IMF Country Report No. 14/78

ALBANIA

March 2014

2013 ARTICLE IV CONSULTATION AND REQUEST FOR EXTENDED ARRANGEMENT

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2013 Article IV Consultation and Request for Extended Arrangement, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on February 28, 2014, following discussions that ended on December 17, 2013, with the officials of Albania on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on February 14, 2014.

- An **Informational Annex** prepared by the IMF.

- A **Staff Statement** of February 28, 2014 updating information on recent developments.

- **Press Releases** including a statement by the Chair of the Executive Board, and summarizing the views of the Executive Board as expressed during its February 28, 2014 consideration of the staff report on issues related to the Article IV Consultation and the IMF arrangement.

- A **Statement by the Executive Director** for Albania.

The following documents have been or will be separately released

Letter of Intent sent to the IMF by the authorities of Albania*
Memorandum of Economic and Financial Policies by the authorities of Albania*
Technical Memorandum of Understanding*

*Also included in Staff Report

The publication policy for staff reports and other documents allows for the deletion of market-sensitive information.

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Washington, D.C.

ALBANIA

February 14, 2014

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION AND REQUEST FOR EXTENDED ARRANGEMENT

KEY ISSUES

Context: Albania's economy has weakened and macroeconomic imbalances have widened. Public debt and financing needs—among the highest regionally—have risen because of fiscal loosening, particularly in the first half of 2013 and the sluggish economy. High nonperforming loans (NPLs) are constraining credit growth, and weak external drivers are preventing a sustained reduction in external imbalances.

Fiscal Policy: Fiscal consolidation should aim at lowering the public debt ratio beginning in 2015, and reducing it to below 60 percent in the medium term. Significant further tax and expenditure policy measures will be required, supplementing the steps taken in late 2013 and in the 2014 budget, supported by extensive public financial management (PFM) and tax administration reforms to tackle the causes of high deficits.

Financial Sector: Reducing NPLs will safeguard financial stability and may help release credit supply constraints by lowering bank risk aversion. Removing structural distortions in collateral execution and bankruptcy laws, enhancing loan restructuring and NPL sales, and clearing government arrears would help. Steadfast implementation of the recent FSAP recommendations, including those covering nonbank financial institutions, will be important.

Structural Reform: Ambitious reforms, including in the areas of pensions, energy, local government, public administration and the business environment, are essential to support medium-term growth and debt sustainability.

Extended Arrangement under the EFF: The authorities have requested a three year arrangement with proposed access equivalent to SDR 295.42 million (492.4 percent of quota). The program seeks to: i) reverse the upward trend in public debt and lay the ground for its sustained reduction; ii) restore banks' confidence in lending by bringing down NPLs and; iii) ease constraints on growth by undertaking ambitious structural reforms. The heavy structural reform need justifies the use of the longer term EFF. Program risks are substantial given the complexity of reforms and the need for strong political commitment. All prior actions have been completed.

Approved By
European Department

Discussions were held in Tirana on December 3–17, 2013. The staff team comprised Mr. Ilahi (head), Ms. Che, Mr. Gaertner, Mr. Ioannou (all EUR), Ms. Unsal (SPR), and Ms. Flynn (FAD), and was assisted by Ms. Spahia (local office). Mr. Senatore (OED) attended some of the meetings. The mission met with the Prime Minister, Finance Minister, Minister of Economy, Bank of Albania Governor, other senior officials, banks, private sector representatives, unions, and parliamentarians.

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CONTEXT

1. **Albania was not directly affected by recent crisis.** It successfully avoided recession in the aftermath of the global crisis and suffered a milder growth shock than neighboring countries. Inflation was kept low and stable. The banking sector maintained adequate capital and liquidity. This performance was largely the result of an early fiscal stimulus, effective monetary policy, and macroprudential actions.

2. **Recently, the economy has shown signs of protracted weakness and macroeconomic imbalances have widened, partly because of policy indiscipline.** Public debt and financing needs—among the highest regionally and heavily dependent on banks—have risen because of fiscal slippage and accumulation of sizable arrears, particularly in 2013H1. As a result, investor confidence has suffered, contributing to the economic slowdown. Rising NPLs and bank risk aversion, as well as incomplete investment climate reforms, have amplified the slowdown (Figures 1–7).

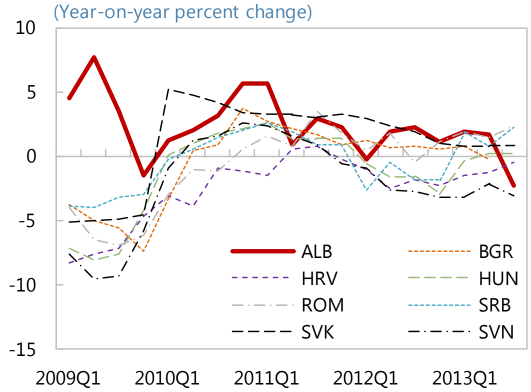
3. **Implementation of earlier Article IV consultation recommendations has been mixed.** The authorities have strengthened financial sector supervision and stretched the maturity profile of public debt in line with 2012 Article IV consultation recommendations, but there was little progress on fiscal consolidation (Box 1).

4. **The new government is committed to economic and structural reforms.** A stronger than usual electoral majority in the 2013 elections has allowed the new authorities to launch difficult public finance and structural reforms, including those required for EU accession. While the EU has acknowledged progress, it has recently postponed the candidacy decision till mid 2014, citing the need for a sustained record of judiciary, parliament and public administration reforms. A strong reform push that improves perceptions about EU accession prospects would help boost business confidence, FDI and growth.

Figure 1. Albania: Background and Outlook

Economic growth has been low since 2011, turning negative in Q3, 2013, largely because of election-related uncertainty....

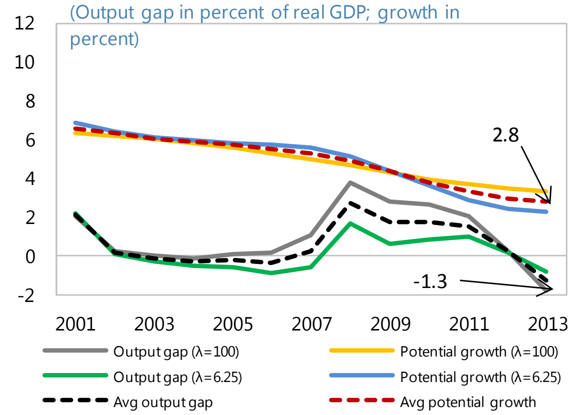
Real GDP, 2009-13
(Year-on-year percent change)



Sources: WEO and staff calculation

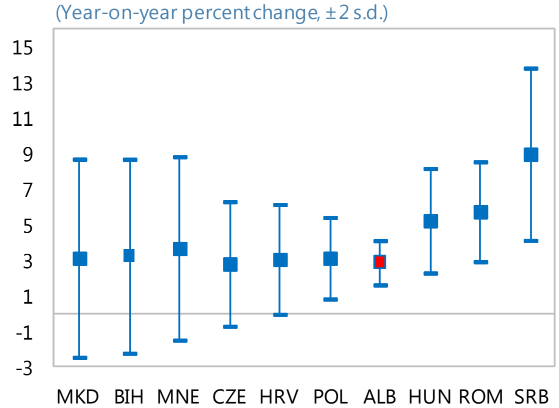
...causing output to fall below potential in 2013...

Output Gap and Potential Growth
(Output gap in percent of real GDP; growth in percent)



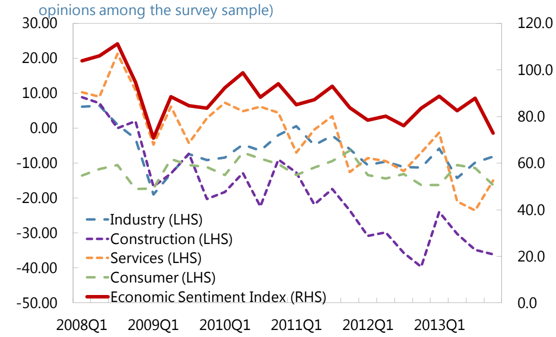
Inflation has remained low and stable...

Average Annual Inflation, 2006-13
(Year-on-year percent change, ±2 s.d.)



...confidence in some key sectors remains weak...

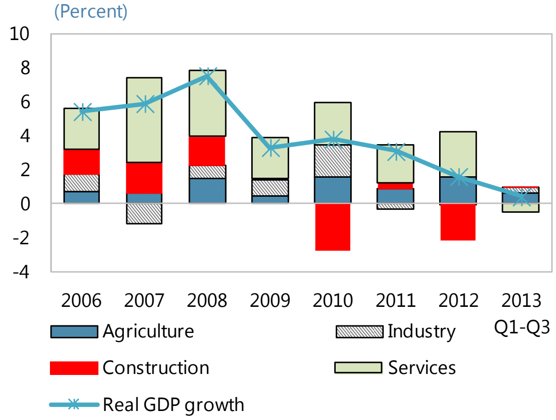
Economic Confidence Indicators
(LHS indicators calculated as % of positive opinions minus % of negative opinions among the survey sample)



Source: Bank of Albania

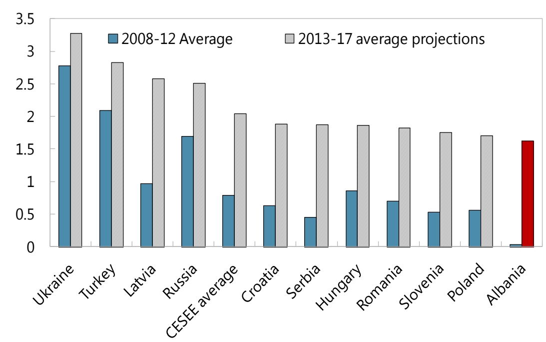
... and services and agriculture sectors have slowed.

Contributions to Growth
(Percent)



Albania's external growth drivers are the weakest in the region, and will remain so over the medium term.

CESEE Partner Country Growth
(Percent)

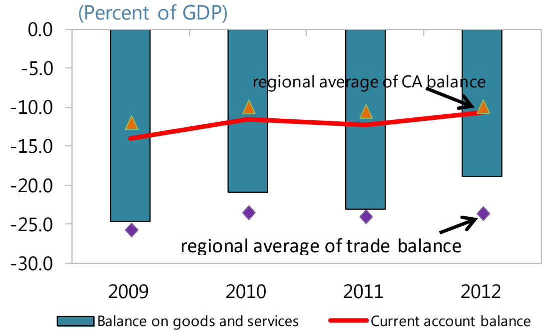


Source: WEO

Figure 2. Albania: External Sector Developments

The current account deficit has narrowed on the back of an improved trade balance...

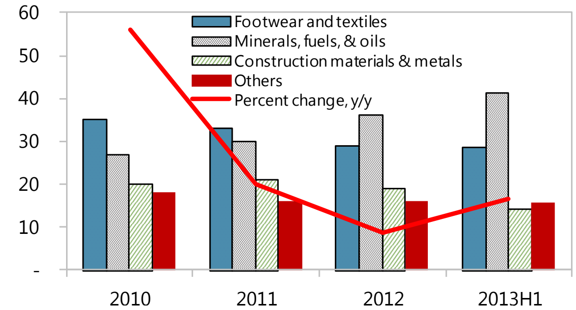
External Balance
(Percent of GDP)



Source: Albanian authorities and IMF staff calculations

...but the improvement is not on a sustained basis, as mainly oil exports have grown and,...

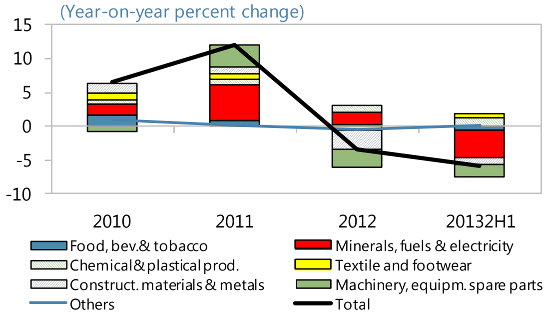
Export Growth and Composition
(Percent)



Source: Albanian authorities and IMF staff calculations

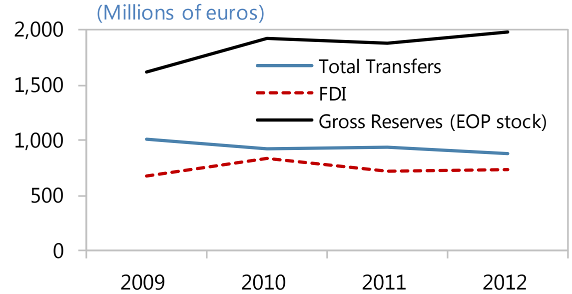
...industrial and electricity imports have fallen because of weak demand and favorable weather, respectively.

Import Growth
(Year-on-year percent change)



FDI and remittances continue to be the main sources of external financing...

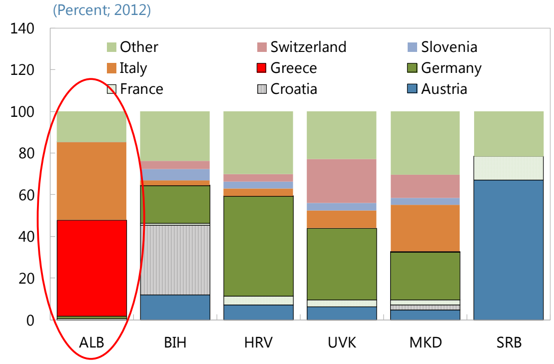
Trade Balance Financing Sources
(Millions of euros)



Source: Albanian authorities and IMF staff calculations

...with Greece and Italy being the biggest sources of remittances.

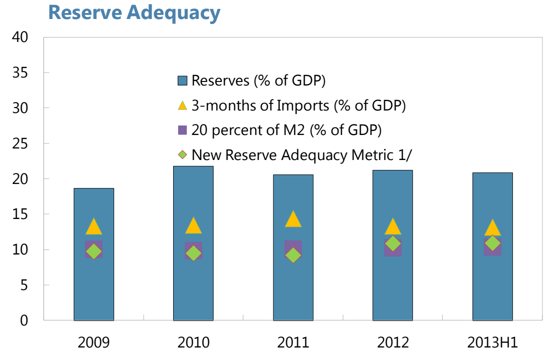
Decomposition of Remittances by Source Country
(Percent; 2012)



Sources: World Bank and country statistical offices

Conventional metrics show the foreign reserve cover as adequate, though Albania's external risks are high.

Reserve Adequacy

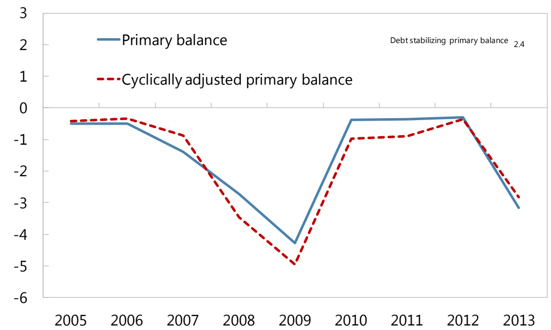


1/ Composed of 30% of Short-term external Debt, 10% of other portfolio liabilities, 5% of M2 and 5% of exports. Short-term debt data excludes deposits due to data limitations.
Source: Albanian authorities and IMF staff calculations

Figure 3. Albania: Fiscal Developments

The fiscal position deteriorated substantially in 2013…

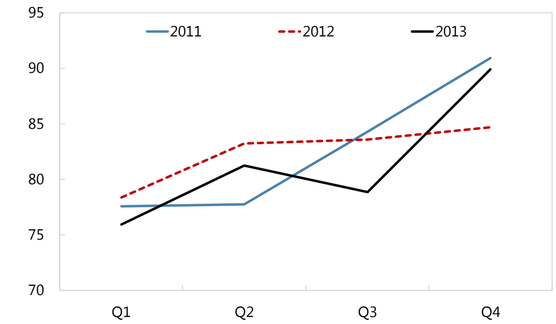
Fiscal Indicators, 2005-12
(Percent of GDP)



Source: IMF staff estimations and projections.

…partly because of election-related revenue shortfalls.

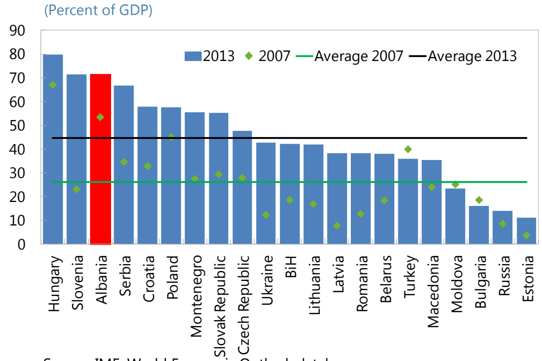
Quarterly Fiscal Revenue Performance, 2013
(in billions of Lek)



Source: MoF

Public debt rose sharply, to over 71 percent of GDP, one of the highest levels in the region.

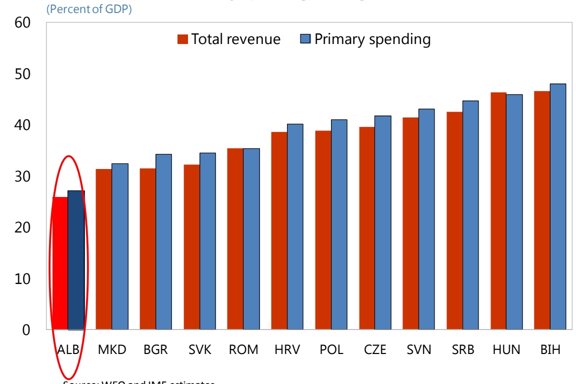
CESEE Public Debt
(Percent of GDP)



Source: IMF, World Economic Outlook database.

Albania's revenue- and spending-to-GDP ratios are low…

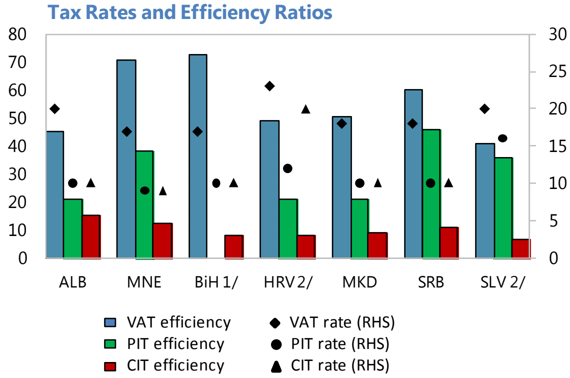
Total Revenue and Primary Spending, Average (2006-12)
(Percent of GDP)



Source: WEO and IMF estimates

…as is tax efficiency.

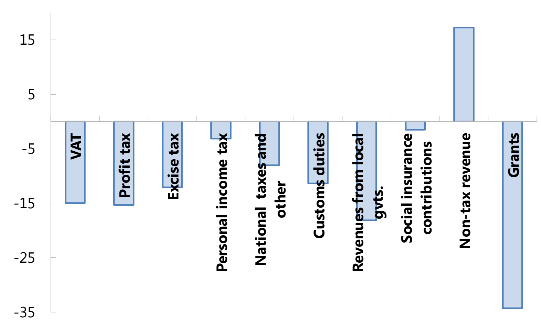
Tax Rates and Efficiency Ratios



1/ CIT revenue data from 2008.
2/ VAT revenue data based on 2011 projection.
Note: Tax efficiency ratio = (Tax revenue / GDP) / Tax rate.

Realistic budgeting has been a challenge.

Fiscal Revenues: Budgeted v.s. Realized
(Percent deviation of realized from budgeted fiscal revenues; 2013)

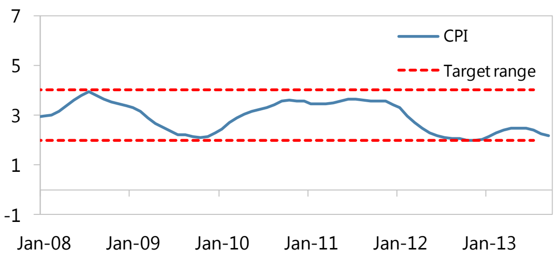


Source: MoF

Figure 4. Albania: Inflation and Monetary Developments

Inflation remains within BoA's target range, and has slowed since 2012...

Average Inflation

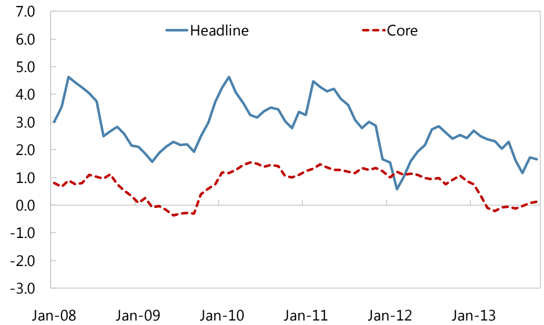


Source: INSTAT and IMF staff calculations

...reflecting both lower food prices and subdued domestic demand.

Inflation

(Year-on-year percent change)

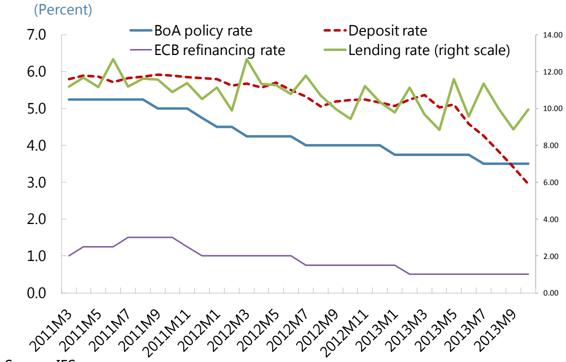


Sources: INSTAT and staff calculation

This has provided scope for further monetary easing, which has helped bring down market interest rates...

Interest Rates

(Percent)

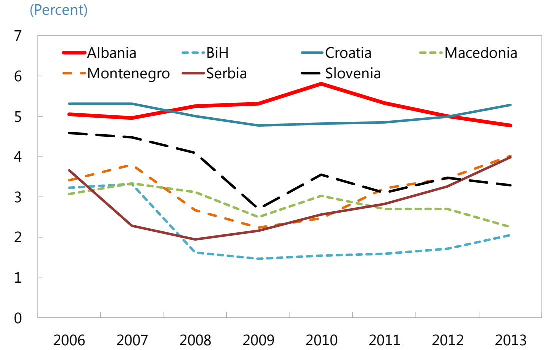


Source: IFS

... and reduce costs on domestic public debt.

Interest Payment to Government Gross Debt Ratio

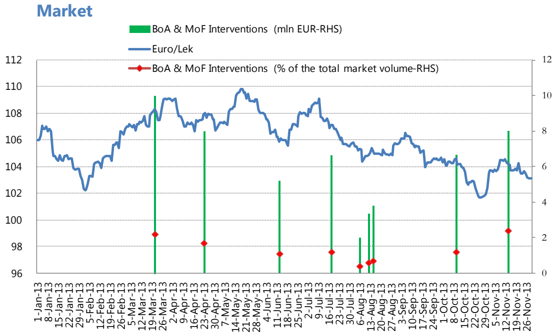
(Percent)



Sources: WEO and staff calculation

The exchange rate has remained stable and BoA/MoF's interventions minimal,...

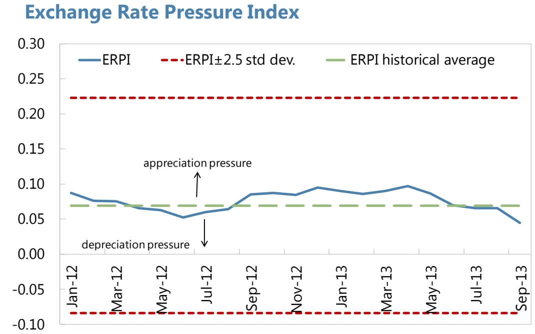
Official Interventions in the Foreign Exchange Rate Market



The auctions of BoA and MoF for foreign exchange are based on a pre-announced schedule. In 2013, all interventions were for the purpose of purchasing foreign currency (EUR), reflecting the EUR 30 mln increase in foreign reserves (up to November) brought by a surge in privatizations receipts and higher FDIs; Source: BoA

... reflecting balanced supply and demand factors in the exchange rate market.

Exchange Rate Pressure Index

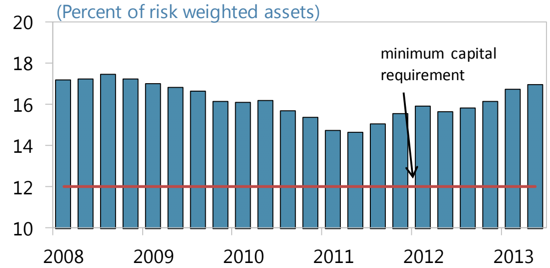


The index is a linear combination of interest rate spread, nominal effective exchange rate, and reserve changes weighted by the inverse of each component's variance: see Eichengreen et al 1994, 1995; Source: BoA

Figure 5. Albania: Financial Sector Developments

The banking sector is well-capitalized....

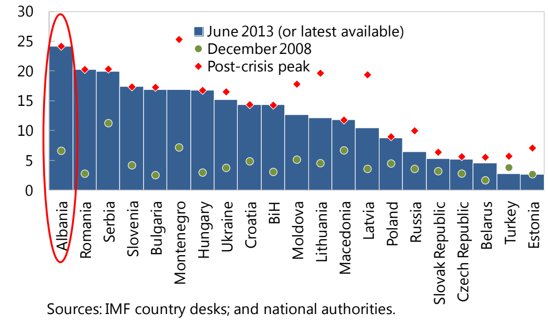
Regulatory Capital
(Percent of risk weighted assets)



Source: Albanian authorities

... though the level of NPLs is high compared to regional peers, and still rising.

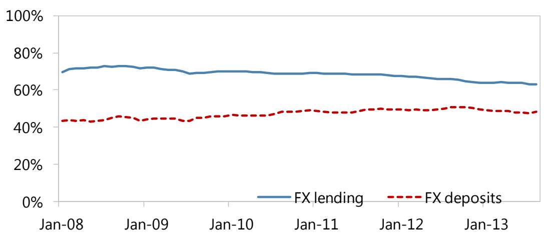
Non-Performing Loans
(NPLs in percent of total loans)



Sources: IMF country desks; and national authorities.
Note: Data are not fully comparable across countries due to differences in national classification practices.

The banking system remains highly euroized...

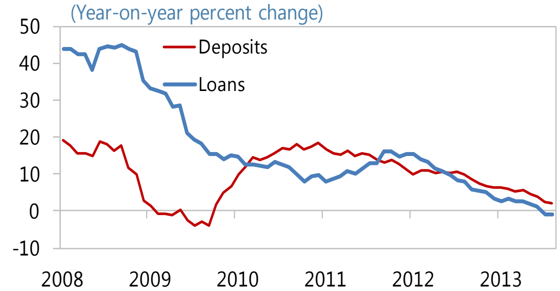
Banking Sector Euroization
(Share of total)



In addition to FX lending, banks also hold other sizable foreign currency denominated assets to limit their open FX position, thus keeping their foreign currency assets and liabilities largely in balance.
Source: Albanian authorities and IMF staff calculations

...and credit has started to contract...

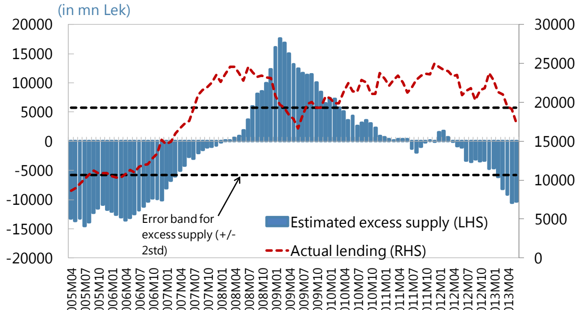
Bank Deposits and Loans
(Year-on-year percent change)



Source: Albanian authorities and IMF staff calculations

...partially reflecting banks' risk aversion.

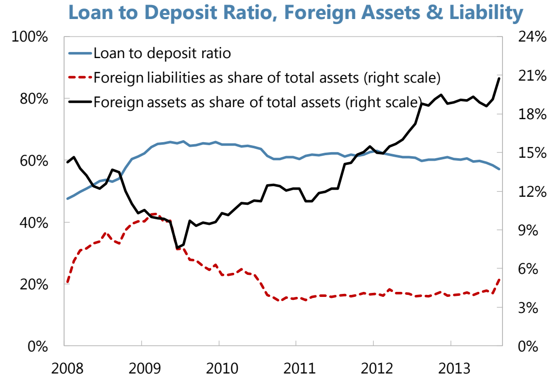
Albania: Estimated Excess Supply of Credit
(in mn Lek)



The excess supply is derived from an econometric model that jointly estimates credit supply and demand in the economy. Excess supply = estimated credit supply - estimated credit demand. ;Source: staff estimation

Banks' low reliance on parent funding protects against external deleveraging pressures. In fact, banks have increased their foreign assets.

Loan to Deposit Ratio, Foreign Assets & Liability

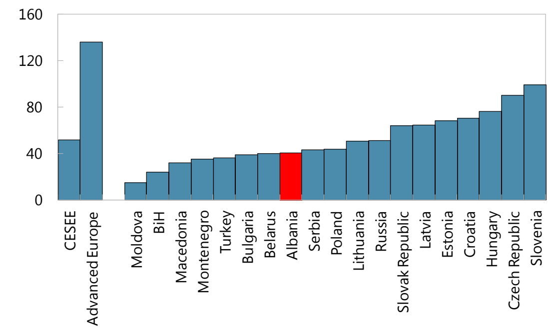


Source: Albanian authorities and IMF staff calculations

Figure 6. Albania: Business Environment and Labor Market

Albania needs significant capital investments…

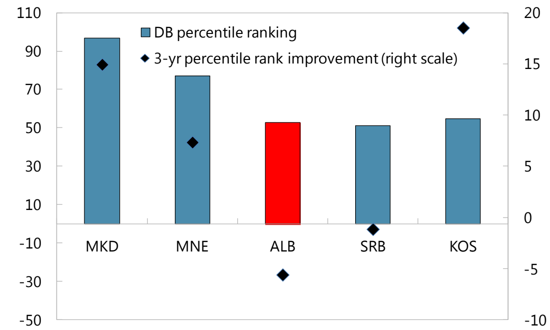
Per capita capital stock, 2011
(Thousands of PPP 2005 US dollars)



Sources: Eurostat and staff calculation

…yet investment climate ranking has deteriorated relative to peers in recent years…

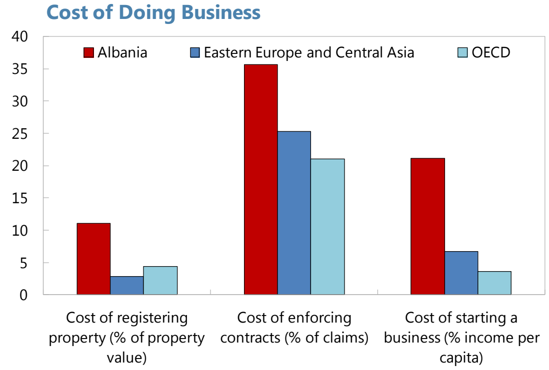
Doing Business Ranking



Source: Doing Business (2014) and IMF staff calculations

… which is partly due to lack of reforms in key areas of business environment.

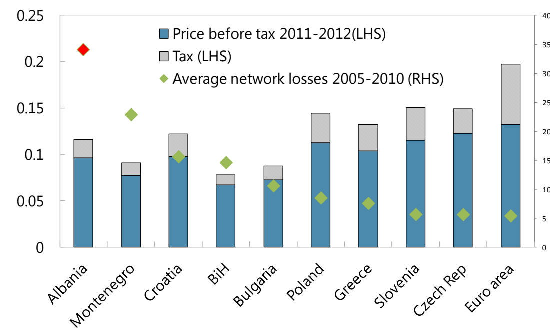
Cost of Doing Business



Sources: Doing Business (2014); and IMF staff calculations.

Although retail electricity price is not particularly low, the electricity sector performs poorly largely due to heavy network losses.

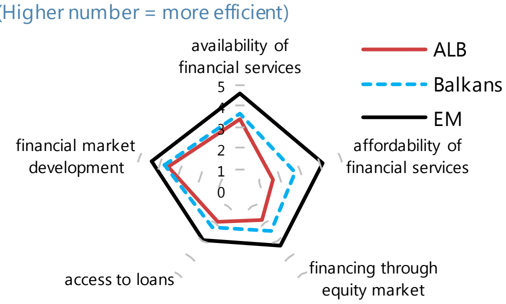
Retail Electricity Price and Network Losses
(price in Euro/kWh; losses in percent of total electricity output)



Sources: Eurostat, World Bank, and staff calculation

Access to finance needs to be enhanced.

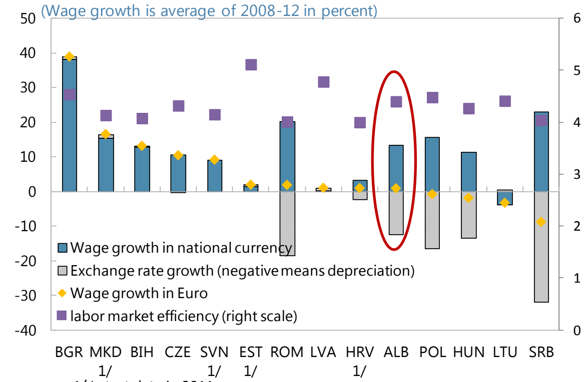
Financial Market Development Indicators
(Higher number = more efficient)



Source: Global Competitiveness Report (2012-13)

On the bright side, wage adjustment appears flexible and labor market relatively efficient.

