

THE INTERNATIONAL MONETARY FUND
AND THE INTERNATIONAL DEVELOPMENT ASSOCIATION

ALBANIA

**Joint Staff Assessment of the Poverty Reduction Strategy Paper
Annual Progress Report**

Prepared by the Staffs of the International Monetary Fund
and the International Development Association

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I. OVERVIEW

1. The Government of Albania has prepared a first Annual Progress Report of its Poverty Reduction Strategy Paper, known in Albania as the National Strategy for Socio-Economic Development (NSSED).¹ The NSSED was launched in Albania in November 2001, and was discussed by the Boards of the International Monetary Fund (IMF) and the International Development Association (IDA) on June 19 and 20, 2002, respectively. The first Joint Staff Assessment (JSA) pointed to a number of shortcomings to be addressed, but overall considered the NSSED an impressive effort. Despite this promising start, political divisions led to three changes of government in 2002, and although each government expressed its commitment to the NSSED, the uncertain political situation impeded its implementation and institutionalization. In late 2002, the Government began efforts to put the NSSED back on track. The Report reflects the country's mixed performance—slow progress during most of 2002 followed by concerted efforts over the last six months. On the whole and considering the context, staffs view the first year of NSSED implementation as satisfactory, but emphasize the need to make considerable progress over the next year.

2. **Many weaknesses identified in the first JSA still need to be addressed.** In particular, it is important to: (i) deepen and institutionalize the participatory process; (ii) elaborate a more specific vision of Albania's long-term economic development; (iii) improve costing and prioritization of policy actions, firmly linking the NSSED to the budget process; (iv) strengthen cross-sectoral linkages; and (v) overall, strengthen capacities within the government for strategy formulation, implementation, monitoring and evaluation, and aid coordination on the basis of the NSSED. The Report would have benefited from more candor in acknowledging and analyzing how to overcome shortcomings in implementation and in specifying the risks the NSSED program faces.

3. **Nevertheless, there have been a number of accomplishments over the past eighteen months.** The Government used the Progress Report process to put the NSSED back on track and

¹ *National Strategy for Socio-Economic Development: Progress Report for Implementation 2002*; Republic of Albania, Council of Ministers; May 8, 2003. The NSSED was known previously as the Growth and Poverty Reduction Strategy (GPRS).

build ownership and momentum. Achievements include: (i) completion of the first representative Living Standards Measurement Survey (LSMS), used to improve the poverty diagnostic; (ii) a better synchronized link between the NSSED and the medium-term expenditure framework (MTEF); (iii) progress in establishing monitoring and evaluation functions within twelve line ministries and in preparing the first NSSED monitoring plans for these ministries; (iv) more awareness and understanding of the NSSED within some line ministries; (v) a better staffed NSSED Department within the Ministry of Finance, with a clear mandate to coordinate NSSED implementation and monitoring; and (vi) efforts to integrate the Millennium Development Goals (MDGs) and emphasize the NSSED's complementarity with the Stabilization and Association Process with the European Union.² The main challenge for the Government is to sustain the intensive efforts of the last few months in order to make greater progress in implementing and institutionalizing the NSSED over the next year.

II. UPDATED POVERTY DIAGNOSTIC

4. **The staffs commend the Government for successfully completing the Living Standard Measurement Survey.** A national census, completed in 2001, paved the way for a fully representative LSMS in 2002, which will provide a much needed baseline on a number of social indicators.

5. **The Report's updated poverty diagnostic, based on the 2002 LSMS, validates the Government's strategy to focus on economic growth, while undertaking priority investments in education, healthcare, and infrastructure.** The dearth of reliable household-level data constrained the Government during NSSED preparation. The poverty analysis in the Report represents a substantial improvement over the NSSED, measuring poverty for the first time using internationally accepted methodological standards, and providing a solid benchmark for monitoring progress in reducing poverty. Based on the analysis, one quarter of the Albanian population—or close to 780,000 individuals—live in poverty. Extreme poverty is much smaller than presented in the NSSED, with less than 5 percent of the population unable to meet basic food requirements. The analysis also reveals marked geographic differences in living standards, with rural areas and especially the north exhibiting a proportionally higher incidence and severity of poverty. Consumption-based inequality is moderate and the analysis suggests that many households are clustered around the poverty line.

