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February 23, 2015

Albania: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

January 27, 2015

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The following item is a Letter of Intent of the government of Albania, which describes the policies that Albania intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Albania, is being made available on the IMF website by agreement with the member as a service to users of the [IMF](#) website.

Albania: Letter of Intent

Tirana, January 27, 2015

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

Dear Ms. Lagarde:

1. The Extended Arrangement approved on February 28, 2014, by the Executive Board of the International Monetary Fund (IMF) is the main anchor of our economic policies. The attached Memorandum of Economic and Financial policies (MEFP) reviews progress in implementing the program, and outlines the policies that the government and the Bank of Albania will pursue during 2015.
2. Performance under the program has been satisfactory so far. All end-June and end-September quantitative performance criteria were met. However, the continuous performance criterion on the accumulation of external arrears was missed because of irregularities in the authentication of signatories. The outstanding amount has since been repaid. We are currently awaiting data to assess two end-December performance criteria (a waiver of applicability is being requested for the ceilings on general government overall cash deficit and expenditure); we expect these to be met. The indicative target on accumulation of new arrears was missed by a small margin, and inflation was slightly below the inner band prescribed under the inflation consultation clause. We are reinforcing internal controls and implementing ambitious PFM reforms to ensure that the government meets its payment obligations on a timely basis. Moreover, the Bank of Albania and Fund staff agreed that given the policy of cautious monetary easing and forward guidance, there is no need for other policy action regarding inflation. The Bank of Albania expects inflation to converge to the medium-term target and is expanding the use of forward guidance to align expectations to its monetary policy objective. As regards structural reforms, one structural benchmark related to the hiring of an external auditor to conduct verification of arrears payments on tax refunds has been delayed due to funding constraints. Another structural benchmark related to the development of a corporate strategy for medium- to long-term capacity building in GDT has been delayed because of the other work priorities related to the implementation of a new IT system. A third structural benchmark on the purchase of a new IT server for the treasury system was not met, as procurement delays have persisted. All other SBs were met, albeit with delay or partially implemented. These delays were to a considerable extent beyond our control.

3. Policy priorities for 2015 focus on pursuing fiscal consolidation while continuing with the payment of arrears, safeguarding financial sector stability and reviving credit growth, and implementing growth-enhancing reforms. In this context, we are committed to pursuing, among other things, an ambitious energy sector reform, as well as fiscal reforms in the areas of public financial management, tax administration, and expenditure policy.
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 Memorandum of Economic and Financial Policies (MEFP) and Technical Memorandum of Understanding (TMU). 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 in economic and financial policy implementation.
7. In view of the strong program performance to date and the strength of policy commitments in the period ahead, we request that the Executive Board of the IMF complete the second and third reviews under the Extended Arrangement. The Albanian authorities also request: 1) a waiver for the nonobservance of a continuous performance criterion on the basis of the corrective action taken; 2) a waiver of applicability for the two performance criteria on general government overall cash deficit and expenditure, given the unavailability of end-December data for assessing quantitative targets; 3) rephrasing of future disbursements to better align missions with our internal work cycle; and 4) the purchase of SDR 47.1 million, following completion of the second and third reviews by the IMF's Executive Board. Finally, the authorities would like to request that the ceiling on Bank of Albania credit to the government be elevated to a quantitative performance criterion, starting with the end-April 2015 test date.
8. The Albanian authorities wish to make this letter available to the public, along with the attached MEFP and TMU, as well as the IMF staff report on the second and third reviews 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.

Attachment I. Memorandum of Economic and Financial Policies

1. This Memorandum lays out the government of Albania's policy priorities in the period ahead, supported by the IMF's EFF. Our policies seek to generate sustained medium-term growth that results in tangible gains, including employment generation and an improvement in the standard of living of Albanians. Achieving these goals will require continued efforts to enhance macroeconomic stability, notably, reducing debt-related vulnerabilities, by putting public finances on a sustainable footing, and unlocking structural constraints to medium-term growth.

RECENT ECONOMIC DEVELOPMENTS

2. **The economy is beginning to recover.** Real GDP is expected to have grown by 2.1 percent in 2014, mostly in the second half of the year. The expansion is associated with higher petroleum production, and a pickup in agriculture, trade, and manufacturing. Arrears clearance, lower interest rates, and a strong export performance in textiles and footwear have yielded a modest pickup in private demand. After a slow start early in the year, public investment picked up subsequently, while electricity production has benefitted from a turnaround in rainfall conditions.

3. **External imbalances are expected to have widened in 2014.** The current account deficit is estimated to have reached 14.0 percent of GDP, a 3.4 percentage point increase compared to last year, mainly because of higher demand for electricity imports due to weak rainfall in the first quarter, and higher intermediate imports. Exports of goods increased thanks to higher agriculture and textile exports. Petroleum exports, however, declined because part of the production was channeled to the recently refurbished local refinery. Remittances have continued on a declining trend, in relation to GDP. The current account deficit was financed largely by higher FDI and borrowing. Gross international reserves are sufficient to cover around 4.3 months of imports of goods and services.

4. **Inflation continues to be modest.** Average CPI inflation was 1.6 percent in 2014, remaining below the Bank of Albania's (BoA) medium-term target of 3 percent (with a tolerance band of ± 1 percentage point). There has been a modest pickup in inflation since 2013:Q4, but it continues to be constrained by weak price pressures from foreign trading partners, the negative output gap, and

modest wage growth. The BoA lowered its policy rate by 25 basis points in November, to a new record low of 2.25 percent.

OUTLOOK

5. Economic recovery is expected to continue in 2015, though low inflation will likely persist. Although the external environment remains weak, a continued recovery in private demand, boosted by further progress on arrears clearance and a modest pick-up in lending, is expected to help support growth. Survey results predict a steady improvement in economic confidence, as well as improving lending conditions, that should support stronger private investment. With better administrative capacity, following the transition problems experienced early in 2014, public investment is expected to recover in 2015. Still, inflation is likely to remain below the BoA target in 2015, as the economy continues to be below potential, and weak price pressures from foreign trading partners persist.

