued in the range between EUR 66 and 90 million. Accordingly, the offer was accepted and the Council of Ministers signed the contract with the Turkish consortium in June 2005.

However, the new Parliament, that took office in September 2005 following the general elections in July 2005, rejected the draft law "*On the ratification of the contract for purchase of the shares of Albtelekom s.a.*" on 13 October 2005. Parliament required the Council of Ministers to provide international expertise concerning the contract formulations, as well as the legality of the tender procedures. Issues to be discussed:

- *The status of Turk Telecom in the consortium*: The tender documents of the Albanian authorities required the buyer to have experience as a mobile phone operator. Turk Telecom fulfilled this requirement, but the status of Turk Telecom in the consortium was unclear. Furthermore, at the time, Turk Telecom was still a state-owned company - which violated the tender requirements (the privatisation of Turk Telecom is has since been completed);

- *The inclusion of the GSM license in the contract*: The inclusion of the GSM licence for the Eagle Mobile in the contract has been contested, as it allowed the buyer of Albtelekom access to the mobile phone market at a 'bargain price'. The other provider of mobile services, the Greek company AMC, paid USD 85.6 million in 2000. However, the renegotiated contract included the licence for Eagle Mobile that was extended in March 2007;
- *The inclusion of roaming rights in the agreement*: As with the original contract, the internal roaming technicalities are excluded from the contract. The telecommunications market in Albania is estimated to be worth $ 500 million, of which the buyer of Albtelekom would have a share of $300 million within 2-3 years (Tirana Times, June 2007). Albanian authorities confirm that national roaming is regulated under another law and could not be part of the contract for the sale of Albtelekom.

The Council of Ministers set up the 'Revision Committee'. Following an international tender in April 2006, the Committee hired an independent, external consultant - the Czech office of Deloitte - to review the legacy of entire tender procedure. Their report was presented in 2006 and constituted the base for the renegotiation of the contract with the Turkish consortium in November 2006. On 20[t] June, the sale of the 76 percent stake of Albtelekom was finalised for EURO 120 million under largely similar contractual conditions. After signing the contract, the company expressed a commitment to make additional investments in Albtelekom amounting to about EUR 30 million (AE News, 19 June 2007).

The remaining stocks in the company will be divided between employees (based on their possession of nominal vouchers issued during the phase of mass privatisation) and land owners (based on the 'Law on Land Compensation'). Any remaining shares will be offered to the Turkish consortium.

Gross macroeconomic impact

The impact on Albania's fiscal situation runs via the increase of the Government's revenues, with EURO 120 million resulting from the sale of Albtelekom in 2007. In accordance with the agreement with IMF, the revenues are used for debt reduction (50 percent) and priority investments (50 percent). Accordingly, the short-term fiscal impact is the reduction of debt in 2007 with EURO 60 million and the increase of public expenditures (in the form of investments) with EURO 60 million.

A number of other factors that negatively impact on the government's budget need to be included in the analysis in order to establish the medium-term and long term fiscal effects of the sale of Albtelekom:

- The forecasted future profits of Albtelekom (Albtelekom's profit was reported at EURO 14 million in 2006 which equals a present value of € 107 million, assuming a time horizon of 10 years at an interest rate of 5 percent);
- The potential costs of the sale of the GMS-licence to a third party (based on the historical experience, these potential costs can be estimated at around EURO 60 millon);

- Costs of reorganisation of Albtelekom (historical experience shows that privatisation is usually accompanied with large scale lay-offs which may negatively impact on the state budget due to increased unemployment allowances).

Taking these factors into consideration, the privatisation of Albtelekom is unlikely to have a significant fiscal effect in the medium to long term. The long-term merits of privatisation are likely to result from the dynamics of private investments in the company and the telecoms sector at large.

With regard to the impact of the privatisation on Albania's external situation (balance of payments), the sale of Albtelekom will significantly increase the flow of foreign direct investment (FDI) in 2007. Although additional investments of the Turkish owners of around EURO 30 million are expected over the coming years, the positive effect on the balance of payments will primarily be a one-off.

Sale of ARMO

ARMO is an oil refining and marketing company located in Fier, and is wholly-owned by the Ministry of Economy, Trade and Energy. Its activities encompass the refinement of the crude oil and gas, and the wholesale of fuel, gas and their associated products.

ARMO has a share of about 20 percent of the internal fuel market in competition with 21 other licensed operators. With around 100 percent of the bitumen and combustibles market, ARMO is one of Albania's major industrial companies. ARMO's main base is the Ballshi refinery with a capacity of 1 million tonnes per year. The Fier refinery has an annual capacity of another 0.5 million tonnes per year. In addition, ARMO owns 33 petrol stations along the main roads throughout the country.

The framework law for the privatisation of ARMO dates from July 2003. In the autumn 2004, Albania called for expressions of interest in purchasing. Initially, 9 companies showed interest. However, at the closing date of the tender, 6 May 2005, only one binding offer was submitted by the UK-based company "Petrofac Resources International Ltd". The offer that was issued by an English company appeared not to be in compliance with the legal tender requirements as it focused on receiving the concessions rather than on the purchase of the 76 percent stake in the company.

The privatisation process began again in 2007. Following the "Revision of the Privatisation Strategy", the Council of Ministers authorised ARMO to segregate its retail store activities from its refinement activities. The preparation process for the privatisation of the retail stores is currently ongoing. Regarding the privatisation of the refinement activities, a consulting company has already been hired to offer assistance with the process. The consultants are currently being acquainted with the company to further specify the tender documents.

Gross macroeconomic effect

No gross macroeconomic effect can be identified, as the status of ARMO has so far not been altered.

Other determining factors (cross-conditionality)

The MFA was not the only factor that may have contributed to the developments with regard to the privatisation of Albtelekom and AMRO. Additional pressures have been exerted by the IFI's World Bank and IMF.

World Bank

In line with the general division of responsibilities among IFIs, the World Bank has led the privatisation programme of Albania. The process of mass privatisation (small and medium-scale non-strategic commercial enterprises) was finalised in 2000 (World Bank, 2004). In June 1999, the World Bank approved the Structural Adjustment Credit for USD 45 million, and focused on completing the privatisation (or liquidation) of small and medium-sized enterprises, and on commencing the privatisation process for telecommunications companies and banks.

Further action on privatisation is mentioned in the Programme Document for the Third PRSC (Poverty Reduction Support Credit) of November 2004. The programme objectives for private sector development included one outlining that the Albanian government 'will prepare Albtelekom for its prompt privatisation' and it 'will fully divest its interests in two oil sector companies over the next 18 months'. Based on the credit, technical assistance for the development of the legal acts for the privatisation of Albtelekom was financed up to an amount of USD 117,000.

IMF

Since 2002, the IMF has included references to the privatisation of Albtelekom and ARMO in the Memorandum of Economic and Financial Policies (MEFP) linked to their PRGF-programme. Table II.5 shows the policy objectives in the consecutive MEFPs since June 2002.

Table II.0.5 Chronology of Albtelekom and ARMO-related policy objectives in Albanian-IMF PRGF agreements

Date of agreement	Policy objective
June 2002	Under our privatisation programme, the fixed network telecommunications company and the largest state-owned bank are the principal remaining entities to be privatised: In relation to Albtelekom, we will improve the marketability of the company and settle the remaining unresolved legal and financial claims by the end of September (structural benchmark), before setting new deadlines for the privatisation. Moreover, we will improve the company's management; strengthen the coordination of the privatisation process; and clarify responsibilities within the Government in this regard.
January 2003	Regarding Albtelekom, we will submit a request for deregistration of its joint venture with New World to the Tirana Court by the end of January 2003. We will also settle the company's remaining unresolved financial claims by the end of March 2003 (structural benchmark) and iIn the oil sector, we will bring all parts of ARMO and SERVCOM to the point of sale by the end of 2003
January 2004	The privatisation process for large enterprises will be accelerated, concentrating mainly on the Savings Bank, Albtelekom, and INSIG: (Albanian Insurance Company) To help prepare Albtelekom for privatisation, we will make efforts in good faith to finalise the settlement of the remaining financial claims before the end of March 2004
June 2004	Building on the newly-gained privatisation momentum, we will prepare Albtelekom for its prompt privatisation
February 2005	The privatisation agenda for 2005 includes Albtelekom and ARMO. In preparation for the sale of Albtelekom, we will fully regularise the company's outstandingfinancial obligations to private creditors; and will instigate reforms to the rural and small operators regime along transparent lines and in accordance with international standards.
July 2006	The sale of Albtelekom has been delayed as we investigate alleged irregularities in the previous tender process. However, once the investigation is concluded, we will move ahead quickly with the privatisation process. Tenders for Albpetrol and ARMO will also be prepared. Our plan is to sell these two companies in their existing condition without first attempting rehabilitation, as we believe this is a task best left to their future owners

European Union

Besides the MFA, the European Union employs other instruments to stimulate the Albanian authorities in reforms. Most importantly, it negotiated policy priorities in the framework of the European Partnership with Albania in June 2004. The agreement included the mid-term priority to complete the privatisation process. The corporations Albtelekom and ARMO were mentioned in particular.