6. **The Report reveals how Albania's income poverty is often compounded by non-income dimensions of deprivation.** About one-third of the population lacks access to two or more basic necessities such as basic education, water, sanitation, or heating. Poverty is still largely correlated with unemployment and underemployment, especially in rural and mountainous areas. The Report notes concerns with women's labor force participation rates, youth, and other groups at risk, although it does not mention small minority groups, such as the Roma, which are among the poorest in Albania according to qualitative poverty studies. The Report's poverty diagnostic is not highly detailed and may have made better use of the available data. Analysis of the census and LSMS is still ongoing and more information will become available after the first panel survey is completed in mid-2003. An IDA Poverty Assessment, to be completed in 2003 in close collaboration with the authorities, will provide a more comprehensive poverty profile and inform future updates of the NSSED.

² Negotiations for the Stabilization and Association Agreement were opened in January 2003.

III. IMPLEMENTATION AND UPDATING OF THE STRATEGY

7. **Overall, the Report is relatively weak at candidly analyzing the achievements and setbacks experienced to date in implementing the NSSED, and in providing specific plans to improve the effectiveness of priority public actions.** Much of the Report focuses on achievements, often without providing data or other evidence, or does not attribute data when provided. However, the Report includes a matrix showing progress in implementing priority measures during 2002 (Annex 1 of the Progress Report), which is more frank than the text. The Report discusses future priority public actions, and includes an updated matrix of priority actions for 2003 (Annex 2 of the Progress Report). Further work is needed, however, to better address cross-sectoral issues, including gender, youth, and the environment. Substantial work is still needed to increase the strategic nature of the NSSED—to better prioritize and cost public actions and develop contingency plans, all grounded in a more elaborated vision of long-term economic development. To address these weaknesses, the Government has secured the support of international partners, including a Multi-Donor Capacity Building for Poverty Reduction Strategy Trust Fund, to undertake a participatory visioning process and build capacity of line ministries for prioritizing and costing public actions.

Macroeconomic and fiscal framework and financing

8. **Although the Progress Report somewhat improves on the analysis of sources of growth in the NSSED, further work is needed in future reports.** GDP growth in 2002, estimated at 4¾ percent, was lower than the 6 percent projected in the NSSED, in part reflecting electricity shortages. A more detailed analysis of the sources of growth in the past, given the new GDP estimates, would have allowed a better sense of the effect of various shocks and stimuli to economic growth, and thus a better understanding of prospects in 2003 and the medium term. The Report gives due attention to the agricultural sector, and appropriately recognizes property rights and land consolidation issues as serious impediments to sustained growth in this sector. Given the importance of the sector for poverty reduction—with more than half of the population and 2 out of 3 poor living in rural areas—an assessment of the impact of policies and reforms on agricultural growth would have been helpful.

9. **Achieving the projected GDP growth of 6 percent, although feasible, hinges on strong efforts to improve the environment for private sector activity.**³ The Report correctly identifies the importance of encouraging investment and exports to ensure sustainable growth. In this context, the decision to implement the recommendations of the recent Foreign Investment Advisory Services (FIAS) Administrative Barriers study is most welcome. The Report could, however, have usefully expanded on these recommendations, particularly in relation to the importance of improving governance and fighting corruption as a cornerstone of the strategy for private sector development. In addition, in the staffs' view and consistent with the findings of the FIAS study, using fiscal incentives to encourage private sector activity—as alluded to in the report—is not an appropriate policy tool, and would undermine tax collection further.

10. **The Report lacks a satisfactory analysis of the impact of the financing and revenue shortfalls in 2002 on priority expenditure.** These shortfalls resulted from privatization delays

³ The authorities' macroeconomic framework has been updated (including by incorporating the new national accounts) since the submission of the Report and is included in the authorities' Memorandum for Economic and Financial Policies. The assessment presented in the JSA is not affected by the revisions.

and weaknesses in tax collection—caused in part by repeated management changes in the tax and customs administrations, in the context of ambitious targets, which weakened reform efforts. The ensuing adjustment in expenditures, however, was not implemented in a sufficiently orderly and systematic manner, reflecting the absence of proper prioritization and poor expenditure monitoring, and resulted in undesirable cuts in spending on health and education—key elements of the strategy. The Report lacks a thorough analysis of the expenditure cuts and a discussion of how to address future revenue shortfalls and implement contingency plans—as described in the Memorandum for Economic and Financial Policies (MEFP), agreed with the IMF.