6. The external account deficit is likely to remain high in 2015. With the economy continuing to recover, imports, including those related to large infrastructure projects (TAP and Statkraft), are likely to outpace improvements in export capacity in 2015. The current account deficit will continue to rise to about 15 percent of GDP but will be financed primarily by FDI, including for large investment projects. Over the medium term, the external current account deficit will decline somewhat because of improvements in export capacity, import substitution, and lower import needs of big FDI projects.

PROGRAM IMPLEMENTATION

7. All end-June and end-September performance criteria (PCs) have been met. The PC on the general government cash deficit, excluding arrears payment, was met, thanks to good revenue performance and the under-execution of current spending (e.g., operations and maintenance, local government, and interest) and public investment (the expenditure ceiling PC was also met). We commit to achieving the end-2014 fiscal deficit and expenditure targets. The lower inner inflation band under the Inflation Consultation Clause was missed because of weak price pressures from foreign trade partners, and the persisting output gap.

8. The continuous PC on the non-accumulation of external arrears was missed. The government accumulated a small amount of external interest arrears (US\$61.7 thousand) because of perceived irregularities in the authentication of signatories, which have since been sorted out, and the payment, due in April, was eventually made in early October. We request a waiver for the nonobservance of a PC on the basis that this was a temporary oversight and has since been corrected. In addition, we have tightened enforcement of the existing regulations on contracting external debt.

9. Most quantitative Indicative Targets (IT) for end-June and end-September were also met. These include the IT on the increase in the BoA credit to the general government, and the floor on clearance of central government domestic arrears. We expect these ITs to have been met for end of December as well. However, the ceiling on accumulation of central government domestic arrears was not met. The results of a survey of five central government ministries (Health, Justice, Transport and Infrastructure, Defense, and Education and Sport) and the General Directorate of Taxation (GDT) show an accumulation of 1.1 billion lek of new arrears. The arrears accumulated in the third quarter amounted to 0.4 billion lek (about 0.03 percent of GDP). The bulk of government arrears were accumulated by the GDT and the Ministry of Transport (Albania Road Authority). All arrears accumulated in the first and second quarters were repaid in the subsequent quarters and the stock of new arrears accumulated in 2014 currently stands at zero. We will take measures to prevent future recurrence (see below), but concrete results may take time.

10. The original timeline for the auditing of arrears proved overambitious. The requirements of completing the first audit by the external auditor, initially envisaged for July, and auditing 20 percent of outstanding nontax claims, envisaged for September, were completed in November. There was a donor-related delay in the contracting of the auditor, which took place in July rather than May. The auditors' preliminary report exceeded the requirements of the two structural benchmarks (SB) because it covered about 70 percent of the nontax claims (in value) as of mid-November 2014. The preliminary report did not find major and systematic problems with the clearance process but in certain cases identified problems related to contracting and procurement at the time the projects were signed. There were challenges in following the first-in first-out principle in part because of difficulties in verifying older claims. We will review the auditors' recommendations and will prepare an action plan for the Arrears Committee to address these deficiencies by mid-

February (the action plan, once adopted, will be posted on the MoF website). The SB on the contracting of an external auditor to conduct verification of arrears payments on tax refunds has been delayed because of funding constraints, which have since been resolved. We will finance the work of the auditor with our own resources and will sign the contract by end-March 2015. The SB on the purchase of a new IT server for the treasury system, initially scheduled for end of September 2014, has been delayed until the first quarter of 2015 due to procurement delays.

11. Although other SBs experienced delays, these were for the most part warranted.

- We have finalized preparations in the treasury system (AGFIS) for the disaggregation of multi-year commitments by individual outer-year allocations, and registration of multi-year commitment limits controlled with the respective allocations. As a result, we have introduced multi-year commitment limits in the 2015 budget submitted to Parliament. However, as envisaged under the recently adopted PFM strategy supported by donors, the changes in the Procurement Law, the Financial Management and Control Law, and the Budget Law have been delayed until end-2015.
- The development of a corporate strategy for medium- to long-term capacity building at GDT, supported by IMF TA, has been delayed to March 2015 to avoid interfering with the installation of new IT software.
- The SB on the approval of a pension reform strategy was met well ahead of schedule, and the new law has become effective on January 1, 2015.
- Finally, changes to the regulatory framework for investment funds on asset valuation and liquidity requirements, initially expected by the end of September 2014, have not been completed due to the need for additional technical assistance from the IMF and World Bank. We expect these changes to be completed by June 2015.

ECONOMIC POLICIES FOR 2015

A. Fiscal Consolidation

12. We commit to continuing with fiscal consolidation, as planned, to lower debt-related vulnerabilities that hamper growth and cause macroeconomic instability. We commit to achieving the 2015 program deficit target, including new guarantees (excluding rollover), of 4.8 percent of GDP, as well as the programmed ceiling on expenditure. Doing so will allow us to bring down public debt as a share of GDP for the first time since 2010, despite the significant energy-related spending next year. Over the medium term, we are committed to lowering the public debt-to-GDP ratio (including guarantees and local government debt) to less than 60 percent by 2018 (below 64 percent by the end of the program in 2017). We also commit to limit new non-energy sector guarantees in 2015-17 to anchor the expected decline in public debt. We will work closely with our international partners, including the IMF, to strengthen our medium-term budget framework.

13. At the same time, we are implementing measures to support critical employment-generating sectors of the economy. In particular, the government has exempted from custom duties some agricultural inputs (e.g., wheat, flour, maize, poultry, animal food preparation, at the cost of 0.2 billion lek), and increased subsidies to the textile sector (0.2 billion lek). In addition, employment in public administration (e.g., police, teachers) will increase to meet pressing needs (2.5 billion lek).

14. To achieve the fiscal deficit objectives, we have adopted a package of fiscal adjustment measures. On the revenue side, the measures include:

- i) increase in the excise tax on cigarettes from 90 lek to 110 lek (savings of 4 billion lek, including VAT impact);
- ii) increase in the circulation tax (national tax) on gasoline and diesel by 10 lek per liter (savings of 6.7 billion lek, including VAT impact); and
- iii) increase in the withholding tax for interest, rent, dividends, and capital gains from 10 percent to 15 percent, in line with the tax on other personal income (savings of 5 billion lek).