In response to the European Partnership, the Albanian authorities approved of an 'Action Plan' in September 2004. The Action Plan set a specific time frame for the privatisation of both Albtelekom and ARMO (see Table II.6).

Table II.0.6 Timeframe on the privatisation in the Action Plan for the Implementation of the European Partnership priorities

Completion of the privatisation process of Albtelekom	Timeframe	Completion of privatisation process of Armo	Timeframe
1. Draft decision 'on the approval of the project contracts for the purchasing of shares' and instructions for opening the offers for the privatisation of Albtelekom'	Ist and 2nd trimester, 2005	1. Draft decision 'on the way of using the incomes resulting from the privatisation of Armo'	2nd semester, 2004
2. Draft decision 'on the approval of the offers evaluation report on the privatisation of Albtelekom'	Ist and 2nd trimester, 2005	2. Draft decision 'on the approval of project contract for the purchasing of shares and instructions on opening the offers for the privatisation of Armo'	2005
3. Draft law 'on the ratification of the Albtelekom contract governing the purchasing of shares'	Ist and 2nd trimester, 2005	3. Draft decision 'on the approval of offers evaluation report for the privatisation of Armo'	2005
		4. Draft law 'on the ratification of the Albtelekom contract governing the purchasing of shares'	2005

In late 2005, a second European Partnership was approved. It included the political requirement to *'take steps to allow for the successful privatisation of Albtelekom'*. Furthermore, the medium-term priority to *'continue privatisation in the financial and energy sectors'* was formulated.

Net impact

The net impact describes the extent to which the gross effect can be attributed to the MFA-conditionality rather than to other causal influences external to the MFA.

For the privatisation of ARMO, no net effect is identified following the absence of a gross effect. For the privatisation of Albtelekom, a substantial short-term gross macroeconomic impact has been identified by the inflow of EUR 120 million on privatisation receipts.

However, this gross impact cannot be attributed to MFA. One reason is that the MFA conditionality was only one factor pushing the privatisation forward. There was a wide consensus among international donors and the Albanian authorities that the privatisation of Albtelekom had to be given priority. Furthermore, it can also not be argued that the MFA-conditionality had speeded up the privatisation reform. Such an operational effect of the MFA can only be attributed to the finalisation of the tender in mid-2005. From the course of events, it is clear that since then, domestic political factors have taken over; making the MFA conditionality without irrelevant. Consequently, the privatisation is finalised more than two years after the conditionality was fulfilled. In these circumstances, it is hard to argue that in the absence of the MFA, it would have taken a longer amount of time to complete the privatisation process.

Appendix III Key persons interviewed

Table II.0.1 Key persons interviewed

Name	Role/involvement in the MFA operation	Active period
EC officials		
Mr. Christophe Pavre de la Rochefordière	DGECFIN, Deputy Head of Unit	Entire MFA period
Mr. Clive Rumbold	DGENLARG, Desk Officer Albania	Since spring 2005
Mr. Jose Castillo Villar	DGENLARG, Desk Officer Albania	Since June 2006
Mr. Pierre Baut	DGECFIN, Former Desk Officer Albania	2000 to April 2004
Mr. Frank Kohlenberger	DGECFIN, Desk Officer Albania	From April 2004 to October 2005
Mr. Martin Spolc	Former Desk Officer at DGECFIN	From October 2005 To July 2007
Mr. Peter Grasmann	DGECFIN, Head of Unit	Mid-2004 to now
Mr. Carlo Natale	DGRELEX, Former head of Economic and Political section at the EC Delegation in Albania	Entire MFA period
Ms. Stanislava Skuodyte	European Commission Delegation in Tirana, EU-Albania Relations officer	Current
Interviews with representatives of IFIs		
Mrs. Ann-Margret Westin	IMF resident representative in Albania	Current
Mr. Istvan Szekely	IMF Mission Chief, Washington DC	Entire MFA period (since 2007 EC official DG ECFIN)
Mr. Geoffrey Oestreicher	Country economist, Washington DC	Entire MFA period
Ms.Camille Nuamah	World Bank Office Tirana, World Bank Country Manager	Current since July 2007
Mr. Erion Luci	World Bank Office Tirana, Economist	Current since (before official from BoA)
Mrs. Alia Moubayed	World Bank Washington DC, Senior country economist	Entire MFA period
Mr. Olav Rex Christensen	World Bank Washington DC, Finance and Public Sector Management Department	Entire MFA period
Mr. Cem Dener	World Bank Washington DC, Finance and Public Sector Management Department	Entire MFA period
Mr. Lalit Raina	World Bank Washington DC, Finance and Private Sector Development Department	Entire MFA period
Mr Vinod K. Goel	World Bank Washington DC, Finance and Private Sector Development Department	Entire MFA period

Name	Role/involvement in the MFA operation	Active period
Interviews with Albanian authorities		
Mr. Gjergji Teneqexhi	Minfin, Former General Secretary	Until December 2006
Mr. Nezir Haldeda	Minfin, General Treasury Director	September 2005 to now
Mr. Pajtim Shehu	Minfin, General Internal Audit Director	September 2005 to now
Ms. Mimoza Dhembi	Minfin, General Budget Director	Current
Mr. Florion Mima	Minfin, Deputy Minister of Finance	September 2005 to now
Mr. Sherefedin Shehu	Minfin, Deputy Minister of Finance	September 2005 to now
Mr. Klodian Shehu	BoA, Financial Stability Department Director	Current
Mr. Endrit Banka	BoA, Supervision Department Director	Current
Mr. Ardian Fullani	BoA, Governor	October 2004
Ms. Evis Ruci	BoA, Research Department, Vice Director	Current
Mr. Edvin Libohova	Chairman of the Bank Association, Chairman of the Board of Banka Popullore	Current
Ms. Pranvera Kastrati	Ministry of Economy Trade and Energy Director Trade Policies Department	Current
Mr. Vaso Pano	Ministry of Economy Trade and energy Expert, General Privatization Directorate	Current
Ms. Valbona Kuko	Council of Ministers, Department of Strategy and Donor Coordination Coordinator for Instrument of Pre-Accession Assistance	Current
Mr. Dritan Shano	Former Deputy Minister of Finance, now ICS	Until September 2005
Mr. Arben Malaj	Former Minister of Finance, now Parliament	Until to September 2005
Mr. Aldo Bumci	Former Minister of Justice, now Parliament	September 2005-April 2007
Mr. Albert Gajo	Ministry of European Integration, Deputy Minister	September 2005
Mr. Ridvan Bode	Minfin, Minister of Finance	September 2005
Mr. Denis Kalenja	Director of AlbInvest	Current
Mrs. Elisabeta Gjoni	Insurance Supervision Authority	Current
Mr. Fatbardh Kadilli	Prime Minister Office	Current
Mr. Edmond Dunga	Former Prime Minister Office, now working on regional corruption project	Until October 2007
Mr. Marjan Gjermeni	Bank of Albania, Director of Monetary Policy Department	Current
Mr. Roland Miklau	EURALIS Head of Mission at the Ministry of Justice	Current
Mr. Artan Hoxha	Institute of Contemporary Studies, independent expert	Current
List of persons that attended the Stakeholders workshop in Tirana, 31st of January 2008		
Mr. Sherefedin Shehu	Minfin, Deputy Minister of Finance	
Mr. Niuton Mulleti	BoA, European Integration Department	
Mr. Gjergji Teneqexhi	Minfin, Former General Secretary	
Mr. Erion Luci	World Bank Office Tirana, Economist	
Mrs.Enkelejda Karaj	World Bank, Assistant	
Mrs. Gentiana Gjonca	Insurance Supervision Authority	
Mr. Roland Miklau	EURALIS Head of Mission at the Ministry of Justice	
Mrs. Ann-Margret Westin	IMF resident representative	

Name	Role/involvement in the MFA operation	Active period
Mr. Artan Hoxha	Institute of Contemporary Studies	
Mrs. Una Kelly	EC Delegation, Tirana	
Mrs. Stanislava Skuodyte	EC Delegation, Tirana	
Mr. Thomas Von Handel	EC Delegation , Tirana	
Mr. Aneil Singh	EC Delegation, Tirana	

Appendix IV Modelling approach to the counterfactual

Objectives

The aim of the quantitative modelling approach is to recover the counterfactual short-term macroeconomic outcomes in the absence of the MFA intervention; to then compare this counterfactual to the actual outcome and thus establish the net effect of the MFA intervention.