11. **The medium-term strategy, furthermore, should be based on a consistent and comprehensive approach to fiscal management, including proper prioritization and costing, and contingency plans.** The weak revenue performance so far this year suggests that the causes of the revenue shortfalls have not yet been adequately addressed, underscoring the need for a more systematic approach to expenditure management. While the Report mentions the need for better budgetary planning, the elements of such a strategy are not fully spelled out. It is imperative that the MTEF—to be updated in July—and the 2004 budget pay particular attention to this issue. The preparation of contingency plans should be viewed as a step toward preparation of alternative macroeconomic scenarios in future MTEFs.

12. **The authorities' policy program in the fiscal area also includes plans to improve fiscal transparency and to regularize public-sector inter-enterprise arrears—neither of which is discussed in the Progress Report.** This limits the scope for drawing on the NSSED (including the Progress Report) in designing these actions. The process of budget drafting, monitoring, and implementation needs much improvement to be considered satisfactory by international standards. While the positive assessment in the Report is unwarranted, reforms are being undertaken based on the recommendations of an IMF fiscal ROSC mission. The authorities have also made some progress in reconciling inter-enterprise arrears.

Structural and sectoral policies

13. **The Report rightly emphasizes the need to improve governance, and denotes the fight against corruption as a priority cross-cutting all reforms in the strategy.** The claim, however, that the index of perceived corruption has fallen is not consistent with a number of recent surveys, including the 2002 Business Enterprise Environment and Enterprise Performance Survey (BEEPS), which shows a perceived increase in administrative corruption and state capture in Albania compared to the first BEEPS undertaken in 1999.⁴ These findings underscore the importance of prioritizing anti-corruption actions, achieving visible results in key areas while also pursuing systemic reform, and tracking progress using neutral monitoring indicators.

14. **Improving the environment for private sector development—the driving force for growth and poverty reduction—will remain a key challenge over the next few years** (see para. 9). Increased private sector investment is also urgent for achieving creditworthiness and accessing international financial markets by mid-decade, necessary to prepare for the expected decline in concessionary lending. In addition to addressing administrative barriers to investment, the Government has taken measures to increase financial sector intermediation, including

⁴ The BEEPS, which cover over 3,000 enterprises in 22 transition countries, are undertaken jointly by IDA/IBRD and the European Bank for Reconstruction and Development.

adopting new insolvency legislation and implementing the secured transactions law. However, in the view of the staffs, the Report continues to place too much emphasis on targeted enterprise policies, such as the small and medium enterprise (SME) law, SME and investment promotion agencies, and credit guarantee schemes, rather than improving infrastructure and strengthening transparency, governance, and rule of law.

15. **The Government has implemented some measures to strengthen education and healthcare**, including increasing teacher and healthcare worker salaries, improving policies for textbooks, increasing the mandatory length of schooling by one year, advancing the HIV/AIDS Strategy, and completing the National Health Promotion Strategy. However, much work remains to be done and these sectors remain plagued by weak governance. The Progress Report set new enrollments targets for different levels of education, although the target for secondary education (90 percent by 2015) is overly ambitious, and there is insufficient attention to early childhood education. As noted earlier (para. 10), the Government did not execute planned increases in education and healthcare expenditures—a key element of the NSSD to address underfunding, target rural areas, and improve service delivery.⁵ The current MTEF program projects additional increases in education and healthcare expenditures over the next three years. The Government plans to conduct a Public Expenditure Tracking Survey for education and healthcare to better understand the dynamics underlying expenditure utilization in these sectors.

16. **As noted in the Report, Albania has implemented significant pension reforms over the last few years**, including increases in retirement ages, reduced contribution rates, higher contribution ceilings, and strengthened collections processes. The Government is also developing options for improving the targeting and effectiveness of cash social assistance and coordinating related areas of social policy. Staffs note that the Report continues to place too much emphasis on job creation through active labor market programs, including social insurance subsidies to some firms—labor market programs should start from the premise that employment growth depends on continuing economic growth and efficient resource allocation, rather than narrow employment-creation programs.