On the spending side, we plan to achieve savings from improved targeting of disability benefits and through restraint in capital spending relative to levels we had envisaged at the time of the first EFF review. Moreover, we have revised downwards our interest spending projections to more accurately reflect spending needs over the medium term. In addition, local government debt will stay at the 2014 level during 2015–19 to support the fiscal effort. All these measures will become effective on January 1, 2015, and have been incorporated in the 2015 budget approved by Parliament in December 2014.

15. We recognize that energy sector spending (in the form of public guarantees) poses a heavy fiscal burden. Public guarantees to the sector have increased to 3.2 percent of GDP, with a large share accruing over the past three years, contributing to the increase in public debt. The financial gap in the electricity sector is projected at US\$150 million in 2014, reflecting the low level of collection, large network losses, and tariffs that are set below cost recovery. Because of these chronic structural problems and costs associated with electricity sector reform, guarantees to the sector will continue to exert significant budget pressure over the medium term. We commit to implementing an ambitious set of structural reforms in the sector (see below) that will remove the need for government guarantees by 2020. Although the energy sector’s financial gap is expected to decline over time as a result of reforms, the government will be obliged to assume the fiscal burden in the meantime. We therefore aim to limit new energy guarantees (excluding rollover) to 13.1 billion lek in 2015, 8.8 billion in 2016, 5.8 billion lek in 2017, 4.8 billion lek in 2018, 1.3 billion lek in 2019, and zero in 2020. To better track the impact of government guarantees on the government’s fiscal position, we will monitor the overall fiscal balance including government guarantees and show explicitly as a memorandum item in budget execution reports the amount of government guarantees to electricity companies, in line with the practice we have recently adopted when submitting the 2015 budget to Parliament. We will also publish on the Ministry of Finance’s (MoF) website details on all guarantees on a monthly basis. If government guarantees exceed the annual programmed amount, we commit to taking additional budgetary measures to offset the impact on the fiscal balance, including guarantees.

16. We are addressing emerging and potential risks to the baseline fiscal framework.

- **Electricity sector:** Notwithstanding the energy sector reform, the prospect of uncertain rainfalls would continue to pose fiscal risk. We will assess the situation in the context of future program reviews through a revised budget.

- **Property compensation:** In addition to payments of 1.0 billion lek in 2014 as compensation for outstanding cases brought against the Albanian government in the European Court of Human Rights (ECHR) in Strasbourg, the Court has begun to process another group of cases which are expected to be decided in 2015; total compensation for these claims could be 3 billion lek. In view of the precedents established by recent cases, additional claims for property compensation may be filed.
- **Capital expenditure risks:** The amount of outstanding (open) but unbudgeted investment projects exceeds the government's ability to absorb them in its Medium-Term Budget Framework (MTBF). To minimize risks, we plan to prioritize all outstanding infrastructure projects (which constitute the vast majority of unfunded projects) using transparent criteria with the aim of cancelling or rescheduling low-priority projects. As a first step, we will conduct a feasibility study of all these projects. Then a ranking of these projects will be approved by the Council of Ministers and posted on the MoF's and Ministry of Economy's websites. The MoF will also publish a list of all projects that will be part of its MTBF to signal its intention not to implement projects excluded from the list. We also plan to add a clause in all new contracts included in the budget stating that acceleration of project work without the MoF's approval will constitute violation of the contract and render null and void any obligations to pay for such work. Finally, we are implementing a module in EAMIS to enhance the tracking and monitoring of investment projects to ensure that contract work proceeds in line with budgetary commitments.
- **Revenue risks:** The 2015 budget includes a contingency of 0.1 percent of GDP in the event of revenue shortfalls. Appropriations allocated under this category will be saved if revenues underperform to safeguard program targets. Any decision to release these funds will be made in consultation with Fund staff, in the context of a supplementary budget request to Parliament in the second half of the year.

17. Tax administration reforms are advancing. We are finalizing preparations for the updating of the IT system at GDT; 8 modules out of 11 have been completed, e-filing is well advanced, and installation of the IT hardware at the central server site (NAIS) is expected by February. The GDT is also preparing a new corporate strategy for medium and long term capacity building and the establishment of a Risk Management Unit (RMU) in GDT. Extensive training is ongoing, including through the Fiscal Academy. The strategy will be drafted by the MoF staff in cooperation with the Fiscal Academy and GDT. The Risk Management Unit is currently active at GDT but will be reviewed in light of the structural changes expected before the end of March 2015.

18. A key priority in 2015 is the reform of the tax refund scheme. The responsibility for tax refund payments, which has been transferred from the GDT and GDC to Treasury since early 2014, will be refined further to ensure that refunds are paid accurately and on time. The new VAT law which passed in July 2014 and became effective on January 1, 2015, eliminates the requirement for compulsory audit of VAT refunds, and establishes risk criteria as the basis for undertaking an audit. Risk-based auditing is expected to begin by June 2015. Prior to that, the risk module for VAT refunds is expected to be operational by March 2015. Restructuring of GDT administration will lead to the creation of a dedicated Refund Unit to coordinate refund efforts on a country basis, and to dedicated functions at regional offices to undertake operational functions related to VAT refunds. Legal changes will also be needed to ensure that the Refund Unit/Directorate has the final authority to decide on refunds.

19. Work by the external consultant on customs administration will continue. The external consultant has assisted the General Directorate of Customs (GDC) in full and partial inspections and detections. A new code of conduct for customs was approved in November 2014. The big boost in collections expected at the time of signing has not yet been realized. The main problem lies in inconsistent application of valuation rules and procedures, and informality.

20. Closer coordination between GDT and GDC would enhance tax administration efforts. To leverage each other's potential and thus improve tax compliance, the GDC and GDT will strengthen cooperation. They will take measures to improve compatibility of their IT systems to enable access to each other's databases. They will also establish joint controls and audits of excisable taxpayers by end of June. Nevertheless, the merger of the two departments is a medium-term objective; any decisions related to this objective will be taken in consultation with the IMF.