The model is also used to support the analysis of MFA contribution to medium-term external sustainability. This is a new element that has not been introduced in previous evaluations. The limitations of this application are discussed in the external sustainability chapter.

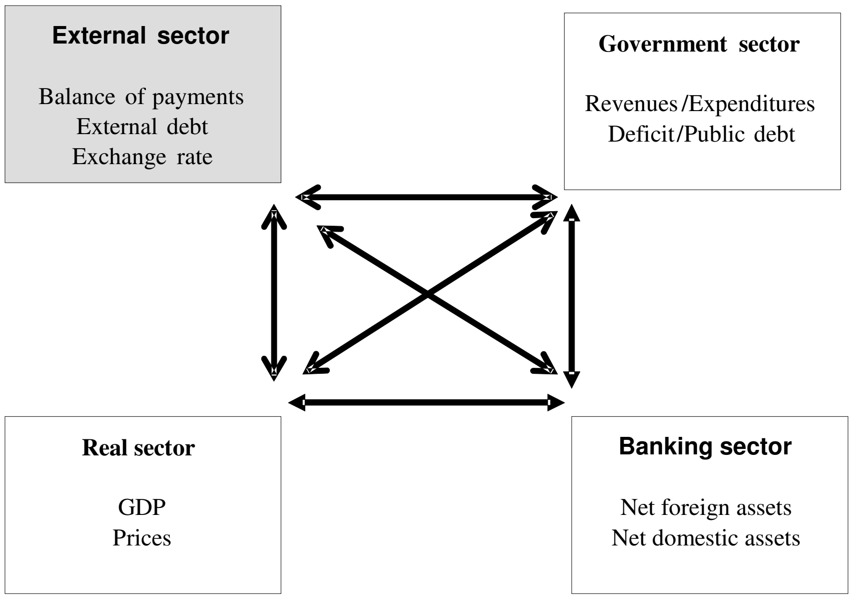
General description

The minimum requirement for the model to yield meaningful counterfactual is its *macroeconomic consistency* that requires inclusion of four basic economic sectors: real, external, government and banking, as illustrated below. Since MFA is an instrument that addresses the financing gap in the Balance of Payments (BoP), counterfactual situations are designed around possible changes in other international financial flows (IMF disbursements, World Bank programmes, other multilateral and bilateral assistance). Therefore, the external sector is at the centre of the quantitative analysis.

The basic structure of the model that recognises links and ensures consistency among four basic economic sectors: real, external, government and banking, as illustrated in Figure A4.1 below. The applied macroeconomic model is broadly similar to the model employed in previous evaluations (evaluation of MFA in the Former Yugoslav Republic of Macedonia, Romania, and Tajikistan). However, some important changes have been introduced to better adapt the model to the specific features of the Albanian economy and features of the MFA operation in Albania (see below).

The main part of the model has been calibrated using annual IMF data available from recent IMF Country Reports, the IMF World Economic Outlook and the Bank of Albania; and has been used to derive the alternative path of major macroeconomic variables in the absence of the MFA.

Figure A4.1 The basic structure of the model that recognises links and ensures consistency between the four basic economic sectors: real, external, government and banking



New features in the Albanian model

Based on previous experiences, the model has been improved in several dimensions:

- the fiscal block of the model allows for a wider range of alternative responses to the no-MFA scenario (i.e. various adjustments on the side of budget revenue, spending and deficit financing);
- the sensitivity analysis has been strengthened in order to be able to present the plausible range of MFA impacts on selected macroeconomic variables besides the point estimates;
- the varied character of MFA operations and the presence of structural reform conditionalities implies that the specific features of a given country; and the MFA operation needs to be incorporated in the model: in the case of the operation in Albania, we focused on one particular mechanism working through the banking sector: the increased flow of public sector wages through the banking sector (rather than wages being paid in cash); this in turn, via the multiplier effect impacts on deposits and credit activity of banks with all subsequent effects in other sections of the model economy.

In the case of Albania, where the MFA operation was small in relation to the country's GDP, this last mechanism proved the most important in determining the overall macroeconomic effects of the MFA operation.

The advantages of our approach are that it corresponds to models used by international financial institutions (especially the IMF), the relatively modest data needs and manageable computing time. Most importantly, the quantitative results can be immediately compared with conclusions of qualitative analysis.

Key features

The absence of the MFA affects the economic system though four main channels. Firstly, there is a direct impact on the balance of payments in the year of disbursement. Additionally, there is a direct negative effect on balance of services due to side-effects of the reinsurance regulation conditionalities (see Section 6.8 for further discussion) The second channel of impact operates through budgetary accounts, as the absence of the MFA implies lower revenues, and thus necessitates an adjustment of the expenditure side and / or fiscal deficit. Thirdly, the combination of changes in net foreign assets and credit to the Government translate into money supply changes and consequently to an alternative inflation scenario. Fourthly, the lack of structural conditions attached to the MFA implies a somewhat slower introduction of the practice of channelling public sector wages through the banking system. This affects deposits and credit activity of banks with all subsequent effects in other sections of the model economy.

Differences from the actual scenario

All channels described above are explicitly modelled to capture differences between counterfactual and actual scenarios. The model is linear and, as a result, most equations used in the model describe the difference between counterfactual and actual values of variables. For example, the equation for a variable X that is determined by some two other variables Y and Z typically takes the following form:

DIF (X) = F[DIF(Y), DIF(Z)]

where DIF denotes the difference between counterfactual and actual values of a variable, and F[] is a function (identity or behavioural equation, as discussed below). The advantage of such specification is the strong focus on variability related to the MFA intervention, as well as the straightforward interpretation of obtained results in terms of net impact of the intervention. Also, it allows for the resolution of problems related to breaks in the historical macroeconomic series which make the comparison of levels of variables infeasible. Finally, it allows for a meaningful analysis to be carried out in a situation when forecasts rather than actual data need to be considered as the basis for the actual scenario. This last feature is important, as the MFA operation in Albania was completed in 2006 and at the time of writing this report (2007), historical data (at annual intervals) were available only until 2006.

Identities and behavioural equations

Two major types of equations are used in the model: identities and behavioural relations.

Identities are equations that must hold by definition to ensure accounting consistency (e.g. balancing the balance of payments, financing the budget deficit, balancing assets and liabilities of the banking sector). The only necessary assumption in simulating the counterfactual in case of identities is the determination of size of adjustment of each of the variables entering the identity in response to a given shock. Often this choice is conditional on policy response or external factors; and assumptions in this respect are based on information gathered during interviews with policy-makers, analysts and advisors in Tirana, Washington and Brussels.

In case of behavioural relations (e.g. determinants of GDP growth, inflation and imports), their functional forms are designed to best reflect the economic impact that should take place according to the economic theory; ideally confirmed by available statistical evidence, and taking into account limitations in data availability and quality. The modelling assumption involves the choice of the variables that best explain the dynamics of an independent variable and in quantification of the size (elasticity) of the impact. The elasticity can be calibrated or assumed depending on the available evidence from Albania and other similar economies.

Although the model consists of larger number of equations, we describe below the three most important identities and three behavioural equations that are at the core of the simulation of the counterfactual.

BoP identity

The first essential equation necessary for establishing the counterfactual is the identity describing the balance of payments. Below we present a stylised version of the actual equation that illustrates the character of modelling choice in determining the type and strength of the BoP response in the counterfactual scenario.

DIF (MFA grant + other CA items) + DIF (MFA loan + other KA items) = DIF (reserve accumulation)

where DIF is the difference between counterfactual and actual value as defined above. CA is Current Account and KA is the Capital and Financial Account. The absence of the disbursement of the MFA is reflected as a drop in the Capital and Financial Account. The balance of payments has to balance ex post, and resulting tighter BoP constraint must lead to adjustment in other items. Specifically, we assume that the necessary BoP adjustment takes place through current account items - primarily through the slowdown of imports.

Budget identity

The second core identity used in the formulation of the counterfactual describes budgetary accounts. The stylised version of this equation is given as:

DIF (government expenditures) – DIF (MFA grant & other government revenues) = DIF (MFA loans + other deficit financing items)

From the perspective of the budgetary identity, the counterfactual scenario without the MFA assistance implies lower Government revenues (due to the lack of the MFA grant) and lower external deficit financing (due to lack of the MFA loan element). In order to balance its books, the Government needs to adjust its expenditures programme and/or revenue collections and/or identify alternative sources of deficit financing. In this respect, the counterfactual is determined by the availability of alternative sources of financing and policy decisions about fiscal tightening. Following the discussion with IFIs and the Albanian government officials, we assume unchanged budget revenues, and unchanged deficit; with an adjustment taking place through a reduction in investment expenditures of the budget.