Nominal wage growth and labor market efficiency
(Wage growth is average of 2008-12 in percent)



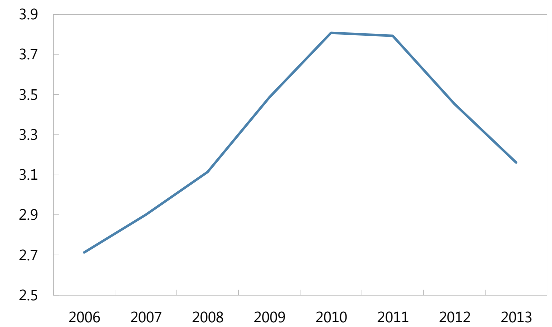
1/ Latest data in 2011
Sources: Haver, Global Competitiveness Report, and staff calculation

Figure 7. Albania: Governance and Public Finances

Quality of public institutions has worsened in recent years...

Institutional Quality Scores

(Higher score means better quality)

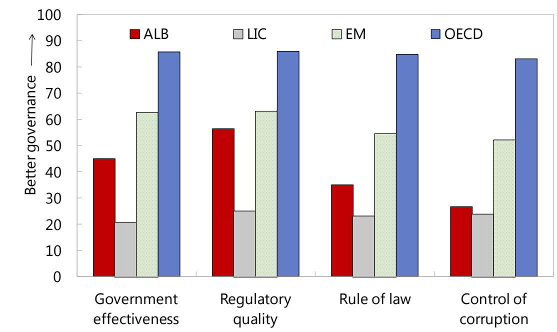


Sources: Global Competitiveness Report

... partly because of corruption and weaknesses in rule of law...

Governance Indicators

(Percentile rank)

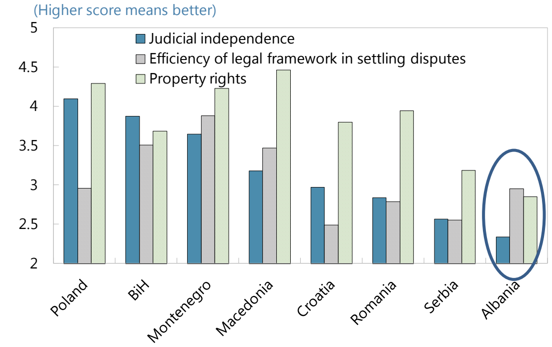


Sources: Worldwide Governance Indicators and staff calculation

... the judicial system is also weak, especially in protecting property rights.

Judicial System and Property Rights Protection

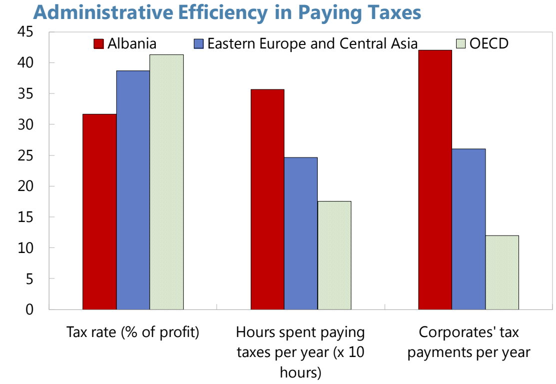
(Higher score means better)



Sources: Global Competitiveness Report (2013)

Tax administration needs major improvement...

Administrative Efficiency in Paying Taxes

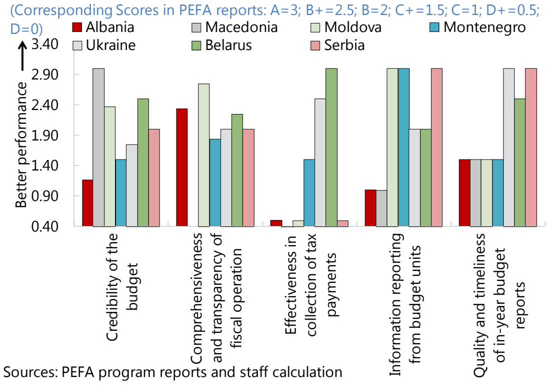


Sources: Doing Business (2014); and IMF staff calculations.

... as do other areas of fiscal management...

Public Expenditure and Financial Accountability

(Corresponding Scores in PEFA reports: A=3; B+=2.5; B=2; C+=1.5; C=1; D+=0.5; D=0)

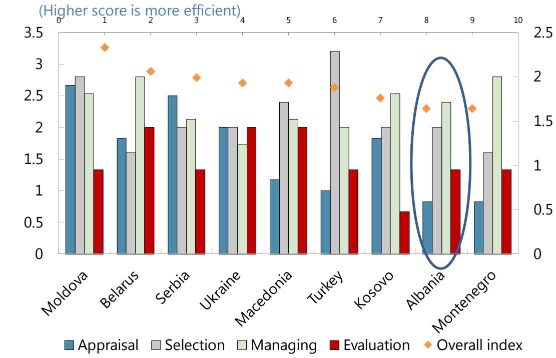


Sources: PEFA program reports and staff calculation

...including the efficiency of public investment spending.

Public Investment Efficiency Index

(Higher score is more efficient)



Source: IMF Working Paper WP/11/37

OUTLOOK AND RISKS

5. **Growth is expected to rebound in 2014** (Table 1). Real growth could be around 2 percent, spurred by dissipation of uncertainties related to elections, change of government and bureaucracy and future policies, and a confidence boost from reducing underlying risks notably in the fiscal area, tackling of high NPLs, monetary easing, and arrears clearance. However, external demand would remain sluggish and remittances continue to weaken (given close links to Greece and Italy). The current account deficit will increase to 10 percent of GDP (compared to 9 in 2013) on account of release of import compression, but the gross reserves cover is expected to remain near 4½ months of imports.

6. **The medium–term outlook is generally favorable**. Economic growth is expected to gradually reach about 4½ percent over the medium term, though still remaining below the more than 5½ percent achieved in the 4 years prior to the crisis, because of weak partner growth. Output will remain below its potential by 2.1 percent in 2014, but the gap will narrow thereafter to close in 2019. The recovery will be driven by improved confidence stemming from implementation of policies to correct domestic imbalances and ambitious structural reforms to boost total factor productivity. EU accession-related reforms would improve Albania's prospects as an investment destination. Investment and growth will also be aided by significant energy-related investments—the recently–agreed Trans Adriatic Pipeline (TAP), and foreign investment in new hydropower production, amounting in total to about 15 percent of 2013 GDP (the fiscal impact of these projects has not been factored in because of lack of data). Underlying external imbalances would improve modestly, and the reserves cover would remain comfortable at about 4 months of imports.

7. **There are significant downside risks to the outlook.** A protracted period of slower European growth could spill over through trade and remittances channels, hurting growth and external and financial sector stability. Insufficient fiscal consolidation effort could undermine fragile investor confidence and increase rollover risks, while lack of progress on structural reforms could lead to a protracted period of slower growth (see RAM, Annex I).

REPORT ON DISCUSSIONS AND PROGRAM POLICIES

A. Fiscal Policy: Laying the Groundwork for Fiscal and Debt Sustainability

Fiscal consolidation should aim at reducing the public debt ratio. This will require tackling the root causes of high deficits through significant tax and expenditure policy measures and extensive PFM and revenue reforms.

Background

8. **High indebtedness is a risk to macroeconomic stability.** Albania's public debt, which has reached unprecedented levels, partly because of the accumulation of unpaid bills and arrears, is prone to risks (Annex II). Short-term financing needs are high and budget financing rollover relies on

banks with already sizable holdings of public debt. High debt could be a significant drag on medium-term growth.

9. Fiscal deficits have been driven up by structural factors and policy slippages. The 2007–08 tax reform—which substantially lowered corporate income tax rates, ostensibly to enhance competitiveness—reduced revenue intake from the corporate income tax (CIT).[1] Excise and property tax rates and other fees have been unchanged for years and, an increase in the personal income tax (PIT) exemption threshold earlier in 2013—now close to the average private sector wage—has further exacerbated the problem. Optimistic revenue assumptions—which in the event forced the government to postpone capital spending—and spending units' use of multi-year commitments without due regard to budget appropriations, have resulted in arrears in excess of 5 percent of GDP. Overall public spending-GDP ratio is still relatively low (Figure 3), and sizeable spending rigidities—wages, transfers, and interest claim more than ¾ of revenues—limit the scope for spending cuts.

10. Pensions are a heavy fiscal burden. The social insurance system deficit has risen to 5 percent of GDP in 2013, because of contribution rate cuts (in 2006 and 2009), and recent unfunded increases in benefits. There is an incentive for high-middle income workers to underreport earnings, or to avoid the system altogether. While worker contributions vary with income, and the highest can be as much as five times the lowest contribution, the highest benefits are at most twice the minimum benefit; this discourages high and middle income earners to contribute and report full earnings. The system also subsidizes the rural self-employed at the expense of the rest (the minimum pension is about 50 percent of average rural income, compared to 35 percent in urban areas). Without reforms the pension system will come under increasing pressure as Albania's young population ages in coming decades.

Policy advice

11. Commit to appropriate medium and long–term public debt targets to anchor expectations. The authorities should aim to reduce public debt to about 60 percent of GDP over the medium term and 40 percent of GDP over the longer term to mitigate risks and strengthen the economy's resilience to shocks. Staff recommends that the debt target be adopted by Parliament inscribed in the organic budget law and announced publicly. The authorities should also improve the credibility of the debt target by adopting a binding medium-term budget framework in the near future.

12. Sizable fiscal adjustment is needed to achieve the medium term debt target. However, excessive fiscal consolidation, in the context of current weak cyclical conditions, could damage growth and adversely impact debt sustainability and social outcomes.[2] Therefore, staff recommends

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[1] The PIT and CIT rates were lowered to 10 percent (flat) from five income dependent PIT rates (5, 10, 15, 25, and 30 percent), and a 20 percent flat tax on profits. Intake from these taxes fell from 3.7 percent of GDP in 2007 to 3.4 in 2012.

[2] Fiscal multiplier estimates for Albania are in the range of 0.4–0.7, with a multiplier of 0.5 used in the DSA (Annex II). Given the large balance sheet improvement expected from arrears clearance, staff estimates the arrears clearance

(continued)

that government policies should aim to begin lowering the debt-GDP ratio in 2015. Doing so in 2014, or even maintaining it at the 2013 level, would necessitate an excessively large adjustment (3 percent of GDP in the structural primary balance) that would be quite harmful for growth. Over the medium term, further improvement in the structural balance of about 3.8 percent will be needed to reduce debt to near 60 percent of GDP by 2019. Even with this adjustment, the medium-term debt profile is subject to risks, including adverse growth shocks.

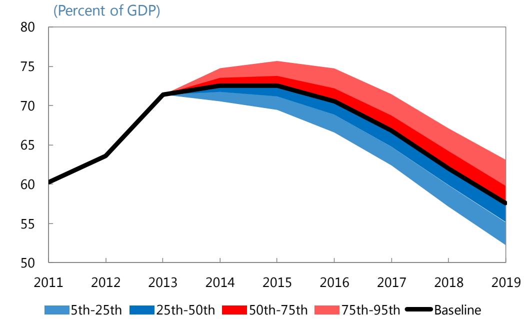
Fiscal consolidation, 2013-19
(Percent of GDP)

	2013	2014	2015	2016	2017	2018	2019
New measures[1]	...	1.1	1.2	1.3	1.1	0.9	0.6
Overall balance	-6.2	-6.7	-4.8	-3.4	-1.3	-0.5	0.0
Primary balance	-2.9	-3.4	-0.7	0.8	2.8	3.4	3.2
Structural primary balance	-2.4	-0.5	0.8	1.9	2.6	3.1	3.2
Change in SPB	-1.9	1.9	1.2	1.1	0.7	0.5	0.1
Public debt	70.5	71.7	71.2	68.8	65.4	61.4	57.1

Sources: IMF staff estimates and projections.

[1] The change in the structural primary balance exceeds the size of new measures primarily because of the weak cyclical position of the economy and tax administration improvements.

Risks to the Baseline: Public Debt and Growth Shocks
(Percent of GDP)



13. Implement tax and spending policy reforms to tackle the root causes of high fiscal deficits. The relatively low level of spending and limits on the extent to which expenditures can be trimmed suggest the burden of adjustment should fall largely on revenues. Revenue measures, some spending restraint and pension reform should form a feasible and credible basis for the needed adjustment (Box 3).[3] To soften the impact of the adjustment on vulnerable groups, staff support targeted relief measures.

14. Clear arrears in a comprehensive and transparent fashion. The government needs to reestablish credibility by acknowledging outstanding arrears through a diligent process, and undertaking clearance impartially and transparently. Arrears clearance should be based on a strategy approved and endorsed by the highest level and made publically available. Amounts cleared should be made public on a regular basis and an external auditor should be employed to ensure the transparency and integrity of the arrears verification and clearance process. The process of documenting and vetting arrears, if implemented appropriately, could take time.

15. Credible measures should underpin the prevention of arrears in future. Tangible and transparent steps are needed to stem the recurrence of unpaid bills and arrears. While rationalizing revenue projections at budget time would help, clear actions to improve reporting of procurement

multiplier to be in the range of 0.1–0.2, about one quarter to one third of the regular multiplier. With credit constraints and the negative output gap, risks are weighted towards multipliers being higher than estimated, which argues against an excessively rapid adjustment.

[3] As the package of fiscal measures beyond 2014 have yet to be specified, Table 2 lists them under "unidentified measures." They will be chosen in due course from the menu listed in Box 3.

and introduction of multiyear commitment limits would be key. Key ministries should regularly report if current obligations are being met as they fall due. Spending discipline will also ensure capital projects do not suffer from funding problems.

16. Implement extensive spending reforms. The approvals of investment projects should be consistent with budget space. The financial planning of local governments should be enhanced to prevent fiscal risks. Making budgetary transfers contingent upon implementation of revenue and PFM reforms at the local level should reduce fiscal risks while improving accountability and the quality of services. External borrowing by local governments should be discouraged, given weak institutional capacity. The existing disability benefit system is also in need of reform.

17. Strengthening tax administration is critical. The authorities should ensure compliance discipline is maintained and steps are taken to build capacity at the General Directorate. Developing a corporate strategy to guide the medium and long term reforms would help. More immediately care should be taken to ensure proper adoption the new IT system. The system of VAT refunds should be streamlined by making the Treasury responsible for making payments.

18. Prepare a pension reform strategy in consultation with the World Bank and IMF. A Pension Reform commission should be established as a first step to devise the reform strategy. Key reform priorities should include: i) raising the retirement age for men and women; ii) upgrading the social transfers system and divorcing it from social insurance (which should be available to only those who contribute); iii) aligning benefit and contribution ceilings; and iv) limiting the size of pension benefits, by keeping increases in public sector wages and pension bills in line with inflation. Staff underscores the importance of up-front announcements to anchor expectations.

19. Manage debt rollover risks. Although bank demand for government paper has been strong in recent months—largely a reflection of their aversion to the high perceived risk of lending to the private sector—this could change in the future. Efforts to lengthen the maturity structure of debt and deepen public debt market by diversifying securities holders and steps to help develop the secondary market should therefore continue.

Authorities' views

20. The authorities commit to achieving medium term fiscal and debt sustainability. They view a medium-term debt-GDP target of 60 percent as feasible, but are cautious about adopting an explicit target of 40 percent by 2024 because such commitment would be difficult to maintain over two electoral cycles. Similarly, a comprehensive medium-term fiscal framework or fiscal rule, while highly desirable, would require time to prepare. The authorities agree with the path of medium term fiscal adjustment recommended by staff and the level of adjustment in 2014. But they underscore the need for flexibility in adhering to the deficit targets in case economic conditions worsen.

21. Tax policy reform will underpin the adjustment effort. Under the approved 2014 budget, there is an increase in the rates of CIT, fuel circulation tax and property tax and imposition of various excise duties and road tolls (Box 3). The personal income tax has been made progressive. While cognizant of the need for tangible measures, the authorities caution that sizable tax rate increases have limits, given the country's narrow tax base and large informal sector.

22. Paying arrears in a transparent and equitable manner is a priority. The authorities agree that re-establishing the credibility of government is critical and will adopt a strategy that includes: i) stocktaking and verification of claims; ii) clear and transparent criteria for the order of settling claims; and iii) scheduling and monitoring of the payment process (MEFP ¶22). An external auditor will conduct risk-based audits of payments made. To release the liquidity drag on business activity, the authorities prefer an accelerated pace of arrears payment, but are also cognizant of the need for due diligence and ensuring the process is properly managed—they expect the amount of arrears cleared to not exceed 0.9 percent of GDP by June and 2.6 percent by December (MEFP ¶23).

23. Credible measures will be taken to prevent future arrears. The authorities will introduce processes to control future commitments, enhance the reporting and approval procedures for procurement orders, and ensure that central government does not accumulate new arrears (MEFP ¶23–27 and MEFP Tables 1 and 2). A quarterly survey of the main ministries will monitor if new obligations are being met. The authorities request continued IMF technical assistance to strengthen PFM capacity in general and arrears prevention in particular.

24. Clear steps will be taken to strengthen tax administration. The authorities will develop a new corporate strategy for medium and long term capacity building in tax administration. They will take tangible steps to improve compliance and reduce fraud, including in tax refunds, and expect to complete the introduction of new IT system by year end (MEFP ¶14–15). IMF technical assistance is expected to continue to play a key role.

25. Pension reform is a key medium term priority. The authorities are working closely with the World Bank on design and implementation of pension reform, though they also caution about potential political and social difficulties. They will establish a pension reform commission soon, and after undertaking extensive stakeholder consultation, will complete a reform strategy by end-2014.

26. Rollover risks will remain manageable. While the authorities acknowledge that the current strong demand for government paper could be temporary, they are of the view that the decline in public debt under the program will help keep yields under control and rollover manageable.

B. Use of Monetary Policy to Ease the Economic Slowdown

Further modest monetary easing could be employed to support the weak economy, provided inflation and exchange market pressures stay muted. The key to reviving credit is restoring banks' confidence in lending by reducing NPLs.

Background

27. The inflation-targeting framework has yielded low and stable inflation, anchoring macroeconomic stability. It has contributed to overcoming various shocks and keeping inflation within the 3±1 percent annual target range, one of the lowest and least volatile in the region.[4] However, inflation in December amounted to 1.9 percent, slightly below the authorities' target range, and core inflation was 0.3 percent.

28. Monetary easing has not prevented a slowdown in credit to date. With continued economic weakness, the Bank of Albania (BoA) has lowered its policy rate—the one-week reverse repo rate was cut by a cumulative 225 basis points since mid-2011 to 3.0 percent. While lek lending and deposit rates have declined somewhat, credit to the private sector has continued to slow, declining by 2.6 percent (yoy) in November (rates on euro loans have not changed much). The weakness in credit is largely the result of tightened lending standards because of banks' perception of risks (which has increased with the rise in troubled loans).

29. Financial stability considerations constrain monetary policy. The monetary transmission mechanism is restricted by heavy euroization, with foreign currency loans amounting to two-thirds of all loans. Aggressive monetary easing runs the risk of exerting exchange market pressures, with a fallout on unhedged foreign currency borrowers.

Policy advice

30. Further moderate monetary policy easing could help with credit, though currency exposure and loan quality risks should be considered. With inflationary and exchange market pressures remaining muted, additional easing could help borrowers as interest rates on existing loans reset. If that contributes to improving loan servicing, then banks' risk aversion could also diminish, thereby easing credit supply constraints. However, further monetary easing should be carefully weighed against the risks posed by unhedged foreign currency exposure and high NPLs.

31. The key to accelerating credit is tackling the large stock of NPLs. Further monetary easing, in the context of weak demand (i.e., profitable projects may be scarce) and supply constraints, is unlikely to have a strong impact. A comprehensive approach is therefore needed to reduce NPLs over the medium term (see below).

32. The exchange rate is broadly in line with fundamentals (Box 4)**.** The standard exchange rate assessment points to a slight overvaluation, but the relatively stable FDI, and the imports associated with it, imply that Albania's current account deficit norm should be higher than that suggested by the standard approaches. Staff believes that the inflation targeting framework and a relatively flexible wage setting process—as indicated by one of the smallest increases in unit labor

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[4] The BoA uses a mid-corridor approach to implement monetary policy, and holds weekly repo operations for which treasury bills and bonds with remaining maturity of one year or less are eligible. It has a clearly articulated policy on foreign exchange market interventions, and has not transacted to affect the value of the exchange rate since 2009.

costs (ULC) in the region since 2008 (Figure 6)—should help avoid currency misalignment, in the future. Advancing structural reforms to improve the business environment and expand the export base would improve competitiveness.

33. Exchange restrictions. In addition to the existing exchange restriction arising from balances under inoperative bilateral payment arrangements and maintained under Article XIV of the IMF Articles of Agreement, which remains in place, staff has identified two further exchange restrictions inconsistent with Article VIII, Sections 2(a) and 3 under the IMF's Articles. These are as follows: (i) an exchange restriction arising from the requirement for residents and nonresidents to submit a tax certificate that they do not owe any outstanding taxes prior to transferring foreign exchange for certain current transactions including the payment of moderate amounts for amortization of loans, the payment of certain insurance premium, and the transfer of profits and dividends from investments in Albania; and (ii) an exchange restriction arising from the requirement to provide customs clearance documents in respect of advance import payments prior to making payments for unrelated foreign exchange transactions. Since these exchange restrictions are not BoP-relevant, staff does not recommend approval of the temporary retention of these measures.

Authorities' views

34. Low inflation and weak domestic demand provide scope for some further modest easing. The authorities agree, however, that the impact is likely to be constrained by impaired corporate balance sheets, and increased risk aversion by banks. They are also aware of the risks of aggressive monetary easing, particularly on the exchange rate.

35. NPL reduction is critical for credit growth. They concur with staff that credit supply rather than demand is currently the binding constraint. They expressed concern that some banks may choose not to re-lend the improved loan repayments associated with arrears clearance,[5] and instead opt to repatriate funds to parent banks. The authorities agreed that macroprudential measures to boost credit have been largely ineffective.

36. Staff exchange rate assessment is broadly appropriate. In the authorities' view, the observed exchange rate stability in recent years reflects a lack of strong market forces to bring a major adjustment of the currency. They are firmly committed to a free floating exchange rate regime, and their intention is to continue to refrain from market interventions. They expect Albania's FDI potential (as underlined by recent gas pipeline and hydropower projects) and ongoing import substitution to improve external balances over the medium run. They believe Albania's current international reserves cover level appropriately reflects the elevated external risks the country faces. The authorities have been notified of the new findings on exchange restrictions; they are committed to removing one (item (i) above), and are discussing removal of the other.

[5] The reduction in NPLs following the commencement of arrears clearance could take time as banks typically require clients to maintain an improved repayment record before the associated loan is re-classified as performing. According to the BoA, the NPL ratio could eventually decline by 5–6 percentage points.

C. Maintaining Financial Stability in the Face of Continued Challenges

Vulnerabilities stem from profitability pressures and potential deleveraging in a system dominated by subsidiaries of foreign banks. High euroization and strong financial links between banks and the government further complicate financial management. A comprehensive long term approach to the NPL problem and steadfast implementation of FSAP mission recommendations are essential.

Background

37. The risk of direct inward financial spillovers is contained. Despite a large share of foreign banks (from Austria, Greece, Italy, and Turkey), the banking system has been resilient to eurozone stress so far, largely because it relies almost exclusively on domestic deposits—the loan-to-deposit ratio is merely 50 percent. Banks' strong solvency ratios and stringent provisioning rules have also contributed to banking system stability.[6]

38. High financial euroization is a risk. Although net open positions in euro are small, risks arise because: (i) half of loans in foreign currency are unhedged; (ii) there are large maturity mismatches; and (iii) credit risk for euro loans may be underpriced. The BoA has a limited capacity to act as lender of last resort in foreign currency.

39. Profitability pressures from high NPLs highlight deleveraging risks. The NPL increase is driven by both cyclical and structural factors, notably government arrears, the adverse tax treatment of write-offs, and a long and unpredictable legal collateral execution process.[7] High NPL-related provisioning is hurting bank profits and puts pressure on capitalization. With parent banks facing their own problems, deleveraging risks (e.g., through loan shedding and shrinking balance sheets) are likely to remain elevated as long as NPLs remain high.

40. Strong link between banks and the sovereign is a concern. Financial interdependence represents systemic risks for banks, which are vulnerable to changes in the value of longer-term debt securities, and for the government, which depends on regular rollover of debt by banks.

41. The recent emergence of investment funds is a sign of financial deepening, but also points to gaps in supervisory infrastructure. The lack of a functioning secondary market for government securities constrains investment funds' ability to manage liquidity risks, given their holdings of mostly illiquid government bonds, thereby increasing systemic liquidity risks.

[6] While most lending is secured by collateral, the BoA does not allow its value to be subtracted from loan-loss provisions for prudential purposes.

[7] Until recently, tax write-offs of loans were not recognized until a final court decision indicated that all legal recovery efforts were exhausted. Recent directives have asked the tax authorities to recognize write-offs 360 days after legal collection efforts are initiated, though this directive does not grandfather the 2008–10 write-offs.

Policy advice

42. Strengthen financial stability by implementing recent FSAP mission recommendations. The authorities should prepare an action plan to guide reforms in financial market supervision, financial market deepening, contingency planning, and the AML/CFT enforcement framework. Box 5 summarizes the findings and recommendations of the recent FSAP mission.[8]

43. A comprehensive and forceful approach is needed to address NPLs. Resolving the tax treatment for loan write-offs and improving collateral execution have been on the reform agenda for a while and require forceful action, particularly as the NPL problem has worsened. Review and reforms of competition policy and bankruptcy laws would help. The clearance of government arrears may also contribute to NPL reduction.

44. Ensure that risks associated with euroization are internalized. The authorities could increase the liquidity requirement on foreign currency deposits, and ensure that banks require higher loan-to-value ratios, if appropriate. New unhedged foreign currency lending could be disallowed. Robust consumer education and protection of borrowers is important.

45. Continue efforts to lengthen maturities and diversify government debt holders. The best way to reduce rollover risks is to bring down public debt. Nevertheless, debt management also has a role to play in minimizing risks from systemic links between banks and the sovereign.

46. Take steps to strengthen nonbank supervision. The Albanian Financial Regulatory Authority (AFSA) should be reformed to ensure its financial and operational independence. Regulation and supervision of investment funds should be beefed up by introducing liquidity and capital adequacy requirements, as well as mark-to-market accounting in calculating unit values. In addition, investment funds should ensure that they have adequate liquidity contingency arrangements with banks, and transparently disclose to clients that they are not covered by deposit insurance.

Authorities' views

47. FSAP recommendations would be implemented. The authorities agree that doing so will further solidify financial sector stability and boost confidence in the banking system. They plan to proceed with a strategy to implement FSAP recommendations in the coming months.

48. Tangible actions will attempt to address the NPL problem. The authorities are cognizant of the risks associated with high NPLs and weak profitability, and how they adversely affect perceptions among parent banks and regulators, and encourage deleveraging. Immediate actions would include, resolving the adverse tax treatment of loan write-offs and ensuring legal collateral

[8] The accompanying Financial Sector Stability Assessment (FSSA) report provides additional details on systemic risks and recommendations on enhancing the system's resilience to shocks and contagion.

execution is facilitated (MEFP ¶32–33 and MEFP Table 2). The authorities will also undertake: i) corporate restructuring, including a review of competition policy and modifications in bankruptcy laws,[9] ii) a monitoring system for corporate and household indebtedness, and iii) a revamped framework of loan restructuring and collateral repossession. They are aware that arrears clearance would help lower outstanding contractor obligations to banks and hence improve credit risk.

49. Financial euroization is structural. Euroization is a reflection of Albania's strong links to the euro area, and in this regard, significant foreign currency deposits provide a cushion. At the same time, monetary policy decisions are planned carefully to avoid exchange market pressures which could adversely impact bank balance sheets, given unhedged foreign currency lending.

50. Systemic risks posed by the recent emergence of investment funds will be addressed. The law governing the AFSA operations will be amended and investment fund regulatory framework would be revised to introduce liquidity, capital and valuation aspects (MEFP ¶37, and MEFP Table 2). Strengthening regulation and supervision of the nonbanking system will require time.

D. Embarking on a Path of Sustained Medium-term Growth

An ambitious reform effort is needed to unlock structural constraints and boost investment and medium term growth. Reforms that aid in progress towards EU accession would help.

Background

51. Lack of reforms has affected the country's growth potential. While macroeconomic imbalances and recent policy slippages have affected confidence in the economy, a sustained deceleration of structural reforms has coincided with declining potential growth in recent years. It has also prevented a broadening of the productive base, reduction in economic informality, and diversification of exports.

52. Albania's business environment is weak. Attracting investment is key to boosting growth, with FDI leading to the transfer of technology, greater innovation, higher productivity, and opportunities for high-wage employment. Despite the relatively flexible labor market and low statutory tax rates, the investment climate has suffered from poor property rights, corruption, weak contract enforcement, an inefficient judicial system and weak access to finance, particularly for SMEs (Figure 6).

53. Structural problems in the electricity sector are a source of fiscal and growth risks. Albania's hydroelectric endowment should enable it to be self-sufficient. However, poor collection, electricity theft, and low quality grid affect the sector's viability. As a result, the state producer has either run down the reservoir in dry years or imported electricity, either by issuing state guarantees

[9] Focusing efforts on bank balance sheet clean up (e.g., sale of troubled assets to asset management companies) without corporate balance sheet restructuring may address supply but not demand factors.

(that are often called), or direct budget support. The lack of payment discipline by consumers has also discouraged investment in new generation capacity.

54. Public administration is inefficient and overly politicized. Many civil service appointments, even for mid-level positions, are based on political affiliation. Political transitions often undermine civil administration because of high turnover—the recent experience with the deterioration in tax administration during the change of government is telling. The EU has made public administration efficiency improvements a critical measure for progress on accession.

55. Weak local government structures pose fiscal risks. Local government revenues have been on a declining trend (down to 0.7 percent of GDP in 2013, from 1.4 in 2005), and PFM is weak, lacks transparency and suffers from corruption. Smaller local governments face capacity constraints. Coordination weakness between local and central government adds to fiscal risks.

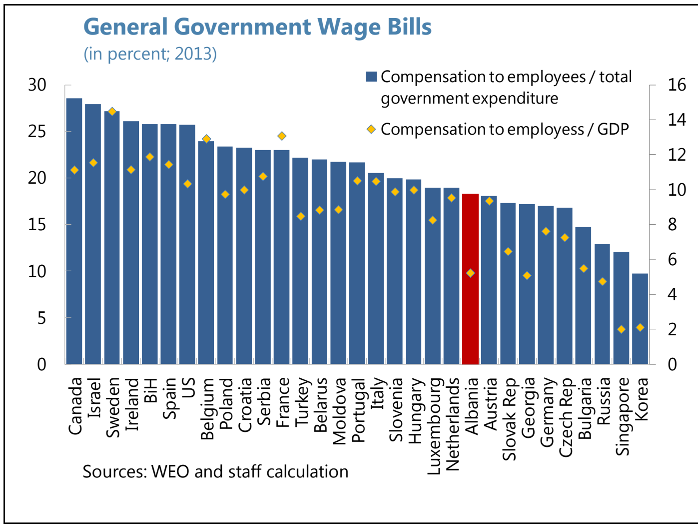
56. National statistics are problematic. Annual national accounts data are based on limited information and data on an expenditure basis have not been published since 2007, while quarterly GDP statistics are subject to significant revisions. Fund TA has focused on developing capacity in national accounts statistics compilation.

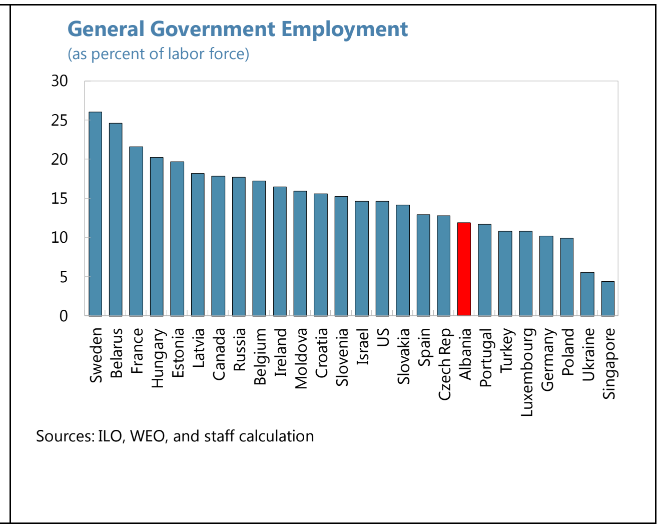
Policy advice

57. Move ahead forcefully with targeted reforms to improve the investment climate. Improving the legal framework and judicial effectiveness related to land titling and property rights should be a priority. Less arbitrary tax enforcement would also improve investor confidence. Expanding access to finance would help ease liquidity constraints, including for SMEs.

58. Initiate energy reform to address both liquidity risks and long term sustainability. The authorities should develop a comprehensive reform plan for the electricity sector, in consultation with the World Bank, to reduce current fiscal risk as well as improve sustainability over the medium term, including through attracting investment. Measures to mitigate near-term fiscal risks—such as limiting subsidized prices to low-income consumers and opening price setting for commercial users to market competition—should be adopted quickly. Actions should also be taken to lower power losses (including through preventing electricity thefts), reform market structure for electricity supply, restructure main participants' balance sheets, and attract private capital into distribution to expand capacity.