21. We are reinforcing public financial management to prevent accumulation of new arrears. We plan to extend AGFIS to 15 budget institutions (including line ministries accounting for 60 percent of the budget) and one local government by the end of September 2015. Several of the new functional configurations will become operational in early 2015, with the rest scheduled to begin by September 2015. Progress however is contingent upon the upgrade of the AGFIS server, which is expected to be completed by the end of July 2015. Changes in the procurement, financial management and control, and budget laws will also further strengthen the MTBF, following the introduction of multi-year commitment limits.

22. Arrears payments will continue to advance in tandem with progress in auditing and verification of paid arrears. The High State Audit will continue to participate in regular meetings of the arrears clearance committee. In addition, the audit by the external auditor of non-tax claims paid will continue. We expect to have 75 percent of non-tax claims paid through end of January 2015 to be audited by April 2015. Similarly, the verification of arrears payments on tax refunds is expected to be completed by April 2015. We will limit the amount of arrears clearance in the first trimester of 2015 to 10 billion lek. Following the findings of the auditors' reports and after consultation with IMF staff, the clearance process may be accelerated beyond the annual budget allocation, currently amounting to 20 billion lek. However, if at any stage of the process there are indications that the arrears clearance process is not proceeding in accordance with the Arrears Prevention and Clearance Strategy (APCS), the arrears clearance process will stop pending consultation with IMF staff. Total arrears payments under the APCS will be limited to 72 billion lek. Any arrears above this amount will be paid using our own resources.

23. We commit to introducing a valuation-based property tax by end-2016. A working group has been established and different options are being reviewed. The reform will be undertaken in consultation with TA from the IMF. As a first step, we plan to introduce a fiscal cadastre to assess tax for each property by end-2015.

24. Pension reform, approved by Parliament in July 2014, has become effective in 2015. Key features include equalizing the minimum contributory wage with the official minimum wage, and increasing the contributory period and retirement age, while removing the benefit ceiling. The new law also indexes pension benefits to inflation. Persons above the age of 70, who do not qualify for pension, would receive a means-tested social pension. A draft law that will also increase the retirement age and contribution rates for the supplementary pension scheme for high government officials has also been prepared and will be approved by Parliament in the first quarter of 2015.

25. We are intensifying efforts to reform the current system of disability benefits. Spending on disability benefits has risen sharply in recent years, in part because of weak controls and fraud. We are working with the World Bank on a medium-term project to reform disability benefits. It envisages the revision of assessment criteria by introducing a social model component, establishing a new multi-disciplinary commission to assess eligibility, and introducing a management information system (MIS) to cross check accuracy of applicants' eligibility. This reform will begin in 2015, but will take time to complete and yield savings. Therefore, for 2015 we have issued and published a decree

that reduces the additional disability benefits for those pursuing higher education degrees, and the support provided to families which have more than one person with disability (currently 50-100% of the disability benefit). The estimated savings from these reforms are 1.1 billion lek.

B. Monetary and Exchange Rate Policy

26. 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 average CPI inflation of 3 percent over the medium term, with a tolerance band of ± 1 percentage point to account for supply-side shocks and inflation inertia. The monetary policy decision-making process will be guided by the deviation of forecasted inflation from this objective, while striving to avoid excessive volatility in the real and financial sector. While the target applies to headline inflation, we will also monitor core inflation as a measure of underlying inflationary pressures. The inflation performance will continue to be monitored under the program through an Inflation Consultation Clause (see TMU).

27. The exchange rate remains fully flexible and determined entirely by market forces. The BoA relies on indirect instruments to steer financial market interest rates and conducts its monetary policy through open market operations. This regime complements our price stability objective and supports our operational framework for monetary policy. The BoA will also aim to maintain adequate reserve coverage over the program. 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 would violate our obligations under Article VIII of the IMF's Articles of Agreement. Also, we will not introduce or intensify import restrictions for balance of payments reasons.

28. Monetary policy is likely to remain accommodative over the near term. The BoA will continue to assess its monetary policy stance in the context of the inflation outlook and the strength of the transmission mechanism. Inflationary pressures remain weak, given below-potential growth, low inflation abroad, and inflation expectations skewed to the downside. In these circumstances, monetary policy is likely to remain accommodative, augmented by the BoA's forward guidance to the financial markets. The monetary policy transmission mechanism remains hampered by the uncertainties around the economic outlook and high risk aversion among the real and the financial sector agents. However, the improved performance of the banking system and ameliorated

conditions in external financial markets, coupled with the higher confidence in the economy, are expected to strengthen the transmission of monetary stimulus in the economy.

C. Safeguarding Financial Sector Stability

29. The BoA is proceeding with implementing the recommendations of the 2013 FSAP. The FSSA found that the BoA has ensured a high level of compliance with the Basel Core Principles for Effective Banking Supervision. Several of the specific recommendations have been implemented under the World Bank's Development Policy Loan (DPL). In particular, the BoA has implemented legal and regulatory changes aimed at strengthening the banking system's resilience. In the first quarter of 2014, the BoA's Supervisory Council approved a new regulation on managing the risk of banks' large exposures, a new guideline for systemic banks on preparing recovery plans, as well as changes to the supervisory policy consolidating the risk-based approach to supervision. The BoA is continuing efforts to strengthen its stress-testing toolkit in line with FSAP recommendations.

30. The BoA is further reinforcing supervision. The overall supervisory process and on-site examinations in particular have focused on imposing an enhanced quality of governance and risk administration in the banking system, emphasizing the role of internal policies, systems, and controls. The BoA will continue to monitor the banks' resilience to risks, in order to maintain an adequate capitalization and liquidity position, ensuring the stability of the banking system.

31. Preparations for adoption of more stringent capital adequacy requirements are ongoing. Since the beginning of 2014, the BoA has established parallel requirements for regulatory reporting on capital adequacy by banks based on the new regulation (standardized approach Basel II), paving the way for its smooth adoption by the end of the year.