Banking sector balance sheet identity

The third core identity describes the accounts of the banking sector. This stylised presentation illustrates key linkages with balance of payments situation that determines the net foreign assets (NFA) through series of auxiliary identities, and budgetary accounts that determine the size of credit to the government (NDC government); with adjustment in other items of net domestic assets (NDA) determining the change in money supply.

DIF (NFA) + DIF (NDC government) + DIF (NDA other) = DIF (Money supply)

Real sector behavioural equations

The set of core identities described above, together with other auxiliary equations constitute the logical framework of the model and indeed produce the majority of the results presented. However, in order to quantify the impact of counterfactual arrangement on the real sector, behavioural equations have to be introduced. This is a challenging task, since the character and strength of the linkages from the balance of payments, fiscal and monetary developments to real sector is highly speculative – neither standard theory, nor available econometric literature provide precise insights into the size of these effects. Due to short time series and structural breaks, it is also not possible to properly estimate relevant elasticities. Therefore, elasticities are selected within the range typically found in other countries, or are assumed in similar models. As a result, they reflect economic common sense supported with very crude estimation techniques.

The first set of behavioural equations predicts credit activity of the banking sector as a function of changes in the demand and time and saving deposits, which are in turn (on the margin) determined by the flows of additional funds through the banking sector (specifically this refers to wages of public sector employees).

DIF (banking sector deposits) = F[DIF (wage bill going through the banking sector), saving rate]

DIF (banking sector claims on the private sector) = F[DIF (banking sector demand deposits), DIF (banking sector time, saving and foreign currency deposits)]

The impact on GDP growth rates in then calculated by separately modelling private consumption expenditure, gross fixed capital formation and imports.

DIF (private consumption expenditure) = F[DIF (banking sector claims on the private sector)]

DIF (gross fixed capital formation) = F[DIF (banking sector claims on the private sector)]

DIF (imports) = F[DIF (domestic consumption and investment demand)]

DIF (GDP growth) = F[DIF (government expenditures), DIF (private consumption expenditure), DIF (gross fixed capital formation), DIF (imports)]

The next central behavioural equation that predicts counterfactual inflation rates is based on the standard theory of inflation, where price increases are related to money stock and real incomes – in the specification below, lower inflation in the counterfactual is determined by slower money growth and weaker GDP growth. Such a specification is typically found to be relatively robust in explaining the money – inflation nexus - at least in the long run; reflecting the famous insight by Milton Friedman that ‘inflation is always and everywhere a monetary phenomenon’.

DIF (inflation rate) = F[DIF (money growth rate), DIF (real GDP growth)]

The last equation is the reverse of the import demand equation that allows the derivation of a nominal exchange rate response in the counterfactual that is consistent with the import development (as predicted by the BoP identity), as well as real GDP and price dynamic (as predicted in the equations above).

DIF (exchange rate) = F[DIF (inflation rate), DIF (imports)]

Sensitivity analysis
Tables in the main text of the report present range estimates or point estimates of the potential impact of the MFA intervention that are related to the model specification and assumed parameter values. Given the intrinsic uncertainty related to the model and data, interpretation of results should be concentrated on signs and relative size of effects, rather than on particular numerical values. Nevertheless, the qualitative results are quite robust to modifications in the parameter values within the reasonable range - in particular, net effects remain small for virtually all plausible parameters.

Appendix V Macroeconomic impact of structural reforms

Introduction

In this evaluation, special attention is paid to the macroeconomic impact of structural reforms. We have made a quantitative estimation of the impact of the reforms through the counterfactual approach (see Chapter 7) This Appendix explains our approach. In order to attribute quantifiable macroeconomic effects of MFA conditionality, we have to establish a direct link between MFA conditions and macroeconomic variables, and/or a plausible impact link between the MFA conditions and those reform areas that can have a quantifiable macroeconomic impact under the assumption that MFA had an impact on the reform activities stated in the conditionalities. For mere practical reasons, we have focussed on quantifying effects and less on the theoretical framework.

Our approach

A quantifiable macroeconomic effect is limited to the extent that structural reforms have an impact on variables and parameters stated in macroeconomic model used in this evaluation (see Appendix IV). We identify the quantifiable macroeconomic impact of the MFA structural conditionalities with the help of a four-step approach.

Step 1: Has the structural reform activity been implemented and led to the desired reform? For example: the law was not only drafted, it was also implemented. Step 1 coincides with the gross impact analysis in Section 6.4.

Step 2: Did the MFA conditionality have an impact on the reforms? Was cross-conditionality applied? And if so, did this cross-conditionality provide any leverage to realise, speed up and/or improve the reforms? Step 2 coincides with the net impact analysis in Section 7.4 on political and operational reinforcing effect.

Step 3: Did the reforms under MFA have a plausible, quantifiable macroeconomic impact through the variables and/or parameters in the macroeconomic model? Here we only analyse those conditionalities for which Steps 1 and 2 have been clearly positive; and links to variables and/or parameters can be established.

Step 4: If the reform activity did not have a plausible macroeconomic impact:
(a) Does the reform area of which the reform activity is part have a macroeconomic impact?

(b) Is it plausible to attribute the macroeconomic effects of the reform area to the reform conditionality?
Question (b) is based on theoretical analysis. For this question, we have to assess whether the reform activity can be seen as a substantial reform within its reform area. If so, then we can make the assumption that implementation of the conditionality contributed to progress of the reform area. This assessment is based on interviews. Here we only analyse those conditionalities for which Steps 1 and 2 have been positive and Step 3 negative. We acknowledge that identification of a reform activity as a core reform activity reflects some subjectivity.

Conclusion

Table V.1 presents a summary of the four-step approach. Steps 1 and 2 are based on the assessment in Chapter 6. The next section in this Appendix provides explanations of Steps 3 and 4. Based on this assessment, we conclude that only Conditionality 6 resulted in a plausible, quantifiable macroeconomic impact of the MFA conditionality.

Table V.1 Summary of the four step approach and conclusions

Conditio-nality	Step 1	Step 2	Step 3	Step 4	Conclusion
Public finance reform					
1	++ (formalisation)	++ (operational), but no real impact	0	(b) = 0	No macroeconomic effect
2	++ (formalisation)	++ (operational), but no real impact	0	(b) = 0	No macroeconomic effect
3	++	++ (political)	0	(b) = 0	No macroeconomic effect
4	+ (15 out of 25)	+ (political), no operational	0	(b) = 0	No macroeconomic effect
5	0	0			No reform effect
Fight against corruption					
6	++	++ (operational)	++		Quantifiable macroeconomic impact
7	++	(+) (political)	0	(b) = 0	No macroeconomic effect
8	0 (in progress)	0			No reform effect yet
Financial sector reform					
9	++	++ (operational)	0 (marginal improvement)	0 (marginal improvement)	Marginal reform effect, therefore no macroeconomic effect
10	++	? (political), no operational	0	(b) = 0	No macroeconomic effect
11	+	(+) (political), no operational	0	(b) = 0	Marginal reform effect
Business environment					
12	++	(+) (political), no operational		(b) = 0	No macroeconomic effect
13	+ (Not fully operational yet)	(?) (political), no operational			No reform effect
14	+ (not ARMO)	(+) (political), no operational	++	(b) = 0	Macroeconomic impact cannot be attributed to MFA conditionality

Explanation of qualifications under step 2:

++ : verifiable and substantial effect

\+ : verifiable but small effect

(+) : not verifiable but possibly a small effect

? : no verifiable effect

No : no effect

Explanation of Steps 3 and 4

Explanation of Step 3

We have identified three conditionalities with plausible macroeconomic impacts:
- Conditionality 6: “Public wages through banks”;
- Conditionality 9: “New banking law”;
- Conditionality 14:”Privatisation of Albtelekom and ARMO”.

Conditionality 6: “Public wages through banks”
This conditionality seemed to have a direct macroeconomic impact through the broadening the capital base of the private banks. This increased the opportunities of banks to expand credit facilities, which contributed to private investments. We quantify the effect of this conditionality based on the following assumptions:
- MFA contributed to 5,000-15,000 extra public sector employees in 2005, 5,000-10,000 in 2006;
- The effect started in 2005, continued in 2006 But had no effect in 2007.

We suggest that this effect faded out because we assumed that the Albanian government intensified the reform targets. Therefore, the initial effect of the MFA conditionality lost ground.