59. Public administration reform should proceed promptly, underpinned by a new civil service reform law. While public sector employment in Albania is not excessive by international standards, reforms have to focus on making it efficient and professional, and improving the delivery of services to the public. A civil service law should provide the legal context to undertaking any future reforms, which would also benefit from close cooperation with the EU and the World Bank.





60. Develop a local government reform agenda to address fiscal risks. Improved transparency and accountability and enhancing capacity should reduce fiscal risks while improving governance and the quality of services at the local level. More immediately, fuller reporting of local governments' new procurement orders would be helpful. The EU and bilateral donors' current support to create larger and more efficient local government units should continue.

61. Improve quality of statistics. Continued improvements in national accounts and balance of payments statistics, as well as strengthening the independence of the statistical agency, are essential for improved surveillance and policymaking. Staff urged the authorities to set up an inter-government data-exchange scheme for macroeconomic statistics to improve data quality.

Authorities' views

62. Prompt implementation of ambitious reforms is a high priority. The government plans to address not only the obvious business environment constraints, but also the more politically difficult problems of property rights and judicial enforcement. Progress in these areas is critical for achieving sustained growth and signaling commitment to EU accession (MEFP ¶40–42).

63. Energy sector problems are complex and multifaceted, but require prompt attention. A newly established task force working directly under the Prime Minister is expected to take the lead in sorting out inter-company debts and short-term investment needs to curb network losses, and handling negotiations with the energy distribution parent company. The authorities will finalize a reform action plan by early 2014, in collaboration with the World Bank. They are also committed to taking near term measures to address the sector's liquidity risks, including through enforcement of bill payments and tariff reforms (MEFP section D).

64. The efficiency of public administration will be enhanced. Reducing the size of public administration is a priority. The authorities also believe that employment flexibility and ability to offer higher salaries to attract key staff will also contribute to improving the quality of public administration. They commit to hiring new staff in compliance with a forthcoming civil service law (MEFP ¶17).

65. Addressing local government problems is important for lowering fiscal risks, and ensuring good governance. In the near term they will issue instructions to local governments to report all new procurement orders to the ministry of finance (MEFP Table 2). The authorities are also committed to addressing local government weakness in a comprehensive manner over the medium term. Administrative and territorial reform, which would be completed before the 2015 local elections, should help tackle concerns about collection of revenues, human resource management, financial control, and transparency. A fractious political climate could constrain progress.

66. Existing statistics weaknesses will be addressed. While insufficient resources have played a role, the politicization of the statistical agency has also been detrimental. The authorities underscored their determination to create a statistical agency that is professional and transparent. In this regard, they are committed to using IMF TA to further improve statistics.

PROGRAM MODALITIES AND RISKS

67. Albania faces a balance of payments need in 2014-16, and staff proposes a three-year extended arrangement under the extended fund facility (EFF) with access equivalent to SDR 295.42 million (492.4 percent of quota) to address it. Albania's large current account deficit reflects low domestic savings stemming from the large fiscal deficit and underperforming non-energy export sector. Repayment of government arrears would require a large fiscal and current account adjustment in 2014 in order to produce the required increase in domestic savings. External support under the EFF will provide the necessary financing to allow the required adjustment to be phased over several years, avoiding a large and disruptive immediate adjustment, while providing space for progress on key structural reforms that would improve the economy's productive capacity, particularly in export-oriented sectors. As a result, the arrangement under the EFF would support the authorities' efforts to increase public savings to repay arrears and put public debt on a sustainable medium-term trajectory, while addressing structural constraints on growth. In addition, Fund support would buttress confidence by signaling sustainable macroeconomic policies, and would help unlock financing from other multilateral institutions.

68. Program disbursements will be in the form of direct budget support. This is essential because i) Albania has limited access to international capital markets, ii) financing the fiscal deficit, including clearance of arrears, through domestic securities markets would further strain the market and aggravate rollover risks in an uncertain environment, and iii) the established practice of very limited, if any, provision of direct credit by the central bank to the government has been an important element of the BoA's operational independence. Direct budget support will contribute to medium term fiscal consolidation, ease risks associated with high public debt and smooth economic adjustment in the short run. This in turn will contribute to the reduction of the external current account deficit. Staff expects that by the end of the three-year program period, the fiscal position would shift into primary surplus, with substantially lower financing and rollover needs, reduced reliance on domestic bank financing and improved access to global financial markets.

69. Performance under the program will be monitored through quarterly quantitative performance criteria and extensive structural conditionality. In 2014, structural conditions and prior actions focus on PFM, revenue administration and financial reforms, the latter based on the recent FSAP update (Box 6 and MEFP Table 2). The Quantitative Performance Criteria and Indicative Targets on NIR, fiscal deficit, accumulation of external arrears, ceiling on central bank lending to government, domestic arrears accumulation, payment of existing arrears, and inflation consultation are elaborated in Box 6 and MEFP Table 1. Over the program period, emphasis will be on PFM, arrears prevention, addressing shortcomings of the pension system, and putting the energy sector on a sustainable footing. Program risks are substantial given the complexity, scale, and scope of reforms and the need for strong political commitment (Box 6).

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70. The economy is slowing at a time of elevated macroeconomic imbalances. Domestic demand has been increasingly sluggish—reflecting the sharp increase in public debt, worsening NPLs, and credit contraction. Ongoing weak external demand, particularly from Greece and Italy, continue to exert economic headwinds.

71. The authorities' economic program—supported by the proposed extended arrangement under the EFF—offers a credible plan for correcting underlying imbalances and supporting sustained growth. The program seeks to: i) reverse the upward trend in public debt and lay the ground for its sustained reduction; ii) bring down NPLs and restore banks' confidence in lending; and iii) reduce structural constraints on growth by undertaking ambitious structural reforms.

72. Sizable further fiscal adjustment is needed over the medium term to correct domestic imbalances and put public debt on a sustainable footing. The adjustment profile strikes a balance between reducing public debt vulnerability and safeguarding growth. Fiscal policy will therefore target a reduction in public debt in 2015, with the objective of further reducing it to 60 percent of GDP by 2019. The authorities should consider building a bipartisan consensus around adopting a longer term debt target of 40 percent of GDP to strengthen the economy's resilience to shocks, and underpinning it through an effective medium term budget framework.

73. Tax and expenditure reforms will be needed to tackle the underlying causes of high fiscal deficits. The burden of fiscal adjustment should fall primarily on revenues, given the country's development needs, the low share of revenues in GDP and embedded inflexibility in expenditures. Pension and energy reform should form a part of medium-term adjustment.

74. Reducing the outstanding stock of arrears and putting in place mechanisms to prevent a recurrence is critical for fiscal sustainability. The announced measures, if implemented properly, should help re-establish credibility of the government, aid with maintaining fiscal sustainability and re-inject liquidity into the private sector. The authorities should proceed cautiously with payments and employing an external auditor promptly to begin conducting ex-post risk based audits is crucial. The authorities' ambitious program of PFM reforms, supported by IMF TA, will help prevent a recurrence of arrears. Nevertheless, the process will take time before tangible results can be seen. The restoration of spending discipline will prevent ad hoc cuts in capital spending.

75. In the absence of fiscal buffers, monetary policy has a role to play in supporting economic recovery, but caution is warranted. Further moderate easing of monetary policy, provided inflation expectations and financial stability remain well anchored, could help. However, two caveats are warranted. First, sluggish credit demand and bank risk aversion would likely limit the effectiveness of conventional easing. Second, the high unhedged foreign currency exposure and the rising NPL level underscore the need for caution. Nonetheless, taking measures to reduce the large stock of NPLs will aid in restoring credit growth.

76. Continued vigilance is needed to maintain financial stability. Rising NPLs is a concern and requires prompt and comprehensive action. Removing structural distortions in collateral execution and bankruptcy laws, revamping the framework for loan restructuring and NPL sales, and clearing arrears would help with bank profitability, and ease deleveraging concerns. Strengthening the regulation and supervision of the nonbank financial system, in line with FSAP recommendations, would help alleviate systemic risks.

77. Embarking on a path of sustained medium-term growth hinges on implementation of an ambitious structural reform program. Planned reforms include pensions, energy, local government, public administration, and business environment. If implemented properly, they will strengthen Albania's ability to attract investment, reduce fiscal risks, and strengthen debt sustainability.

78. Risks to the program are significant. The proposed program will require strong political commitment by a largely untested new government. The key risk is therefore that implementation will be delayed or faced with unanticipated challenges, particularly given the complexity of some of the proposed reforms. The authorities' commitment to undertake broad based reforms and make upfront commitments should help mitigate these risks.

79. Staff supports the authorities' request for an Extended Arrangement. In view of Albania's balance of payments need, the policy actions already taken, and the authorities' commitment to implement ambitious reform package over the duration of the program, staff supports the authorities' request for an Extended Arrangement in an amount equivalent to SDR 295.42 million.

80. It is recommended that the next Article IV consultation with Albania be held on the 24-month cycle, subject to Decision No. 14747, as amended.

Box 1. Implementation Recommendations of the 2012 Article IV Consultation

Advice	Status
➢ Arrest the upward trend in public debt and undertake sustained fiscal consolidation in the medium term. Reduce budget financing rollover risk.	Public debt has continued to rise in 2013 as a result of fiscal slippages and accumulation of arrears. Some efforts have been made to extend public debt maturity profile.
➢ Contain spillovers from the eurozone crisis and minimize negative feedback from a slowing economy	The authorities strengthened supervision and maintained close cooperation with foreign regulatory authorities. Despite some measures to ease the execution of collateral, NPLs have risen.
➢ Strengthen property rights, improve contract enforcement, and simplify the tax system to encourage investment and medium-term growth	There has been limited progress on structural reforms; Albania’s rankings on major cross-country business environment indicators have worsened in 2013.

Box 2. Albania: Reform Agenda

OBJECTIVE

Enhance economic growth and correct macroeconomic imbalances

KEY POLICY AREAS

- Boost private sector credit while maintaining financial stability
- Strengthen public finances
- Reform energy sector
- Improve business climate

KEY MEASURES

Boost private sector credit while maintaining financial stability

NPL resolution:

1. Improve the insolvency regime, collateral execution and private bailiff incentive structure.

2. Clarify tax treatment of loan write-offs.

Financial sector supervision

1.Improve coordinated supervision.

2. Enhance supervision of investment funds by AFSA particularly with regard to liquidity management and consumer protection.

Domestic money & securities market development:

1.Improve infrastructure for repo and money market activities.

2.Deepen the secondary market for public debt, while undertaking necessary regulatory reforms.

Strengthen public finances

Tax policy:

1. Introduce progressivity in Personal income tax.

2. Broaden VAT base and reduce exemptions.

3. Revise the excise taxes.

4. Reform the property tax.

Tax administration reform:

1. Review and implement the new corporate strategy for GDT.

2. Implement the IT system transition.

3. Speed up VAT refund process.

Elimination and prevention of arrears:

1. Create a comprehensive strategy for arrears clearance.

2. Establish a commitment control system.

Social security system reform:

1. Increase retirement ages.

2. Separate low-contribution pensions from the pension system and include them as part of the social assistance program.

3. Reform the social assistance program.

Reform energy sector

1. Address quickly the dispute with CEZ.

2. Implement reforms to reduce power loss and improve payment collection.

3. Enhance governance of energy SOEs to ensure financial viability.

Improve business climate

1. Improve land registration and titling.

2. Curb corruption and enhance rule of law.

3. Reform civil service.

Box 3. Possible Tax and Expenditure Measures, 2014–16

Achieving the deficit targets over the course of the proposed program will require sizable tax and expenditure reforms.

Possible Tax and Expenditure Measures 2014-2016

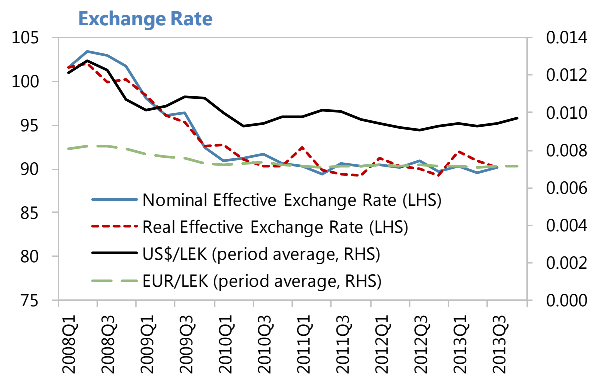
Possible measures 1/	Description	Yield (% GDP)
	Measures agreed with the authorities	
Revenue measures		
Raise CIT rate 2/	Increase in the profit tax rate from 10 to 15 percent.	0.5
Increase in excises 2/	Increase in the excise tax on cigarettes, wine, beer, alcoholic beverages, energy drinks, tobacco, and grease	0.4
Increase in Property Tax 2/	Doubling of property tax for commercial purposes	0.1
Circulation tax (environmental tax) 2/	Increase in fuel prices at the pump by about 6.5%	0.4
Simplified profit tax on small businesses 2/	Levy a tax of 7.5 percent on businesses with turnover between lek 2-8 million	0.1
Health care contributions 2/	Remove ceiling on health care contributions	0.1
Expenditure measures		
Freeze on nominal wages 2/	Maintain the nominal level of wages in the public sector (except police) at the 2013 level	0.1
Pensions 2/	Limit pension increases to inflation	0.04
	Other potential measures (S, M, L denote short-, medium-, and long- term measures respectively)	
Revenue measures		
Widen VAT base by reducing exemptions (S)	Reduce VAT exempt status of educational services, and ship import	
Introduce tolls on the highway to Kosovo (S)	Introduce a 2% tax on highway turnover (concession)	
Increase in the annual tax on used cars (S)	An increase in the annual fees on used vehicles by 50 percent	
Substitute VAT on new residential construction for VAT on rental properties (M)	Charging VAT on the sale of new construction, including the land value, while dropping the VAT on rentals	
Introduce VAT on incoming telephone calls (M)	Applying VAT on incoming telephone calls from abroad	
Introduce a foreign visit tax (M)	A flat tax on all residents traveling abroad	
Widen tax base for property tax (M)	Collecting property tax on the basis of purchase agreement instead of the title	
Introduce an annual vehicle license fee (M)	Introduce a fee on annual vehicle registration renewals based on the purchase price or value of the vehicle	
Introduce a tax on luxury goods (M)	Excise taxes on luxury goods such as jewelry and high-end cars	
Increase the withholding tax on capital incomes (S)	Increase in the withholding tax rate on incomes from interests, share of profit, rents, dividends, and payments on intellectual properties from 10% to 12%	
Expenditure measures		
Reduce network loss in electricity distribution (S/M)	Improve collection rate and grid quality, reduce energy theft	
Reform wage setting in the public sector (M)	Review and reform the remuneration system of the public sector as part of the civil service reform	
Increase of retirement age (L)	Increase retirement age to 67 for men and 65 for women	

1/ Missing yield means technical estimates of yields are not available.

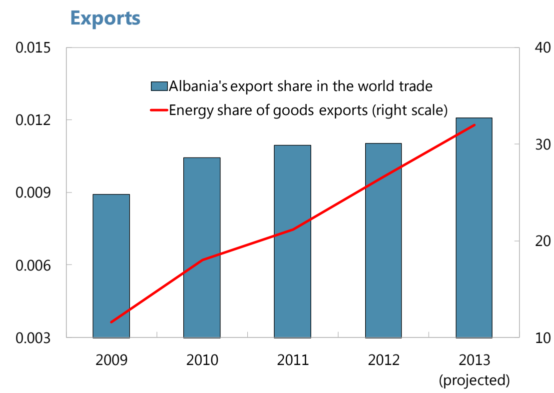
2/ These measures have been incorporated in Table 2.

Box 4. Albania: Exchange Rate Assessment

The exchange rate remained relatively stable in 2013, while higher energy exports aided Albania in raising its global export share.

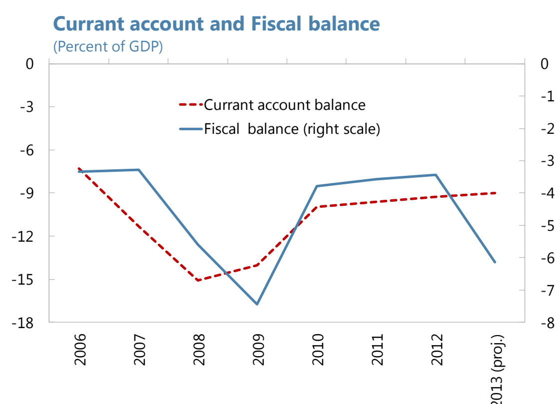


Source: WEO, IMF staff calculations

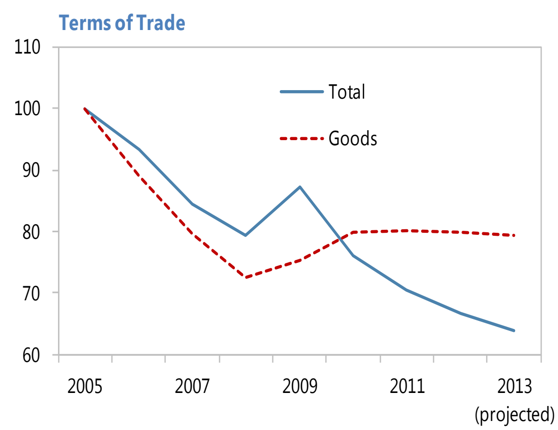


Sources: WEO, IMF staff calculations

The current account balance continued to improve steadily in 2013, despite the deteriorating fiscal imbalance. Strong energy export performance and weaker imports of goods have helped.



Sources: Albanian authorities and IMF staff calculations



Sources: Albanian authorities and IMF staff calculations

Box 4. Albania: Exchange Rate Assessment (Concluded)

The real exchange rate assessment is based on three different methodologies: the Equilibrium Real Exchange Rate (ERER), the Macroeconomic Balance (MB), and the External Sustainability (ES) approaches.[1] The ERER is estimated as a function of terms of trade, relative productivity, government consumption, and remittance inflows. In the MB approach, the current account is estimated as a function of a set of macroeconomic fundamentals—population and output growth, oil trade balance, fiscal balance, net foreign assets (NFA) and aid inflows. The ES approach computes the current account balance-GDP ratio required to stabilize Albania's NFA-GDP ratio at its end-2012 level.[2]

	Current Account Balance	Current Account Norm	Real Effective Exchange Rate	Equilibrium Real Exchange Rate	Real Exchange Rate Overvaluation
MB Approach	-7.4	-4.0	-	-	15.5
ERER Approach	-	-	91.0	88.0	3.0
ES Approach	-7.4	-3.5	-	-	17.7

Source: IMF staff projections and calculations. Current account elasticity with respect to the real effective exchange rate is estimated to be -0.22.

The exchange rate level appears broadly in line with fundamentals in the ERER approach, and moderately overvalued in the MB and ES approaches. The ERER approach points to a relatively small difference (of about 3 percent) between the REER and the estimated equilibrium real exchange rate. The MB and ES approaches suggest a gap between the projected 2019 current account deficit and the estimated norm of about 3.5–4.0 percentage points of GDP. These approaches, however, do not take into account Albania's stable and large FDI flows which are associated with import needs without raising external sustainability concerns. In particular, the medium term current account and FDI projections reflect two recent energy-related investments—Trans Adriatic Pipeline (TAP) and foreign investment in new hydropower production—amounting in total to about 15 percent of 2013 GDP. These suggest that the gap between the current account and its norm would be smaller than estimated once the FDI-related imports are accounted for.

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1/ The methodologies, discussed in Lee et al. (2008), are in line with the analysis of the Consultative Group on Exchange Rate Issues (CGER).

2/ In the MB and ERER approaches, a panel regression model is estimated for a sample of 184 economies over the period of 1973–2013. For a methodological reference on extension of the CGER methodology applied here for a larger sample of developed and developing countries, please refer to Vitek (2012).

Box 5. Albania: Conclusions of the 2013 FSAP

Several key features of the banking sector in Albania increase its vulnerability to shocks. These include its high euroization, strong financial links between banks and the government and the dominant presence of subsidiaries of foreign banks. The risks have been exacerbated in recent years by the high and rising rate of NPLs and resulting decline in bank profitability.

Stress tests show that banks are vulnerable to shocks, but the aggregate capital shortfall in these scenarios is limited. In severe macroeconomic scenarios, banks suffer simultaneous losses from credit, market, and sovereign risks, and at least 6 banks (representing 21 percent of the assets of the banking system) become undercapitalized. The additional capital requirement is relatively modest, however, while liquidity stress tests show that banks are amply liquid and able to confront large deposit withdrawals. Credit risk is also mitigated by solvency ratios that are above international norms and stringent provisioning rules. Sensitivity tests show that banks are most vulnerable to lek depreciation, given the large share of unhedged foreign currency lending, and that credit risk is exacerbated by the high concentration of loan portfolios.

Reduction of the large stock of existing NPLs is essential. The authorities are moving forward with the adoption of legal and prudential measures to support voluntary restructuring, encourage NPL sales, resolve tax ambiguities and reform the insolvency and collateral execution regime. This should be supported by stronger financial reporting requirements, an expanded definition of related parties and an asset quality review. In addition, more effective risk-based supervision, focusing on the quality of credit policies and underwriting standards, will help to ensure that new loans are of better quality.

The strong financial links between financial institutions and the sovereign pose challenges. Large holdings of government securities present systemic risks for banks, making them vulnerable to changes in interest rates and the value of debt securities. At the same time, the government depends on regular rollover of debt by banks. The risk is heightened by the lack of a secondary market, which creates significant liquidity risk for bondholders.

The recent emergence of investment funds has helped diversify the ownership of government securities, but attendant risks must be managed carefully. These funds face significant liquidity risk, which could have wider systemic implications in the event of a sudden demand for redemptions that forces the sales of assets into a largely illiquid market. It is essential to put in place a framework that helps ensure that key risks are understood (by both the funds and their investors) and contained.

With new insurance and investment fund complexities arising, it is essential to improve the capacity of the nonbank financial regulator (AFSA). The effectiveness of AFSA to date has been severely constrained by its lack of independence, limited financial resources, and shortage of qualified personnel. Major institutional reform is needed to strengthen AFSA's financial and operational independence and turn it into an effective regulator.

The legal and institutional framework for macroprudential policy, the financial sector safety net, and crisis preparedness are generally strong but need further refinement. Banking supervision should be strengthened by expanding consolidated supervision, formalizing cooperation with home supervisors, increasing supervision staff and enhancing their legal protection. The BOA has used macroprudential tools to manage the credit cycle, but should remain cognizant that using prudential tools to boost credit has potential risks to financial stability and that their impact is likely to be limited due to the difficulty of effectively targeting these measures. The institutional framework for Emergency Liquidity Assistance (ELA) is generally strong, but could be strengthened by increasing supervisory reach on banks in receipt of ELA, establishing a contingency plan in the event the BOA's foreign currency resources are insufficient to meet ELA demands, and establishing guidelines for reporting the use of ELA.

Box 6. Albania: Program Modalities and Risks

Access and Phasing

Albania will face a moderate balance of payments financing gap in 2014–16—about 7.1 percent of GDP (2.5 percent of GDP in 2014). Staff proposes a 36-month extended arrangement under Extended Fund Facility (EFF) with total access equivalent to SDR 295.42 million (about 492.4 percent of quota) to support Albania's BOP need and the authorities' policy and structural reforms.

Upon approval, the Fund arrangement will also unlock about €145 million in World Bank budget support in 2014–the World Bank will support the reform program through a series of Development Policy Loans (DPLs) focused in the fiscal and financial area, but also incorporating energy and pension reform measures. Filling the remainder of the gap in 2014 will require about 94.2 million SDR, or 157 percent of quota from the Fund (Table 7). The EU will provide support, but in 2016. The Fund-supported program is expected to be fully financed in the first year. The phasing over three years under the program has been determined after accounting for the support expected from other multilateral partners.

Given the independence of the central bank and budget financing constraints, the authorities intend to use the domestic currency equivalent of Fund resources for budgetary financing. This is also consistent with the limits on the domestic debt market's ability to continue to absorb high budget financing need, including that for arrears clearance. A government-BoA MoU establishing a framework on the modalities for the repayment to the Fund has been prepared. A safeguards assessment of the BoA will be conducted by FIN prior to the time of the first review.

Conditionality and Monitoring

The program entails structural reforms, notably, to strengthen PFM, arrears prevention, addressing shortcomings of the pension system, and putting the energy sector on a sustainable footing. Financial sector reforms would be based on recent FSAP recommendations. Program reviews will initially be on a quarterly basis (for the first five reviews) and subsequently on semi-annual basis, conditional on strong program performance in the first year.

Quantitative targets. There will be performance criteria on the overall deficit, net international reserves, and accumulation of external arrears. Given the well functioning inflation targeting framework, monetary conditionality will be embedded in the inflation consultation clause. Lastly, there will be indicative targets on BoA credit to the general government, and on accumulation and payment of central government domestic arrears (MEFP Table 1).

Structural benchmarks. Strengthening PFM, notably related to arrears clearance and prevention would be prominent in conditionality in the first year of the program. Structural benchmarks include the contracting of an external auditor to conduct risk–based audit of arrears payments, publication of report on arrears payment, quarterly surveys on new arrears accumulation in key ministries, and introduction of multi-year commitment limits. Financial sector measures will address the NPL problem and strengthen nonbank supervision (MEFP Table 2).

Capacity to Repay the Fund

Albania is expected to meet its repayment obligations to the Fund. By the end of the proposed extended arrangement, Fund credit outstanding is projected to be 3.1 percent of GDP, or 16 percent of gross reserves (Table 8). After peaking at 43.1 percent of GDP in 2014, external debt will decline to 32 percent of GDP by 2019, with external public debt falling from 30.9 to 21.1 percent of GDP. Albania has a strong record of repaying the Fund.

Risks

The political climate remains contentious. Implementation risks also arise because of the complexity of reforms. However the authorities are committed to launching a broad based reform agenda and will make up front announcements on planned measures. If economic growth does not evolve as expected, fiscal objectives, including the envisaged reduction in public debt, could be undermined, and there could be further pressure on bank asset quality, profitability and capitalization. In that event, staff will consider easing, in subsequent, reviews, the nominal deficit targets to allow automatic stabilizers to work consistently with a broadly unchanged structural balance.

Table 1. Albania: Basic Indicators and Macroeconomic Framework, 2009–19

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
					Est.			Projections			
Real sector					(Growth rate in percent)						
Real GDP	3.3	3.8	3.1	1.3	0.7	2.1	3.3	4.2	4.5	4.5	4.7
Consumer Price Index (avg.)	2.3	3.5	3.4	2.0	1.9	2.7	2.8	3.0	3.0	3.0	3.0
Consumer Price Index (eop)	3.7	3.4	1.7	2.4	1.9	2.6	3.0	3.0	3.0	3.0	3.0
GDP deflator	2.0	2.6	3.5	2.1	1.7	2.3	2.5	2.7	2.8	2.8	2.8
Saving-investment balance					(Percent of GDP)						
Foreign savings	14.1	10.0	9.6	9.3	9.0	10.3	12.4	14.8	13.0	9.9	8.2
National savings	16.2	16.9	16.2	15.0	15.2	15.0	13.4	13.0	15.7	17.1	18.8
Public	1.0	1.2	1.6	0.9	-1.0	0.2	0.8	1.9	2.9	3.7	4.3
Private	15.2	15.6	14.6	14.1	16.2	14.8	12.7	11.1	12.8	13.4	14.6
Investment	30.3	26.9	25.8	24.3	24.2	25.3	25.8	27.8	28.7	27.0	27.0
Public	10.1	6.8	6.2	5.2	6.2	5.2	5.2	5.2	5.2	5.2	5.2
Private	20.2	20.1	19.6	19.1	18.0	20.1	20.6	22.6	23.5	21.8	21.8
Fiscal sector					(Percent of GDP)						
Revenues and grants	26.0	26.1	25.8	24.9	24.0	25.4	25.3	25.2	25.2	25.2	25.2
Tax revenue	23.6	23.6	23.7	22.7	21.6	23.3	23.3	23.3	23.3	23.3	23.3
Expenditures	33.5	29.9	29.3	28.4	30.1	32.1	31.3	31.1	29.9	29.7	29.5
of which: Clearance of unpaid bills						2.5	1.3	1.1			
Primary	30.3	26.5	26.1	25.2	26.9	28.9	27.1	26.9	25.8	25.8	25.8
Interest	3.2	3.4	3.2	3.1	3.2	3.2	4.1	4.2	4.1	3.9	3.7
Unidentified measures (cumulative)						0.0	1.2	2.4	3.3	4.0	4.3
Overall balance	-7.4	-3.8	-3.6	-3.5	-6.2	-6.7	-4.8	-3.4	-1.3	-0.5	0.0
Primary balance	-4.3	-0.4	-0.4	-0.3	-2.9	-3.4	-0.7	0.8	2.8	3.4	3.7
Net domestic financing	3.3	1.4	1.9	2.3	5.4	3.0	1.6	1.5	2.3	2.1	1.3
of which: Privatization receipts	2.4	0.4	0.0	0.1	1.2	0.0	0.0	0.0	0.0	0.0	0.0
Foreign financing	3.7	2.1	1.6	1.2	1.0	1.2	1.1	-0.3	-1.0	-1.6	-1.3
Public Debt	59.5	58.5	60.3	62.4	70.5	71.7	71.2	68.8	65.4	61.4	57.1
Domestic	36.1	33.3	34.2	35.5	43.7	42.3	40.3	38.1	37.8	37.4	36.1
of which: Unpaid bills and arrears					5.3	2.6	1.2	0.0			
External (including publicly guaranteed)	23.3	25.2	26.0	27.0	26.8	29.3	30.9	30.7	27.6	24.1	21.1
Monetary indicators					(Growth rate in percent)						
Broad money growth	6.8	12.5	9.1	5.0	2.9	4.6	5.9	6.8	7.1	7.0	7.7
Private credit growth	10.3	10.1	10.4	1.4	-3.0	2.6	4.9	6.2	6.4	6.5	6.7
Velocity	1.3	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2
Interest rate (3-mth T-bills, end-period)	6.3	5.3	5.3	5.0	3.3	…	…	…	…	…	…
BoA repo rate (in percent)	5.3	5.0	4.8	4.0	3.0	…	…	…	…	…	…
External sector					(Percent of GDP, unless otherwise indicated)						
Trade balance (goods and services)	-24.7	-20.9	-23.1	-19.0	-17.1	-17.0	-18.4	-20.8	-18.9	-15.8	-13.7
Current account balance (including official transfers)	-14.1	-10.0	-9.6	-9.3	-9.0	-10.3	-12.4	-14.8	-13.0	-9.9	-8.2
Current account balance (excluding official transfers)	-14.7	-12.0	-12.5	-11.0	-10.4	-11.3	-13.2	-15.5	-13.7	-10.5	-8.8
Official transfers	0.7	2.1	2.9	1.7	1.4	1.0	0.9	0.8	0.7	0.7	0.6
Gross international reserves (in billions of Euros)	1.6	1.9	1.9	2.0	2.0	2.1	2.1	2.2	2.2	2.3	2.5
(In months of imports of goods and services)	4.1	4.4	4.5	4.8	4.8	4.5	4.1	4.0	4.1	4.0	4.0
(Relative to external debt service)	2.4	3.4	8.4	7.9	5.8	4.7	2.6	3.9	3.7	3.4	3.8
(In percent of broad money)	26.0	27.0	24.9	24.6	24.6	24.2	23.5	22.6	21.7	20.8	21.3
Change in real exchange rate (eop, in percent)	-7.8	-2.5	-0.5	-1.1	…	…	…	…	…	…	…
Memorandum items											
Nominal GDP (in billions of lek)	1148.1	1222.5	1282.3	1326.5	1357.9	1418.0	1501.6	1607.4	1726.0	1853.5	1994.4
Output gap (percent, - = gap)	1.8	1.8	1.7	0.5	-1.5	-2.2	-2.1	-1.4	-0.8	-0.4	0.1

Sources: Albanian authorities; and IMF staff estimates and projections.