32. We plan to undertake additional measures to facilitate problem loan restructuring. These include cooperation with the World Bank to facilitate loan restructuring through developing recovery and resolution plans for large problem borrowers. We are also working on a review of the commercial bankruptcy law, for which we plan to seek IMF technical assistance, in order to facilitate private balance sheet restructuring.

33. Recent regulatory and legal changes to facilitate collateral execution and increase loan write-offs are showing modest results. The changes to the civil procedures code, which came into effect in September 2013, intended to minimize execution suspension gaps. This has contributed to

an increase in recoveries (value of collateral collected) by 36 percent in the twelve months through September. However, the volume of loans that remains in the process of execution is very large, at 20 percent of the total outstanding. The amendment to the Tax Law in April 2014 (a tax guideline had been issued in June 2013) to remove legal and technical issues impeding loan write-offs, has had a relatively limited effect, with an increase of loan write-off by 2.3 percent (or 0.15 percent of the NPL portfolio). A new regulation requiring mandatory write-off of loans categorized as "lost" for more than three years came into force at the beginning of 2015 and is expected to reduce NPLs by 3 percentage points.

34. The authorities remain committed to implementing the amendments of the Albania Financial Supervisory Authority's (AFSA) law to ensure its independence. Parliament approved several candidates to fill vacancies on the AFSA Board in late December 2014; the remaining positions are expected to be filled in early 2015. Once this process is completed, we expect that many technical regulations which are currently pending will be approved, especially the introduction of the new insurance law. The process is also dependent on approval of the amendments to the civil servant law. We remain committed to finalizing these reforms in line with FSAP recommendations.

35. We are continuing efforts to strengthen the regulatory framework for investment funds. The Board of the AFSA has approved the capital requirement regulation as well as the disclosure regulation. However, changes to the regulations on liquidity requirements and asset valuation have moved more slowly than planned, due in part to the complexity of the reform and the need to for additional technical work to assess the pace of implementation. We are continuing to work with IMF and World Bank technical experts to formulate the new regulations. In the meantime, we will not issue or approve any new entrants into the investment fund sector until all regulatory changes are in place. We expect to have the new regulations in place by June 2015.

36. The BoA is taking measures to implement recommendations of the 2014 safeguards assessment. In particular, the Supervisory Council has established an audit committee comprising five members of the Supervisory Council (excluding the Governor and Deputy Governors) with a mandate of three years (with the right of re-appointment). The Audit committee will assist the Supervisory Council in fulfilling its oversight responsibilities for the financial reporting process, the system of internal control, the audit processes, and the bank's process for monitoring compliance with laws, regulations, and code of conduct. It will meet regularly, including with the BoA's external auditor at the planning stage and conclusion of the external audit, without the Governor or Deputy

Governor present. The chairman and deputy chairman of the Supervisory Council, the Inspector General, employees of the BoA, and representative of the external auditor may participate in the meetings of the Audit committee, but without voting rights. In addition, we have completed the terms of reference for the hiring of an external technical expert to assist the Audit Committee and we expect the contract to be signed by the end of February. The external expert should have extensive audit or accounting experience with a reputable international audit firm. Once a new Inspector General is appointed, internal and external assessments of the internal audit function are planned for 2015.

D. Structural Reforms

Business climate

37. The government is committed to creating a business friendly environment. It has established the National Economic Council, as an advisory body for the government, which includes representatives from the business community, key ministries, and multilateral partners. It is now finalizing steps to create an investment council, funded by the EBRD, which will address business community concerns. The inter-ministerial working group created to implement “Doing Business” reforms, with support by the IFC, worked on a range of reforms, including paying taxes, starting a business, access to electricity, and registering property. As a result of these efforts, Albania has recorded the biggest improvement (from 108th to 60th place) among all countries in its Doing Business rank. Reforms will continue next year focusing on resolving insolvency, starting a business, paying taxes, registering property, enforcing contracts, and trading across borders. The high-level government working group is already working on a range of measures to facilitate and improve performance in these indicators.

38. Additional progress will be made in simplifying business registration procedures. The National Registration Center (NRC) is currently testing the online business registration procedures; these could become operational in early 2015. We are also assessing the feasibility of creating a single service window for businesses by merging the NRC and the National Licensing Center (NLC) into a single entity.

Energy Sector

39. In addition to addressing the fiscal risks in the energy sector, we are moving forward with an integrated approach to addressing problems in the sector:

- *Institutional changes.* We have prepared a draft power sector law that will restructure the institutional relationship between the three public power companies responsible for generation, transmission and distribution (KESH, OST, and OSHEE), and move toward further market liberalization, in line with the EU's 2009 Electricity Directive. Specifically, the responsibility for wholesale purchases from independent producers will shift from KESH to OSHEE. The draft law also sets in place a schedule for moving all medium-voltage customers out of the regulated tariff structure by end-2017, beginning with 35KV customers by end-2015 (on completion, the share of de-regulated consumption would increase from 13 to 40 percent). The draft law also clarifies the responsibilities and full independence of the energy sector regulatory authority (ERE). The draft law was submitted to Parliament in December 2014, and implementation will begin in the first quarter of 2015. The shift of 35KV customers out of the regulated tariff structure is a SB under the program for December 2015.
- *Tariff adjustments.* The three public power companies submitted applications to ERE for tariff adjustments, which were approved by ERE and went into effect in January 2015, as follows:
 - restructuring of the retail tariff for households by eliminating the subsidized lower block. As a result, the current tariff for 2012–2014 of 7.7 lek/kWh for consumption of up to 300 kWh and 13.5 lek/kWh for consumption above that threshold was replaced with a single tariff of 9.5 lek/kWh;
 - increase in tariffs for commercial users ranging from 10 to 39 percent; and
 - adjustment in the purchase price for electricity from independent power producers to reflect current import prices, based on a benchmark price from the Budapest power exchange.

We certify that these changes are consistent with the estimated funding gap included in the fiscal framework. We will also undertake a review of our current tariff methodology, with a view to moving toward more frequent and automatic adjustments based on market pricing, in cooperation with the World Bank.