Conditionality 9: “New banking law”
Financial sector reforms in Albania through strengthening financial sector supervision and increasing the autonomy of the supervisory authorities create more stability within the sector. This could facilitate an improved investment climate, and contributes to economic growth in Albania. More supervision and regulation of the banking sector could reduce risks for banks; and this is generally reflected in high gaps between borrowing and lending rates, due to the existence of adverse selection problem. Financial sector reform can be expected to positively affect domestic as well as foreign investment decisions - which will contribute to economic growth. The decision to invest is also contingent on a number of variables of the monetary block (interest rates, inflation rates, exchange rates). Hence, financial sector reform would contribute to stability in the financial sector, which in turn would (conditionally) enable a more attractive investment climate to develop. This would positively affect the capital account and growth through the monetary block. If interest rates change, exchange rates would be influenced (higher interest rates, raise the exchange rate), and lower inflation rates would tend to show an appreciation in the currency value (and vice versa).

The new law on the banking sector (Conditionality 9) improved banking supervision. However, the law from 1999 - which was replaced by this law - was already quite a good law. In addition, the banking sector was already a relatively stable sector in the Albanian economy. Therefore, we conclude that the improved quality of the banking law, although a merit in itself, did not contribute to the stability of the financial sector.

Conditionality 14:”Privatisation of Albtelekom and ARMO.
Albtelekom was sold in October 2007. The proceeds of the privatisation are reflected in the budget for 2007 (50 percent for additional investments and 50 percent for deficit

reduction). However, we identified only a small political reinforcing effect. Therefore, we cannot establish a clear link between privatisation and the MFA conditionality.

Explanation of Step 4 (b)

Step 4 question (b) focuses on the issue of whether the conditionalities affected progress in the reform area. The MoU (2004) identified four reform areas:

1. Public finance reform (5 conditionalities);
2. Fight against corruption and public administration reform (3 conditionalities);
3. Financial sector reform (3 conditionalities);
4. Business environment (3 conditionalities).

Public finance reform

We identify the conditionalities ‘Policy Paper on Public Finance Control’ (Conditionality 4), ‘Introduction of the Treasury IT system’ (Conditionality 5) as core reform activities within the area of public finance reform. Both reforms have the potential to substantially improve the public finance system. However, the interviewees stated that roughly half of the reforms resulting from the policy paper had actually been implemented. In addition, progress in implementing the new Treasury IT system has been slow. It is expected to be operational from 1st of January 2008. We therefore conclude although the two activities can be seen as core activities, the limited progress does not legitimise attribution of progress of the reform area to the MFA conditionalities.

The fight against corruption and public administration reform

Although all three conditions have value added in the fight against corruption and improving the public administration, they do not seem to be core reform activities. Limiting the delay in the judicial process contributes to the quality of the judicial process. However, other factors, such as the quality of the judges and lawyers, seem to be even more crucial for the quality of the judicial process. In addition, the legal framework for conflict of interest can certainly contribute to reducing corruption. However, existing practice - such as political civil servant appointments - diminish the impact of such a law. All in all, the conditions were not core activities for the fight against corruption and public administration reform. Therefore, progress in the reform area cannot be attributed to the MFA conditions.

Financial sector reform

Of the three conditionalities in this reform area, Conditionality 9 “New law on the banking sector” seems to be a core activity. The new law is a qualitative improvement on the previous supervision law of 1999, and is in line with EU regulations. However, the previous law was already of a relatively high standard. Therefore, most experts take the view that the law itself did not have a major impact on financial sector reform. Therefore, we conclude that progress in financial sector reform cannot be attributed to the MFA conditions.

Business environment

The facilitation of market entry is improved by the removal of administrative barriers and the approval of the new Law on Commercial Registration. This could contribute to more competition on the markets. The potential macroeconomic effects of these reforms would be higher growth rates generated by the private sector. Higher economic growth rates can be achieved through productivity growth within the private sector. Private sector development enables job creation and reduces poverty, as well as increasing the tax base for the delivery of public services. Alternatively, the removal of administrative barriers contributes to growth in the sense that it reduces the size of informal economic activities. Moreover, the strengthening of the private sector will affect the domestic production positively - which could then be exploited in order to substitute imports and promote exports. Hence, the current account balance will be improved.

Unfortunately, progress is lagging behind. Experts state that this lack of progress is caused by too many aspects of the business environment needing to be improved in order to generate results. The interviewees did not see the conditionalities as core activities to bring about improvements to the business climate.

Appendix VI Results of Delphi questionnaire

Methodological justification

The Delphi questionnaire has been delivered to 13 persons who were considered by the evaluation team, to have sufficient knowledge on the MFA-related developments. This pool of experts consisted of 9 representatives of Albanian government institutions and 4 representatives of IFIs. In total, 7 Albanian experts and 3 international experts have returned the questionnaire in the first round of the Delphi method. In the second round of the Delphi method, the respondents have been confronted with the consolidated responses and have been given the opportunity to adjust their previous answers. Four respondents have used this opportunity to change some of their initial replies.

Part 1 Impact on macroeconomic stability

Table VI.1 reflects the perception of the experts with regard to the macroeconomic stability of Albania in 2007 compared to 2003.

Table VI.0.1 Responses to the question “How do you assess the likelihood of a future financial crisis in Albania?”

	Highly unlikely	Slightly unlikely	Slightly likely	Highly unlikely	Don’t know	Total
In 2003	5	4	1	0	0	10
In 2007	4	4	2	0	0	10

The table shows that the macroeconomic situation in Albania in 2003 was considered to be fairly stable. The following reasons underlying the scores are given:

- The financial sector situation was stable, profitable and capitalised, while the last remaining state-owned bank, the Savings Bank, was banned from crediting and was in the process of becoming privatised;
- The economic growth was stable at around 5-6 percent;
- The inflation was under control;
- The state budget was realistic and there was a gradual decrease in the deficit;
- The inflow from remittances and official financing showed a relatively stable pattern.

The stability of the macroeconomic situation has slightly deteriorated in the perceptions of the Delphi respondents in 2007. The relative importance of the various risk factors is assessed in Table VI.2. The table shows little variation in the importance of the various risk factors. All factors score in the range between 3 and 5. The factor that is considered to constitute the highest risk for Albania’s external situation is the political stability within the country. The lowest risk is assigned to a slowdown of foreign direct investments. The reason for this is that the level of FDI is considered to be so low that deterioration is not to be expected.

Table VI.0.2 Responses to the question “What are the most important risk factors for the Albania’s external sustainability situation in the future? Please score the following factors in order of importance (‘1’ most important – ‘7’ least important).”

	Risk factor	Average score
1	Shift in political priorities resulting in larger fiscal deficit	3.0
2	More expensive debt financing	3.4
3	Imbalance of trade account: Slowdown of exports	3.7
4	Decline of remittances	3.9
5	Imbalance of trade account: Increase of imports	4.1
6	Decline in FDI	4.8
7	Others	0

Table VI.3 focuses on the contribution of the MFA to macroeconomic stabilisation. Based on the objectives of the MFA as laid out in the Council Decision (2005/580/EC), the Delphi respondents are offered three alternatives of the perceived value added of the MFA. From Table VI.3 it can be inferred that the MFA has been used to support the budget in order to facilitate structural reforms. The support to the balance of payments is considered to be of minor importance. One Delphi respondent explicitly specifies the value added of the MFA as an instrument to build confidence of the international financial market in Albania’s stability. Another respondent mentioned the contribution of the MFA in increasing the commitment of the Albanian government vis-à-vis the international community.

Table VI.0.3 Responses (of Albanian officials and representatives of IFI’s) to the question “How did you perceive the value added of the MFA? Was it mainly contributing to the balance of payments? Or did you perceive its contribution more as general budget support or as support to structural reforms?”

	Balance of payment support	Budgetary support	Facilitation of structural reforms	Others (specify)	Total
Albanian	17 %	45 %	33 %	5 %	100%
Internationals	11 %	37 %	47 %	5 %	100 %
Total	**15 %**	**42 %**	**38%**	**5 %**	**100%**

Table VI.4 explores the counterfactual situation of the absence of MFA. It aims at discovering the likelihood of certain alternative arrangements by the main institutions involved in the macroeconomic stability of the country. From the table, it can be inferred that the most likely adjustment, in case that MFA had not existed, would have been made by the Albanian government. Neither the IMF nor the EU nor other donors, such as the World Bank, are expected to have changed their programmes in the absence of the MFA. The Albanian government is expected to have either widened its fiscal deficit financed by more borrowing, or it would have left the fiscal deficit unaltered and decreased its expenditures. The results shown in Table VI.4 leave both course of actions open for the Albanian government. However, a counterfactual based on a cut in government expenditures can rely on broader consensus. Another element of the counterfactual in the absence of the MFA, although less significant, seems to be the weakening of the reserve position.