Table 2a. Albania: General Government Operations, 2009–19

(Percent of GDP)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
					Est.			Projection			
Total revenue and grants	26.0	26.1	25.8	24.9	24.0	25.4	25.3	25.2	25.2	25.2	25.2
Tax revenue	23.6	23.6	23.7	22.7	21.6	23.3	23.3	23.3	23.3	23.3	23.3
VAT	9.6	9.3	9.3	8.8	8.0	8.3	8.3	8.3	8.3	8.3	8.3
Profit tax	1.5	1.4	1.2	1.3	1.1	1.6	1.6	1.6	1.6	1.6	1.6
Excise tax	2.9	3.2	3.2	2.7	2.7	3.2	3.2	3.2	3.2	3.2	3.2
Small business tax	0.2	0.2	0.2	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Personal income tax	2.3	2.2	2.2	2.1	2.1	2.0	2.0	2.0	2.0	2.0	2.0
Customs duties	0.7	0.6	0.5	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Other taxes	1.2	1.5	1.7	2.2	2.1	2.6	2.6	2.6	2.6	2.6	2.6
Property and local taxes	0.8	0.8	0.7	0.7	0.6	0.8	0.8	0.8	0.8	0.8	0.8
Social insurance contributions	4.3	4.4	4.4	4.3	4.4	4.5	4.5	4.5	4.5	4.5	4.5
Non-tax revenue	2.1	2.1	1.8	1.8	1.8	1.5	1.5	1.5	1.5	1.5	1.5
Grants	0.4	0.4	0.3	0.4	0.6	0.6	0.4	0.4	0.4	0.4	0.4
Total expenditure	33.5	29.9	29.3	28.4	30.1	32.1	31.3	31.1	29.9	29.7	29.5
Current expenditure	24.6	24.5	23.8	23.6	24.5	24.4	25.3	25.3	25.2	25.1	24.9
Personnel cost	5.4	5.4	5.3	5.2	5.3	5.2	5.2	5.2	5.2	5.2	5.2
Interest	3.2	3.4	3.2	3.1	3.2	3.2	4.1	4.2	4.1	3.9	3.7
Of which: domestic	2.7	2.9	2.7	2.6	2.7	2.6	2.8	2.7	2.7	2.6	2.6
Operations & maintenance	2.8	2.7	2.6	2.4	2.6	2.5	2.5	2.5	2.5	2.5	2.5
Subsidies	0.2	0.3	0.3	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Social insurance outlays	8.6	8.7	8.9	9.0	9.4	9.6	9.6	9.6	9.6	9.6	9.6
Local government expenditure	2.9	2.5	2.2	2.1	2.1	2.1	2.1	2.1	2.1	2.1	2.1
Social protection transfers	1.7	1.5	1.5	1.6	1.7	1.6	1.6	1.6	1.6	1.6	1.6
Capital expenditure	8.8	5.9	5.5	4.6	5.7	4.7	4.7	4.7	4.7	4.7	4.7
Lending minus repayment	0.0	-0.5	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Reserve and contingency funds 1/	0.0	0.0	0.0	0.0	0.0	0.6	0.0	0.0	0.0	0.0	0.0
Repayment of unpaid bills						2.5	1.3	1.1	0.0	0.0	0.0
Unidentified measures (cumulative)						0.0	1.2	2.4	3.3	4.0	4.3
Overall balance	-7.4	-3.8	-3.6	-3.5	-6.2	-6.7	-4.8	-3.4	-1.3	-0.5	0.0
Financing	7.4	3.8	3.6	3.5	6.2	4.2	2.7	1.2	1.3	0.5	0.0
Domestic	3.3	1.4	1.9	2.3	5.4	3.0	1.6	1.5	2.3	2.1	1.3
Privatization receipts	2.4	0.4	0.0	0.1	1.2	0.0	0.0	0.0	0.0	0.0	0.0
Net borrowing	0.9	0.9	2.1	2.2	4.2	2.9	1.6	1.5	2.3	2.1	1.3
Of which: Banks						1.3	0.8	0.8	1.2	0.8	0.6
Other	0.0	0.1	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	3.7	2.1	1.6	1.2	1.0	1.2	1.1	-0.3	-1.0	-1.6	-1.3
Accumulation of Arrears	0.5	0.3	0.0	0.0	-0.3	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap (+=gap)						2.5	2.1	2.2	0.0	0.0	0.0
World Bank						1.4	0.7	0.6			
Residual financing (e.g., EU)						0.0	0.5	0.4			
IMF						1.0	0.9	1.1			
Memorandum Items:											
Primary balance	-4.3	-0.4	-0.4	-0.3	-2.9	-3.4	-0.7	0.8	2.8	3.4	3.7
Overall balance, excl. repayment of unpaid bills						-4.2	-3.5	-2.3	-1.3	-0.5	0.0
Public debt	59.5	58.5	60.3	62.4	70.5	71.7	71.2	68.8	65.4	61.4	57.1
Domestic general government	36.1	33.3	34.2	35.5	43.7	42.3	40.3	38.1	37.8	37.4	36.1
Unpaid bills and arrears					5.3	2.6	1.2	0.0			
External	23.3	25.2	26.0	27.0	26.8	29.3	30.9	30.7	27.6	24.1	21.1
GDP (in billions of leks)	1148	1222	1282	1326	1358	1418	1502	1607	1726	1853	1994

Sources: Albanian authorities; and IMF staff estimates and projections.

1/ Spending contingencies are reported according to their economic classification at outturn.

Table 2b. Albania: General Government Operations, 2009–19

(Billions of leks)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
					Est.	Projection					
Total revenue and grants	299.0	319.6	330.4	330.4	325.8	360.8	379.5	405.6	435.4	466.9	502.4
Tax revenue	270.8	288.8	303.9	300.9	293.8	331.1	350.6	374.9	402.6	432.1	465.4
VAT	110.1	114.0	119.2	116.5	109.0	117.9	124.9	133.2	143.6	154.6	166.4
Profit tax	17.1	17.6	16.0	16.9	15.0	23.0	24.4	26.1	28.0	30.1	32.8
Excise tax	33.5	38.8	40.4	36.4	37.3	44.9	47.5	50.9	54.6	58.6	63.1
Small business tax	2.5	2.3	2.6	2.1	1.8	0.0	0.0	0.0	0.0	0.0	0.0
Personal income tax	26.8	27.1	28.0	28.0	28.4	28.5	30.2	32.3	34.7	37.3	40.1
Customs duties	7.9	7.3	6.9	6.1	5.6	5.9	6.2	6.7	6.7	6.6	7.1
Other taxes	13.4	18.4	21.4	28.7	28.6	36.4	38.5	41.2	44.3	47.5	51.1
Property and local taxes	9.7	9.6	9.2	8.7	8.0	10.7	11.3	12.1	13.0	13.9	15.0
Social insurance contributions	49.8	53.8	56.6	57.4	60.0	63.8	67.6	72.4	77.7	83.4	89.8
Non-tax revenue	23.7	26.2	22.7	24.0	24.1	21.2	22.4	24.0	25.8	27.7	29.8
Grants	4.4	4.6	3.8	5.6	7.9	8.5	6.5	6.7	7.1	7.1	7.1
Total expenditure	384.4	365.8	376.2	376.2	409.4	455.2	469.5	499.6	515.7	551.0	588.8
Current expenditure	282.9	299.9	305.6	312.6	332.1	345.5	379.4	407.0	435.2	464.5	495.7
Personnel cost	62.4	65.8	67.4	69.4	71.6	74.0	78.4	83.9	90.1	96.7	104.1
Interest	36.3	41.6	41.1	41.5	43.9	46.0	62.3	67.2	70.6	72.8	74.2
Operations & maintenance	32.1	33.3	33.0	31.8	35.0	35.3	37.4	40.0	43.0	46.1	49.6
Subsidies	2.0	3.5	3.3	1.9	1.6	1.6	1.8	2.0	2.1	2.0	2.1
Social insurance outlays	98.4	106.2	113.9	119.9	128.1	136.3	144.4	154.7	166.0	178.5	192.0
Local government expenditure	33.6	30.8	28.1	27.3	28.6	29.4	30.9	33.1	35.5	38.1	41.0
Social protection transfers	19.1	18.7	18.7	20.7	23.3	22.9	24.3	26.1	27.9	30.2	32.7
Capital expenditure	101.4	71.6	70.6	61.7	77.3	66.7	70.1	75.0	80.6	86.5	93.1
Reserve and contingency funds 1/	0.0	0.0	0.0	0.0	0.0	8.0	0.0	0.0	0.0	0.0	0.0
Repayment of unpaid bills						35.0	20.0	17.5	0.0	0.0	0.0
Unidentified measures (cumulative)						0.0	17.7	39.0	57.6	74.1	85.8
Overall balance	-85.4	-46.2	-45.7	-45.9	-83.6	-94.4	-72.3	-54.9	-22.7	-9.9	-0.7
Financing	85.4	46.2	45.7	45.9	83.6	59.1	41.2	19.2	22.7	9.9	0.7
Domestic	37.5	16.7	24.9	30.3	73.5	42.2	24.7	24.7	40.4	39.7	26.9
Privatization receipts	27.6	4.5	0.4	1.2	15.8	0.4	0.0	0.0	0.0	0.0	0.0
Net borrowing	9.9	11.1	27.0	28.6	57.1	41.8	24.7	24.7	40.4	39.7	26.9
Of which: Banks						17.9	12.4	12.4	20.2	14.8	12.3
Other	0.0	1.2	-2.5	0.5	0.5	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	42.4	25.4	20.9	15.6	13.6	16.9	16.5	-5.5	-17.7	-29.8	-26.2
Accumulation of Arrears	5.5	4.1	0.0	0.0	-3.5	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap (+=gap)						35.3	31.1	35.7	0.0	0.0	0.0
World Bank						20.5	10.2	10.1			
Residual financing (e.g., EU)						0.0	7.1	7.2			
IMF						14.9	13.8	18.4			
Memorandum Items:											
Primary balance	-49.1	-4.6	-4.6	-4.4	-39.7	-48.4	-10.0	12.3	47.9	62.8	73.5
Overall balance excl. repayment of unpaid bills						-59.4	-52.3	-37.4	-22.7	-9.9	-0.7
Current balance excluding grants	11.6	15.1	21.0	12.2	-14.2	2.8	-6.4	-8.1	-6.8	-4.6	-0.5
Public Debt	682.5	715.5	772.7	828.3	957.3	1016.3	1068.6	1106.0	1128.7	1138.6	1139.3
Domestic general government	415.0	407.5	438.8	470.6	593.7	600.5	605.2	612.4	652.8	692.5	719.4
Unpaid bills and arrears					72.6	37.5	17.5	0.0			
External	267.5	308.0	333.9	357.6	363.6	415.8	463.4	493.5	475.9	446.1	419.9
Direct government external debt	227.3	268.1	294.3	319.8	332.2	369.0	412.0	437.8	415.7	383.9	355.6
Government guaranteed external debt	40.2	39.9	39.7	37.8	31.4	46.7	51.4	55.8	60.1	62.1	64.3

Sources: Albanian authorities; and IMF staff estimates and projections.

1/ Spending contingencies are reported according to their economic classification at outturn.

Table 3a. Albania: Balance of Payments, 2009–19

(Percent of GDP)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
					Est.	Projection					
Current account	-14.1	-10.0	-9.6	-9.3	-9.0	-10.3	-12.4	-14.8	-13.0	-9.9	-8.2
Balance of goods and services	-24.7	-20.9	-23.1	-19.0	-17.1	-17.0	-18.4	-20.8	-18.9	-15.8	-13.7
Exports	28.7	33.0	34.5	33.4	33.8	34.2	34.7	34.9	35.1	35.1	34.5
Goods	9.0	13.2	15.4	16.0	18.1	18.5	18.9	19.3	19.7	20.1	20.2
Services	19.7	19.8	16.0	17.4	15.7	15.7	15.8	15.6	15.4	14.9	14.3
Imports	53.4	53.9	57.6	52.4	50.9	51.2	53.0	55.7	54.0	50.9	48.2
Goods	35.1	36.8	39.9	37.1	34.8	34.7	36.0	38.3	36.6	33.7	31.5
Services	18.3	17.2	17.7	15.4	16.1	16.5	17.0	17.4	17.4	17.2	16.7
Income balance	-1.0	-1.0	0.5	-0.9	-0.5	-0.8	-1.1	-0.9	-0.7	-0.4	-0.4
Of which: Interest due	0.8	0.8	1.0	1.0	1.2	1.3	1.6	1.5	1.5	1.4	1.4
Private transfers 1/	11.0	9.9	10.0	8.9	7.1	6.6	6.3	6.1	5.9	5.7	5.5
Official transfers	0.7	2.1	2.9	1.7	1.4	1.0	0.9	0.8	0.7	0.7	0.6
Financial account	11.2	13.1	10.3	8.8	8.2	8.2	10.6	13.0	13.4	10.3	8.8
Direct investment	7.7	9.3	7.9	7.6	7.7	8.4	11.1	15.0	18.0	18.9	18.9
Other capital	-0.4	1.4	0.8	-0.3	-0.5	-1.4	-1.6	-1.7	-3.7	-6.9	-8.8
Medium- and long-term loans (net)	3.9	2.3	1.6	1.5	1.0	1.2	1.1	-0.3	-1.0	-1.6	-1.3
New borrowing	4.5	5.4	2.4	2.5	2.4	2.9	5.8	1.5	1.0	0.9	0.8
Multilateral loans	1.5	1.3	1.8	1.9	1.6	1.7	1.6	1.0	0.6	0.4	0.4
World Bank	0.3	0.2	0.4	0.3	0.2	0.3	0.2	0.3	0.2	0.1	0.1
EBRD	0.4	0.2	0.4	0.3	0.2	0.3	0.3	0.3	0.2	0.2	0.2
Other	0.7	0.8	1.0	1.3	1.2	1.1	1.1	0.5	0.2	0.1	0.1
Bilateral loans	0.9	0.7	0.6	0.5	0.8	1.1	1.4	0.4	0.4	0.4	0.4
Commercial debt	2.2	3.4	0.0	0.0	0.0	0.0	2.8	0.0	0.0	0.0	0.0
Amortization	-0.7	-3.0	-0.8	-1.0	-1.4	-1.7	-4.7	-1.8	-2.0	-2.5	-2.1
Errors and omissions 3/	2.3	0.4	-1.1	1.6	1.5	0.0	0.0	0.0	0.0	0.0	0.0
Net balance	-0.5	3.6	-0.4	1.0	0.7	-2.1	-1.7	-1.8	0.4	0.5	0.6
Available financing	0.5	-3.5	0.4	-1.0	-0.7	-0.4	-0.3	-0.5	-0.4	-0.5	-0.6
Change in net reserves (increase = -) 2	0.5	-3.5	0.4	-1.2	-0.7	-0.4	-0.3	-0.5	-0.4	-0.5	-0.6
Financing gap 4/	0.0	0.0	0.0	0.2	0.0	2.5	2.1	2.2	0.0	0.0	0.0
World Bank						1.4	0.7	0.6			
Residual financing (e.g., EU)						0.0	0.5	0.4			
IMF						1.0	0.9	1.1			

1/ Bank of Albania data plus IMF estimate (to capture some unrecorded inflows not captured in the BOA estimate).

2/ Net of valuation changes in 2008–11. In projections for 2012–17, valuation effects are assumed to be zero.

3/ Net errors and omissions include unidentified flows of private transfers.

4/ The financing gap, if any, is expected to be fully covered by arrears rescheduling.

Table 3b. Albania: Balance of Payments, 2009–19

(Millions of euros)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
					Est.	Projection					
Current account	-1,225	-882	-877	-885	-876	-1,040	-1,306	-1,654	-1,552	-1,261	-1,120
Balance of goods and services	-2,148	-1,852	-2,107	-1,804	-1,651	-1,713	-1,938	-2,325	-2,260	-2,020	-1,907
Exports	2,504	2,922	3,153	3,181	3,273	3,444	3,658	3,911	4,195	4,486	4,822
Goods	785	1,172	1,406	1,526	1,754	1,860	1,992	2,161	2,351	2,575	2,819
Services	1,718	1,751	1,747	1,655	1,518	1,585	1,666	1,750	1,844	1,911	2,003
Imports	4,652	4,774	5,260	4,985	4,923	5,157	5,596	6,236	6,455	6,506	6,729
Goods	3,054	3,255	3,647	3,525	3,370	3,499	3,804	4,288	4,379	4,311	4,394
Services	1,598	1,519	1,613	1,460	1,553	1,658	1,792	1,948	2,076	2,196	2,335
Income balance	-91	-90	48	-89	-44	-84	-119	-97	-83	-57	-54
Of which: Interest due	67	71	87	97	119	135	168	171	180	184	186
Private transfers 1/	957	877	916	847	684	661	661	683	706	731	756
Official transfers	58	182	266	161	135	96	90	85	85	85	85
Financial account	977	1,160	940	833	789	827	1,122	1,456	1,598	1,323	1,207
Direct investment, net	672	827	717	727	741	847	1,173	1,683	2,157	2,416	2,588
Other capital	-34	124	73	-32	-48	-140	-167	-188	-437	-887	-1,201
Medium- and long-term loans (net)	340	208	150	138	97	120	116	-39	-123	-206	-180
New borrowing	396	474	221	233	233	289	614	166	118	109	106
Multilateral loans	127	111	165	185	152	176	167	117	67	58	54
World Bank	30	22	38	28	19	30	23	29	20	15	11
EBRD	33	14	36	32	19	33	32	32	28	28	28
Other	63	75	91	124	114	113	112	55	19	15	15
Bilateral loans	77	62	56	49	81	114	147	49	51	52	52
Commercial debt	193	300	0	0	0	0	300	0	0	0	0
Amortization	-57	-266	-71	-95	-137	-169	-498	-204	-241	-315	-286
Errors and omissions 3/	201	37	-101	150	150	0	0	0	0	0	0
Net balance	-47	314	-38	98	64	-213	-184	-198	46	62	87
Available financing	47	-314	38	-116	-64	-38	-34	-50	-46	-62	-87
Change in net reserves (increase = -) 2/	47	-314	38	-116	-64	-38	-34	-50	-46	-62	-87
Financing gap 4/	0	0	0	19	0	251	219	249	0	0	0
World Bank						145	72	70			
Residual financing (e.g., EU)						0	50	50			
IMF						106	97	128			
Memorandum items:											
GDP in Euros	8,714	8,853	9,130	9,509	9,678	10,071	10,553	11,196	11,960	12,791	13,714
Gross usable reserves	1,621	1,926	1,879	1,988	2,044	2,075	2,105	2,152	2,196	2,252	2,338
(months of imports of goods and services)	4.1	4.4	4.5	4.8	4.8	4.5	4.1	4.0	4.1	4.0	4.0
Balance of goods and services (percent of GDP)	-24.7	13.2	15.4	16.0	18.1	18.5	18.9	19.3	19.7	20.1	20.2
Current account (percent of GDP)	-14.1	-10.0	-9.6	-9.3	-9.0	-10.3	-12.4	-14.8	-13.0	-9.9	-8.2
Debt service (percent of exports of goods and services) 5/	4.0	9.7	2.8	3.5	4.0	4.2	13.5	4.6	5.4	6.7	5.3
Debt service (percent of central government revenues) 5/	4.8	13.1	3.9	4.7	5.5	5.9	19.0	6.5	7.6	9.6	7.5
Total external debt stock (percent of GDP) 6/	33.7	34.1	35.3	37.3	38.4	41.3	43.1	42.7	39.4	35.9	32.1
Volume of Exports of Goods and Services (percent change)	-5.9	24.7	11.0	2.3	15.5	10.4	9.2	9.4	9.2	9.0	8.8
Volume of Imports of Goods and Services (percent change)	0.9	-4.4	4.9	-9.0	0.5	7.6	9.3	11.6	3.6	0.6	2.9
Terms of trade (percent change) 7/	4.2	5.8	0.3	-0.1	-1.1	-0.4	-0.6	-0.3	-0.2	0.0	0.0

Sources: Ministry of Finance; Bank of Albania; donors; and IMFstaff estimates and projections.

1/ Bank of Albania data plus IMF estimate (to capture some unrecorded inflows not captured in the BOA estimate).
2/ Net of valuation changes in 2008–11. In projections for 2012–17, valuation effects are assumed to be zero.
3/ Net errors and omissions include unidentified flows of private transfers.
4/ The financing gap,if any, is expected to be fully covered by arrears rescheduling.
5/ Public and publicly guaranteed debt only.
6/ Public and private external debt, including arrears. Debt stock converted into Lek at the e-o-p exchange rate.
7/ Fund Staff estimates and projections.

Table 4a. Albania: Monetary Survey, 2009–14

(In billions of leks, unless otherwise indicated; end-period)

	2009	2010	2011	2012	2013	2014
					Proj.	
Net foreign assets	244	339	387	451	484	503
Bank of Albania	214	253	256	267	277	289
Commercial banks	30	16	132	185	206	214
Net domestic assets	627	641	683	672	673	707
Claims on central government, net	336	341	359	351	374	394
Bank of Albania	66	55	54	52	52	52
Commercial banks	270	285	305	299	322	343
Claims on public enterprises	12	9	19	24	25	25
Claims on the private sector	422	465	513	521	505	518
In leks	133	149	177	192	187	191
In foreign currency	289	316	336	328	318	327
Other items, net	-144	-174	-207	-223	-231	-231
Broad money	871	981	1,070	1,124	1,157	1,210
Currency outside banks	209	195	195	193	198	208
Deposits	662	785	875	931	958	1,003
Domestic currency	369	410	452	477	491	514
Foreign currency	293	376	423	454	467	489
Memorandum items:						
Broad money growth (% change)	6.8	5.0	4.3	2.0	2.9	4.6
Reserve money growth (% change)	4.8	-0.5	2.2	2.7	4.3	4.1
Private sector credit growth (% change)	10.3	10.1	10.4	1.4	-3.0	2.6
Broad money (as percent of GDP)	75.9	80.2	83.5	84.7	85.2	85.4
Private sector credit (as percent of GDP)	36.8	38.0	40.0	39.2	37.2	36.5
Velocity (nominal GDP/broad money)	1.3	1.2	1.2	1.2	1.2	1.2
Money multiplier (absolute values)	3.1	3.5	3.7	3.8	3.7	3.7
Currency (as share of broad money)	24.0	19.9	18.2	17.2	17.2	17.2
Foreign currency deposits/total deposits	44.3	47.8	48.3	48.8	48.8	48.8
Gross reserves (millions of euros)	1,621	1,926	1,879	1,977	2,031	2,075

Sources: Bank of Albania; and IMF staff estimates.

Table 4b. Albania: Summary of Accounts of the Central Bank, 2009–14

(In billions of leks, unless otherwise indicated; end-period)

	2009	2010	2011	2012	2013 Proj.	2014 Proj.
Net foreign assets	214	253	256	267	277	289
Assets	236	275	276	288	298	309
Liabilities	22	22	21	22	21	20
		16				
Net domestic assets	70	31	34	31	33	34
Domestic credit	100	70	81	75	69	70
Net claims on central government	66	55	54	52	52	52
Assets	77	64	64	65	65	65
Liabilities	11	9	10	13	13	13
Other credit	34	14	27	24	18	18
Private sector	2	2	2	2	2	2
Commercial banks	32	13	25	22	16	16
Other items, net (assets = +)	-30	-39	-47	-44	-36	-36
Reserve money	285	283	290	298	310	323
Currency in circulation	209	195	195	193	198	208
Bank reserves	76	88	95	105	109	114
Other nonbank deposits	0	0	0	0	3	2

Sources: Bank of Albania; and IMF staff estimates.

Table 5. Albania: IMF Core Indicators of Financial Soundness, December 2005–June 2013

		Dec-05	Dec-06	Dec-07	Dec-08	Dec-09	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13
I	Capital-based																	
(i)	Regulatory capital as a percent of risk-weighted assets	18.6	18.1	17.1	17.2	16.2	15.4	14.8	14.6	15.1	15.6	15.9	15.7	15.9	16.2	16.8	17.0	17.8
(ii)	Regulatory Tier 1 capital as a percent of risk-weighted assets	18.1	17.1	16.0	16.3	15.3	14.5	13.9	13.6	13.9	14.3	14.7	14.5	14.5	14.6	15.2	15.4	14.8
(iii)	Capital as a percent of total assets																	
	Regulatory Tier 1 capital as a percent of total assets	5.4	5.9	5.8	6.7	8.7	8.6	8.2	8.0	8.1	8.1	8.3	8.0	7.9	7.9	8.2	7.9	7.7
	Regulatory capital as a percent of total assets	5.6	6.2	6.2	7.0	9.2	9.1	8.7	8.7	8.7	8.8	9.0	8.6	8.6	8.8	9.0	8.8	9.2
	Shareholders' equity as a percent of total assets	6.6	6.8	7.6	8.6	9.6	9.4	9.1	8.6	8.7	8.7	8.7	8.6	8.5	8.6	8.6	8.5	8.3
(iv)	Nonperforming loans net of provisions as a percent of capital																	
	Nonperforming loans net of provisions as a percent of regulatory Tier 1 capital	4.4	7.2	12.0	27.2	29.9	38.1	40.4	51.2	55.3	56.6	58.8	60.5	64.9	61.8	62.8	62.5	54.7
	Nonperforming loans net of provisions as a percent of regulatory capital	4.3	6.8	11.2	25.7	28.2	35.9	38.1	47.4	51.2	52.0	54.2	55.8	59.5	55.6	57.0	56.4	45.4
	Nonperforming loans net of provisions as a percent of shareholders' equity	3.6	6.3	9.1	21.1	27.1	34.8	36.2	47.6	51.6	52.6	56.0	56.3	60.8	56.9	59.4	58.4	50.7
(v)	Return on equity (ROE) (annual basis)	22.2	20.2	20.7	11.4	4.6	7.6	2.9	2.4	1.9	0.8	8.0	4.8	4.2	3.8	5.2	2.9	-1.7
(vi)	Net open position in foreign exchange as a percent of capital																	
	Net open position in foreign exchange as a percent of regulatory Tier 1 capital	9.5	5.5	1.8	4.5	4.1	5.3	3.0	4.0	-3.3	4.3	4.3	6.5	4.5	4.1	4.0	4.5	5.2
	Net open position in foreign exchange as a percent of regulatory capital	9.3	5.2	1.7	4.3	3.9	5.0	2.8	3.7	-3.0	3.9	4.0	6.0	4.1	3.7	3.6	4.0	4.3
	Net open position in foreign exchange as a percent of shareholders' equity	7.8	4.8	1.4	3.5	3.7	4.9	2.7	3.7	-3.1	4.0	4.1	6.1	4.2	3.8	3.8	4.2	4.8
II	Asset-based																	
(vii)	Liquid assets as a percent of total assets (Liquid-asset ratio) 1/	62.6	57.6	49.8	42.8	27.6	25.9	26.6	25.5	26.3	26.5	29.0	35.9	29.0	41.9	41.9	43.3	43.6
(viii)	Liquid assets as a percent of short-term liabilities 1/	75.2	69.5	55.6	104.7	32.6	30.6	31.4	30.2	31.3	33.1	36.1	36.0	35.8	34.9	34.9	33.8	36.5
(ix)	Return on assets (ROA) (net income to average total assets) (annual basis)	1.4	1.4	1.6	0.9	0.4	0.7	0.3	0.2	0.2	0.1	0.7	0.4	0.4	0.3	0.4	0.3	-0.1
(x)	Nonperforming loans (gross) as a percent of total loans	2.3	3.1	3.4	6.6	10.5	14.0	14.7	17.0	18.4	18.8	20.1	21.1	22.7	22.5	23.7	24.2	24.2
(xi)	Sectoral distribution of loans to total loans	na	na	na	na	na	na	na	na	na	na	na	na	na	na	na	na	na
III	Income and expense-based																	
(xii)	Interest margin to gross income	84.0	92.6	92.7	106.5	119.6	118.9	137.2	146.6	147.6	147.7	119.7	129.5	130.6	130.4	123.6	131.2	148.3
(xiii)	Noninterest expenses to gross income	76.3	65.7	58.5	69.6	83.0	75.5	85.1	88.4	89.4	91.3	71.7	80.4	82.2	85.0	78.7	87.5	98.3
IV	Memorandum items																	
	Other (noncore) indicators:																	
	Customer deposits as a percent of total (non-interbank) loans	342.5	265.5	215.5	162.6	154.3	166.4	164.6	163.7	166.3	163.2	164.0	168.1	172.3	171.6	171.9	173.9	180.9
	Foreign currency-denominated loans to total loans	75.5	71.9	72.5	72.6	70.2	69.8	69.4	68.7	68.8	67.9	68.2	67.1	66.5	64.5	64.8	64.5	63.7
	Foreign currency-denominated liabilities as a percent of total liabilities	41.0	44.0	46.9	48.5	48.9	51.0	50.2	50.3	52.1	51.9	52.1	52.3	53.7	52.6	52.4	51.8	52.9
	Other indicators:																	
	Risk weighted assets as a percent of total assets	30.0	34.6	36.4	40.8	56.7	59.2	58.7	59.3	58.1	56.5	56.3	55.2	54.5	54.2	53.7	51.7	52.0
	Total loans as a percent of total assets	25.7	31.7	39.4	47.6	50.8	49.6	50.0	50.1	49.6	50.5	50.2	49.4	48.5	48.6	48.6	48.1	46.0
	Total loans as a percent of shareholders' equity	387.0	469.5	516.4	555.1	530.2	527.0	547.9	580.2	572.3	581.9	578.8	575.5	573.6	567.4	562.4	566.7	555.0

Source: Data provided by Bank of Albania.

1/ Definition of liquid assets and short term liabilities were changed in October 2009.

Table 6. Albania: External Financing Requirement and Sources, 2012–19

(In millions of euros)

	2012	2013	2014	2015	2016	2017	2018	2019
		Est.			Proj.			
Total financing requirement	1096	1076	1247	1839	1908	1838	1638	1493
Current account (incl. official transfers)	885	876	1040	1306	1654	1551	1261	1119
Amortization	103	144	176	503	207	243	320	287
Of which: IMF	8	8	7	5	3	2	5	1
Change in gross reseves (increase = +)1/	108	56	31	30	47	44	56	86
Total financing sources	1078	1076	996	1620	1660	1838	1638	1493
Foreign direct investment	727	741	847	1173	1683	2157	2416	2588
Other capital	-32	-48	-140	-167	-189	-437	-888	-1202
Official medium- and long-term loans	233	233	289	314	166	118	109	106
Multilateral (excluding IMF)	185	152	176	167	117	67	58	54
Bilateral	49	81	114	147	49	51	52	52
Commerial borrowing (Eurobond)				300				
Other 2/	150	150	0	0	0	0	0	0
Commercial	0	0	0	0	0	0	0	0
Total financing needs	19	0	251	219	249	0	0	0
Expected financing	0	0	145	122	120	0	0	0
World Bank	0	0	145	72	70	0	0	0
EU	0	0	0	50	50	0	0	0
Remaining financing gap	19	0	106	97	128	0	0	0
Fund disbursement	0	0	106	97	128	0	0	0

Sources: Ministry of Finance; Bank of Albania; donors; and Fund staff estimates.

1/ The change in gross reserves is net of valuation changes for 2012. In projections for 2013-18, valuation effects are assumed to be zero.

2/ Includes errors and omissions.

Table 7. Albania: Schedule of Review and Purchases (provisional)[1/]

Date	Amount (millions of SDR)	In Percent of Quota	Conditions
February 28, 2014	23.55	39.3	Board approval of arrangement
June 28, 2014	23.55	39.3	Observance of end-March 2014 and continuous performance criteria and completion of first review
September 15, 2014	23.55	39.3	Observance of end-June 2014 and continuous performance criteria and completion of second review
December 15, 2014	23.55	39.3	Observance of end-September 2014 and continuous performance criteria and completion of third review
March 27, 2015	28.88	48.1	Observance of end-December 2014 and continuous performance criteria and completion of fourth review
June 28, 2015	28.88	48.1	Observance of end-March 2015 and continuous performance criteria and completion of fifth review
December 10, 2015	28.88	48.1	Observance of end-September 2015 and continuous performance criteria and completion of sixth review
June 28, 2016	57.29	95.5	Observance of end-March 2016 and continuous performance criteria and completion of seventh review
December 15, 2016	57.29	95.5	Observance of end-September 2016 and continuous performance criteria and completion of eighth review
Total	295.42	492.4	

1/ Albania's IMF quota: 60 million SDR

Table 8. Albania: Indicators to Capacity to Repay to the Fund, 2012–19 [1/ 2/]

(under Obligated Repurchase Schedule)

(In millions of SDRs)

	2012	2013	2014	2015	2016	2017	2018	2019
		Projections						
Fund repurchases and charges								
In millions of SDRs	6.8	6.8	6.6	6.1	6.2	7.5	10.7	1.58
In millions of euro	8.0	7.6	7.4	6.8	6.8	8.2	11.6	1.71
In percent of gross international reserves	0.4	0.4	0.4	0.3	0.3	0.4	0.5	0.00
In percent of exports of goods and services	0.3	0.2	0.2	0.2	0.2	0.2	0.3	0.00
In percent of GDP	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.02
In percent of external public debt	0.3	0.3	0.2	0.2	0.2	0.2	0.3	0.05
In percent of quota	11.3	11.3	11.1	10.2	10.3	12.5	17.8	13.41
Fund credit outstanding (end of period)								
In millions of SDRs	23.2	16.4	104.8	187.1	298.8	296.8	291.7	290.14
In millions of euro	27.2	18.4	117.0	207.3	328.5	323.9	316.6	13.41
In percent of gross international reserves	1.4	0.9	5.6	9.9	15.3	14.8	14.1	13.41
In percent of exports of goods and services	0.9	0.6	3.4	5.7	8.4	7.7	7.1	6.50
In percent of GDP	0.3	0.2	1.2	2.0	2.9	2.7	2.5	2.80
In percent of external public debt	1.0	0.7	3.8	6.1	9.1	9.3	9.5	10.01
In percent of quota	38.7	27.3	174.6	311.8	498.0	494.6	486.2	483.6
Memorandum items:								
Gross international reserves	1695	1821	1858	1899	1957	2012	2075	2164
Exports of goods and services	2712	2915	3084	3301	3557	3844	4133	4463
GDP	8107	8622	9017	9524	10182	10957	11785	10361
External public debt	2234	2417	2760	3083	3296	3204	3063	2899
Quota	60.0	60.0	60.0	60.0	60.0	60.0	60.0	60.0

Source: Fund staff estimates.

1/ Projections are based on current interest rates for PRGF and the EFF.
2/ End-of-year value.

Appendix I. Letter of Intent

Tirana, February 5, 2014

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C., 20431

Dear Ms. Lagarde:

1. Albania is experiencing serious economic challenges—an economic slowdown and elevated domestic imbalances. To tackle these challenges, we are proposing a strong and ambitious reform program, aimed at reducing macroeconomic vulnerabilities and promoting economic recovery.

2. To accompany our reform efforts, we have turned to our international partners for support. Our estimate is that the external financing need would be up to 7.1 percent of GDP during the duration of the three-year program. We therefore request that the Fund support our policy program through a three year extended arrangement under the Extended Fund Facility, in an amount equivalent to SDR 295.42 million (about EUR 331.1 million, and 492.4 percent of quota). This arrangement, along with support from the World Bank and the European Commission, is expected to close Albania's financing gap. The Fund's support is therefore critical for reducing risks as we begin to restore market confidence and return to sustainable growth.