17. **The Government has continued to emphasize rural development**, and agriculture continues to play an important role in the economy. The Government is working to complete first time land registration and improvements to the registration process. Further progress has also been made to restructure water departments, marketing activities, rural advisory services, and consumer protection. Staffs note that many of the actions described in the Report are not completed and require the Government's continued strong efforts to succeed.

18. **Overall, implementation of the measures to be taken in the energy sector are proceeding well**, despite some difficulties in meeting quarterly targets in 2002 that are not mentioned in the Report. There has also been progress in the transport and water sectors, including increasing private sector participation in road maintenance and municipal water supply, strengthening local government authority in water supply, and improving the financial situation and enforcement capacity of water utilities.

⁵ Education expenditures dropped from 3.3 percent of GDP in 2002 to 2.9 percent in 2003; and healthcare expenditures dropped from 2.3 percent to 2.1 percent.

Targets, indicators, and monitoring

19. **The Government has established monitoring and evaluation units in twelve line ministries**, although much work remains to build the capacity of the units, and to link monitoring and evaluation to policy formulation. While still at an early stage, the Government's efforts to strengthen monitoring and evaluation are encouraging and could, if continued, introduce a policy culture that focuses on results.

20. **The twelve new units have elaborated detailed monitoring plans, improving NSSD indicators and targets.** These monitoring plans (Annex 3 of the Progress Report) are of varying quality and some require substantial further work. There is also the need to more explicitly link the priority public actions to the targets and indicators. Nevertheless, the monitoring plans represent a significant achievement that provides the basis for further policy dialogue. The Report is more explicit than the NSSD in setting targets, and some targets relate directly to the Millennium Development Goals. IDA will continue to provide substantial support for strengthening monitoring and evaluation through the PRSC program and other interventions.

21. **The Government is making good progress in implementing its program to improve the statistical base on poverty and living conditions.** There have also been noteworthy improvements in public access to data. The Government has not yet made progress in institutionalizing periodic qualitative studies to complement the quantitative studies, but the Multi-Donor Capacity Building for Poverty Reduction Strategy Trust Fund will provide assistance in this area. A pilot participatory monitoring and evaluation exercise is underway in the health sector. The Government is also developing capacity to geographically map data and indicators.

22. **The Report would have benefited, however, from a more thorough assessment of recent efforts to improve macroeconomic data collection and the remaining deficiencies.** Progress in this area includes the publication of the 1996-2000 national accounts. Yet the Report does not incorporate the new national accounts in its analysis of growth or in its description of the macro/fiscal framework (although this is done in the context of the authorities' MEFP). Nor does it include an adequate examination of the remaining data deficiencies, relating to real and external sectors. In particular, although Albania's Institute of Statistics has produced some new quarterly indices, mostly based on tax records, and a project on survey-based short-term indicators is under way, the absence of a consistent set of timely short-term indicators seriously hampers sound policy making and monitoring and evaluation efforts.

IV. THE PARTICIPATORY PROCESS

23. **The Government remains open to public participation, but there has been limited progress in institutionalizing participation in policy making.** Participation during the preparation of the full NSSD set a precedent for civil society involvement in public policy formulation, but was not sustained. Consultations during preparation of the Progress Report took place under a severe time constraint—from February to April 2003—that reduced their quality and credibility. Furthermore, the Report is weak in describing the consultative process, the feedback received, and how it was or was not taken into consideration. The consultations, organized and facilitated by The Carter Center and other partners, revealed that much of the public and local government remains unaware of the NSSD. The consultations also indicated a disconnect between central Government actions and perceived results in the regions, caused

either by time lags or faulty implementation, pointing to the importance of participatory monitoring and evaluation. Several external partners are working to address this disconnect by establishing NSSED regional focal points to disseminate information and gather feedback. The NSSED Department should become fully engaged in this effort.

24. **Government requested input from members of Parliament**, during a half-day workshop, and key members of Parliament participated in a national NSSED Conference on April 23, 2003. Despite the Parliament's somewhat limited participation in preparing the Report, there are plans to increase the institution's involvement with the NSSED process, including the creation of an *ad hoc* NSSED Committee.

