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**Statement by Mr. Wang and Mr. Chen on Albania  
(Preliminary)  
Executive Board Meeting 06/68  
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We thank the staff for the comprehensive set of papers and Mr. Sadun and Mr. Gola for their informative Buff.

Since the last review, the Albanian economy has remained sound, maintaining a relatively strong growth momentum and subdued inflation. Fiscal discipline has been strictly enforced with public debt and the deficit being well checked, while monetary conditions have proved stable and resilient to external shocks. However, notable downside risks have emerged in the economy, particularly in the institutional weaknesses giving rise to underinvestment and slower productivity growth, which have affected the growth outlook and external position. The release of further growth potential depends on key structural reforms rather than macroeconomic management, which has to retain a tightening bias for the time being. Moreover, as the low revenue base allows only a little room for the fiscal automatic stabilizer to work, and the prevalent use of foreign currencies in the banking system undermines monetary operations, the role of macroeconomic policy will be rather limited. With reforms enabling major improvement of both the physical and institutional infrastructure, the economy will gradually be able to develop its own economic engines—in addition to external aid and remittances—and move toward a sustained growth path.

In the fiscal area, in our view, the top priority for the reform agenda will be expanding the revenue base by minimizing the informal economy and encouraging compliance. The authorities' planned reduction of the tax burden should be linked with more efficient revenue collection, and remains largely revenue neutral with little weight given to the deficit and public debt. We concur with staff that tax reduction should be well sequenced to avoid any disruptive impact on the authorities' targeted decline of public debt. We support their intention to cut labor taxes first as the gains will be significant given their much higher level than other middle-income economies, and agree that there is no urgent need to reduce other

taxes at the current stage. Besides revenue policies, public spending should be well focused and prioritized to make best use of the valuable public funds. We welcome the authorities' decision to increase capital spending without raising the overall cap on expenditure—crucial in facilitating capital formation and infrastructure construction in an economy with a relatively weak private sector.

Supported by a restrictive fiscal policy and a flexible exchange rate, the monetary authorities have successfully stabilized prices within the targeted range. However, although the current credit boom can largely be attributed to a natural catch-up from the previous financial depression, it does entail potential financial risks while at the same time fueling demand for non-tradables and imports, and dampening the inflation outlook as well as the external position. We note that the authorities are aware of these risks and endorse the supervisory measures they are ready to take to address any possible deterioration in credit quality. To benefit from the favorable credit conditions, we call on them to pursue structural policies to encourage investment—particularly in capital construction. We share staff's appraisal of the authorities' plan to establish a unified and independent supervisor of non-bank financial activities. Before a sophisticated supervisory system is in place, the authorities' caution regarding market entry of non-bank financial firms is well justified.

We recognize the progress the authorities have made with the structural reform agenda and their quick remedial actions after the slippage of the performance criteria on the operation of KESH demonstrated their strong will to remove this key bottleneck to growth. It is true that institutional weakness is equally depressing for infrastructure construction as shortage of funds, and we encourage the authorities to facilitate private sector involvement with assistance from the World Bank. The authorities' continuing efforts to improve the business climate have seen some concrete achievements, but still not sufficient to boost private investment and FDI, which we reiterate is of vital importance to the economy's growth potential and international competitiveness.

Based on Albania's sound performance and the progress made under the current program, we endorse the waiver of the missed performance criteria and the completion of the first review of the PRGF/EFF-supported program and the financing assurances review.

With these remarks, we wish the authorities all the best in their future endeavors.