- *Improvements in electricity collections and legal enforcement.* In October 2014, we launched a campaign to enforce criminal penalties for electricity theft and disconnect service for nonpayment of bills. The criminal code has been revised to make power theft and damages to the electricity system infrastructure punishable by imprisonment rather than just an administrative offence. As a result, we were able to reduce electricity distribution losses in

October 2014 to 35 percent, compared with 45 percent in October 2013. For 2014 as a whole, we expect distribution losses to have averaged 38 percent; we are committed to further reducing distribution losses by about 5 percentage points per year, to 15 percent by 2019. The level of distribution losses will be monitored as an indicative target under our program with the IMF. We are also committed to improving our collection rate on amounts billed from 83.4 percent in January–October 2014 to 93 percent in 2019. Our efforts in this area will be supported by a World Bank project that will finance targeted investments in priority areas to accelerate cash collection and reduce losses, including metering, grid infrastructure, and upgrades to the commercial billing and collection system. The government is also committed to ensuring that budgetary, non-budgetary, and local government institutions make timely payment of electricity bills. These efforts will be supported by a restructuring of the state electricity companies with a view to improving efficiency. In this regard, the distribution company will have a performance management contract. We are currently in consultation with an expert who submitted a report in mid-December 2015. We expect a contract to be signed in mid-2015.

Property rights

40. Reform of the land registry/cadastre is critical for securing property rights and attracting investment. Given the multiplicity of conflicting claims, we are committed to resolving existing uncertainties in titling and property rights. By mid-2015, we plan to prepare a strategy to clarify the legal environment and verify ownership in the land registry and cadastre.

41. Reform of the property compensation system is essential. In view of the precedents established by recent court cases in Strasbourg, additional claims may be filed unless we come up with a credible domestic remedy. We understand the importance of acting quickly to avoid significant fiscal and reputation risks, and are currently preparing an action plan to be finalized by end of June 2015 in order to determine available options, including revision of the legal framework on property compensation. An interagency working group, headed by the Deputy Prime Minister, is working to assess the total cost of compensation claims and identify available land for compensation in kind. In this regard, the government has recently adopted a decision that transfers ownership of state-owned land from local governments to the Agency for Restitution and Compensation of Property for use by the restitution fund.

Local government reform

42. Local government reform is proceeding as planned. The Parliament approved a local government law in July 2014. According to the Law, the number of local government units will decrease to 61 from the 373 communes and municipalities currently in place. The number of regional councils will remain unchanged at 12. This is expected to be implemented after local elections in mid-2015, and once in place, it could result in savings of about 4 billion lek annually. In addition, an inter-ministerial working group is preparing the new national decentralization strategy which aims to increase the number of functions and competencies of local government, while minimizing risks to fiscal sustainability.

Public administration reform

43. Improving the quality of services provided by the public sector is a priority. We are taking measures to make the public administration more efficient and professional, including by continued training. Having in place a professional public administration will be critical in preparation of EU accession negotiations and for combating crime. In addition, we intend to strengthen capacity at the local level, in order to improve services, transparency, and accountability.

E. Statistics

44. INSTAT will continue efforts to improve the quality of statistics. A revised time series of annual GDP by production and expenditure approaches was published in June 2014 that incorporated improvements in compilation and methodology in line with assistance from the IMF and EU. In addition, INSTAT is in the process of: 1) setting up an efficient system of administrative data exchange for statistical purposes; 2) improving data processing and verification procedures; 3) establishing and promoting electronic data reporting; and 4) improving compilation of the short-term indicators of economic activities. Our objective is to meet the requirements of the EU ESA 2010 Transmission Program and Special Data Dissemination Standard of the IMF.

PROGRAM MONITORING

45. We anticipate that the fourth program review will take place on or after April 15, 2015, and require observance of the conditionality for end-December 2014. Thereafter, reviews will occur every four months starting on or after July 15, 2015, and require observance of the conditionality for the most recent test date. The final review will take place on or after February 15, 2017 and require observance of the conditionality for end-November 2016.

Table 1. Albania: Quantitative Performance Criteria and Indicative Targets for 2014–15
(In billions of leks, unless otherwise indicated)

	2014											2015			
	Mar			Jun			Sep			Dec			Apr	Aug	Dec
	Prog.	Prog. Adj.	Act.	Prog.	Prog. Adj.	Act.	Prog.	Prog. Adj.	Act.	Prog.	Proj.	Act.	Prog.	Prog.	Prog.
I. Quantitative Performance Criteria															
1. Floor on net international reserves of the BoA (EUR million)	1289		1463	1330		1495	1330		1525	1330		1539	1507	1507	1507
2. Ceiling on general government overall cash deficit (cumulative) 2/ 3/	16.0	16.0	0.8	20.3	20.3	3.1	31.6	31.6	4.7	58.8	38.5	...	16.9	32.7	52.1
3. Ceiling on general government expenditure (cumulative) 3/	...		...	194.9		178.3	300.9		271.4	423.5	406.4	...	141.6	292.9	463.6
4. Ceiling on the increase of Bank of Albania credit to the general government (cumulative) 4/	0.0		-0.1	0.0		0.0	0.0		0.0	0.0	0.0	...	0.0	0.0	0.0
II. Continuous Performance Criteria															
5. Accumulation of new external payment arrears by the general government (EUR million)	0.0		0.0	0.0		0.04	0.0		0.0	0.0	0.0	...	0.0	0.0	0.0
III. Inflation Consultation															
6. 12-month percent change in consumer prices															
Upper outer band	5.0			5.0			5.0			5.0			5.0	5.0	5.0
Upper inner band	4.0			4.0			4.0			4.0			4.0	4.0	4.0
Actual/center point	3.0		1.9	3.0		1.6	3.0		1.7	3.0		1.3	3.0	3.0	3.0
Lower inner band	2.0			2.0			2.0			2.0			2.0	2.0	2.0
Lower outer band	1.0			1.0			1.0			1.0			1.0	1.0	1.0
IV. Indicative Targets															
7. Ceiling on subsidies to the energy sector	...		...	...		...	...		...	...	...	...	4.4	8.7	13.1
8. Average distribution losses by energy distribution company (OSHEE) (percent, cumulative from beginning of year)	...		...	...		...	...		...	...	...	37.8	37.0	34.5	34.0
9. Ceiling on contracting of nonenergy guarantees	...		...	...		...	...		...	...	...	...	0.0	0.0	0.0
10. Ceiling on accumulation of central government domestic arrears (as reported by MoF's quarterly survey on arrears accumulation)	0.0		0.4	0.0		1.1	0.0		0.4	0.0	0.0	...	0.0	0.0	0.0
11. Floor on clearance of central government domestic arrears 5/	0.0		1.0	1.0		19.1	1.0		25.9	14.2	35.0	...	5.0	10.0	15.0