Table VI.0.4 Responses to the question "What would have happened in your opinion if the MFA had not been granted to Albania?

	Very unlikely	Unlikely	Likely	Very likely	Don't know	No answer	Total
IMF would opt for …							
Larger programmes	3	2	1	0	1	3	10
Tighter policy requests	2	3	1	2	1	1	10
Laxer policy requests	4	2	0	0	1	3	10
EU would …							
Allocate more CARDS money	2	1	1	0	5	1	10
Other donors would …							
Switch money from TA	2	1	2	0	0	3	10
More debt cancellation	5	2	0	0	2	1	10
Albanian institutions							
More taxes	1	5	2	0	0	2	10
Less public spending	0	1	6	3	0	0	10
More borrowing	2	1	5	1	0	1	10
Less to reserve position	2	1	3	2	0	2	10

Table VI.5 elaborates on the macroeconomic consequences of the counterfactual that the Delphi respondent identified in answering question 4. Seven out of ten questionnaires included a response to the question. The respondents show consensus that the macroeconomic consequences would include a slower growth in GDP resulting from less government expenditure. However, due to the small size of the MFA, the impact on GDP growth is expected to be tiny. The respondents do not feel that the balance of payments situation would have altered in the absence of MFA.

Table VI.0.5 Responses to the question "Please elaborate on the fiscal land balance of payments consequences of your more likely scenario from question 4. What would be the most important outcome in the economic sphere if the MFA had not existed?

1	*"Less public spending would have a negative effect on GDP growth, but its importance would depend on the size of spending contraction and the affected sectors. The impact on the balance of payment is difficult to predict, but in the short term it might affect more the imports, having a positive impact on the balance of payments situation."*
2	*"Confidence in budget planning and execution would have been at a lower level; there would be less money in the economy and, consequently, a slower economical growth."*
3	*"The € 25 million financial assistance, when considering the conditionalities, was stretched throughout 2 budgetary years, approximately stretched at 1.5 billion (AL) Lekë per annum. Historically, the public expenditures programme in the state budget has been realised at the 90-93 % level, thus spending a little over 15-20 billion (AL) Lekë. Consequently, the impact on the state budget would not have been huge."*
4	*"It would have hardly have had any consequences on macro and Balance of Payments. MFA amount is hardly significant for the budget. Obviously, there would be less spending. There can not be an educated guess about the resulting expenditure cuts; discretion of the Ministry of Finance & Prime Minister when such need arises within the limits recognised by the budget law."*
5	*"Had the response to a lack of Macro Financial Assistance been a one-for-one decline in public spending, there would be zero effect on reserve levels, but possibly a small decline in economic growth."*
6	*"The impact would have been marginal in several aspects."*
7	*"As domestic borrowing was strictly limited under the IMF program, not getting this money would have been felt on the external debt and/or reserve fronts. But honestly, the amount involved is so small that this issue."*

Part II Impact on structural reforms

Table VI.6 shows the perception of the Delphi respondents on the relevance of the MFA conditionalities.

Table VI.0.6 Responses to the question "How do you assess the relevance of these specific reforms at the time they were proposed in relation to the national reform agenda?"

Total	Not relevant	A minor issue. Hardly relevant	Relevant but not a priority	Important issue and top priority	Empty
Public finance reform					
Safety of fund disbursement procedures		4	3	3	
Effectiveness of internal audit			2	8	
Overall level of control in public finance			2	8	
Level of IT automation of Treasury			4	6	
Public administration reform					
Public wages through banking system			3	7	
Legislation on conflicts of interest			4	5	1
Delays in judicial processes			1	9	
Financial sector reform					
Banking system regulatory environment		1	3	6	
Level of automation of Central Bank		1	5	4	
Prudentrules on reinsurance		1	4	4	1
Business environment					
Administrative barriers to SME development			2	8	
Legal framework for company registration			3	7	
Privatisation of Albtelekom and AMRO		2	1	7	

With the exception of the conditionality related to Government disbursement procedures, all conditionalities can be considered as relevant to the Albanian policy agenda at that time. Nevertheless, some differences in emphasis stand out. Internal audit procedures and delays in judicial processes come out as the top priorities in the list, closely followed by business environment reform. The reforms in the financial sector receive a relatively low level of consensus. The privatisation of Albtelekom and AMRO is the only item attracting genuinely differing views.

Table VI.7 reports the assessment of respondents on the progress achieved in the policy areas subject to MFA conditionality. The table shows that there is strong consensus regarding the channelling of wages through the banking system and financial reform (except for reinsurance) was the policy area with the highest degree of success. Also progress in the business environment is favourably assessed, although in slightly less enthusiastic terms. Reform in public finance control is also assessed favourably, although strongly differing opinions appear. Delays in judicial processes seem to be the area where the least amount of progress has been achieved.

Table VI.0.7 Replies to the question “How do you assess progress in the following areas in comparison with the situation in mid-2003?”

	Worsened	The same	A bit better	Much better	Empty
Public finance reform					
Safety of fund disbursement procedures		3	5	2	
Effectiveness of internal audit	2		6	2	
Overall level of control in public finance	2	1	3	4	
Level of IT automation of Treasury		4	4	2	
Public administration reform					
Public wages through banking system				10	
Legislation on conflicts of interest			7	2	1
Delays in judicial processes		4	5		1
Financial sector reform					
Banking system regulatory environment			2	8	
Level of automation of Central Bank			5	5	
Prudent rules on reinsurance	1	1	5	1	2
Business environment					
Administrative barriers to SME development		1	7	2	
Legal framework for company registration		1	4	5	

Table VI.8 below, summarises the importance attributed to the role played by the various actors in bringing about reforms through various pressure mechanisms, including conditionalities. The table shows that the progress on most conditionalities is primarily attributed to the government’s own commitment. The World Bank is only considered to be driving the reforms in the areas of the ‘enhancement of IT Treasury operations’ and ‘prudent rules on reinsurance’. At any rate, in all the various instances, the case for reform is always driven by many factors and MFA is never considered the leading one.

If the MFA and the EU Partnership Agreement is consolidated to reflect the EU influence on reform progress, the EU influence dominates the reforms in the domain of Public finance management. Also the judicial reforms and the reform of company registration are linked to the EU.

Table VI.0.8 Replies to the question "What was the relative importance of the following factors in bringing about reforms?"

	Government's own commitment	World Bank pressure	IMF pressare	EU Partnership Agreement	MFA
Public finance reform					
Safety of fund disbursement procedures	26 %	18 %	16 %	16 %	16 %
Effectiveness of internal audit	25 %	17 %	8 %	26 %	24 %
Overall level of control in public finance	28 %	17 %	11 %	21 %	23 %
Level of IT automation of Treasury	18 %	38 %	11 %	11 %	22 %
Public administration reform					
Public wages through banking system	30 %	2 %	46 %	4 %	18 %
Legislation on conflicts of interest	34 %	25 %	7 %	14 %	21 %
Delays in judicial processes	25 %	20 %	7 %	28 %	20 %
Financial sector reform					
Banking system regulatory environment	27 %	18 %	28 %	9 %	18 %
Level of automation of Central Bank	21 %	17 %	31 %	9 %	22 %
Prudent rules on reinsurance	21 %	37 %	16 %	14 %	12 %
Business environment					
Administrative barriers to SME development	31 %	19 %	17 %	16 %	17 %
Legal framework for company registration	31 %	17 %	14 %	12 %	26 %
Privatisation of Albtelekom and AMRO	38 %	15 %	17 %	4 %	26 %

Table VI.9, below, reports the assessment of respondents on the type of influence exerted by the MFA in the policy areas subject to MFA conditionality. The table shows that the prevailing view in all policy areas is that MFA contributed to the speeding up of the reform process. Notable exceptions to this are of the banking reform - where the harmonisation aspect is deemed prevalent; conflict of interest – again an EU subject; and the wage reform process - because the new MFA-agreed threshold "forced" the Government to expand the geographical scope of reform.

Table VI.0.9 Responses to the question “What contribution, if any, did the MFA have in bringing about these reforms?”