3. The attached Memorandum of Economic and Financial Policies (MEFP) outlines the policies that the government and the Bank of Albania will implement during the next three years. We are confident that by the end of the program we will achieve our objectives of high and sustained growth and reduced macroeconomic vulnerabilities.

4. Implementation of our program will be monitored by the Fund through reviews, quantitative performance criteria and indicative targets, as well as structural benchmarks, as described in the attached MEFP and Technical Memorandum of Understanding (TMU). There will be 5 quarterly reviews and 3 bi-annual reviews under the arrangement. The reviews will assess progress in implementing the program and reach understandings on any additional measures that may be needed to achieve its objectives.

5. While we are confident that the policies described in the MEFP are adequate to achieve program objectives, we stand ready to take additional measures that may be required for this purpose. In accordance with the Fund's policies, we will consult with the Fund on the adoption of such measures in advance of revisions to the policies contained in this letter and the MEFP.

6. The government of Albania will provide the IMF with such information as it may request to monitor progress made in economic and financial policy implementation.

7. The Albanian authorities wish to make this letter available to the public, along with the attached MEFP and Technical Memorandum of Understanding (TMU), as well as the IMF staff report on the 2013 Article IV consultation and the request for a three year extended arrangement under the EFF. We therefore authorize their publication and posting on the IMF website, subject to Executive Board approval. These documents will also be posted on the official websites of the Albanian government.

Sincerely,

/s/	/s/	/s/
Shkelqim Cani	Ardian Fullani	Arben Ahmetaj
Minister of Finance	Governor, Bank of Albania	Minister of Economic Development

Attachments: Memorandum on Economic and Financial Policies
Technical Memorandum of Understanding

Attachment I. Memorandum of Economic and Financial Policies

1. This Memorandum lays out the economic program of the government of Albania by highlighting the policy and structural reforms that we will be undertaking in the period ahead, supported by the IMF. Our economic policies are aimed at putting the Albanian economy on a path of sustained medium term growth that results in tangible gains, including employment generation and improvement in the standard of living of the Albanian population. We will undertake broad-ranging economic reforms that improve the business environment and remove the constraints that hamper economic development. We are committed to pursuing our growth objectives while enhancing macroeconomic stability and, in this regard, will strive to lower the debt related vulnerabilities that the country faces today by putting public finances on a sustainable footing.

I. RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

2. The Albanian economy has been slowing sharply since 2012. Output growth held up relatively well in the aftermath of the global financial crisis, but has been slowing sharply since 2012. Although remittances (which come primarily from Italy and Greece) have been on a downward trend, the direct impact of the global financial crises was small because of the limited financial exposure to international markets and an expansionary fiscal policy initiated before the crisis. Real GDP growth has slowed sharply since 2012, however, as weak credit growth and rising government payment arrears have contributed to significant weakness in domestic demand. The uncertainty associated with 2013 parliamentary elections has also dampened confidence of the private sector. External demand has been the primary driver of growth in the last two years, but remains limited by lingering weakness in the euro zone, including our immediate trading partners, and a narrow export base. Growth in 2013 is projected to slow to around 0.7 percent, the lowest level since 1997. We expect growth to recover to 2.1 percent of GDP as confidence is restored and domestic demand begins to recover.

3. External imbalances have declined but remain high. After reaching 14 percent of GDP in 2009 the current account deficit has steadily declined to 9.5 percent in 2012 and is projected to be 9 percent in 2013. While most of the adjustment is a result of improved export performance, particularly petroleum exports, it also reflects the subdued domestic demand which has curtailed imports. External debt has nearly doubled since 2004 to around 40 percent of GDP in 2012, the largest part of which reflects external public debt. Despite slowing remittances, Albania's FDI potential (as underlined by recently agreed gas pipeline and hydropower projects amounting to a projected $1.5 billion), combined with increasing domestic production that lowers our reliance on imports (especially for agricultural products), is expected to improve external sustainability over the medium and long run.

4. Inflation remains muted due to weak domestic demand. Headline CPI inflation fluctuated around the lower band of the target range during 2012 and the first three quarters of 2013, reflecting both weak demand and low imported inflation. Core inflation has also fallen amidst subdued wage pressures. With inflation expectations subdued, the BoA has steadily reduced its policy interest rate by 225 basis points over the past 24 months to 3.0 percent.

5. The financial sector has remained largely stable despite a sharp increase in nonperforming loans (NPLs). Although the banking system is almost entirely foreign-owned, the impact of the financial crisis was limited by foreign bank subsidiaries' lack of reliance on foreign funding, including from their parents, with most banks entirely financed by local deposits. However, the level of NPLs in the banking system has increased significantly in the aftermath of the financial crisis, reaching 24 percent of gross loans at end-November 2013. Comparatively strict provisioning requirements and a comfortable capital adequacy ratio have helped to contain the negative shocks to the system thus far. However, the large increase in NPLs and deterioration in the economic outlook have caused banks to take a much more conservative approach to lending and contributed to a sharp slowdown in credit growth. Annual credit growth turned negative in September 2013 for the first time in the last decade, declining by 3 percent (year-on-year). Banks have raised provisions for credit risk, which in September reached 62.3 percent of NPLs and 15.2 percent of total loans.

6. The fiscal deficit has widened significantly in 2013. The slowdown in the economy together with general elections in June 2013 led to an expansionary fiscal policy during the first half of 2013. In addition to higher expenditures, tax revenue underperformed considerably. The sharp deterioration in revenues forced the government to increase the deficit projection to about 6 percent of GDP from 3.5 percent planned initially. Public debt (including arrears) will exceed 70 percent of GDP by end 2013.

7. Public debt and accumulated arrears have reached a level that poses significant macroeconomic risks for Albania. The high public debt level has also led to elevated interest expenditures, presenting a major vulnerability to the budget and crowding out other more productive spending. A large portion of debt depends on short term financing that is subject to considerable rollover risks. In addition, an ambitious capital investment program in the context of persistently optimistic revenue projections has resulted in a large accumulation of payment arrears in recent years. The bulk of the arrears are in the Ministry of Public Works and Transport, but arrears have also been arising elsewhere, including the Ministries of Education and Health. There have also been long delays in VAT and profit tax refunds. Preliminary estimates of IMF staff, based on currently available information, show a total stock of arrears of 5.3 percent of GDP at the end of 2013.

II. FISCAL CONSOLIDATION

8. The government is committed to fiscal consolidation to put public finances on a sustainable footing and lower public debt over the medium term. Given the weak economy it is important to calibrate the extent of fiscal consolidation. We are committed to beginning the process of fiscal consolidation in 2014, in order to achieve a reduction in public debt in 2015. We plan to adjust our future fiscal targets, in consultation with IMF staff, in line with the strength of the economy—fiscal adjustment will be loosened in the event that economic growth is weaker than envisaged, and vice versa.

9. Medium-term fiscal consolidation will also be key to achieving fiscal sustainability. Over the medium-term, we aim to bring it down to 69 percent of GDP by the end of the program with the IMF in 2016 and to well below 60 percent by 2019. We will work closely with our international partners, including the IMF to strengthen medium-term fiscal framework and introduce fiscal rules into our policy framework in 2015.

10. We are targeting a fiscal deficit of about 4.0 percent of GDP in 2014, excluding spending on the repayment of arrears, down from near 6 percent estimated for 2013. The approval of the 2014 budget in line with the agreement with IMF staff is a prior action under the program.

11. The 2014 budget incorporates a number of policy measures to support fiscal consolidation. On the revenue side, there will be increases in i) the corporate income tax (CIT) rate from 10 to 15 percent (a level still well below the rate of 23 percent that was in place until 2008); ii) excise tax rates on cigarettes, tobacco, beer, energy drinks, wine, and alcoholic drinks and industrial lubricants (grease) will increase; 3) circulation tax increase, equivalent to an increase in gasoline and diesel fuel prices of about 6.6 percent; 4) property tax rates paid by businesses (local tax) to rise. On the spending side, we will i) refrain from increasing public sector salaries in 2014, with the exception of a structural increase for police officers (given our desire to tackle widespread corruption more effectively), and ii) limit pension increases to cost of living adjustments (a requirement under the pension law).

12. At the same time, we will also implement initiatives to ease the burden of fiscal adjustment on individuals, small businesses, and vulnerable groups. In particular, we plan to introduce a progressive income tax system on salaries with rates of 0, 13 and 23 percent corresponding to monthly salaries up to lek 30, 130, and in excess of 130 thousand respectively, abolish the small business tax (local tax), and reduce the rate for the simple tax on profit for small businesses to half the corporate tax rate. To counter the impact of the tax increases on vulnerable groups, we will provide targeted food support to those in need (half of the VAT paid for some basic food products will be subsidized), as well as support those who have difficulties paying their electricity bills (half of the VAT paid for electricity will be subsidized). To support agriculture, which sustains a large number of the rural population, we will refund VAT by April 1, 2014, partially paid on agricultural inputs. Finally, we plan to exempt medicines and medical services from VAT, in line with EU regulations.

13. There is a built-in flexibility in the design of the program to ensure that the fiscal objectives are achieved. The 2014 budget includes a contingency in the event of revenue shortfalls. Appropriations allocated under this category will be saved unless revenues over-perform as a result of better tax policies and administration. Any decision to release these funds will be made in consultation with Fund staff, in the context of a supplementary budget request to Parliament during the second half of the year. If on the other hand, revenue performance is better/worse than currently expected as a result of improved/worsened economic conditions, the over/under performance so calculated will be applied toward tightening/loosening fiscal policy in consultation with IMF staff. In this manner the proposed program with the IMF will allow us to calibrate the speed of fiscal adjustment over the medium term in line with the economic cycle.

14. Improving tax administration will be critical for realizing the program objectives. Revenue collection in Albania continues to be undermined by the high level of informality in the economy, resulting in one of the lowest tax efficiency ratios in the region. We have recently received technical assistance from the IMF on tax administration, and plan to move forward with recommendations in 2014, including completing the introduction of a new IT system by end-2014. In addition, we have contracted a foreign consultant to assist customs in tax collection, which we expect to begin having sizable impact in improving efficiency and reducing corruption. Tax administration will also establish committees to guide its strategic and operational decision making (prior action). A new corporate strategy for medium and long term capacity building will be developed by end-June (structural benchmark, June 2014). To reduce incentives for delaying VAT refunds, beginning in January 2014 the Treasury will be responsible for making payments on all new VAT refund claims after approval by the Tax Administration. Tax administration practices will also be revised to ensure consistent application of rules and procedures, and the tax administration will make progress in speeding up the repayment of VAT refunds with minimum delays.

15. We are in the process of implementing a series of measures to increase tax compliance and reduce fraud. We plan to implement lotteries on sales receipts by June, 2014 to give consumers more incentives to request receipts in market transactions. For the businesses to which the government owes arrears, we will check tax payment records and net out tax debt from the arrears payments they will receive. We will launch a public awareness campaign beginning in June, 2014 through media on the importance of paying taxes. To reduce fraud in VAT and CIT refunds, we will carry out more thorough verifications of refund claims, and in 2015, will change the verification process to link it directly to businesses' online tax payment records, so as to reduce the risk of corruption. Undertaking the verifications electronically will also help in expediting the refund process.

16. We will begin preparations shortly to move to a valuation-based property tax by 2015. Property tax collections at the local level are currently very low, reflecting weak compliance and incomplete property records that make the system difficult to administer. We have requested technical assistance to introduce a valuation-based property tax that will be based on objective appraisal of property values. Toward this end, we plan to begin the work for geospatial imaging, and reinforcement of the land registry by end of 2014.

17. Public Administration reform is high on our policy agenda. Our objective is to create a professional civil service that is immune from political interference. We will conduct a review of public administration in 2014 to inform future reforms. Our aim is to increase the efficiency and cut costs, including by reducing the number of employees in public administration. The government will not hire new staff beyond the level allowed by the current organigrams and the number of employees in the public administration in 2014 will not exceed the current level of 87,700. Going forward, we are committed to hiring new employees on merit, and in strict compliance with the new Civil Service Law that is to be implemented by April, 2014.

18. Pension reform is a key medium-term priority. The current system constitutes a significant burden on budgetary resources, in large part due to the very low level of collections, and requires comprehensive reform in order to ensure its medium-term fiscal sustainability. We acknowledge that putting public pensions on a sustainable footing would require rationalization of benefits and contributions. A new Reform Commission, which will be established by March, 2014 (structural benchmark), will launch a comprehensive review of the pension system in cooperation with the World Bank, and present a medium-term reform strategy to Council of Ministers for approval by December, 2014 (structural benchmark).

19. The existing benefit structure will be reviewed. We intend to reform of the disability system to prevent abuse. In this regard, we intend to prosecute those who are found guilty of abusing the system so as to deter similar incidents in the future. Moreover, we will streamline the program for property compensation and tackle fraud, with the Social Assistance Scheme of the World Bank.

20. In the coming year, we also plan to launch a comprehensive local government reform effort. Weakness in local government administration adds to fiscal risks and hampers the effective delivery of services. Our goal is to streamline finances, increase autonomy, and make them more accountable for their decisions. Administrative and territorial reform, which should be completed before the 2015 local elections, should help tackle some concerns about the functioning of local government units, related to the collection of revenues, human resource management, financial control, and transparency.

21. Further boosting capital expenditure is essential for meeting our development objectives over the medium term. Finalizing the ongoing infrastructure projects is a major priority in the short term in order to minimize delays which give rise to additional costs. In this regard, we intend to renegotiate existing project commitments during 2014 to release space for accommodating new initiatives while reducing outstanding government obligations. We are committed to gradually increasing budgetary allocations toward this end consistent with the medium term macro framework.

III. PREVENTION AND CLEARANCE OF GOVERNMENT ARREARS

22. Our first priority is to meet the government's payment obligations and to avoid the recurrence of new arrears in the future. The significant accumulation of public sector arrears during the last few years is a major contributing factor in the slowdown in economic activity, and has created a negative chain of payment delays that have adversely affected both corporate and bank balance sheets. A prompt clearance of these obligations should help to restore confidence and alleviate the liquidity constraints in the private sector.

23. Arrears repayment will be guided by a comprehensive and transparent prevention and clearance strategy, which will be published quarterly on the MoF website**.** The Arrears Prevention and Clearance Strategy (APCS; prior action) will comprise measures the government will undertake to ensure weaknesses in the system that generated the arrears problem are addressed. It will also lay out the structure of the clearance process, including the committee in charge of executing the clearance (the Arrears Committee). We expect to pay arrears without delay upon verification. The High State Audit will be involved in the verification and monitoring of the procedures followed and its adherence with the APCS. We will also contract an external auditor to perform ex-post risk-based audit of randomly chosen cases (structural benchmark, June 2014), to ensure that the repayment process adheres to the APCS. The breakdown of individually cleared arrears, by amount, and result of the external auditor's findings will be published quarterly on the Ministry of Finance website (continuous structural benchmark). External financing from the IMF and the World Bank will enable us to meet our goal of a timely clearance of these arrears, without overstretching domestic financial markets with the volume of domestic bond issuance that would otherwise be required. Nonetheless, we expect that the due diligence and verification process would limit the amount of arrears cleared to 11.7 billion lek by June 2014 and 35 billion lek by December 2014. We will consult with Fund staff should arrears clearance exceed these clearance bands.

24. Besides clearance of existing arrears, we are also committed to putting in place the necessary processes to monitor future commitments and avoid arrears accumulation. The first step in this regard was the inclusion of the Albanian Roads Authority as one of five institutions in the pilot rollout of the extension of the Treasury System in November 2012. This change has given five institutions the responsibility to register all contract commitments and pre-commitments in the Treasury system. In addition, we have strengthened commitment management by requiring all new procurement orders (for goods, works and services) to be sent to the MoF for clearance prior to starting the biding process. Submission to Parliament of legislation to clearly define expenditure arrears and payment terms is a prior action under the program, for January 2014.

25. In addition, we will enhance the reporting and approval procedures for procurement orders, especially for multi-year commitments. One important cause for the build-up of contract arrears was the lack of control over the procurement process, especially for multi-year contracts that demand budget resources beyond the current year. To tackle the problem, beginning in March 2014 we will require all procurement orders to be sent to MoF for clearance based on appropriations and outer-year commitment ceilings. Operationally, this will be done through the following steps:

- MoF will issue budget instructions by January, 2014 to all central government entities to report all proposed new procurement orders for MoF clearance, and suspend issuing any new multi-year procurement orders until outer-year commitment ceilings are approved by the Council of Ministers (CoM) (prior action). This is to ensure that new procurements will only be made in observance of the outer-year commitment ceilings.
- MoF will start clearing in-year procurement orders based on appropriations and sign on each cleared procurement order (January 2014).

- MoF will record signed procurement orders for all investment contracts and for all current expenditures of higher than $300,000 a year in a designated database. (January 2014)
- MOF will issue instructions to all local governments to report all new procurement orders to MOF starting September 2014 (structural benchmark, March 2014).
- MoF will submit to CoM proposals for outer-year commitment limits and get them approved (March 2014)
- Government entities will be allowed to resume issuing multi-year procurement orders and start reporting them to MoF, including their disbursement schedules by year (March 2014)
- MoF will start clearing multi-year procurement orders based on annual appropriations and outer-year commitment ceilings (March 2014)

The above reporting and clearance procedures will be in place until we reconfigure the Treasury System to fulfill the same functions for key ministries and gradually extend the coverage of the system to 60 percent of the state budget and Tirana Municipality by end-2014.

26. We are planning to make several additional improvements in public financial management in 2014. These will include: i) modification of the commitment module in the treasury system to disaggregate multi-year commitments by individual year allocations by June, 2014; ii) require the registration in the Treasury system of all invoices received, regardless of cash availability within 5 days of acceptance by June 2014, iii) strengthening the timeliness and flow of tax and revenue information so that the gross transactions and values of collections and refunds are captured in the treasury system on weekly bases using the interface for data exchange between Tax Information System and Treasury System by 2015. In addition, we have already granted the authority and responsibility to the treasury to execute tax refund payment transactions starting January 2014. We are also receiving assistance from the Instrument for Pre-Accession Assistance (IPA)-financed twinning project (supported by the French and Austrian governments) which is providing technical assistance on Public Financial Management reforms, particularly a comprehensive review of primary and secondary legislation.

27. We plan to start introducing commitment limits with the 2015 budget (structural benchmark, December 2014)**.** The commitment limits will specify, for every line item of the budget, the amounts of commitments that can be made in the current year and for each outer-year. The sum of the commitment limits will be lower than the cash ceilings for the outer-years, to preserve room for new commitments that will be made in the outer-years. We will also amend the relevant laws in 2014 to legally enforce the commitment limits. Meanwhile, we will conduct public campaigns to inform the business community of the above reform measures.

28. To monitor any potential new accumulation of arrears, we will strengthen financial data reporting of government agencies, starting with the ministries that have created the largest amounts of existing arrears. Starting in the first quarter of 2014, the MoF will carry out a quarterly survey of arrears accumulation among selected parts of central government (the Ministries of Transportation, Health, Education, Justice, and Defense, and the GDT) to collect information on all unpaid obligations (structural benchmark, April, 2014). Coverage of the arrears survey should be gradually expanded (structural benchmark, October, 2014). A new unit responsible for conducting the surveys and consolidating the results will be established within the MoF; the unit will collect and monitor arrears data. We will send a consolidated survey report to the IMF for review, 45 days after the end of each quarter. Meanwhile, we will conduct financial reporting training for all line ministries, with the goal of gradually extending the survey to other ministries. By the end of 2014, the survey is expected to cover the 10 ministries with the highest existing arrears stocks.

IV. MONETARY AND EXCHANGE RATE POLICY

29. The BoA remains committed to preserving price stability under an inflation-targeting framework. As defined in our medium-term strategy, the BoA aims to achieve a headline average CPI inflation target of 3 percent over the medium term, with a tolerance band of +/-1percentage points to account for supply side shocks and inflation inertia. The monetary policy decision-making process is guided by the deviation of forecasted inflation from this objective, while striving to avoid excessive volatility in the real and financial sector. The BoA targets headline inflation, but will also monitor core inflation as a measure of underlying inflationary pressures. The inflation performance will be monitored through an inflation consultation clause (see TMU).

30. The BoA remains committed to a free floating exchange rate regime. This regime complements our price stability objective and supports our operational framework of monetary policy. The BoA will also aim to maintain adequate reserve coverage over the program; reserve coverage is currently well above the level prescribed by most standard reserve metrics. For the duration of the program we will not, without Fund approval, introduce or intensify restrictions on the making of payments and transfers for current international transactions, nor introduce or modify any multiple currency practices or conclude any bilateral payments agreements that are inconsistent with Article VIII of the Fund's Articles of Agreement. Moreover, we will not introduce or intensify import restrictions for balance of payments reasons.

31. The main tool of monetary policy will continue to be the one week repo rate. Our monetary operations will aim to achieve an adequate supply of liquidity, so that short term interest rates in the interbank market are close to our policy rate. The BoA will aim to improve its operational framework in order to increase the efficiency of the transmission mechanism and to promote the development of money markets. In order to increase our transparency and effectiveness, and improve the anchoring of inflation expectations, the BoA will also continue to enhance its communication strategy.

V. SAFEGUARDING FINANCIAL SECTOR STABILITY

32. The BoA will continue to closely monitor the situation in the banking sector to ensure that it remains well-capitalized and liquid. If necessary, BoA will apply higher minimum required levels of risk weighted capital and liquidity ratios, according to risk profiles of individual banks. In order to identify other potential vulnerabilities in the banking sector, BoA will also continue to regularly perform top-down and bottom-up solvency and liquidity stress tests, applying scenarios that assume persistent uncertainties in the economic environment and increased volatility in macroeconomic indicators.

33. **NPL reduction is a priority, and the BoA will focus on actions to bring this about, and to ensure that standards on new lending are strengthened.** In this regard, the BoA will improve by February 2014 the regulatory framework to strengthen credit standards and provide more guidance on NPL management. The BoA and the MoF, in conjunction with the Ministry of Justice and other related agencies, and Albanian Banking Association has submitted the legal amendment of the Tax Law to the Parliament to remove legal and technical issues that impede the loan write-offs from banks' balance sheets within January 2014. In addition, we will prepare (with IFC assistance) changes in the Civil Code and other relevant laws in order to introduce improvements in insolvency requirements, set the payment to bailiffs in line with success rate (rather than requiring full up-front payment as at present), and restrict judicial discretion in postponing borrowers' payments or determining priority in collateral claims. Of course, arrears clearance will also help NPL reduction.

34. **The Bankruptcy Law will also be reviewed.** The present law is inadequate, particularly with regard to setting timelines for the process and liquidation of property. A joint project with the IFC will start in February to review the legal framework dealing with bankruptcy issues.

35. **The BoA will also continue to strengthen its macro-prudential framework.** In this regard, it will gather additional information on the interlinkages between the banking sector and the nonbank financial institutions, and strengthen its financial crisis preparedness framework to address systemic risk issues by end 2014, including its Emergency Liquidity Assistance (ELA) framework to align with FSAP recommendations. The BoA, along with other authorities, will ensure that the meetings of the Financial Stability Advisory Group (FSAG) take place on a quarterly basis as required and focus on financial stability and systemic risk management. By end of March 2014, we will also introduce monthly meetings at a technical level (structural benchmark, March 2014). All the authorities will cooperate under the FSAG guidance, to strengthen FSAG legal support for prevention and management of a systemic financial crisis. In order to ensure that risks from the lack of a secondary public debt market are effectively mitigated, the BoA also plans to issue a regulation by March 2014 that applies the same collateral standards to all monetary operations of the BOA (including repurchase and reverse repurchase agreements) and expands collateral eligibility to all negotiable securities issued by the government of Albania (structural benchmark, March 2014).

36. **BoA will further improve its stress-testing toolkit.** It will aim at developing sound technical skills in banks over time in order to improve the quality of bottom-up solvency stress-tests. In this regard, BoA will streamline its procedures by September 2014 to ensure that its macro-model and other satellite models are effectively used to determine macroeconomic scenarios and estimate their impact for stress-testing purposes.

37. **During 2014, the BoA plans to take measures that will facilitate the development of the secondary market for government securities.** The new system—which includes fully automating the clearing and registration of government securities transactions—aims to minimize the risks

involved in transactions, such as settlement risk, liquidity risk and legal risk. This should help to both foster the development of the secondary market in government securities as well as the repo market with such underlying securities. In addition, strengthening the technological and legal environment for trading government paper could also help to foster increased participation from foreign investors in this market.

38. We will also strengthen the regulatory framework for the nonbank financial sector. We will move forward with amendments to the law governing the operations of the Albanian Financial Supervisory Authority (AFSA) in order to strengthen its operational and financial independence, and amend the insurance law in line with recommendations from the recent FSAP (structural benchmark, June 2014). We will also revise the regulatory framework for investment funds in Albania to introduce liquidity and capital requirements (structural benchmark, June 2014) and require the calculation of net asset value to be done on a mark to market basis (structural benchmark, June 2014). We have requested technical assistance to determine how to set the market value of these assets, given the lack of a secondary market, and implementation would be based on the outcome of the technical assistance. We will also strengthen requirements for funds' disclosure and consumer protection by September 2014 to align with the FSAP recommendations.

VI. IMPROVING COORDINATION OF MACROECONOMIC POLICIES

39. To strengthen coordination of macroeconomic policy, we have taken steps to institutionalize this cooperation. The recently formed National Economic Council (NEC) will function as a roundtable forum where the business community can reach the highest levels of the government with their concerns, ideas and propositions. The NEC is chaired by the Prime Minister, and will coordinate government policies with the needs and demands of the business sector and donors, in order to create functional policies and efficient communication between all interest groups. A new Inter-Ministerial Commission for Economic Development Policies will also help to provide an integrated reaction from all government institutions on key economic issues. We also made effective a tax council—a consultative body of the Ministry of Finance that will engage with the business community.

VII. STRUCTURAL REFORMS

A. Business Climate

40. Business climate is an important factor in enhancing investment, and the government is committed to taking a proactive role in reforms in the area. Our approach entails addressing the problem issues both over the short and medium term. In addition to resolving the problem of arrears, which is critical for restoring the health of the private sector, we are taking active steps, including creating the National Economic Council which will facilitate the direct communication between the business community and government, the wrong and harmful procedures competition, posted on the website of the Ministry of Economic Development and ongoing, which will address procedural problems, and the review of the VAT legislation, which is currently under way, to ensure that business complaints are addressed immediately. Measures we are implementing in improving revenue administration, including the hiring of a consultant will help reduce ad hoc practices by government revenue agencies.

41. We plan to undertake a comprehensive assessment of the regulatory framework for business that will provide the basis for our medium-term agenda. The Ministry of Economy (MoETDE) will seek input from the local business community through direct communication with them and interest groups (currently ongoing regarding Manufacturing relief measures) in order to identify the key deficiencies that need to be addressed. We hope to move on an EBRD project on a business climate reform by the second half of 2014. MoU will most likely be signed by the Prime Minister during the official visit to EBRD headquarters on February 24, which will identify and resolve key legislative and procedural obstacles to private sector activity. The Ministry is also preparing a questionnaire that will be sent to the business community on the most harmful and time consuming procedures that they face in Albania. The competition was held from December 6, 2013, until January 6, 2014, identifying 19 procedures, but has been reopened in order to allow more time for the business community to provide their comments and suggestions. By addressing the concerns of the market with adequate policy and institutional procedures, the government will ensure that the basis for a more functional market is being established, which should also help to facilitate new investment. The MoETDE is also reviewing the existing concessions for elements of exclusivity that result in monopolies. Any amendments should be made consistent with applicable laws.

42. A reform of business registration procedures will be high priority. The objective would be to improve transparency and reduce the time spent by businesses in this area. We plan a comprehensive review of the National Registration Office by the beginning of 2015, including the review of the legislation, the launch of online applications and online financial tables, which will be the basis for reforming bureaucratic processes, improving recordkeeping, and ensuring transparency. In particular, we plan to reform the regulatory framework of the tourism sector by the beginning of the second half of 2014 to improve the quality of service and ensure adherence to international standards.

B. Agriculture Reform

43. We also plan a series of reforms in the agricultural sector, which we believe has significant underutilized potential. We plan to carry out agricultural land reform, which would strengthen property rights and yield economies of scale and facilitate investment in the sector. Our goal is to distribute 70 percent of land titles by 2015. Improvements in coordination with all government institutions with jurisdiction in licensing, certification and granting of ownership titles to create an integrated system of information on farmers and land will also support the reform effort. We will also establish the Farm Accountancy Data Network by 2017 which will contain individual accounts for all farmers, and will help farmers with access to lending and markets. The Rural Development and Water administration (MoARDWA) will strive to improve irrigation infrastructure and food safety, by developing initiatives for capacity building in the sector. Finally, we intend to decentralize the management of the Rural Development funds by 2016 and move the organizational structure closer to EU requirements.

C. Social Welfare Programs

44. On social protection, the government seeks to improve equity and efficacy of the system. The Ministry of Welfare will aim to "de-institutionalize" the social services, by combining direct monetary transfers with the provided services. A new TA project with the World Bank will modernize the social assistance scheme, and produce a unified formula for evaluating all applicants for Economic Aid and the Special Needs Pension. We also plan to introduce by April 2014 a database that will allow different government agencies to exchange publicly held data on individuals, which will enable easier cross-checking of claims and reduce fraudulent claims for social benefits, which have ballooned in recent years. By improving the screening of social benefit programs, we expect to reduce the number of recipients by 20 percent by 2016.

45. We are developing an initiative to complement social benefits with vocational training in order to empower recipients to find work. A portion of the people who get economic aid will be offered a small payment instead of the aid, and will be engaged in community work. This policy will be in place by year 2015. In addition, we plan to expand the incentive system that would provide financial compensation to companies for employing these individuals.

D. Energy Sector

46. The Task Force for energy sector reform will develop a medium-term strategy, in cooperation with the World Bank. There will be changes in all laws regulating the power sector—Law "On power sector" by the end of June, and the Law on Renewable and Law on Efficiency, by December 31, 2014, with a revised market model including all the necessary sublegal acts and regulations ready by December 31, 2014. The Ministry of Energy will design a plan by first quarter of 2014 to increase billing in the regions where informality is prevalent. The Ministry will also push for an increase in correct billing, at first through average expenses based on consumption, and then with special measures that will account for the energy before it reaches the consumer. We will also review by end of June, 2014 the tariff system to bring prices closer to the market prices, and revise the prices for feed-in energy produced by small private hydro-electric companies (HEC) plants by December 31, 2014. In addition, we will review by end of June, 2014 and distinguish clearly the types of customers that require subsidies for electricity. A Strategy is expected to be presented to Parliament in December**.**

47. Administrative measures are planned to reduce system losses and broaden the base of bill payers. A task force in collaboration with other law enforcement agencies will identify the consumers who are receiving service illegally, cut them off the grid unless there is a proper legal request and provide assistance to re-connect these as new customers, legally. The task force will publish quarterly reports on progress achieved, one month after the end of each quarter. The Task

Force will also identify the immediate needs for meter repairs and grid maintenance and propose an investment plan by first quarter of 2014.

48. In addition, we plan to resolve the inter-company debts that have accumulated in the energy sector. Because of the heavy network losses and low collection rate of the distribution company, the company has accumulated significant arrears to the state power company. The energy sector Task Force and the Ministry of Energy will devise a plan by first quarter of 2014 to sort out these inter-related debts which have rendered the sector dysfunctional. An amicable resolution of the conflict with the distribution company remains our immediate priority.

49. Finally, we plan to upgrade the electricity distribution grid to increase the security of supply and lower losses. This will include installation of smart meters and a smart grid by a partial application in a pilot zone, by end 2014; we will also need to improve the transmission grid and complete the construction of the interconnection line Tirane–Prishtine by the end of 2014 and for Elbasan–Bitola (study completed but no deadline for the construction). The initiation of new important projects for the generation of new sources of power, such as the Skavica HEC is also a long term objective. There will be an analysis on the feasibility of the Interconnection project with Italy and also the Master Plan for the gasification of the country, given the possibilities presented by the TAP Project. The World Bank will support the above reform measures through an investment operation in coordination with other IFIs.

E. Education and Health

50. We envisage a comprehensive agenda for educational and health reform. First, the Ministry of Education will increase investment in early child education to increase access to and enrollment in pre-school education and will overhaul of the long-term budgeting process. Higher education reforms will focus on allocating resources to public universities on the basis of quality and cost performance. We will launch a comprehensive review of the poor performance of the professional education system, and based on the findings, we intend to increase the number of professional education and training institutions, with an emphasis on improving the skills quality and lower skill mismatches in the labor market. For this, we also plan to engage the business community in design of the curriculum, and establish apprentice arrangements with companies, in order to ensure that professional education will be directly connected to the demands of the labor market. In the health sector a new National Agency for Medicines and Medical Materials will improve procurement of pharmaceuticals and other medical materials.

F. EU Integration

51. We plan to launch a complete review of the legal framework for European integration, in line with the recommendations of the 2013 Progress Report of the European Commission. This review and subsequent reform will aim to update the national coordinating structures for addressing the challenges and tasks identified by the EU. The new structure will seek to develop a comprehensive approach at the institutional level and an increased awareness of the public with regard to integration issues.

G. Statistics

52. Improving inter-agency data sharing is a priority in order to improve the reliability and timeliness of national accounts and other macroeconomic statistics. We plan, together with INSTAT and Bank of Albania, to introduce by the end of 2014 a more systemic way to share administrative data in line with the European Statistics Code of Practice and with the IMF Data Quality Assessment Framework, which would eliminate or minimize duplications in data submission and streamline requests for information from businesses.