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

1/ All adjusters are described in the Technical Memorandum of Understanding (TMU).

2/ Data revisions have led to a downward adjustment of the end-March cash deficit by 1.2 billion (from 2.0 billion in EBS/14/71 to 0.8 billion now), or 0.08 percent of GDP.

3/ Excluding arrears payment. The assessment of performance in 2014 will also exclude new energy and nonenergy guarantees (which were not part of the original PC but are now included in the fiscal framework).

4/ Indicative target through December 2014.

5/ General government for March 2014.

Table 2a. Albania: Structural Benchmarks for 2014–15 under the Extended Fund Facility Arrangement			
Conditionality	Test Date	Status	Remarks
Structural Benchmarks			
I. Public Financial Management			
<i>Arrears Clearance</i>			
1. Contract an external auditor with a mandate to conduct risk-based audits of arrears payments.	End-May 2014	Met with delay.	Contract signed in July.
2. Publish a report on arrears paid (on a quarterly basis) on the MoF website (starting in June 2014).	Continuous	Met.	
3. The external auditor to complete first audit of arrears payment.	July 15, 2014	Met with delay.	Audit completed in November; delay related to late signing of auditor's contract.
4. The external auditor to complete auditing of 20 percent of outstanding non-tax claims paid during January–June 2014.	End-Sept. 2014	Met with delay.	Audit completed in November; delay related to late signing of auditor's contract.
5. Contract an external auditor to conduct verification of arrears payments on tax refunds (see TMU).	End-Sept. 2014	Not met.	Delay due to funding constraints. Now expected in March 2015.
6. MoF to purchase a new IT server for the treasury system.	End-Sept. 2014	Not met.	Now expected in March 2015.
<i>Arrears Prevention</i>			
1. MoF to report quarterly survey results on new arrears accumulation (starting with the period from January-March 2014) among five key ministries (Ministries of Transportation, Health, Education, Defense, and Justice), and GDT (starting with the period from April–June 2014).	Continuous	Met.	

Table 2a. Albania: Structural Benchmarks for 2014–15 under the Extended Fund Facility Arrangement (Concluded)

Conditionality	Test Date	Status	Remarks
2. MoF to expand the reporting of quarterly survey on arrears accumulation to five additional ministries (Ministries of Interior, Agriculture, Finance, Economy, and Social Welfare) (starting with the period from October–December 2014) and publish it on the MoF's website.	Continuous		
3. 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-Dec. 2014	Not met.	Multi-year commitment limits introduced in November. Changes in laws delayed to 2015 in line with PFM strategy supported by donors.
<i>II. Tax Administration</i>			
1. The GDT to develop a corporate strategy for medium- to long-term capacity building.	End-Dec. 2014	Not met.	Now expected in March 2015.
2. Establish and commence operations of a permanent Risk Management Unit (RMU) in GDT (see TMU).	End-March 2015		RMU has been set up in October 2014. Risk modules under implementation.
<i>III. Expenditure Policy</i>			
1. Council of Ministers to approve a pension reform strategy.	End-Dec. 2014	Met.	Approved in July 2014.
<i>IV. Financial Sector</i>			
2. In agreement with BoA and Albanian Financial Supervisory Authority (AFSA), amend the regulatory framework for investment funds on asset valuation, liquidity requirement, and capital adequacy requirement.	End-Sept. 2014	Not met.	Capital adequacy requirement was amended. Other changes expected in June 2015.

Table 2b. Albania: Proposed Structural Benchmarks for 2014–15 under the Extended Fund Facility Arrangement

Conditionality	Test Date	Status	Remarks
Structural Benchmarks			
<i>I. Public Financial Management</i>			
1. The MoF to prepare and publish an action plan with measures to address weaknesses identified in the auditor's report on non-tax claims payments.	Feb. 15, 2015		
2. The government to prepare a report on the prioritization of all outstanding infrastructure projects, including a ranking approved by the CoM using transparent criteria; both the report and criteria for ranking will be published on the MoF and MoE websites.	End-June 2015		
3. External auditor to complete the audit of 75 percent of outstanding non-tax claims paid through January 2015.	End-Apr. 2015		
4. External auditor to complete verification of arrears payments on tax refunds.	End-Apr. 2015		
5. Roll out the AGFIS to 15 budget institutions (60 percent of budget).	End-Sept. 2015		
6. Change the Procurement Law, the Financial Management and Control Law, and the Budget Law related to multi-year commitment limits (the limits on commitments made in the current year for both the current year and each outer year).	End-Dec. 2015		
<i>II. Tax Administration</i>			
1. Install the new IT software at the central server site (NAIS) and commence testing.	End-Feb. 2015		
2. Commence auditing of tax refunds on a risk basis.	End-June 2015		
3. Create a fiscal cadastre to assess tax for each property.	End-Sept. 2015		
4. The GDT to develop a corporate strategy for medium- to long-term capacity building.	End-Mar. 2015		
<i>III. Financial Sector</i>			
1. Hire an external expert to assist the Audit Committee of the Bank of Albania.	End-Feb. 2015		
2. Albanian Financial Supervisory Authority (AFSA) to amend the regulatory framework for investment funds on asset valuation and liquidity requirement.	End-June 2015		
<i>IV. Energy Sector</i>			
1. Prepare a quarterly survey of the gross consolidated arrears of the electricity sector (KESH, OST, OSHEE) to the private sector (starting with the period January-March 2015).	Continuous		
2. Remove 35KV medium-voltage consumers from the regulated tariff system.	End-Dec. 2015		

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 U.S. dollar at lek 103.17 = \$1, and to the SDR at lek 158.05 = SDR 1. The gold price in euro is set at 920.18 oz = €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, 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 options); and all arrears on principal or interest payments to commercial banks, suppliers, or

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

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.