	Raised the issue in the policy agenda	Speeded up the reform process	Shaped the contents of reform	Don’t know
Public finance reform				
Safety of fund disbursement procedures	1	6	1	2
Effectiveness of internal audit	2	4	1	3
Overall level of control in public finance	3	5		2
Level of IT automation of Treasury	2	4	1	2
Public administration reform				
Public wages through banking system		5	5	2
Legislation on conflicts of interest		5	4	3
Delays in judicial processes	3	1	1	5
Financial sector reform				
Banking system regulatory environment		3	5	2
Level of automation of Central Bank		5	3	2
Prudent rules on reinsurance	3	4	1	2
Business environment				
Administrative barriers to SME development	4	1	3	2
Legal framework for company registration	1	5	2	2
Privatisation of Albtelekom and AMRO		5	2	3

Table VI.10, below, reports Delphi respondents’ opinions on what would have happened to the various structural reforms if the MFA had not been there. It shows that there is almost unanimous consensus among the respondents that in none of the cases would the reform have been neglected or not taken over by other international organisations in the absence of the MFA. For certain items (where it often was de facto already there), other channels of external pressure is perceived as more likely; while for other items, genuine Government interest is thought to be likely.

Table VI.0.10 Responses to the question “What would have happened to the requested reform activities linked to the FA if the MFA had not existed (more options can be selected)?”

	Would have been incorporated in IMF programme	Would have been incorporated in World Bank programme	Would have been strengthened under Partnership Agreement	Would have become part of Government agenda	Would neither be part of any programme nor part of Government's own agenda
Public finance reform					
Safety of fund disbursement procedures	3	4	1	2	
Effectiveness of internal audit	1	1	3	4	
Overall level of control in public finance	2	3	3	2	
Level of IT automation of Treasury	2	4	2	2	1
Public administration reform					
Public wages through banking system	3			7	
Legislation on conflicts of interest	1	1	2	4	1
Delays in judicial processes	1		2	5	1
Financial sector reform					
Banking system regulatory environment	2	2	2	2	
Level of automation of Central Bank	2	2	2	2	
Prudent rules on reinsurance	2	5	1		
Business environment					
Administrative barriers SME development	1	6		4	
Legal framework for company registration	2	4		5	
Privatisation of Albtelekom and AMRO	1	1		5	

Appendix VII Historical overview

Table VII.0.1 Historical overview events relevant for the MFA operation

Date	Event
1992	First MFA to Albania
1994	Second MFA to Albania
January 1997	Pyramid investment schemes fails; chaos and armed revolt
March – June 1999	Kosovo crisis
April 1999	Third Council Decision 1999/282/EC on MFA to Albania up to € 20 million
July 2002	IMF PRGF three-year programme is agreed.
January 2003	Start negotiations for SAA
July 2003	IMF review: financing gap of USD 46 million is identified
September 2003	Minister of Finance Mr. Islami officially requests MFA for Albania (by letter)
October 2003	EFC is consulted on new MFA to Albania
December 2003	First Council proposal for MFA to Albania
March 2004	Operational Assessment
April 2004	Repeal of Council Decision 1999/282/EC Council Decision 2004/580/EC on Fourth MFA to Albania up to € 25 million
April 2004	The Savings Bank is sold to foreign investor, resulting in privatisation proceeds totalling EUR 103 million
July 2004	Fourth programme IMF-PRGF review
11-14 October 2004	ECFIN mission to Tirana to negotiate the MoU
November 2004	EFC was consulted on the draft MoU
February 2005	Follow-up Operational Assessment
May 2005	Memorandum of Understanding is signed
3 July 2005	General Elections; Sali Berisha, leader of the Democratic Party, back in power
July 2005	Sixth review of IMF PRGF programme
September 2005	New government (Democratic Party) led by Mr. Sali Berisha takes office
September 2005	Albanian Parliament approves the Loan agreement under MFA (Law 9422)
November 2005	First tranche is released, grant of EUR 3 million is disbursed
21-24 November 2005	ECFIN mission to Tirana review second tranche
November 2005	New EC Enlargement Strategy Paper
December 2005	Revised European Partnership for Albania is adopted by the EC
January 2006	New 3-year IMF PRGF programme (February 2006 to January 2009, about EUR 20 million)
March 2006	Second part of the first tranche is released, loan of EUR 9 million
25-27 April 2006	EC staff mission to Tirana; review conditions for second tranche
May 2006	First review of new IMF PRGF programme
June 2006	SAA is signed
June – July 2006	IMF identified a residual financing gap for 2006 of EUR 41 million

Date	Event
July 2006	Second tranche is released, grant of EUR 13 million
February 2007	Local government elections
July 2007	Presidential elections. New President Mr. Topi is elected

Appendix VIII Overview of IMF programmes

Table VIII.0.1 Overview of IMF activities in Albania in the period 2002-2007

Date	Activity	Selection of IMF comments
June 2002	**PRGF IMF programme agreed**	
March 2003	1st review	Albania's performance during the first six months of the three-year PRGF supported programme has been satisfactory. However, progress in the area of structural reform has been relatively weak, reflecting political uncertainties and governance problems
July 2003	2nd review	"Fiscal policy has been hindered by weaker-than-expected revenue collection, but the deficit targets have been met. The steadfast implementation of structural reforms remains crucial to high private-sector led growth. Key priorities are removing administrative barriers to investment, improving governance, and fighting corruption."
January 2004	3rd review	Executive directors commended the authorities for the successful promotion of macroeconomic stability, but expressed concerns about the delays in the structural reforms and the shortfall in revenue collection, and emphasised the need to strengthen governance.
July 2004	4th review	Directors emphasised that efforts to improve governance and the business climate were crucial to elicit private investment and enhance growth prospects. Directors also indicated that budget revenue mobilisation remained critical to the success of the authorities' poverty reduction strategy.
March 2005	5th review	Performance under the programme since the fourth review has been good and programme conditionalities were observed, some with significant margins.
August 2006	6th review	Despite some progress, revenue and expenditure administration reforms and financial sector development remain key priorities. Privatisation efforts have had mixed success. The sale of Albtelecom is at an advanced stage - although parliamentary approval is still required - but ARMO's tender was unsuccessful.
January 2006	**2nd PRGF/EFF IMF programme agreed**	
July 2006	1st review	The implementation of the PRGF/EFF-supported programme has been broadly satisfactory, but the performance criterion on the collection and loss rates of KESH was not fulfilled. However, the authorities have taken strong corrective action
February 2007	2nd review	Albania's macroeconomic performance remains strong. Progress in structural reform has been generally good. Policy discussions focused on two issues: (1) Fitting the authorities' road development programme into the medium-term fiscal framework. (2) Anchoring inflation expectations to the 3 percent target.
July 2007	3rd review	All quantitative programme targets and structural conditionality for the third review have been met. On the basis of the strong programme performance and the authorities' commitments, staff recommends completion of the Third Review.

Source: www.imf.org

Appendix IX Overview of World Bank programmes

Development Policy Loan

This loan was approved in March 2007. The first proposed programmatic Development Policy Operations under this loan has the objective to improve the investment climate for private sector-led growth, improve fiscal sustainability of public service delivery, and improve government effectiveness.

Business Environment Reform and Institutional Strengthening (BERIS)

This facility was approved in October 2006. The Albania Business Environment Reform and Institutional Strengthening Project (USD 3.7 million) under this facility aims to provide assistance to the Government to:

- facilitate business entry and operations in the formal economy;
- strengthen the enterprise sector's capability to increase exports towards regional and European Union (EU) markets.

The project consists of the following three components:

1. Facilitating business entry and operations by improving the quality of business regulations, including their potential impact on market competition;
2. Strengthening the enterprise sector's capability to export to regional and EU markets by developing the Metrology, Standards, Testing and Quality system further;
3. Project coordination support component.

The Third Poverty Reduction Support Credit

The Third Poverty Reduction Support Credit (PRSC-3) December 2004 – December 2005 supported the National Strategy for Social and Economic Development (NSSED), in line with the Bank's strategy presented in the Country Assistance Strategy (CAS). The programme supported the implementation of key reforms aimed at promoting economic growth, strengthening public sector governance, and improving social service delivery. Furthermore, the project also consolidated reforms in public administration, public expenditure management and accountability, and social sector service delivery. The World Bank explicitly stated that the support under this project was followed by balance of payments support from the European Community. The outcome of the Third Poverty Reduction Support Credit Project in Albania was satisfactory, with sustainability likely, substantial institutional development impact, and satisfactory performance.

The second Poverty Reduction Support Credit

The Poverty Reduction Support Credit (PRSC-2) July 2003 – December 2004 supported the development and implementation of policies within the framework of the

Government's three-year National Strategy for Social and Economic Development (NSSED) supporting a better quality of life (especially for the poor), and consistent with, and supportive of the country's overall growth strategy. This operation supported more effective and efficient policy formulation and implementation; improved access to social services; better targeting of scarce fiscal resources to those most in need, as well as policies conducive to sustained growth. The project outcome was satisfactory, sustainability is highly likely, and the institutional development impact substantial.