VIII. PROGRAM MONITORING

53. The program will be subject to quarterly reviews for the first five reviews and semiannual reviews thereafter based on performance criteria, indicative targets and structural benchmarks as set out in Tables 1-2 and in the attached Technical Memorandum of Understanding (TMU). We anticipate that the first four reviews will take place on June 28, 2014; September 15, 2014; December 15, 2014; and March 27, 2015, respectively. These reviews will require observance of the conditionality for end-March 2014, end-June 2014, end-September 2014, and end-December 2014, respectively.

Table 1. Albania: Quantitative Performance Criteria and Indicative Targets

(In millions of leks, unless otherwise indicated)

	2013	2014			
	Proj.	Mar	Jun	Sep	Dec
I. Quantitative Performance Criteria					
1. Floor on net international reserves of the BoA (EUR million)		1289	1289	1289	1289
2. Ceiling on general government overall cash deficit excluding arrears payment (cumulative)	83.6	16.0	26.6	33.4	56.8
II. Continuous Performance Criteria					
3. Accumulation of new external payment arrears by the general government (EUR million)	…	0	0	0	0
III. Inflation Consultation					
4. 12-month percent change in consumer prices					
Upper outer band		5.0	5.0	5.0	5.0
Upper inner band		4.0	4.0	4.0	4.0
Actual/center point	1.9	3.0	3.0	3.0	3.0
Lower inner band		2.0	2.0	2.0	2.0
Lower outer band		1.0	1.0	1.0	1.0
IV. Indicative Targets					
5. Ceiling on the increase of Bank of Albania credit to the general government (cumulative)	…	0	0	0	0
6. Ceiling on accumulation of central government domestic arrears (as reported by MoF's quarterly survey on arrears accumulation)	…	0	0	0	0
7. Floor on clearance of general government domestic arrears		0.0	0.0	0.0	14.2

Source: Albanian authorities; and Fund staff estimates and projections.

Adjustors:
1. These will be adjusted to reflect the difference in disbursements of budgetary support from official external creditors relative to the baseline projection.
2. These will be adjusted to exclude payments for the clearance of arrears.
3. These will be adjusted in subsequent reviews to reflect any changes in the underlying stock from previously unrecognized arrears.
6. These will be adjusted to reflect the difference in disbursements of budgetary support from official external creditors relative to the baseline projection.

Table 2. Albania: Prior Actions and Structural Benchmarks Under the Extended Arrangement under the EFF

	Conditionality	Test date
	Prior Actions	
1.	The Parliament to pass the 2014 budget that includes measures needed to meet the fiscal objective.	
2.	The GDT to establish management committees for (a) reform issues; (b) daily business operations; and (c) taxpayer compliance improvements that will be in charge of strategic decisions in these areas.	
3.	The Working Group of the BoA and MoF, in agreement with the Tax Authority, to submit to parliament legislation that provides clear and consistent tax treatment of NPL write-offs.	
4.	Publish a comprehensive arrears prevention and clearance strategy (APCS) on MoF website (see TMU).	
5.	Submit to parliament amended Law for Payment of Arrears on Contractual Obligations to define expenditure arrears and payment terms.	
6.	MoF to issue budget instructions to all central government entities to i) report all new procurement orders for MoF clearance, and ii) suspend issuing any new multi-year procurement orders until outer-year commitment ceilings are approved by the Council of Ministers (CoM) (see MEFP).	
	Structural Benchmarks	
	I. Public Financial Management	
	Arrears Clearance	
1.	Contract an external auditor with a mandate to conduct risk-based audits of arrears payments.	End May, 2014
2.	Publish a report on arrears paid (on a quarterly basis) on the MoF website (starting in June, 2014).	Continuous
	Arrears Prevention	
3.	MoF to issue instructions to all local governments to report all new procurement orders to MoF starting September, 2014.	End March, 2014
4.	MoF to report quarterly survey results on new arrears accumulation (starting January, 2014) among 5 key ministries (Ministries of Transportation, Health, Education, Defense, and Justice), and GDT (starting in April, 2014).	Continuous
5.	MoF to expand the reporting of quarterly survey on arrears accumulation to 5 additional ministries (Ministries of Interior, Agriculture, Finance, Economy, and Social Welfare) (starting in October, 2014).	Continuous

Table 2. Albania: Prior Actions and Structural Benchmarks Under the Extended Arrangement under the EFF (Concluded)

	Conditionality	Test date
6.	Introduce multi-year commitment limits (the limits on commitments made in the current year for both the current year and each outer-year) in the 2015 budget, and change the Procurement Law, the Financial Management and Control Law, and the Budget Law accordingly.	End December, 2014
	II. Tax Administration	
1.	The GDT to develop a corporate strategy for medium to long term capacity building.	End December, 2014
	III. Expenditure Policy	
1.	Establish a Pension Reform Commission to devise a reform strategy of the pension system.	End March, 2014
2.	Council of Ministers to approve a pension reform strategy.	End December, 2014
	IV. Financial Sector	
1.	Amend the MOU covering operations of the inter-agency Financial Sector Advisory Group (FSAG) to: (i) require technical-level meetings every month (in addition to the existing three-monthly high-level meetings); and (ii) exclude financial development from the mandate of the FSAG.	End March, 2014
2.	In agreement with BoA and Albanian Financial Supervisory Authority (AFSA), amend the regulatory frame work for investment funds on asset valuation, liquidity requirement, and capital adequacy requirement.	End June, 2014
3.	BoA to amend the regulatory framework that applies the same collateral standards to all monetary operations of the BOA (including repurchase and reverse repurchase agreements) and expands collateral eligibility to all negotiable securities issued by the government of Albania.	End March, 2014
4.	Present to parliament an amended AFSA law, a new insurance law, and amendments to the Civil Servant Law and the Law on Salaries of Independent Institutions, to improve AFSA supervisory and operational independence, in line with FSAP recommendations (see TMU).	End March, 2014

Attachment II. Technical Memorandum of Understanding

1. This Technical Memorandum of Understanding (TMU) defines the indicators used to monitor developments under the program, according to the understandings between Albanian authorities and IMF. The TMU also defines the associated reporting requirements.

2. The exchange rates for the purposes of the program of the lek to the euro is set at lek 140.25 = €1, to the US dollar at lek 103.17 = $1, and to the SDR at lek 158.05 = SDR 1. These are the rates shown on the Bank of Albania's website as of November 30, 2013.[1]

3. For the purpose of the program, the **central government** includes the central government and extra-budgetary funds. The **general government** includes the central government the local governments and the Social Security Institute (SSI), and the Health Insurance Institute (HII).

4. The fiscal year starts on January 1 and ends on December 31.

I. QUANTITATIVE PERFORMANCE CRITERIA

A. Floor on Net International Reserves of the BoA

Definition

5. Net international reserves (NIR) are defined as reserve assets minus reserve liabilities of the Bank of Albania. **Reserve assets** are readily available claims of the Bank of Albania on nonresidents denominated in foreign convertible currencies, and held for the purpose of meeting balance of payments financing needs, intervention in exchange markets, and other purposes. They include Bank of Albania holdings of monetary gold, SDRs, Albania's reserve position in the IMF, foreign currency cash, securities, and deposits abroad. Excluded from reserve assets are any assets that are pledged, collateralized, or otherwise encumbered; claims on residents; precious metals other than monetary gold; assets in nonconvertible currencies; illiquid assets; and claims on foreign exchange arising from derivatives in foreign currencies vis-à-vis domestic currency (such as futures, forwards, swaps, and options).

6. **Reserve liabilities** are defined as foreign exchange liabilities to residents and nonresidents of the Bank of Albania, irrespective of their maturity. They include: foreign currency reserves of commercial banks held at the Bank of Albania; foreign currency deposits of the government held at the Bank of Albania; all credit outstanding from the IMF that is a liability of the Bank of Albania; commitments to sell foreign exchange arising from derivatives (such as futures, forwards, swaps, and

[1] http://www.bankofalbania.org/web/Time_series_22_2.php?evn=agregate_detaje&evb=agregate&cregtab_id=644&periudha_id=1

options); and all arrears on principal or interest payments to commercial banks, suppliers, or official export credit agencies. Reserve assets and reserve liabilities will both be expressed in euros, at the program exchange rate.

Reporting

7. Data will be provided by the BoA to the Fund with a lag of no more than five days past the test date.

B. Cumulative Ceiling on General Government Overall Cash Deficit Excluding Arrears Payments

Definitions

8. **The overall cash deficit of the general government** will be measured from the financing side (below the line) at current exchange rates, based on the template below:

CASH BALANCE
Financing (Cash)
Domestic
Privatization receipts
Domestic borrowing
National
Local
Other
Foreign
Loan(Drawings)
Change of statistical account
Repayments

9. In determining the overall cash balance, the following considerations will apply:

- Privatizations: Privatization receipts should be reported on a gross basis
- Domestic borrowing: Domestic borrowing is reported on a net basis and is determined on the basis of the residency criterion. It covers bank loans, securities issued, overdraft accounts, and other debt instruments, less government deposits.
- Other: "Other" refers to the change in the Single Treasury Account, the accounts of Special Funds, and other transitory accounts.

- Foreign borrowing: Foreign borrowing is reported on a gross basis and is determined on the basis of the residency criterion. It covers disbursements by international financial institutions, bank loans, securities issued, overdraft accounts, and other debt instruments.

- Change of Statistical Account: This item covers balances held by nonresidents in financial institutions for project-related spending.

- Repayments: This item refers to all payments to nonresidents related to disbursements by international financial institutions, bank loans, securities, overdraft accounts, and other debt instruments.

10. Excluded from the calculation of the overall cash deficit of the general government are the arrears payments to be made in the context of the Arrears Prevention and Clearance Strategy (APCS). The amount of arrears paid will be identified using the verified arrears list and matching the list with the Treasury payment records. A summary of the total amount of arrears paid under the clearance strategy, as defined above, will be provided on a monthly basis.

Reporting

11. Data, including the amount of arrears payments under the APCS, will be provided to the Fund using current exchange rates with a lag of no more than four weeks after the test date.

Adjuster

12. **The ceiling on the overall cash deficit** of the general government will be adjusted upward (downward)—that is, the deficit target will be increased (reduced)—by 50 percent of the privatization receipts, up to total privatization receipts of lek 14 billion in a given year. The programmed amount of privatization receipts in 2014 is Lek 400 million.

II. CONTINUOUS PERFORMANCE CRITERIA

A. Accumulation of New External Payment Arrears by the General Government

Definitions

13. External debt is determined according to the residency criterion. The term "debt"[2] will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or

[2] As defined in Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements, Decision No. 6230-(79/140), as amended.

services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:

- Loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

- Suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided; and

- Leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property. For the purpose of the program, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.

14. Under the definition of debt set out above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

15. Under this definition of debt set out above, external payments arrears consist of arrears of external debt obligations (principal and interest) falling due after the due date and grace period, as specified in the contract, has passed. Arrears resulting from nonpayment of debt service for which a clearance framework has been agreed or rescheduling agreement is being sought are excluded from this definition.

16. The external arrears of the general government will be calculated based on the schedule of external payments obligations reported by the MoF. Data on external arrears will be reconciled with the relevant creditors, and any necessary adjustments will be incorporated in these targets as they occur.

17. This performance criterion does not cover arrears on trade credits.

18. The performance criterion will apply on a continuous basis.

Reporting

19. The MoF will provide the final data on the external arrears of the general government to the Fund, with a lag of not more than two weeks after the test date.

III. INFLATION CONSULTATION

20. The quarterly consultation bands apply to the 12-month rate of inflation in consumer prices (as measured by the headline consumer price index (CPI) published by the INSTAT). Should the observed year-on-year rate of CPI inflation (quarterly average) fall outside the outer bands, the authorities will complete a consultation with the IMF on their proposed policy response before requesting further purchases under the program. In addition, the BoA will conduct discussions with IMF staff should the observed year-on-year rate of CPI inflation (quarterly average) fall outside the inner bands specified for the end of each quarter.

IV. INDICATIVE TARGETS

A. Ceiling on Accumulation of Central Government Domestic Arrears

Definition

21. Domestic expenditure arrears are defined as payments to residents determined by contractual agreements that remain unpaid 30 days after the due date specified by the contract or by the law. Domestic tax refund arrears are defined as obligations on tax refunds in accordance with tax legislation that remain unpaid 30 days after the due date. The due date refers to the date in which domestic debt payments are due according to the relevant contractual agreement or legislation, taking into account any contractual grace periods.

22. For the purpose of this target, the accumulation of domestic arrears will be monitored through MoF's quarterly survey on arrears accumulation, which will cover the following part of the central government: General Directorate of Taxation, Ministries of Transportation, Health, Education, Defense, Justice and their subordinate agencies, starting 2014:Q1, and will be extended to cover Ministries of Interior, Agriculture, Finance, Economy, and Social Welfare by 2014:Q4.All Ministries will be included in the survey from 2015:Q2. Table 1 and 2 contain templates for the survey form sent to the ministries and the GDT respectively, to be filled out on a quarterly basis. The recording of invoices and tax refund claims should be cumulative—the recording in each quarter should include all invoices/refund claims that have not been paid from the previous quarters, starting 2014:Q1. The MoF should verify that the invoices/refunded claims reported in the survey is not already included in the arrears clearance database.

Table 1. Template for Quarterly Survey on Expenditures Arrears Accumulation

(1) Economic Code	(2) Name of Supplier/ creditor	(3) Commitment number from Treasury System	(4) Commitment amount	(5) Invoice/claim details			(6) Age of Invoice (Due date) Enter Amount			(7) Reason for delayed payment
				Number (from Treasury System)	Date	Amount	30-59 days	60-90 days	+90 days	
Invoices recorder in the Treasury System										
Invoices not in the Treasury System										
Totals										

Table 2. Template for Quarterly Survey on VAT Tax Arrears Accumulation

(1) Name of company	(2) Tax identification number	(3) Date of Assessment	(4) Refund details			(5) Age of claim Enter Amount:			(6) Reason for delayed payment
			Number	Date	Amount	30-59 days	60-90 days	+90 days	
Totals									

Reporting

23. The MoF should send to the Fund the consolidated data from the survey with a lag of no more than 40 days after each quarter.

B. Clearance of General Government Domestic Arrears

Definitions

24. Domestic expenditure arrears are defined as payments to residents determined by contractual agreements that remain unpaid 30 days after the due date specified by the contract or by the law. Domestic tax refund arrears are defined as obligations on tax refunds in accordance with tax legislation that remain unpaid 30 days after the due date. The due date refers to the date in which domestic debt payments are due according to the relevant contractual agreement or legislation, taking into account any contractual grace periods. General government domestic arrears include arrears on domestic general government direct debt, including to suppliers, all recurrent and capital expenditure commitments, and all tax refund arrears.

25. The limit on clearance of general government domestic arrears consists of a floor for the amount of arrears payment.

26. Data will be collected through payments identified as made through the Treasury system under the arrears clearance strategy.

Reporting

27. Data will be provided by the MoF to the Fund with a lag of no more than four weeks after the test date.

C. Cumulative Ceiling on the Increase of Bank of Albania Credit to the General Government

Definitions

28. Credit of the central bank to the general government is defined as outstanding claims of the Bank of Albania on the general government, including overdrafts, direct credit, and holdings of government securities excluding repo operations.

Reporting

29. Data will be provided by the BoA to the Fund on a quarterly basis with a lag of no more than fifteen days.

V. Structural Benchmarks

The structural benchmarks shall include those listed in Table 2 of the MEFP. The below provides additional details on selected measures.

30. Publish a comprehensive arrears prevention and clearance strategy. The strategy should include the government's plan and prioritization criteria for the liquidation of arrears, and measures for arrears prevention. The draft strategy should be sent to the Fund for review before being submitted to the Council of Ministers for approval.

31. Contract an external auditor with a mandate to conduct risk-based audits of arrears payments. The MoF should submit the Terms of Reference for the external auditor to the IMF for review before starting the tendering process.

32. Introduce multi-year commitment limits in the 2015 budget, and change the Procurement Law, the Financial Management and Control Law, and the Budget Law accordingly. Commitment is an obligation to make a future payment subject to the fulfillment of certain conditions (contractual or otherwise). Commitment limits specify the amounts that can be committed in the current year for both the current year and each outer-year per line item of the budget. The sum of the commitment limits for an outer-year should be lower than the cash spending ceiling for that year, to leave sufficient room for the amounts that can be committed within that year.

33. The GDT to develop a corporate strategy for medium to long term capacity building. The strategy should be developed in consultation with IMF TA.

34. In agreement with BoA and Albanian Financial Supervisory Authority (AFSA), amend the regulatory frame work for investment funds on asset valuation, liquidity requirement, and capital adequacy requirement. The amended regulations should:

1. Require that the calculation of the unit value represent the proportionate share of the aggregate market value of the underlying assets of the fund;
2. Introduce capital adequacy requirements aligned with relevant E.U. regulations;
3. Introduce liquidity requirements consistent with recent E.U. regulatory developments and the current level of development of the Albanian market.

35. The Parliament to pass an amended Albanian Financial Supervisory Authority (AFSA) law, a new insurance law, and amendments to the Civil Servant Law and the Law on Salaries of Independent Institutions, to improve AFSA supervisory and operational independence, in line with FSAP recommendation. The above laws should be amended to

1. abolish the requirements for the AFSA to have its organizational structure approved by the Parliament, and
2. remove the AFSA from the government employee compensation and benefits structure, so it has the ability to attract and retain sufficient experienced technical staff.
3. give the AFSA's Board and staff the legal protection from the bona fide discharge of their governmental, regulatory and administrative functions and powers.

VI. Monitoring and Reporting Requirements

36. To facilitate the monitoring of program performance, the authorities will provide the following information on a monthly basis (except where noted).

The Bank of Albania will supply to the Fund:
(i) The balance sheets of the Bank of Albania;
(ii) The consolidated accounts of, separately, the commercial banks, and the Savings and Loan Institutions (SLIs);
(iii) The monetary survey;
(iv) Banking sector prudential indicators;
(v) The net foreign assets of the Bank of Albania and their components;
(vi) Comprehensive information on reserve assets that are pledged, collateralized, or otherwise encumbered.
(vii) The foreign exchange cash flow of the Bank of Albania, including the level of NIR;
(viii) Daily average exchange rates;
(ix) Quarterly balance of payments data and updates of balance of payments estimates;
(x) Inflation forecast on a monthly basis

The Albanian Financial Supervisory Agency will supply to the Fund:
(i) The consolidated accounts of nonbank financial institutions.
(2) Nonbanking sector prudential indicators.

The Ministry of Finance will supply to the Fund:
(i) The summary fiscal table, including the overall budget deficit, on a modified cash basis;
(ii) Issuance of treasury bills by the MOF, including gross value and cash received;
(iii) Privatization receipts;
(iv) Information on the contracting and guaranteeing of new debt;
(v) Information on the stock of short-, medium- and long-term debt;
(vi) Information on official grants for projects or budget support purposes.
(vii) Information on the stock of expenditure arrears identified in the Arrears Prevention and Clearance Strategy and progress in arrears repayment.
(viii) Information on the accumulation of new arrears in central government ministries.
(ix) Information on the implementation of stronger procurement and commitment controls.

The General Directorate of Customs will supply to the Fund:
(i) Detailed monthly data on customs revenues collected; and

The General Directorate of Taxation will supply to the Fund:
(i) Detailed monthly data on tax revenues collected.
(ii) Information on progresses in implementing business restructuring and IT reforms.
(iii) Information on the stock of VAT refunds claimed, refund arrears, and refunds paid out every month will be supplied within one month of the end of the reporting period.

The Albanian Statistical Agency (INSTAT) will supply the Fund:
(i) The consumer price index (CPI index) at the aggregated level and at the level of each individual item making up the basket.
(ii) The producer price index.
(iii) The construction cost index
(iv) All short term indicators as they become available as defined in INSTAT's quarterly publication "Conjoncture".
(v) In addition INSTAT will communicate to the Fund on a regular basis the preliminary estimates for Quarterly GDP. It will also communicate as early as possible the preliminary estimates for annual GDP disaggregated by 22 sectors and distinguishing between the observed and non-observed economy.

Annex I. Risk Assessment Matrix[1]

Source of Risks	Overall Level of Concern Relative Likelihood (high, medium or low)	Impact if Realized (high, medium or low)
1. Surges in global financial market volatility	**High** Higher long-term rates in advanced economies could trigger a movement of capital flows out of risk assets, with a sustained increase in risk premiums for frontier market sovereigns. Depreciation and/or interest rate pressures could emerge. Mitigating factors: Limited short-term financial transmission channels, with little nonresident participation in domestic financial markets, and banks fully funded by local deposits. BoA international reserves are adequate.	**Medium** Deterioration in external market conditions could complicate rollover of Albania's Eurobond maturing in late 2015. Policy response: plan financing needs well in advance to allow flexibility in timing external borrowing.
2. A reemergence of financial stress in the euro area and/or exit of a foreign bank from the market.	**Medium** Stress in European parent banks could reduce their ability to re-capitalize Albanian subsidiaries, if needed. Mitigating factors: The level of capital adequacy in Albania's banking system remains high; banks are fully funded by domestic deposit, and do not depend on parent funding.	**High** If parent banks are unable to capitalize subsidiaries, banks may be forced to cut lending. Policy response: closely monitor possible capital shortfalls and require banks to respond promptly.
3. Protracted period of slower European growth	**High** Weak demand and larger than expected deleveraging could delay a recovery in Albania's key external partners, contributing to weaker export demand, tourism, remittances, and FDI. Mitigating factors: The share of exports in GDP remains low.	**Medium** A weaker-than-expected economic recovery with implications for debt sustainability and NPLs. Policy response: fiscal targets could be adjusted to avoid over-burdening the economy. Lek depreciation could affect unhedged borrowers, and affect bank solvency. Mitigating factors: Bank capitalization is healthy
4. Insufficient implementation of structural reforms	**High** Political and social tensions could hinder implementation of the authorities' ambitious structural reform agenda.	**High** Business environment reforms are key to medium-term growth-prospects, while pension and energy sector reforms are critical to underpin targeted fiscal adjustment. Failure to advance in any of these areas would undermine medium-term debt sustainability.

		Medium	High
5.	Rollover of government debt.	Uncertainty about economic conditions, and concerns about debt sustainability may make banks hesitant to rollover government debt, a large part of which is short term.	Higher borrowing costs will exacerbate debt sustainability. Policy response: avoid disorderly fiscal adjustment.

[1] The RAM shows events that could materially alter the baseline scenario path—the scenario most likely to materialize in the view of the staff. The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline.

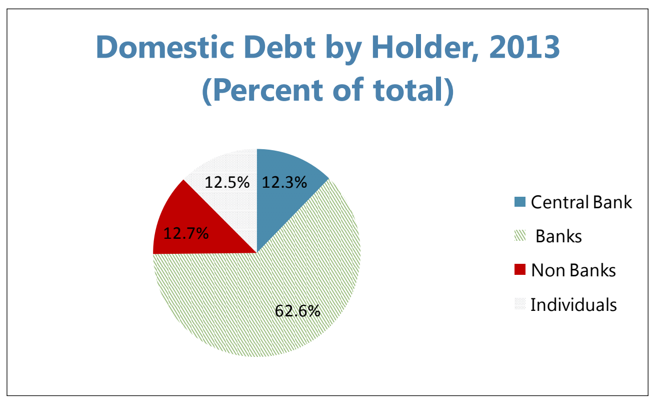
Annex II. Debt Sustainability Analysis

Albania's public debt is high and requires urgent action to bring back toward a sustainable level. Over the medium term, substantial further fiscal consolidation will be needed to put debt on a downward trajectory and mitigate risks to debt sustainability. Albania will have to tackle a variety of risks, notably rollover risk and exposure to shocks.

I. BACKGROUND

1. Albania's public debt at end 2013 is estimated at 70.5 percent of GDP. This amount includes outstanding arrears and unpaid bills (5.3 percent of GDP). Most public debt—defined at the level of general government and in gross terms—is domestic (about 62 percent of the total) and short term (about 30 percent),[1] and includes guaranteed debt (about 5 percent of the total).[2] Local government debt is negligible (0.04 percent of the total). Most domestic debt is held by commercial banks and increasingly by nonbanks. External debt is owed to multilateral creditors (about 51 percent), official bilateral creditors (28 percent), and private creditors (21 percent).

2. Public debt has increased sharply in recent years. Since 2008, public debt as a percent of GDP has increased by more than 10 percentage points. The increase also led to the breach and ultimate removal of the 60 percent of GDP debt ceiling in 2012.



3. In line with the guidelines on Public DSA in market access countries, Albania is considered a higher scrutiny case. In particular, Albania meets the following criteria for higher scrutiny: i) current (and projected) public debt exceeding 60 percent of GDP, ii) gross financing needs (25 percent of GDP in 2013) exceeding 10 percent of GDP.

4. The macroeconomic assumptions underpinning the DSA are in line with the macroeconomic adjustment program. There is a gradual recovery of growth to about 4.7 percent in the medium term, supported by a rebound of confidence and higher private investment flows. Inflation expectations will remain anchored keeping inflation within the central bank's 3±1 percent

[1] About half of domestic debt is short term.

[2] Gross debt includes: i) central government debt, ii) central government guarantees, and iii) local government debt, as reported by the Ministry of Finance. The coverage of public debt is consistent with that of the fiscal accounts.

annual target range. Given the sharp increase in the fiscal deficit estimated to have taken place in 2013 and the accumulation of unpaid bills and arrears, reduction in public debt will require sizable fiscal adjustment. The overall fiscal balance is expected to decline from an estimated deficit of 6.2 percent of GDP in 2013 to a balanced position in 2019. The external current account deficit is expected to decline gradually as higher investment leads to a widening of the export base and fiscal consolidation reduces demand for imports.

II. PUBLIC DSA RESULTS

5. Albania's debt is expected to decline gradually over the medium term, but will remain high. Under the baseline scenario, Albania's debt is expected to decline below 60 percent of GDP only at end-2019. Debt near that level poses significant risks because of i) high rollover need, ii) rising interest rates, iii) close links to the financial sector, and iv) vulnerability to terms of trade shocks.

6. The financing profile continues to pose risks. On the positive side, short term debt is expected to decline over time, in line with the authorities' efforts to lengthen the maturity profile of debt and reduce rollover risk. Nevertheless, public gross financing needs will remain elevated in the near term, above the 20 percent of GDP early warning benchmark associated with past debt crises. Interest rate risk on the other hand is expected to increase with the lengthening of maturities, although the lack of a secondary market limits the impact on valuations. Foreign currency debt is expected to increase over the medium term, reflecting external financing under the program and efforts to contract debt with longer maturities. Exchange rate risk will therefore increase, but Albania's comfortable level of reserves would help mitigate this risk. While the creditor base is currently heavily weighted toward banks, it is expected that over the medium term there will be some diversification toward other institutions (e.g., investment funds).

7. Alternative scenarios underscore risks associated with the baseline scenario. Two alternative standardized scenarios based on the historical scenario and constant primary balance scenario[3] suggest that reducing public debt below 60 percent of GDP by 2019 would require a clear departure from past practice. Specifically, the historical scenario suggests that public debt will remain slightly above 70 percent of GDP, while the constant primary balance scenario suggests a substantial increase to about 83 percent of GDP by 2019.

8. The results of the alternative scenarios do not warrant adjustment of the baseline scenario. First, the historical period is rather short and not representative of the current economic environment.[4] High growth at the time led to pro-cyclical fiscal policy while easy financing was a

[3] Under the historical scenario, real GDP growth, the primary balance, and real interest rates are set at their historical average while other variables are the same as in the baseline. Under the constant primary balance scenario, the primary balance remains unchanged compared to the first projection year (in percent of GDP), while all other variables are the same as in the baseline.

[4] Due to data limitations, the historical period covers data since 2006.

disincentive for fiscal adjustment.[5] Use of the constant primary balance scenario may also be inappropriate because the authorities understand that maintaining the primary balance at its 2014 projected level would entail significant risks for macroeconomic stability and growth.[6]

9. The realism of the baseline scenario is further corroborated by other countries' experience. The track record of projecting macroeconomic variables (growth, primary balance, inflation) relative to other countries does not reveal systematic one-sided biases. Forecast errors for these variables were generally within the 25–75 inter-quartile range. For the primary balance, in particular, projections have been rather conservative in recent years. [7]

10. Nevertheless, the planned fiscal consolidation effort is ambitious and poses risks. The proposed fiscal consolidation, measured by the three-year adjustment in the structural primary balance, is among the largest for high debt countries (those with debt exceeding 60 percent of GDP). Still, the level of the three year average cyclically adjusted primary balance is broadly typical of other countries' adjustment experience.

III. STRESS TESTS

11. Debt indicators could worsen significantly if Albania was hit by macro and fiscal shocks. Stress tests included shocks on the primary balance, real GDP growth, interest rate, exchange rate, and a combined macro–fiscal shock. Albania would be particularly vulnerable to a combined macro–fiscal shock (which incorporates the largest effect of individual shocks on all variables) because it would lead to a permanent increase in debt relative to 2013. It would increase to about 80 percent by 2016, and then decline gradually to about 70 percent by 2019. A growth shock (reduction in real GDP growth by one standard deviation for two consecutive years) would also lead to an increase in debt to 75 percent of GDP by 2016, before declining to about 65 percent by 2019. Shocks also have a negative impact on gross financing needs. Under the combined macro–fiscal shock, gross financing needs are higher by more than 6 percentage points of GDP relative to the baseline.

12. A customized shock scenario examines the potential impact of a reduction in foreign banks' exposure to Albania. Under this scenario, a substantial withdrawal of exposure could lead to a further reduction in the supply of credit, raising government borrowing costs, and putting pressure on the exchange rate. The depreciation could raise inflation in the near term and result in an increase in the monetary policy rate. Economic growth and fiscal revenues would suffer. Given expenditure rigidities, the primary balance could deteriorate relative to the baseline, exerting

[5] In the past arrears accumulation concealed the impact of expansionary fiscal policy on debt indicators.

[6] This option may not be feasible given financing constraints.

[7] While Albania's growth projection may appear optimistic compared with other boom-bust cases, it is built on the assumption of an investment rate that is lower than during 2006–11. Medium term growth will also be driven by ambitious reforms which will boost total factor productivity. Energy–related investments including the Trans Adriatic Pipeline (TAP) and foreign investment in new hydropower production will support the growth outlook.

pressure on government borrowing costs and investment. The resulting drag on growth could persist throughout the projection period.

13. The impact of this customized scenario on public debt and financing requirement could be severe. Under this scenario—which is only illustrative of the risks associated with the program—public debt and gross financing needs would rise steadily throughout the projection period to about 85 percent and 35 percent of GDP respectively. At such high debt level and with large rollover needs, multiple equilibriums risks would increase substantially. The risk of a "bad equilibrium"—the government effectively loses domestic market access as investors become concerned about solvency—is impossible to quantify precisely. However, even under this not–so–extreme scenario, the danger that deteriorating investor confidence would morph into a "bad equilibrium" is plausible.

14. Fan charts also present the possible evolution of debt over the medium term by simulating a large number of shocks to macroeconomic variables. Fan charts show a spectrum of possible outcomes for the level of debt based on a probabilistic view of uncertainty around the baseline. These simulations suggest that under a symmetric distribution, the debt stock could range between 40 and 70 percent of GDP by 2019. Nevertheless, risks are likely to be on the upside. As a result, under a restricted distribution (which precludes a positive shock to the primary balance), debt could increase up to about 85 percent of GDP by 2019 relative to the baseline scenario.

IV. CONCLUSION

15. Albania's debt is high and poses significant risks. Shocks related to growth, primary balance, interest rates, and the exchange rate push Albania's debt and gross financing needs above relevant benchmarks, providing early warning signs of emerging risks. Specifically, Albania's debt exceeds the 70 percent debt benchmark both under the baseline and various shocks (red in the standardized heat map). Similarly, gross financing needs exceed 15 percent of GDP under the baseline and specific shocks (red in the standardized heat map). Finally, changes in the debt profile pose moderate risks (yellow in the standardized heat map), with the exception of changes in short term debt which pose low risks (green in the standardized heat map).

16. Addressing the risks associated with high debt is critical for macroeconomic stability. High debt is associated with lower growth and may prolong recession. High debt also means higher vulnerability to shocks. Even stabilizing debt at high level (much more reducing it) requires large primary surpluses for many years which may be politically difficult to sustain. Finally, high debt is associated with high rollover requirements which increase vulnerability to sudden reversals in market perceptions.