25. **Inter-governmental participation reflected an increasing awareness and understanding of the NSSED.** A decision by the Prime Minister in September 2002 clarified and strengthened the institutional framework for coordinating the NSSED, including the elevation of the NSSED Technical Secretariat within the Ministry of Finance to a NSSED Department, which is now fully staffed. An Inter-Ministerial Working Group chaired by the Minister of Finance and composed of deputy ministers met frequently and led the process of preparing the Report. Recognizing its limited capacity, the Government once again contracted local consultants and private experts to provide support, but less so than during the preparation of the NSSED. Overall, the quality and quantity of line ministry participation, while still weak in many cases, increased in comparison to 2001/2002.

26. **Albania's development partners are increasing their support for the NSSED and working to improve donor coordination.** The NSSED Core Donors Group, comprising about fourteen international partners, meets monthly to keep abreast of NSSED progress.⁶ The Core Donors organized a retreat in March 2003 to discuss alignment with the NSSED, which resulted in the creation of a technical working group to formulate specific recommendations for better aid coordination. In addition to these efforts, international partners should increasingly consider how to minimize transaction costs posed on Government by donor working practices, and the Government should play a stronger role in—and eventually lead—aid coordination. Members of the Core Donors Group expressed some disappointment with both the Progress Report and the mixed performance in implementing the NSSED over the last eighteen months, but the Group appreciates the Government's efforts since late 2002 to move the NSSED forward.

V. RISKS TO THE STRATEGY

27. **NSSED implementation remains subject to the political and institutional risks identified in the first JSA.** Foremost is the fragility of domestic political stability—Albania's politics remain relatively divisive and could distract from efforts to achieve NSSED targets. The precarious electricity situation continues to pose a principal risk to growth and stability, requiring the Government's rigorous adherence to the quarterly targets in its power sector action plan. Capacity constraints within the Government are also likely to hamper NSSED implementation; strengthening institutional capacity is critical for translating higher public expenditures into

⁶ The group includes the Canada International Development Agency, Department for International Development (UK), EU, Germany, Greece, Italian Cooperation, IMF, Netherlands, Organization for Security and Co-operation in Europe, Sweden International Development Agency, UNDP, UNICEF, US Agency for International Development, and the World Bank.

results. Finally, decentralization needs to proceed judiciously, in line with strengthening local government capacities, transparency, and accountability.

28. **Maintaining a stable macroeconomic environment—as assumed in the Report—requires a continuation of policies that ensure low inflation, and fiscal and external sustainability.** Albania’s public sector debt has remained manageable, owing to high growth rates and concessional interest costs, and a declining primary fiscal deficit. The baseline scenario assumes a continuation of these favorable conditions—albeit with gradually declining concessional external borrowing. However, fiscal slippage, in particular on the revenue side, could place the fiscal strategy at risk. Regarding external debt sustainability, the report discusses the worsening current account, but does not reflect on the implications for sustainability. Prospects for external debt may not be worrisome at the moment, but increased non-concessional borrowing, a decline in private remittances, and insufficient improvements in exports and foreign direct investment could endanger sustainability. Finally, while Albania is not dependent on private capital markets, a weaker global economy could affect privatization receipts, official transfers, and remittances.

VI. CONCLUSIONS

29. **Overall, given the context, the first year’s performance in implementing the NSSED is satisfactory,** and the Progress Report, despite weaknesses, is acceptable. However, NSSED implementation and the quality of the Report do not fully meet expectations raised by the Government’s promising start in producing the NSSED. Future progress reports would benefit from being more candid and analytical—assessing progress made based on data and other evidence, obstacles encountered, and identifying improvements.

30. **The challenge for Albania is to maintain the momentum of the last six months.** It is especially important to strengthen the Government’s capacity to formulate, implement, and monitor policies. The Government—with the assistance of a number of international partners—plans to implement various initiatives to build capacity and strengthen institutions.

31. The staffs of the World Bank and IMF consider that the country’s efforts toward implementation of the strategy provide sufficient evidence for its continuing commitment to poverty reduction, and therefore the strategy continues to provide a credible framework for Bank and Fund concessional assistance. The staffs recommend that the respective Executive Directors of the World Bank and the IMF reach the same conclusion.