The first Poverty Reduction Support Credit
The Poverty Reduction Support Credit (PRSC-1) June 2002 – June 2003 for Albania supported the implementation of fiscally-sustainable policies within the framework of the Government's three-year Growth and Poverty Reduction Strategy. This operation supported more effective and efficient policy formulation and implementation; improved access to social services and better targeting of scarce fiscal resources to those most in need, as well as policies conducive to sustained growth. The outcome of the PRSC-1 for Albania was rated as satisfactory with sustainability likely, the institutional development impact substantial.

The Financial Sector Adjustment Credit
The Financial Sector Adjustment Credit Project (FSAC) June 2002 – December 2004 supported financial sector reforms as specified in the Growth and Poverty Reduction Strategy. Designed to support the implementation of the final phase of the State's divestiture from the financial sector, and to change the State's role from an owner to a regulator, the project supported this transition by improvements to the legal and institutional framework which are necessary for a market based financial sector to function properly. The project generated a satisfactory project outcome, with sustainability highly likely, and high institutional development impacts.

The Public Administration Reform Project
The objective of the Public Administration Reform Project (PACTA), March 2007 – December 2006, was to provide assistance the Albanian government to improve its capacity with regard to policy formulation and coordination, and administrative performance. More than half of the resources have been devoted to improving public expenditure management by addressing macroeconomic forecasting, budget execution (including the Treasury), accounting (including internal audit) and procurement. The outcome of the project was rated 'moderately unsatisfactory'.

Appendix X Review of recommendations

Recommendations arising from ex-post evaluations of MFA operations	
FYRoM, Romania, Armenia, Tajikistan, BiH	**MFA Albania**
Objectives	
The objectives for MFA should be clearly specified and presented more explicitly to all MFA actors involved. Also, the possible hierarchy of objectives should be set out more clearly.	Confirmed: The Council Decision includes various objectives. Most MFA stakeholders among the Albanian authorities were not aware that the prime objective of the MFA relates to the balance of payments.
Given the success of the operation in terms of contributing to the short-term macroeconomic stabilisation of the Armenian economy, it is recommended that future MFA operations are more focused on achieving this objective.	Not applicable: At the time of the MFA operation, Albania's short-term macroeconomic situation was stable. In such circumstances, it can be advised that more attention be given to strengthening external sustainability in the medium term.
It is recommended that MFA operations focus primarily on supporting a return to macroeconomic stability in the shorter term. EU support to promote medium to longer-term institutional and economic change should be left to other instruments implemented in the framework of the European Neighbourhood Policy.	Not applicable: The case of Albania combines the presence of a residual financing gap with short-term macroeconomic stability. In such circumstances, it can be advised that more attention be given to conditionalities that aim to strengthen external sustainability in the medium term.
Conditionality	
Conditionality should primarily have directly measurable links with the core objective of MFA, i.e. filling a foreseen residual financing gap in the balance of payments.	Partly confirmed: the set of conditionalities included in the Albanian MFA operation encompassed reforms that were closely linked to external sustainability (e.g. privatisation, banking law) but also reforms which are less related to external sustainability (e.g. judicial reforms).
The choice for cross-conditionality with IMF/WB appears to be logical and pragmatic. However, more selective use of cross-conditionality could improve the reinforcing effects.	Not applicable: in the Albanian case cross-conditionality has been applied in a pragmatic manner and has not reduced the effectiveness of the instrument
A less ambitious and more focused approach with a restricted number of 'critical' structural MFA conditions should be considered, especially when the implementation capacity of a government is limited.	Not applicable: the conditionalities were realistic and their number was in balance with the size of the operation.
If the EC has explicit preference for more EU-specific conditions within MFA, it should ensure that other EU programmes provide technical assistance to help with	Not applicable: A lack of technical assistance has not appeared to inhibit the fulfilment of the conditionalities.

Recommendations arising from ex-post evaluations of MFA operations	
FYRoM, Romania, Armenia, Tajikistan, BiH	**MFA Albania**
the design and monitoring of these conditions.	
Structural conditionalities should primarily be focused on reform areas which have a direct and unambiguous link to the underpinning of macroeconomic stability in the short term. In cases where support is provided for reforms that by their nature have to be implemented on a step-by-step basis over a number of years, or will only give rise to effects over the medium to the longer term; timescales should be made explicit when conditionalities are established.	Partly confirmed: The set of conditionalities included in the Albanian MFA operation encompass both reforms that were closely linked to macroeconomic stability in the short term, as well as reforms aimed at medium to long-term institutional change. However, in the case of Albania - which combines the presence of a residual financing gap with short-term macroeconomic stability - it can be advised that more attention be given to reform areas that strengthen external sustainability in the medium term. In the case of Albania, these latter reforms were part of consistent long-term change agenda with an explicit timescale (European Partnership Agreement).
Efforts should be focused on ensuring complementarity and coherence of MFA operations with instruments implemented as part of the European Neighbourhood Policy, as well as with possible future budget support operations under the European Neighbourhood Partnership Instrument.	Not applicable: the MFA conditionalities were well-aligned with the European Partnership Agreements
When broader-ranging conditionalities are considered necessary to support essential reforms in areas that are more intractable/cross-cutting in nature; they should be implemented as early as possible in the operation, so that they support subsequent conditionalities aimed at underpinning other reforms that are to some extent contingent upon early reform efforts (i.e. as illustrated by the interlinked nature of corruption, business environment and tax administration reforms in this evaluation)	Not applicable: the operation did not include multiple MoU's related to different tranches
Structural conditionalities should be formulated in a homogeneous and unambiguous fashion in order to avoid potential misinterpretations or divergences of views regarding their fulfilment.	Partly confirmed: The conditionalities in the MFA operation in Albania were mostly clear and unambiguously formulated. However, some conditionalities gave rise to a different interpretation.
To facilitate good implementation of conditions under MFA, the Commission should continue to consider the drafting of structural conditions with reference to genuinely owned programmes as best practice and their existence, whenever possible, as a precondition showing that some debate has taken place within government.	Not applicable: The ownership of the required reforms was not an issue. The Albanian government was committed to the conditionalities as they were well aligned with the country's own reform agenda.
Management	
An investigation should determine the extent to which MFA procedures could be made less rigid to allow	Not applicable: The MFA operation in Albanian did not face problems due to rigidity of the instrument. In

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modification of some terms and conditions within the original agreement (e.g. granting waivers, changing conditions, targets).	contrast, in some cases the EC responded in a flexible manner to changing circumstances.
When deciding on the terms of MFA, the EC should not only pay attention to its own support, but should also take into consideration the terms of the total support package to a country. This requires timely information to be made available about the support programmes of the IFIs and/or other donors.	Not applicable: There was adequate consultation with IFIs.
Also, the Commission should carefully consider the necessity of small tranches in the case of support to large economies. Splitting up tranches should be carefully assessed, as this might reduce the intended (economic and non-political) effects of the tranches.	Not applicable: The size of the main second tranche was large enough to be of political significance to the country.
Close and regular policy dialogue with the authorities in charge of implementing the reform measures is key to ensuring ownership and to monitoring results. The evaluation shows that a greater presence in the field, or the direct involvement of qualified staff in the EC delegations would be necessary to increase the impact of future MFA operations.	Not applicable: The ownership of the required reforms was not an issue. The Albanian government was committed to the conditionalities as they were well aligned with the country's own reform agenda.
We would also recommend that in complex legal environments the Commission should participate as early as possible in the preparation phase; not only the Operational Assessment, as is currently being done, but also in any other legal due diligence activity.	Not applicable: The legal context was not an issue.
Design	
The Commission should continue considering having recourse to a grant option in exceptional cases of complex operations in International Development Association (IDA) countries.	Confirmed: The grant element in the MFA operation was a prime incentive for the Albanian government to commit itself to the MFA agreement
Although domestic dissemination of information about MFA clauses should largely remain the responsibility of the counterpart government, the Commission should find ways to ensure that minimum communication requirements are enshrined in MFA design. This is in order to ensure that agencies involved in implementing conditionalities are fully aware of the existence of the MFA.	Confirmed: Most key stakeholders linked to the structural reforms that were part of the conditionalities were not aware of the MFA operation.
The design of MFA should refrain from excessive recourse to prior actions or conditions to be fulfilled for disbursement of the first tranche, apart from those related to the OA - which can be considered as a kind of legal pre-requirement.	Not applicable: Only two prior actions were formulated. Moreover, these actions were directly related to the Operational Assessment.
Secure cooperation among relevant Directorates	Not applicable: The Albanian case shows no evidence

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	of insufficient cooperation among EC Directorates.
Make use of Operational Assessment as the source of highly relevant EC-specific conditionality	Not applicable: The Albanian MFA operation included two prior actions that directly resulted from the Operational Assessment.