Albania Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

(in percent of GDP unless otherwise indicated)

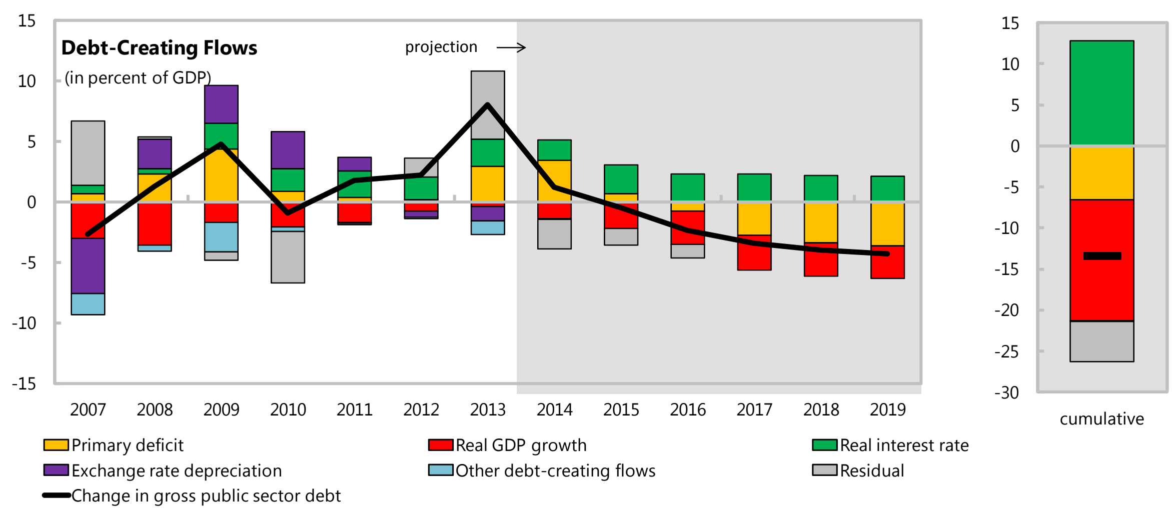
Debt, Economic and Market Indicators 1/

	Actual			Projections					
	2006-11 2/	2012	2013	2014	2015	2016	2017	2018	2019
Nominal gross public debt	57.1	62.5	70.5	71.7	71.2	68.8	65.4	61.4	57.1
Public gross financing needs	23.4	21.8	25.3	27.9	29.2	25.4	21.8	20.1	18.2
Real GDP growth (in percent)	4.8	1.3	0.7	2.1	3.3	4.2	4.5	4.5	4.7
Inflation (GDP deflator, in percent)	2.8	2.1	1.7	2.3	2.5	2.7	2.8	2.8	2.8
Nominal GDP growth (in percent)	7.8	3.4	2.4	4.4	5.9	7.0	7.4	7.4	7.6
Effective interest rate (in percent) 4/	5.8	5.4	5.3	4.8	6.1	6.3	6.4	6.4	6.5

As of November 30, 2013		
Sovereign Spreads		
EMBI (bp) 3/		n.a.
CDS (bp)		n.a.
Ratings	Foreign	Local
Moody's	B1	B1
S&Ps	B	B
Fitch	n.a.	n.a.

Contribution to Changes in Public Debt

	Actual			Projections							
	2006-11	2012	2013	2014	2015	2016	2017	2018	2019	cumulative	debt-stabilizing primary balance 9/
Change in gross public sector debt	1.4	2.18	8.03	1.2	-0.5	-2.4	-3.4	-4.0	-4.3	-13.4	
Identified debt-creating flows	0.3	0.67	2.38	3.7	0.7	-1.7	-3.8	-4.3	-4.2	-9.5	
Primary deficit	1.5	0.2	2.9	3.4	0.7	-0.8	-2.8	-3.4	-3.7	-6.5	-0.5
Primary (noninterest) revenue and grant	26.1	24.9	24.0	25.4	25.3	25.2	25.2	25.2	25.2	151.6	
Primary (noninterest) expenditure	27.6	25.1	26.9	28.9	25.9	24.5	22.5	21.8	21.5	145.0	
Automatic debt dynamics 5/	-0.3	0.6	0.6	0.4	0.0	-0.9	-1.0	-0.9	-0.5	-2.9	
Interest rate/growth differential 6/	-0.9	1.1	1.8	0.3	0.2	-0.5	-0.6	-0.6	-0.6	-1.9	
Of which: real interest rate	1.5	1.9	2.2	1.7	2.4	2.3	2.2	2.2	2.1	12.8	
Of which: real GDP growth	-2.5	-0.8	-0.4	-1.4	-2.2	-2.8	-2.9	-2.7	-2.7	-14.8	
Exchange rate depreciation 7/	0.6	-0.5	-1.2	…	…	…	…	…	…	…	
Other identified debt-creating flows	-0.9	-0.1	-1.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
General government net privatization p	-0.9	-0.1	-1.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
(Specify)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes 8/	1.1	1.5	5.7	-2.5	-1.3	-1.1	0.0	0.0	0.0	-4.9	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ EMBI.

4/ Defined as interest payments divided by debt stock at the end of previous year.

5/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the denominator in footnote 4 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).

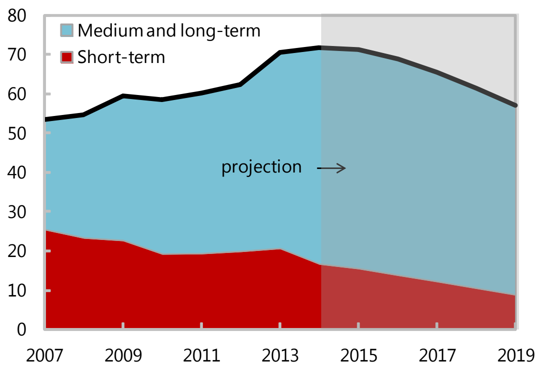
8/ For projections, this line includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

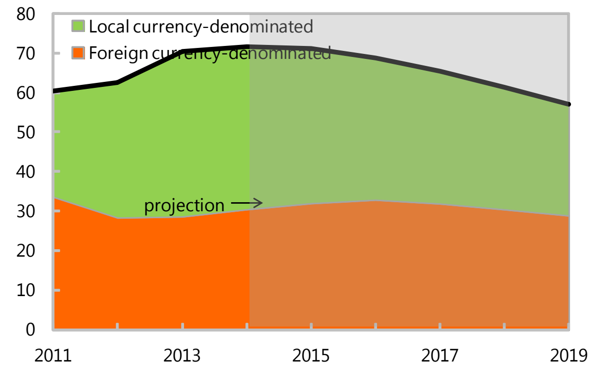
Albania Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



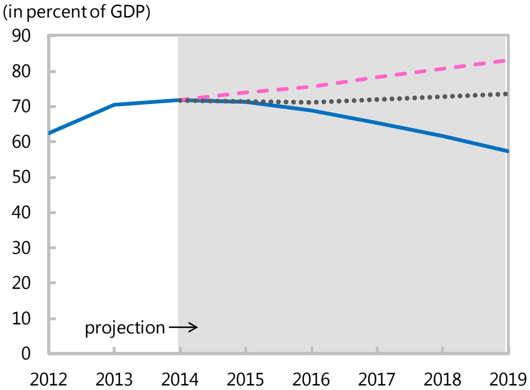
By Currency
(in percent of GDP)



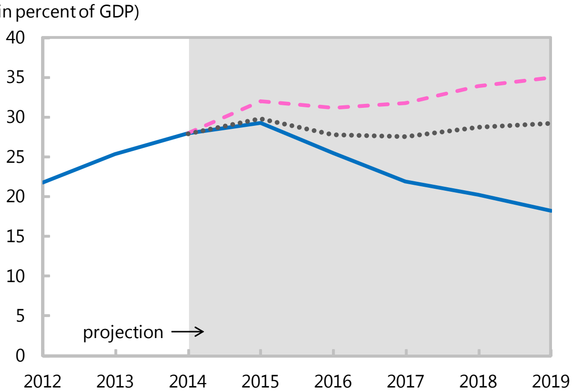
Alternative Scenarios

Baseline — Historical — Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



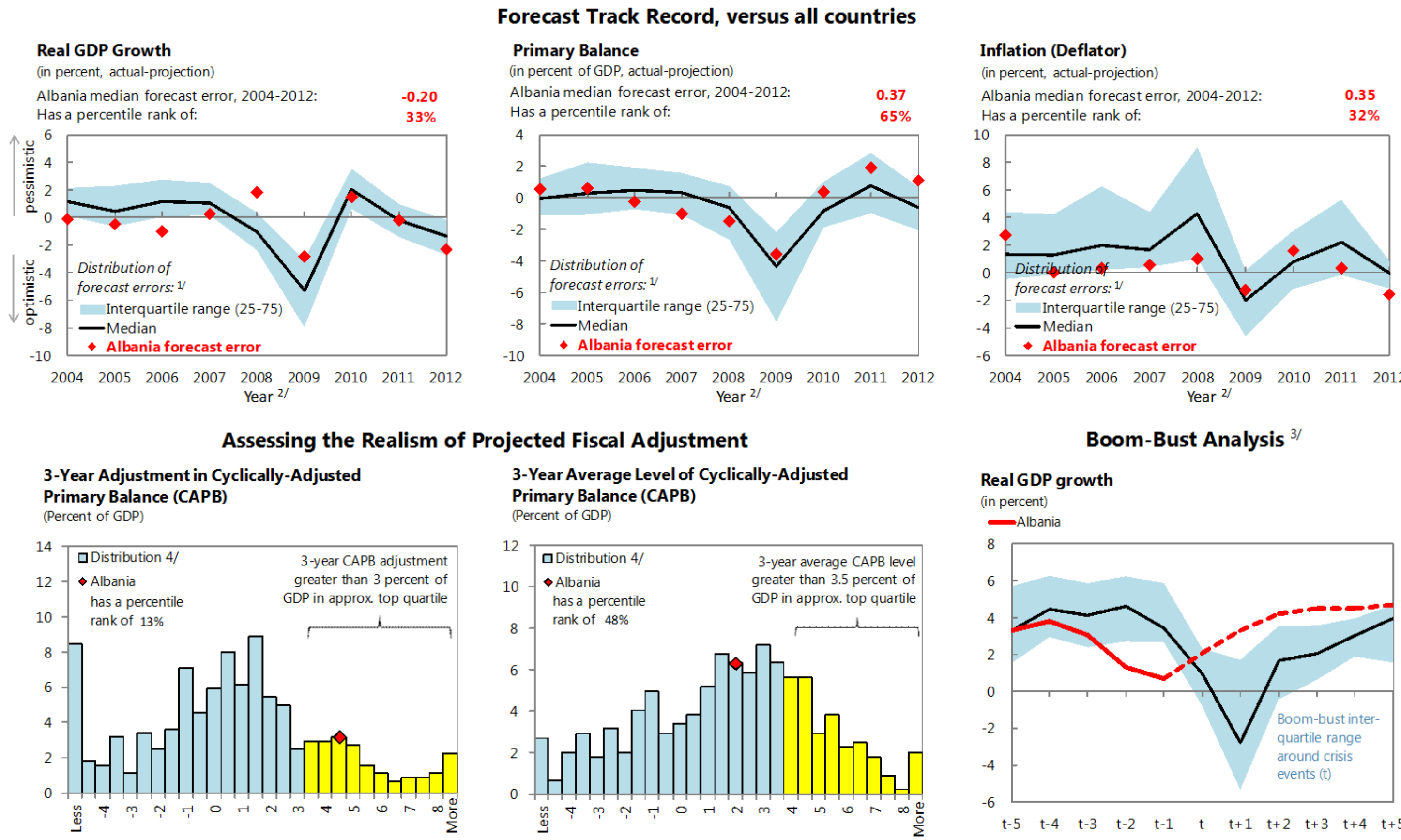
Underlying Assumptions
(in percent)

Baseline Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	2.1	3.3	4.2	4.5	4.5	4.7
Inflation	2.3	2.5	2.7	2.8	2.8	2.8
Primary Balance	-3.4	-0.7	0.8	2.8	3.4	3.7
Effective interest rate	4.8	6.1	6.3	6.4	6.4	6.5
Constant Primary Balance Scenario						
Real GDP growth	2.1	3.3	4.2	4.5	4.5	4.7
Inflation	2.3	2.5	2.7	2.8	2.8	2.8
Primary Balance	-3.4	-3.4	-3.4	-3.4	-3.4	-3.4
Effective interest rate	4.8	6.1	6.1	6.2	6.2	6.2

Historical Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	2.1	4.3	4.3	4.3	4.3	4.3
Inflation	2.3	2.5	2.7	2.8	2.8	2.8
Primary Balance	-3.4	-1.5	-1.5	-1.5	-1.5	-1.5
Effective interest rate	4.8	6.1	6.1	6.1	6.1	6.1

Source: IMF staff.

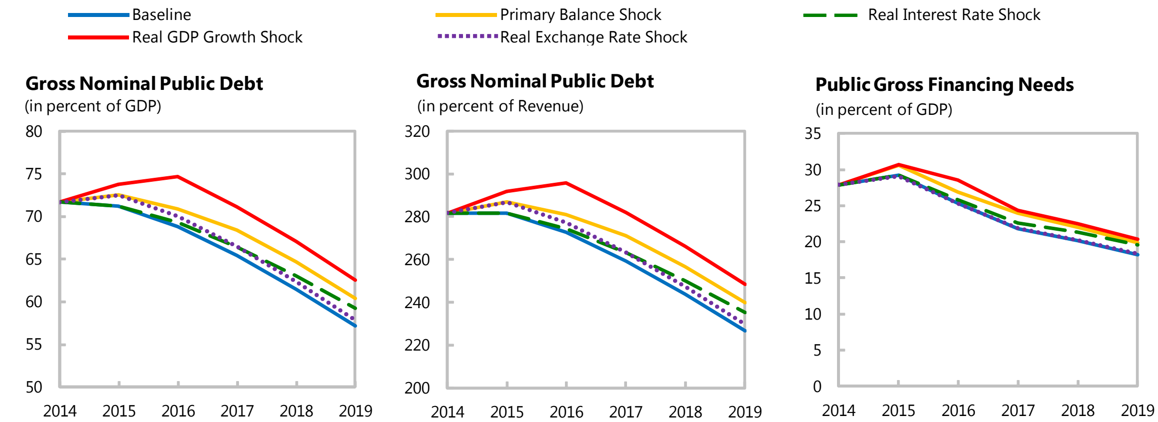
Albania Public DSA - Realism of Baseline Assumptions



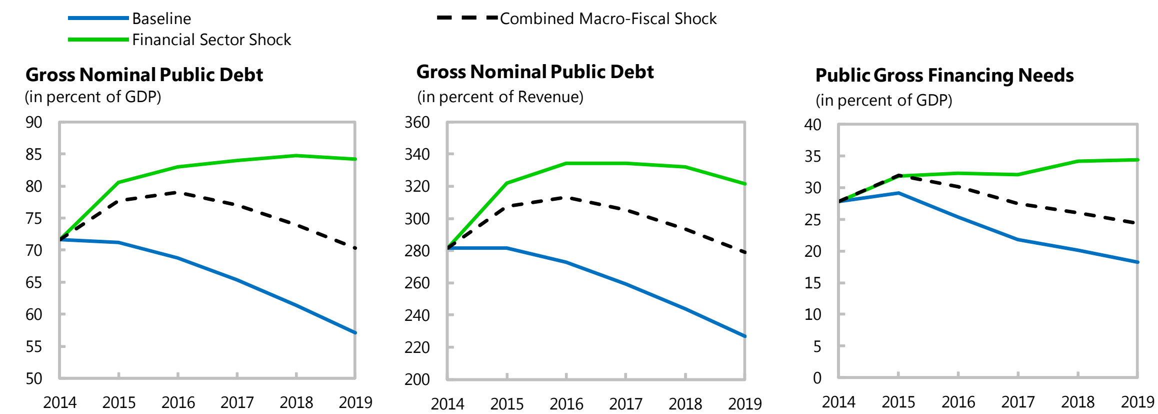
Source: IMF Staff.
1/ Plotted distribution includes all countries, percentile rank refers to all countries.
2/ Projections made in the spring WEO vintage of the preceding year.
3/ Albania has had a positive output gap for 3 consecutive years, 2011-2013. For Albania, t corresponds to 2014; for the distribution, t corresponds to the first year of the crisis..
4/ Data cover annual observations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Albania Public DSA - Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

	2014	2015	2016	2017	2018	2019
Primary Balance Shock						
Real GDP growth	2.1	3.3	4.2	4.5	4.5	4.7
Inflation	2.3	2.5	2.7	2.8	2.8	2.8
Primary balance	-3.4	-2.0	0.1	1.8	3.1	3.5
Effective interest rate	4.8	6.1	6.3	6.3	6.4	6.4
Real Interest Rate Shock						
Real GDP growth	2.1	3.3	4.2	4.5	4.5	4.7
Inflation	2.3	2.5	2.7	2.8	2.8	2.8
Primary balance	-3.4	-0.7	0.8	2.8	3.4	3.7
Effective interest rate	4.8	6.1	7.0	7.2	7.4	7.5
Combined Shock						
Real GDP growth	2.1	1.1	2.0	4.5	4.5	4.7
Inflation	2.3	2.0	2.2	2.8	2.8	2.8
Primary balance	-3.4	-2.0	-0.6	1.8	3.1	3.5
Effective interest rate	4.8	6.3	6.8	7.1	7.3	7.5
Financial Sector Shock						
Real GDP growth	2.1	-1.6	-0.7	1.1	2.2	3.5
Inflation	2.3	5.2	3.4	2.8	2.8	2.8
Primary balance	-3.4	-2.1	-1.5	0.4	-0.3	0.0
Effective interest rate	4.8	6.3	7.5	7.8	8.0	8.0

	2014	2015	2016	2017	2018	2019
Real GDP Growth Shock						
Real GDP growth	2.1	1.1	2.0	4.5	4.5	4.7
Inflation	2.3	2.0	2.2	2.8	2.8	2.8
Primary balance	-3.4	-1.4	-0.6	2.8	3.4	3.7
Effective interest rate	4.8	6.1	6.3	6.4	6.3	6.3
Real Exchange Rate Shock						
Real GDP growth	2.1	3.3	4.2	4.5	4.5	4.7
Inflation	2.3	5.2	2.7	2.8	2.8	2.8
Primary balance	-3.4	-0.7	0.8	2.8	3.4	3.7
Effective interest rate	4.8	6.3	6.1	6.2	6.2	6.3

Source: IMF staff.

Albania Public DSA Risk Assessment

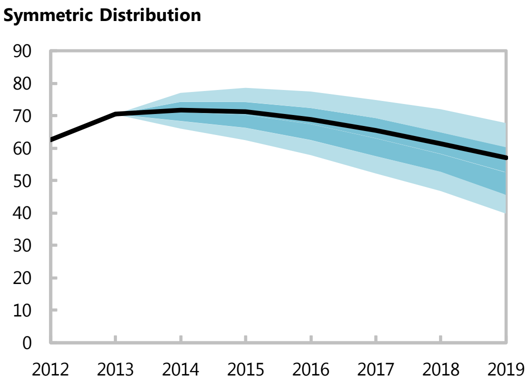
Heat Map

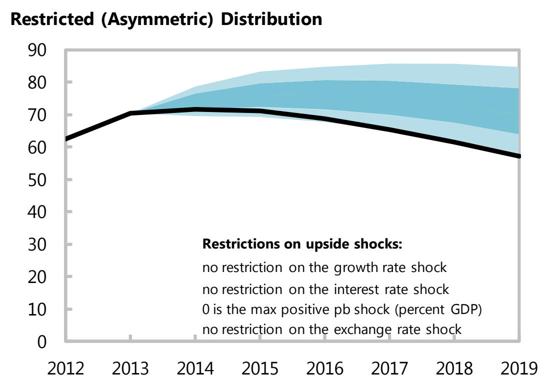
Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)

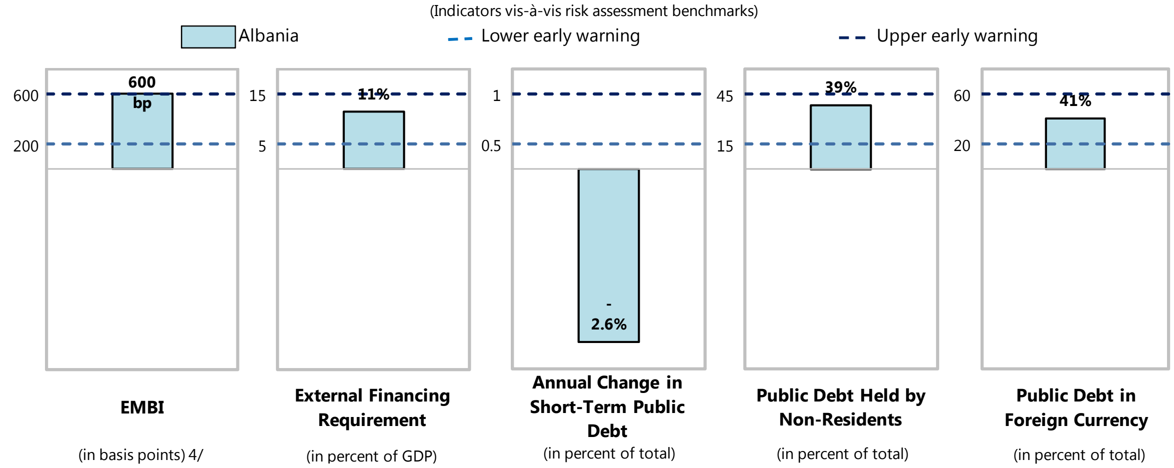
Baseline Percentiles: 10th-25th 25th-75th 75th-90th





Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.

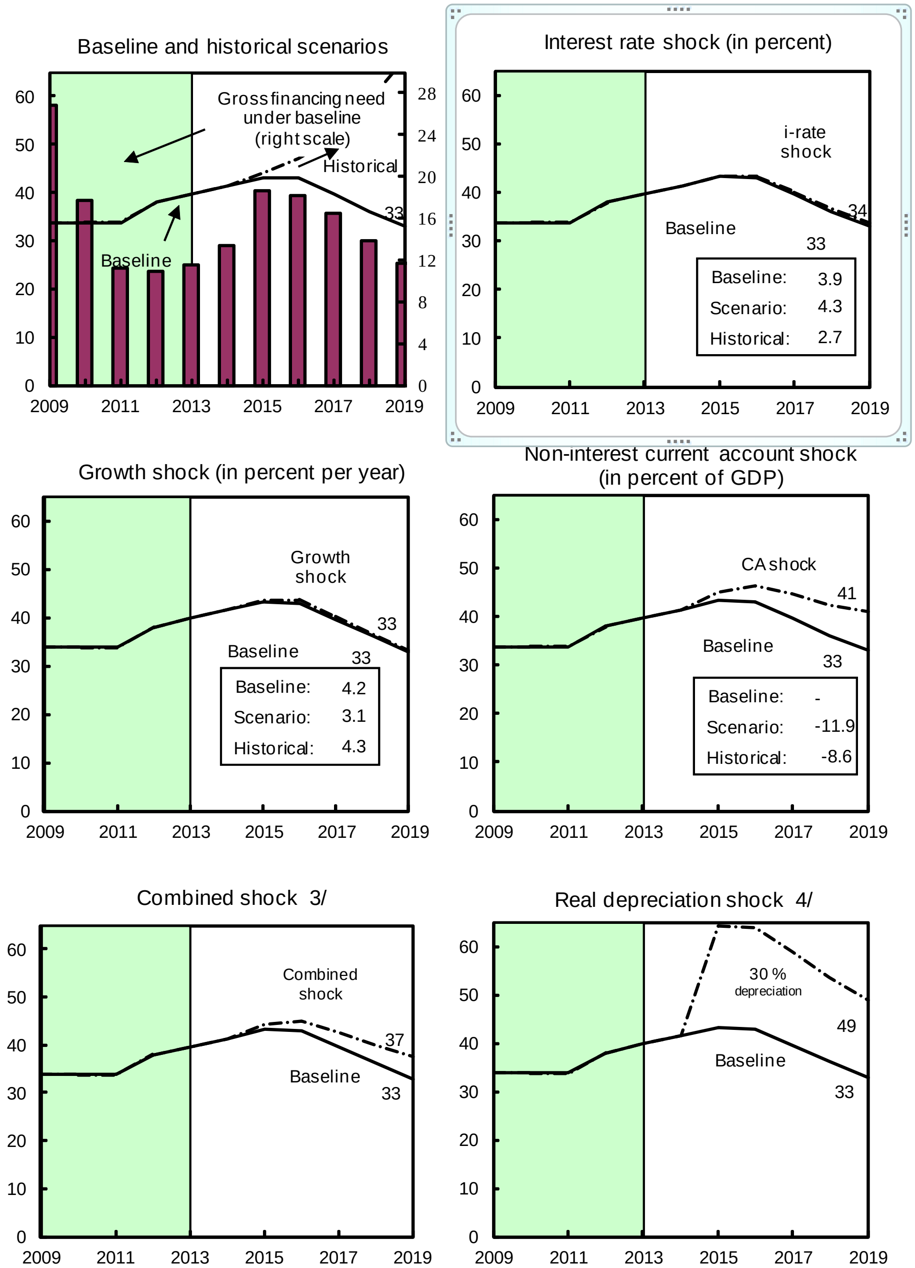
Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ An average over the last 3 months, 01-Sep-13 through 30-Nov-13.

Annex III. External Debt Sustainability

Albania: External Debt Sustainability: Bound Tests 1/ 2/
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs.

INTERNATIONAL MONETARY FUND

ALBANIA

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

February 14, 2014

Prepared By: EUR Department

CONTENTS

FUND RELATIONS

(As of December 31, 2013)

Membership Status: Joined October 15, 1991; Article XIV.

General Resources Account:	**SDR Million**	**Percent Quota**
Quota	60.00	100.00
Fund Holdings of Currency	59.51	99.18
Reserve Position	6.18	10.30

SDR Department:	**SDR Million**	**Percent Allocation**
Net cumulative allocation	46.45	100.00
Holdings	66.98	144.19

Outstanding Purchases and Loans:	**SDR Million**	**Percent Quota**
Extended Arrangement	5.68	9.47
ECF Arrangements	10.70	17.83

Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
ECF[1]	2/01/2006	1/31/2009	8.52	8.52
EFF	2/01/2006	1/31/2009	8.52	8.52
ECF[1]	6/21/2002	11/20/2005	28.00	28.00

Projected Obligations to Fund:

(SDR Million,; based on existing use of resources and present holdings of SDRs);

	Forthcoming			
	2014	2015	2016	2017
Principal	5.80	4.32	2.90	2.01
Charges/Interest	0.06	0.05	0.03	0.01
Total	5.86	4.38	2.93	2.01

[1] Formerly PRGF.

Safeguards Assessments: A safeguards assessment mission will take place in February 2014 and the assessment will be issued soon after. The last safeguards assessment of the Bank of Albania, completed on July 14, 2006, found that some weaknesses existed in the central bank's safeguards framework. The main vulnerabilities identified by the assessment concerned the quality of the external audit, lack of audit committee oversight of the external and internal audit functions and the system of internal controls, and certain weaknesses in the controls over the Fund data reporting process. Subsequent to the assessment completion, external audit quality has been improved by adding a cosignatory from a larger office of the audit firm, and the data reporting process was modified as recommended. The authorities are working to address remaining vulnerabilities in the internal audit function, but have not yet established an audit committee.

Exchange Rate Arrangement: On July 1, 1992 the Albanian authorities adopted a floating exchange rate system. The de jure exchange rate system is classified as free floating, but the de facto exchange rate arrangement is floating, with the monetary authorities occasionally intervening in the foreign exchange market in order to avoid excessive and short-term disruptions in the functioning of the market and to accumulate reserves. The country still avails itself of the transitional arrangements under Article XIV and maintains an exchange restriction in the form of outstanding debit balances on inoperative bilateral payment agreements, which were in place before Albania became a Fund member. These relate primarily to debt in nonconvertible and formerly nonconvertible currencies. Albania maintains two further exchange restrictions inconsistent with Article VIII, Sections 2(a) and 3 under the IMF's Articles: (i) an exchange restriction arising from the requirement for residents and nonresidents to submit a tax certificate that they do not owe any outstanding taxes prior to transferring foreign exchange for certain current transactions including the payment of moderate amounts for amortization of loans, the payment of certain insurance premium, and the transfer of profits and dividends from investments in Albania; and (ii) an exchange restriction arising from the requirement to provide customs clearance documents in respect of advance import payments prior to making payments for unrelated foreign exchange transactions. The exchange rate stood at lek 103.17 per U.S. dollar on November 30, 2013.

Article IV Consultation: The 2012 Article IV consultation was concluded on December 3, 2012 (IMF Country Report No. 13/7).

FSAP Participation and ROSCs: The most recent FSAP was carried out in November 2013 (Board date February 28, 2014). A data module ROSC was published on the Fund's website in June 2000. A fiscal ROSC was completed in June 2003. Albania participates in the General Data Dissemination System (GDDS), and a complete set of GDDS metadata for the external, financial, fiscal, and real sectors, as well as for the socio-demographic indicators is posted on the Fund's Dissemination Standards Bulletin Board (http://dsbb.imf.org). A data module ROSC reassessment using the Data Quality Assessment Framework was conducted in March 2006. A ROSC for assessing the Financial Action Task Force (FATF) recommendations for Anti-Money Laundering (AML) and Special Recommendations on Combating the Financing of Terrorism (CFT) was conducted in November 2010 and the report was published in July 2011.

Technical Assistance: The Fund, other multilateral organizations and donors have provided extensive assistance for institutional development in Albania. The Fund has sent several technical assistance missions to Albania every year since 1991. The extent and focus of Fund TA since FY 2008 is briefly listed below.

Table 1. Albania—Technical Assistance since FY2008

Department	Purpose	Date
FAD	Cash Management and Public Finance Strategy	May 2008
	Cash Forecasting and Management	October 2012
	Revenue Administration	October/November 2008
	Advice on IT Strategy and Business Process Reengineering	April 2009; March 2010
	Capacity Building in Taxpayer Compliance and Information Technology	November 2011
	Tax Administration	April 2009; March 2010; April 2011; April 2012; November 2013; January 2014
	Cash forecasting and management	October 2012
	Arrears Clearance and Prevention	November 2013
	Tax Policy	November 2013
LEGAL	Review of the Albanian AML/CFT law	August 2007
	TA on Repurchase Transactions Law	March 2008
	Banking Seminar for Judges and Bank Regulators	November 2008
	TA in Central Banking Law	April 2009
	TA on Payments Systems	May 2009
	ROSC on AML and CFT	Nov 2010
MCM	Monetary Policy	25 visits between June 2007 and April 2010;
	Management	June, July 2007
	Credit Registry	October 2007; January 2008
	Modeling and Forecasting	October 2007; March 2008
	Monetary Policy Strategy for Small Countries	December 2007;
	Banking Supervision	13 visits between February 2008 and March 2010;
	Delivery vs. Payment	April/May 2008
(together with LEGAL)	Central Bank Law	April 2009: February 2010
	Treasury Bill Registry	November 2009
	Modeling of Monetary Policy	December 2009; March, April, September 2010, January 2011, October 2011

Department	Purpose	Date
	Stress testing, liquidity testing	April 2011, July 2011, September 2011
	Contingency planning and Crisis Management	September 2011
	Basel II implementation	June 2013
	Stress testing	September 2013
STATISTICS	Balance of Payment Statistics	September–October 2007
	GDDS: Consultation	October 2007
	STE: Consumer Prices/Producer Price	November 2007
	LTE: Government Finance Statistics	February 2008
	STE National Accounts Statistics	5 visits between February 2008 and November 2009
	SDDS: Assessment	April, July 2010
	National Accounts Statistics	March 2011
	LTE: National Account Statistics	June 2012
	Producer Price Statistics	September 2013

Resident Representative: A Fund resident representative was posted in Tirana from April 1993 to August 2009. Ms. Ann-Margret Westin filled the position from August 2005 to August 2009.

WORLD BANK GROUP RELATIONS

The Republic of Albania has been a member of the World Bank since 1991. Since then, the WBG has provided strong support to Albania, including 72 IDA, IBRD and GEF projects in different sectors totaling US $1.4 billion, IFC investments of US$621 million, and MIGA guarantees totaling US$8.6 million. The quality of the active portfolio has continued to improve, with an increasing focus on long-term capacity development and implementation through Government structures.

The National Strategy for Development and Integration (NSDI) for 2007-2013 outlined the Government's economic and social development program. The strategic goals of the NSDI were: (i) integration to the European Union (EU), strengthening the rule of law and democratization; and (iii) achieving rapid and sustainable economic and social development. The authorities have made progress towards the NSDI goals. First, Albania joined NATO in 2008 and submitted its application for EU membership in 2009. In November 2010, the European Commission found out that "negotiations for accession to the EU should be opened with Albania once the country has achieved the necessary degree of compliance with the membership criteria." Second, its GDP growth continued throughout the global financial crisis, while poverty continued to decline. However, despite adopting some business environment reforms, Albania declined in its overall ranking on the World Bank's 2014 Doing Business (DB) Indicators to the 90th position.

The new Government, which took office in September 2013, is in the process of revising the draft National Strategy for Development and Integration (NSDI) for 2014–2020. The Strategy for 2014–2020 is expected to be finalized by September 2014. The current draft, which is undergoing a consultative process, has three broad pillars or overarching goals: (i) to prepare Albania to become a full member of the European Union; (ii) to foster strong and sustained economic growth; and (iii) to transform growth and enhanced wealth into improved well-being for all citizens in a fair and cohesive society. These broad goals are to be advanced through measures in four key areas: (i) good governance, democracy and rule of law; (ii) growth through fiscal stability and increased competitiveness, forming Pillar I; (iii) sustainable growth through efficient use of resources, forming Pillar II; and (iii) investing in people and social cohesion, forming Pillar III.

The current Bank Group Country Partnership Strategy (CPS) for 2011–14 supports the Government's National Strategy for Development and Integration by focusing on three strategic objectives: (i) supporting Albania's economic recovery and growth in a crisis-affected Europe; (ii) broadening and sustaining Albania's social gains; and (iii) reducing vulnerability to climate change and natural disasters. The CPS program also supports governance improvements in Albania and the EU integration agenda. It focuses on accelerating the implementation of the ongoing program, while selectively introducing new IBRD lending in strategic areas, increasing IFC financing for the private sector to US$120–150 million, strengthening partnerships with other IFIs and donors, and expanding its knowledge program through regional and national activities. As part of its initiative to help several countries in Central, East, and South East Europe mitigate the impacts of the Eurozone crisis, the IBRD has increased the financing envelope available to Albania under the CPS, initially set at around US$300 million, to US$575 million, mainly for strengthening financial stability, macroeconomic management, and growth. The Progress Report has been prepared reconfirming CPS priorities, with an increased focus on supporting growth, competitiveness, and energy sector development.

The 2010 CAS proposed a lending range of US$ 75–US$ 196 million, with actual lending to have been determined by the pace of reform in key sectors. The current portfolio consists of five projects totaling US$200 million in IDA credits and IBRD loans. The portfolio has been consolidating significantly in the past few years, from 18 projects at the end of FY09 to five projects by FY13. Portfolio performance as measured by disbursement improved in FY11, with 22 percent, and FY12 with 24 percent, but it was 17 percent in FY13, partly because of some new projects and also because of deteriorating macro-fiscal performance, forcing the Government to cut expenditure even under IFI financing and leading to arrears under several projects. In order to improve performance, a number of steps taken in collaboration with the Government to simplify and streamline the portfolio, restructure problem projects, and introduce regular portfolio performance reviews have produced results.

Albania: Bank-Fund Joint Management Action Plan Matrix

(As of January 2014)

Title	Product	Provisional Timing of Missions	Expected Delivery date
A. Mutual information on relevant work programs			
The World Bank work program in the next 12 months	Environmental Services Project Energy Sector Recovery Project Financial Sector Modernization Loan Public Finance and Growth Loan	March 2014 March 2014 March 2014 February 2014	May 2014 May 2014 May 2014 May 2014
The Fund work program in the next 12 months	Program review: First review of the EFF arrangement	 April 2014	 Board meeting in June 2014
	Second review of the EFF arrangement	August 2014	Board meeting in September 2014
	Third review of the EFF arrangement	November 2014	Board meeting in December 2015
	<u>Technical assistance:</u> *Monetary and financial sector* Safeguard assessment	 1 missions	 Ongoing
	Fiscal sector Strengthening tax compliance Public financial management	 1 missions 2 missions	 Ongoing Ongoing

	Statistics National accounts statistics	1 mission	Ongoing
B. Requests for work program inputs (as needed)			
Fund request to Bank	Growth diagnostics, assessment of competitiveness, and related structural reforms (e.g., electricity sector) Fiscal governance and PEM Public expenditure reform needs (in particular civil service and pension reforms) Nonbank financial sector development		
Bank request to Fund	Periodic macro updates Joint approach to advisory work on institutional reform at the MoF in debt management Debt Sustainability Analysis		

STATISTICAL ISSUES

ALBANIA—STATISTICAL ISSUES APPENDIX

(As of January 31, 2014)

I. Assessment of Data Adequacy for Surveillance

General: Data provision has some shortcomings, but is broadly adequate for surveillance. The main obstacles are in real sector statistics.

National Accounts: The weaknesses in national accounts are mainly due to poor source data. While technical assistance has been provided on methodological procedures, source data still do not provide sufficient information to compile reliable estimates, especially on the unobserved economy. The long lag in handling certain source data, e.g., the Structural Business Survey (SBS), also hampers the timeliness of annual GDP publication, which is currently around 13 months after the year. INSTAT is considering adopting partial electronic survey reporting, which can potentially shorten the processing time for the SBS, but would require considerable resources. Quality and timeliness of national accounts can also be improved by better inter-government agency data sharing of administrative data. But without speeding up source data processing, timeliness of GDP publication is not likely to improve in the short run.

INSTAT has benefited from technical assistance from the Fund and the European Union, mainly to address weaknesses in methodology, basic data sources, and coverage of the private sector. The Labor Force Survey was incorporated into the estimates of the unobserved economy in the annual national accounts while attempts were made to use the Household Budget Survey to develop a new benchmark estimate of private consumption. A new methodology for gross fixed capital formation based on a commodity flow approach was developed. Due to severe resource constraints at INSTAT, the improvement in the national accounts has been relatively slow. INSTAT is currently working on adopting the ESA95 methodology. The revised methodology for GDP compilation will, among other things, render more comprehensive coverage of the informal economy. INSTAT plans to revised annual GDP numbers for 2008–2011 using the new methodology in Q2:2014.

The quarterly GDP is published with a lag of over 90 days, using the so-called indirect method based on selected indicators and certain statistical assumptions. Due to differences in compilation methods, there are large discrepancies between the aggregated quarterly GDPs and the annual GDP estimates.

Labor statistics: The quality of Labor Force Survey (LFS) is of insufficient quality, which in turn affects the quality of employment/unemployment data. Remote areas are under surveyed due to resource constraints. The treatment of agricultural employment needs to improve, as currently all individuals that own agricultural land is considered self-employed by the survey. Various short-comings in LFS lead to the lack of variation in the employment/unemployment data.

Price statistics: Compilation generally follows international standards, and the estimation of imputed rent within the CPI was improved in 2003. In December 2007, INSTAT updated the CPI weights using the results of a new national-level HBS conducted during the period October 2006–September 2007. PPI has been published only quarterly due to financial constraints. The weights were derived from the Structural Business Survey of two years before.

Government finance statistics: Fiscal source data is sufficiently adequate to allow a broad presentation of the Albanian general government's fiscal operations in line with to the Government Finance Statistics Manual 2001 (GFSM 2001) framework. Transitioning to the GFSM 2001 fiscal presentation does not appear to substantially change the overall picture (Appendix Table 1). However, transitioning also necessities further improvements in the

alignment of the fiscal statistics, above all by (i) providing greater detail on some of accounts (such as National Taxes, Income of Budgetary Institutions, Property Compensation, and Compensation for Electricity); (ii) reporting transactions of Albania's local governments in a separate statement instead of with the general government; (iii) breaking down the Net Acquisition of Nonfinancial assets (labeled as Capital Expenditure in the local presentation) into the GFSM 2001 subcategories (i.e., fixed assets, inventories, valuables, and nonproduced assets); and (iv) breaking down the financing section into net acquisition of financial assets and net acquisition of liabilities (and their respective instruments).	
Monetary statistics: The monetary data compilation framework conforms to the methodology recommended in the *Monetary and Financial Statistics Manual (MFSM) 2000*. The depository corporations' survey covers the Bank of Albania (BoA) and all the other deposit-taking institutions (commercial banks and savings and loans associations (SLAs)). The accounts of the SLAs, with the exception of loans, are produced on a cash basis, which contrasts with the *MFSM*'s recommendations of accrual accounting. Another deviation from the *MFSM*'s methodology is that the BoA's and commercial banks' holdings of nontradable long-term securities are recorded at book value.	
External sector statistics: The Balance of payments data is compiled by the BoA with a time lag of less than 90 days, and is methodologically sound, though some of the estimates, particularly for international transactions outside the banking system, need to be refined. Problems remain in the areas of service transactions and remittances, and in the monitoring of financial account transactions, foreign assistance (grants from abroad to regional and local governments are underreported), and external debt. The estimation methods for transactions outside the banking system (mostly remittances and investment transactions by nonresident Albanians) require further improvement, though this is arguably a less concern going forward as remittances are more and more channeled through the banking system. The BoA will conduct a household survey in 2014 to improve the accuracy of remittance estimates. The external debt database ensures timely and accurate reporting of external government debt (including commitments of state-owned enterprises). The collection of data on external grants (EG) is not timely and only covers the central government. The BoA is working on revising the EG numbers. The International Investment Position (IIP) data is compiled annually by the BoA, which plans to shorten the timeliness of publication—currently 15 months after the year—to 9 months in 2014.	
II. Data Standards and Quality	
Albania participates in the General Data Dissemination System (GDDS).	Data ROSC published in October 2006.

Table 1. Albania: Statement of Operations–General Government, 2009–19

(Billions of leks)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
					Est.			Projection			
Revenue	299.0	319.6	330.4	330.4	325.8	360.8	379.5	405.6	435.4	466.9	502.4
Taxes	221.0	235.0	247.3	243.4	233.8	267.2	283.0	302.5	324.8	348.7	375.6
Social contributions	49.8	53.8	56.6	57.4	60.0	63.8	67.6	72.4	77.7	83.4	89.8
Grants	4.4	4.6	3.8	5.6	7.9	8.5	6.5	6.7	7.1	7.1	7.1
Other revenue	23.7	26.2	22.7	24.0	24.1	21.2	22.4	24.0	25.8	27.7	29.8
Expenditure	385.3	371.5	376.2	374.2	409.4	420.1	449.5	482.0	515.7	551.0	588.8
Expense	283.9	299.9	305.6	312.6	332.1	353.5	379.4	407.0	435.2	464.5	495.7
Compensation of employees	62.4	65.8	67.4	69.4	71.6	74.0	78.4	83.9	90.1	96.7	104.1
Use of goods and services	32.1	33.3	33.0	31.8	35.0	35.3	37.4	40.0	43.0	46.1	49.6
Interest	36.3	41.6	41.1	41.5	43.9	46.0	62.3	67.2	70.6	72.8	74.2
Subsidies	2.0	3.5	3.3	1.9	1.6	1.6	1.8	2.0	2.1	2.0	2.1
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Social benefits	117.6	124.9	132.6	140.6	151.4	159.2	168.7	180.8	194.0	208.7	224.7
Other expense	33.6	30.8	28.1	27.3	28.6	37.4	30.9	33.1	35.5	38.1	41.0
Net acquisition of nonfinancial assets	101.4	71.6	70.6	61.7	77.3	66.7	70.1	75.0	80.6	86.5	93.1
Domestically financed	81.1	50.7	42.7	27.4	37.4	28.1	29.2	31.3	33.6	36.1	38.8
Foreign financed	20.3	20.9	27.9	34.3	39.9	38.6	40.9	43.8	47.0	50.5	54.3
Unidentified measures (cumulative)						0.0	17.7	39.0	57.6	74.1	85.8
Gross Operating Balance	15.1	19.7	24.8	17.8	-6.3						
Net lending/borrowing	-86.3	-51.8	-45.7	-43.9	-83.6	-59.4	-52.3	-37.4	-22.7	-9.9	-0.7
Transaction in financial assets and liabilities	-86.3	-51.8	-45.7	-43.9	-83.6	-59.4	-52.3	-37.4	-22.7	-9.9	-0.7
Net acquisition of financial assets	-27.6	-10.1	-0.4	0.8	-15.8	-0.4	0.0	0.0	0.0	0.0	0.0
Domestic	-27.6	-10.1	-0.4	0.8	-15.8	-0.4	0.0	0.0	0.0	0.0	0.0
Foreign	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	58.8	41.7	45.3	44.6	67.7	59.0	52.3	37.4	22.7	9.9	0.7
Domestic	16.4	16.4	24.4	29.1	54.1	6.7	4.7	7.2	40.4	39.7	26.9
Foreign	42.4	25.4	20.9	15.6	13.6	52.2	47.6	30.2	-17.7	-29.8	-26.2

Sources: Albanian authorities; and IMF staff estimates and projections.

Albania: Table of Common Indicators Required for Surveillance

As of January 31, 2014

	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]	Memo Items: Data Quality – Methodological Soundness[8]	Memo Items: Data Quality – Accuracy and Reliability[9]
Exchange Rates	1/30/14	1/30/14	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	11/13	12/15/13	D	W	M		
Reserve/Base Money	11/13	12/15/13	M	M	M	O, O , O , LO	O, LO, LO, O, O
Broad Money	11/13	12/30/13	M	M	M		
Central Bank Balance Sheet	11/13	12/15/13	M	M	M		
Consolidated Balance Sheet of the Banking System	11/13	12/30/13	M	M	M		
Interest Rates[2]	1/30/14	1/20/14	D	D	D		
Consumer Price Index	12/13	1/15/14	M	M	M	O, LO, O, LO	LO, LO, LO, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	12/13	1/30/14	M	M	M	LO, O, O, O	LO, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	12/13	1/30/14	M	M	M		

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of reporting[7]	Frequency of publication[7]	Memo Items:	
						Data Quality – Methodological Soundness[8]	Data Quality – Accuracy and Reliability[9]
Stocks of Central Government and Central Government-Guaranteed Debt[5]	12/13	1/30/14	Q	Q	A		
External Current Account Balance	2013:Q3	12/10/13	Q	I	I	O, O, O, LO	LNO, O, LO, LO, O
Exports and Imports of Goods and Services	12/13	11/30/14	M	M	M		
GDP/GNP	2013:Q3	12/15/13	Q	Q	Q	O, LNO, O, LO	LNO, O, LNO, LO, LO
Gross External Debt	2013:Q3	12/10/13	Q	I	Q		
International Investment position[6]	2011	12/2/13	A	I	A		

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents. The IIP is currently being developed by the Albanian authorities and is not yet published. The authorities will publish the data once quality checks have been completed.

[7] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).

[8] Reflects the assessment provided in the data ROSC published on October 31, 2006, and based on the findings of the mission that took place March 8–22, 2006, for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).

[9] Same as footnote 8, except referring to international standards concerning source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

Statement by the IMF Staff Representative on Albania
February 28, 2014

1. **This statement provides information that has become available since the issuance of the Staff Report.** The information does not alter the thrust of the staff appraisal.

2. **Preliminary data for 2013 indicate that the fiscal deficit was 4.8 percent of GDP, compared to 6.2 percent of GDP in the staff report** (Table 1). The improved performance was primarily the result of lower than expected capital expenditure (foreign–financed). Tax revenues were higher than envisaged, particularly VAT. Without a clear sign of a pickup in economic activity, the improved revenue collection is likely to have been from better administration—following resolution of uncertainty associated with elections and change of government. The good revenue performance was partially offset by lower than expected nontax revenues and grants.

3. **Credit to the economy declined by 2.6 percent in November (y-o-y), unchanged from September.** The profitability of the banking system remains weak, but provisioning has increased slightly relative to September. Financial soundness data for November indicate that the NPL ratio was unchanged at 24.2 percent of gross loans, the same level as in September. The nominal stock of NPLs fell slightly on a month-on-month basis.

Table 1. Albania: General Government Operations, 2012–13

(Percent of GDP)

	2012	2013	
		SR	Prel.
Total revenue and grants	24.9	24.0	24.2
Tax revenue	22.7	21.6	22.2
Of which: VAT	8.8	8.0	8.3
Profit tax	1.3	1.1	1.1
Excise tax	2.7	2.7	2.8
Personal income tax	2.1	2.1	2.2
Social insurance contributions	4.3	4.4	4.4
Non-tax revenue	1.8	1.8	1.6
Grants	0.5	0.6	0.4
Total expenditure	28.4	30.1	29.0
Current expenditure	23.7	24.5	24.2
Capital expenditure	4.7	5.7	4.8
Of which: foreign financed	2.7	2.9	2.1
Lending minus repayment	0.0	0.0	0.0
Overall balance	-3.5	-6.2	-4.8
Financing	3.5	6.2	4.8
Domestic	2.3	5.4	4.0
Foreign	1.2	1.0	1.1
Accumulation of Arrears	0.0	-0.3	-0.3

Sources: Albanian authorities; and IMF staff estimates and projections.

Press Release No. 14/81
FOR IMMEDIATE RELEASE
February 28, 2014

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves €330.9 Million Extended Arrangement for Albania

The Executive Board of the International Monetary Fund (IMF) today approved a 36-month SDR 295.42 million (about €330.9 million, or about US$457.1 million; 492.4 percent of country's quota in the Fund) arrangement under the Extended-Fund Facility (EFF) for Albania in support of the authorities' reform program. The approval allows for immediate disbursement of SDR 23.55 million (about €26.4 million, or about US$36.4 million). The World Bank and the EU are also likely to provide assistance to the authorities' reform program.

Following the Executive Board's discussion on Albania, Mr. David Lipton, First Deputy Managing Director and Acting Chair, stated:

"Albania's economic outlook is expected to improve in 2014, spurred by the planned reduction of underlying risks in the fiscal area, clearance of arrears, tackling of high nonperforming loans (NPLs), and the launch of structural reforms. However, risks are significant and refinancing needs are large. The EFF will help Albania meet its external financing needs while providing the necessary support to strengthen fiscal and debt sustainability, lower public financing risks, and put the economy on a sustained medium-term growth path.

"Albania's high public indebtedness calls for fiscal consolidation that aims to lower the public debt ratio to below 60 percent of GDP in the medium term. This will require significant tax and expenditure policy measures, supported by extensive public financial management and tax administration reforms. Lowering the outstanding stock of arrears and putting in place mechanisms to prevent their recurrence will also be critical.

"Further moderate easing of monetary policy could help to support economic recovery, provided inflation expectations and financial stability remain well anchored. However, this would need to be carefully balanced against risks posed by high unhedged foreign currency exposure.

“Preserving financial stability while promoting access to credit is necessary to facilitate a durable recovery. Reducing NPLs will safeguard financial stability and may help release credit supply constraints by lowering bank risk aversion. Steadfast implementation of the recent Financial Sector Assessment Program recommendations, including those related to lowering risks in the non-bank financial sector, will be important.

“The authorities’ plans to reform pensions, energy, local government finances, public administration, and the business environment are welcome. If implemented properly, these reforms should strengthen Albania’s ability to attract investment, improve prospects for sustained medium-term growth, and reduce fiscal risks, Mr. Lipton stated.”

Press Release No. 14/109
FOR IMMEDIATE RELEASE
March 19, 2014

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Concludes 2013 Article IV Consultation with Albania

On February 28, 2014, the Executive Board of the International Monetary Fund (IMF) concluded the 2013 Article IV Consultation with Albania.[1]

Albania successfully avoided recession in the aftermath of the global crisis and suffered a milder growth shock than neighboring countries. Recently, however, the economy has shown signs of protracted weakness and macroeconomic imbalances have widened.

Weak investor confidence, bank risk aversion, as well as incomplete investment climate reforms, have amplified the slowdown. Real GDP growth is expected to decline to 0.7 percent in 2013, the lowest in more than a decade. Inflation has remained low, largely within the central bank's 2–4 percent target range, reflecting the negative output gap. The external current account deficit has begun to adjust on account of oil exports and import compression, but weak external drivers are preventing a sustained reduction.

The fiscal position deteriorated significantly in 2013. Public debt and financing needs—among the highest in the Central, Eastern and Southeastern European region—have risen because of fiscal loosening prior to the 2013 elections, the accumulation of significant unpaid bills and arrears, and the weak economy. Fiscal deficits have been driven up also by structural factors, with pensions exerting a heavy fiscal burden.

The banking system has been resilient to eurozone stress so far, largely because it relies almost exclusively on domestic deposits. Banks' strong solvency ratios and stringent provisioning rules have also contributed to banking system stability. Nevertheless, non-performing loans (NPLs) have increased considerably, further constraining credit growth and putting pressure on bank profitability.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

The authorities have requested IMF's financial assistance in support of their program to boost growth and support macroeconomic stability. The program seeks to: i) reverse the upward trend in public debt and lay the ground for its sustained reduction; ii) restore banks' confidence in lending by bringing down NPLs and; iii) ease constraints on growth by undertaking ambitious structural reforms, including in the areas of pensions, energy, public administration, and the business environment. The program will be supported by an IMF arrangement under the Extended Fund Facility (see Press Release No. 14/81).

Executive Board Assessment[2]

Executive Directors commended the authorities for their adoption of a package of measures to restore fiscal sustainability, safeguard financial stability, and improve the investment climate, which will be critical for reviving the economy and allowing sustained medium-term growth. Noting the significant risks from underlying imbalances, they looked forward to strong and lasting commitment to the program.

Directors stressed that given Albania's high debt, fiscal consolidation should aim to lower the public debt ratio to below 60 percent of GDP in the medium term. Achieving this objective requires significant further tax and expenditure policy measures, supplementing the steps taken in late 2013 and in the 2014 budget, supported by extensive public financial management and tax administration reforms. Adopting a medium-term budget framework or fiscal rule would anchor the commitment to the debt target. Directors generally agreed that the burden of fiscal adjustment should fall primarily on revenues, given the country's development needs and the low share of revenues in GDP. Pension and energy reforms should form a key part of medium–term adjustment. Reducing the outstanding stock of arrears and putting in place mechanisms to prevent their recurrence is critical for fiscal sustainability and restoring confidence. At the same time, Directors underscored the importance of proceeding cautiously with payments and employing an external auditor promptly to begin conducting ex post risk-based audits.

Directors commended the authorities for maintaining low inflation under the inflation-targeting framework. Most Directors saw scope for moderate monetary policy easing to support economic recovery, provided inflation expectations and financial stability remain well anchored. Nevertheless, they stressed the need for a cautious approach, given that further easing could increase the risks posed by high unhedged foreign currency exposure, while its effectiveness could be limited by sluggish credit demand and bank risk aversion. Directors also encouraged the removal of exchange restrictions as soon as possible.

Directors underscored the importance of continued vigilance to maintain financial stability. They encouraged prompt and comprehensive action to address rising non-performing loans

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[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

to help boost bank profitability and credit growth, including through removing impediments to collateral execution and loan restructuring, and clearing arrears. Strengthening the regulation and supervision of the nonbank financial system, in line with recommendations from the recent Financial Sector Assessment Program, will help alleviate systemic risks.

Directors stressed that embarking on a path of sustained medium-term growth hinges on the implementation of ambitious structural reforms. Planned reforms include pensions, energy, local government, public administration, and measures to improve the business environment. If implemented properly, these reforms should strengthen Albania’s ability to attract investment, reduce fiscal risks, and strengthen debt sustainability.

Albania: Basic Indicators and Macroeconomic Framework, 2009–13

	2009	2010	2011	2012	2013 (Est.)
Real sector			(Growth rate in percent)		
Real GDP	3.3	3.8	3.1	1.3	0.7
Consumer Price Index (avg.)	2.3	3.5	3.4	2.0	1.9
Consumer Price Index (eop)	3.7	3.4	1.7	2.4	1.9
GDP deflator	2.0	2.6	3.5	2.1	1.7
Saving-investment balance			(Percent of GDP)		
Foreign savings	14.1	10.0	9.6	9.3	9.0
National savings	16.2	16.9	16.2	15.0	15.2
Public	1.0	1.2	1.6	0.9	-1.0
Private	15.2	15.6	14.6	14.1	16.2
Investment	30.3	26.9	25.8	24.3	24.2
Public	10.1	6.8	6.2	5.2	6.2
Private	20.2	20.1	19.6	19.1	18.0
Fiscal sector			(Percent of GDP)		
Revenues and grants	26.0	26.1	25.8	24.9	24.0
Tax revenue	23.6	23.6	23.7	22.7	21.6
Expenditures	33.5	29.9	29.3	28.4	30.1
Primary	30.3	26.5	26.1	25.2	26.9
Interest	3.2	3.4	3.2	3.1	3.2
Unidentified measures (cumulative)					
Overall balance	-7.4	-3.8	-3.6	-3.5	-6.2
Primary balance	-4.3	-0.4	-0.4	-0.3	-2.9
Net domestic financing	3.3	1.4	1.9	2.3	5.4
of which: Privatization receipts	2.4	0.4	0.0	0.1	1.2
Foreign financing	3.7	2.1	1.6	1.2	1.0
Public Debt	59.5	58.5	60.3	62.4	70.5
Domestic	36.1	33.3	34.2	35.5	43.7
of which: Unpaid bills and arrears					5.3
External (including publicly guaranteed)	23.3	25.2	26.0	27.0	26.8
Monetary indicators			(Growth rate in percent)		
Broad money growth	6.8	12.5	9.1	5.0	2.9
Private credit growth	10.3	10.1	10.4	1.4	-3.0
Velocity	1.3	1.2	1.2	1.2	1.2
Interest rate (3-mth T-bills, end-period)	6.3	5.3	5.3	5.0	3.3
BoA repo rate (in percent)	5.3	5.0	4.8	4.0	3.0
External sector			(Percent of GDP, unless otherwise indicated)		
Trade balance (goods and services)	-24.7	-20.9	-23.1	-19.0	-17.1
Current account balance (including official transfers)	-14.1	-10.0	-9.6	-9.3	-9.0
Current account balance (excluding official transfers)	-14.7	-12.0	-12.5	-11.0	-10.4
Official transfers	0.7	2.1	2.9	1.7	1.4
Gross international reserves (in billions of Euros)	1.6	1.9	1.9	2.0	2.0
(In months of imports of goods and services)	4.1	4.4	4.5	4.8	4.8
(Relative to external debt service)	2.4	3.4	8.4	7.9	5.8
(In percent of broad money)	26.0	27.0	24.9	24.6	24.6
Change in real exchange rate (eop, in percent)	-7.8	-2.5	-0.5	-1.1	…
Memorandum items					
Nominal GDP (in billions of lek)	1148.1	1222.5	1282.3	1326.5	1357.9
Output gap (percent, - = gap)	1.8	1.8	1.7	0.5	-1.5

Sources: Albanian authorities; and IMF staff estimates and projections.

Statement by Mr. Andrea Montanino, Executive Director for Albania and Marco Senatore, Advisor to Executive Director
February 28, 2014

On behalf of the Albanian authorities, we thank staff for their helpful and constructive cooperation during the missions to Tirana and for the informative documents which have been prepared.

The Article IV and FSAP missions, together with the negotiation for the proposed three – year Extended Fund Facility (EFF) program, have provided valuable insight to the authorities in the pursuit of their macroeconomic objectives.

In the current juncture, Albania has the chance to improve significantly its macroeconomic environment, and, to this aim, the country is pursuing a path of wide-ranging reforms that are expected to contribute to economic recovery and to the reduction of arrears and nonperforming loans (NPLs).

The Albanian authorities assign the highest importance to such reforms and to the cooperation with the Fund which is needed to successfully pursue them.

Request for an Extended Arrangement under the EFF

The proposed three-year program under the EFF has been requested by the Albanian authorities on the basis of the estimated external financing need, amounting to about 7.1 percent of GDP in 2014-16. With the support of the program, the authorities will undertake initiatives aimed at significantly reducing public debt, bringing down NPLs in order to restore banks' confidence in lending and introducing structural reforms to promote long-term growth, while at the same time achieving a gradual fiscal adjustment.

As for the modality chosen for the program, direct budget support, it is to be recalled that, while in the current juncture domestic markets could not finance the fiscal deficit without significant risks, on the other hand external financing of the budget may be catalyzed only after the involvement of the IMF, as the country has limited access to international capital markets.

The agreement, which foresees access to Fund resources, will increase confidence in the economy and ease the impact of the fiscal adjustment required.

The authorities are aware of the risks linked with the program, but they are also committed to putting the Albanian economy on a path of sustained medium term growth, by increasing private sector credit, strengthening public finances, reforming the energy sector and improving the business climate.

Economic developments and outlook

In the last few years economic growth in Albania has continued to slow down, and for 2013 it is estimated to have reached 0.7 percent, the lowest level since 1997. This is the result of weak domestic demand, which in turn is dependent on weak confidence in the business and household sectors.

The gradual decline in the current account deficit (estimated at 9 percent of GDP in 2013), has been linked most of all with the good performance of exports and with the reduction of imports. The positive financial account received a significant contribution from direct investments, which have remained stable, at around 8 percent of GDP. In the last ten years, external debt has almost doubled, and it could reach about 43 percent of GDP in 2014, before declining in the following years.

For 2014, a significant contribution to growth should come from the initiatives aimed at reducing NPLs and clearing arrears, as well as from improved confidence. For the next years, the Albanian authorities are committed to wide-ranging reforms which, with the support of the EFF program, will significantly contribute to sustained growth.

Fiscal policy

In the past few years the public debt to GDP ratio in Albania has significantly increased, from about 60 percent in 2009 to about 71 percent in 2013. Such figure, which represents a historical peak, includes unpaid bills and government arrears (about 5 percent of GDP) linked with contracts signed by the Public Administration. Moreover, the estimated deficit for 2013 is of 4.8 percent of GDP.

In the current juncture, on one hand, domestic financial markets would be too much stressed by the volume of bond issuance which would be required to significantly reduce arrears. On the other hand, arrears represent a significant obstacle for economic growth, as they generate NPLs and constrain credit dynamics.

Against this backdrop, a significant part of the measures envisaged by the proposed EFF program is aimed at clearing arrears, in order to provide liquidity to the real sector. In this regard, a comprehensive arrears prevention and clearance strategy (APCS) has been published on the website of the Ministry of Finance (MoF). Moreover, an amended Law for Payment of Arrears on Contractual Obligations has been submitted to Parliament to define expenditure arrears and payment terms. An external auditor will be contracted to conduct risk-based audits of arrears payments.

The authorities are also committed to monitoring future expenditure commitments and avoiding arrears accumulation. For instance, all new procurement orders will be sent to the MoF for clearance prior to starting the biding process. Moreover, the reporting and approval procedures for procurement orders will be enhanced, especially for multi-year commitments. To this aim, MoF has already issued budget instructions to all central government entities to report all proposed new procurement orders for MoF clearance, and suspend issuing any new multi-year procurement orders until outer-year commitment ceilings are approved by the Council of Ministers.

The authorities also plan to start introducing commitment limits with the 2015 budget.

At a more general level, the authorities are committed to fiscal consolidation, in order to reduce the debt ratio to 69 percent of GDP by the end of the proposed EFF program in 2016 and to well below 60 percent by 2019. Moreover, the fiscal deficit target for 2014 is about 4 percent of GDP, excluding the repayment of arrears.

To this aim, the 2014 budget envisages increases in the corporate income tax (CIT) rate, (from 10 to 15 percent), in excise tax rates, in fuel tax and property tax rates. On the spending side, there will be, with the exception of police officers, no increase in public sector salaries in 2014. Moreover, pension increases to cost of living adjustments will be limited. The authorities will also ease the burden of fiscal adjustment on small businesses and vulnerable groups, introducing a progressive income tax and reducing the rate for the simple tax on profit for small businesses to half the corporate tax rate.

Tax administration (an area where the Fund has provided technical assistance to the authorities) will be improved, as a foreign consultant will assist customs in tax collection. Moreover, management committees for taxpayer compliance have been established to guide decision making of the tax administration.

Some initiatives are also envisaged to reduce fraud, for instance by verifying more efficiently refund claims and, in 2015, changing the verification process to link it directly to businesses’ online tax payment records.

In the medium term, a pension reform will be adopted. To this aim, a Reform Commission will be established by the end of next March and will present a medium-term strategy to Council of Ministers for approval by December 2014.

Monetary policy

The monetary policy of the Bank of Albania (BoA) has managed to keep inflation low and relatively stable. At the same time, the impact of macroprudential measures has been low or marginal in boosting credit growth. According to the authorities, the monetary stance could be moderately expansive, taking into account the low inflation and weak demand, but they will try to avoid excessive strains in financial stability.

The BoA will improve its operational framework in order to increase the efficiency of the transmission mechanism and to promote the development of money markets.

The BoA will also continue to enhance its communication strategy.

Financial sector

The BoA is fully committed to implementing the FSAP recommendations, and to using the assessment as a guideline for the action plan to advance the level of supervisory standards towards the best practices, considering that this is also the best contribution to its mandate of guaranteeing the banking and financial stability.

The banking sector is well-capitalized and liquid. Branches of foreign banks do not depend on parent funding, as they are fully funded by domestic deposits. Moreover, a number of measures will be aimed at reducing the level of NPLs, which is relatively high. In particular, a legal amendment of the Tax Law has already been submitted to Parliament to remove issues which impede the loan write-offs from banks’ balance sheets. Moreover, the regulatory framework to strengthen credit standards will be improved. The Civil Code and other laws will also be amended to improve insolvency requirements, set the payment to bailiffs in line with success rate and restrict judicial discretion in postponing borrowers' payments. A contribution to the reduction of NPLs will also come from arrears clearance.

Moreover, the BoA will further improve its macro-prudential framework. The regulatory framework for the nonbank financial sector will also be strengthened, by improving the operational and financial independence of the Albanian Financial Supervisory Authority (AFSA). The regulatory framework for investment funds will be revised to introduce liquidity and capital requirements and require the calculation of net asset value to be done on a mark to market basis.

Structural reforms

Lack of reforms, as observed by staff, has negatively affected the growth potential of Albania. Against this backdrop, the authorities are committed to undertaking interventions in several areas.

Measures aimed at improving the business climate will include an assessment of the regulatory framework for business and a reform of business registration procedures in order to improve transparency and reduce the time spent by the businesses in this area.

In the energy sector, a Task Force will develop a medium-term strategy, in cooperation with the World Bank. By the first quarter of 2014 a plan will be designed to increase billing in the regions where there is a greater percentage of informal sectors. The Task Force and the Ministry of Energy will also develop a plan aimed at sorting out inter-company debt accumulated in the energy sector. By the first half of 2014 the tariff system will be reviewed to bring prices closer to the market prices.

For the agricultural sector, a land reform will strengthen property rights, distributing 70 percent of land titles by 2015. Moreover, the irrigation infrastructure and food safety will be improved by the Rural Development and Water administration, through capacity building.

Another area of intervention will be social protection, where a TA project with the World Bank will modernize the social assistance scheme. A new database should also be introduced by April 2014, in order to allow exchange of information on individuals among different government agencies.

In Public Administration, the authorities are committed to using meritocratic criteria in hiring new employees, in compliance with the new Civil Service Law.

The authorities will also increase investment in early child education, launch a review of the professional education system and establish apprentice arrangements with companies.

A review of the legal framework will be launched in order to address the issues identified by the European Commission with a view to future integration with the EU.

Finally, statistics will be improved through better inter-agency data sharing.

Conclusion

All in all, my Albanian authorities believe that the combination of deep structural reforms, coupled with gradual fiscal consolidation, will set the stage for a return of the Albanian economy to sustainable growth, and request the Board's support of their ambitious program under the EFF.