Adjustor

8. **The floor on net international reserves** of the BoA will be adjusted downward by any shortfall in external budget support relative to the programmed amount. Budget support is defined as non-project financial assistance that is provided to the central government. The programmed amount of budget support is lek 31.1 billion for 2014 and lek 76.2 billion for 2015.

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

Definitions

9. 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	Code
Financing (Cash)	
Domestic	
Privatization receipts	B/1160000-116ZZZZ
Domestic borrowing	
Central	000-009/1600000-169ZZZZ
Local	010-999/1600000-169ZZZZ
Other	
Change in balance of TSA bank account	001/010-ZZZ/5120100/TH000; 001/5120100/TH008; 001/5120100/TH009; 001/5120100/TH010; 5120100/TH011
Change in balance of S&HII's bank account	5000000-54ZZZZZ/5800000-58ZZZZZ
Trust accounts (3020)	4660000-466ZZZZ
On-Loan's Principal (3030)	2500200
Liability to SSI (3015) (receipts (3016) minus payments (3017))	4351291; 4351298-4351299
Variance Accrual-Cash [4030=4019 (4011->4018)-4029(4021->4028)]	More detailed codes submitted to staff
Float (3060)	001/5200000/B0000-52ZZZZZ/BZZZZ
Transitory accounts - Guaranties on Custom Duties (3021)	4701100
Others-Float (mean time)	

Foreign	
Long-term Loan(Drawings) (1010=2600(00/1700000-99/174ZZZZ)/1030/1040)	
Change of statistical account (1040)	More detailed codes submitted to staff
Repayments 1030= (2081->2082)	More detailed codes submitted to staff
Memo: arrears clearance	

10. In determining the overall cash balance, the following considerations will apply:²

- 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.

11. The overall cash deficit estimated below the line will also include all new issues of government guarantees (excluding rollover) for the energy and non-energy sectors.

12. 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.

² All cash balance data come from Treasury.

Reporting

13. Data, including new guarantees and 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 30 days after the test date for March, June, and September test dates. For December test dates, data should be provided no more than 60 days after the test date.

Adjustor

14. 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 15 billion in a given year. The programmed amount of privatization receipts in 2015 is zero.
- the excess (shortfall) of new energy guarantees, excluding rollover, issued during the course of the year up to a maximum of the annual budgeted allocation (lek 13.08 billion in 2015). The adjustor will not apply to the end-year amount of new energy guarantees, excluding rollover. Energy guarantees are defined as guarantees issued by the general government for the benefit of the electricity operators KESH, OST, and OSHEE. The programmed amount of new energy guarantees is lek 4.36 billion for April 2015 and lek 8.72 billion for August 2015.

C. Cumulative Ceiling on General Government Expenditure Excluding Arrears Payment

Definitions

15. General government expenditure is defined as general government spending on personnel, interest, operations and maintenance, subsidies, social insurance outlays, local government expenditures, other expenditures (social protection transfers), capital expenditure, reserve and contingency funds, and net lending, as reported in the government's monthly fiscal indicators table. For the purpose of this target, arrears payments are excluded from the calculation. The amount of arrears payment is identical to the number used in the calculation of the performance criterion on cash deficit (Section B).

Reporting

16. Data will be provided to the Fund using current exchange rates with a lag of no more than 30 days after the test date for March, June, and September test dates. For December test dates, data should be provided no more than 60 days after the test date.

Adjustor

17. The **ceiling on expenditure** of the general government will be adjusted upward (downward)—that is, the expenditure ceiling will be increased (reduced)—by:

- 50 percent of the privatization receipts, up to total privatization receipts of lek 15 billion in a given year. The programmed amount of privatization receipts in 2015 is zero.
- the excess (shortfall) of new energy guarantees, excluding rollover, issued during the course of the year up to a maximum of the annual budgeted allocation (lek 13.08 billion in 2015). The adjustor will not apply to the end-year amount of new energy guarantees, excluding rollover. Energy guarantees are defined as guarantees issued by the general government for the benefit of the electricity operators KESH, OST, and OSHEE. The programmed amount of new energy guarantees is lek 4.36 billion for April 2015 and lek 8.72 billion for August 2015.

18. The **ceiling on expenditure** of the general government will be adjusted upward—that is, the expenditure ceiling will be increased—by:

- Excess of one-off revenues over programmed amounts, up to a maximum of lek 3 billion. One-off revenues are defined as revenues that accrue only in the current year (e.g., one time fees from mobile operators).
- The excess of project grants from the programmed amount, up to a maximum of lek 15 billion in a given year. The programmed amount of project grants in 2015 is lek 10 billion.

II. CONTINUOUS PERFORMANCE CRITERIA

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

Definitions

19. External **debt** is determined according to the residency criterion. The term “debt”³ 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 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);

³ As defined in Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements, Decision No. 6230-(79/140), as amended.

- 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.

20. 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.

21. 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.

22. 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.

23. The authorities will not accumulate any external arrears. This performance criterion does not cover arrears on trade credits.

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

Reporting

25. 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 each month.

Adjustor

26. The performance criterion on the accumulation of new external payment arrears by the general government will exclude any arrears relating to obligations prior to 2014 and which existed prior to the program but are now recognized.

III. INFLATION CONSULTATION

27. 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 Subsidies to the Energy Sector

Definition

28. Subsidies to the energy sector are defined as new guarantees issued by the general government for the benefit of the electricity operators KESH, OST, and OSHEE, excluding rollover.

Reporting

29. Data will be provided to the Fund by the Ministry of Finance on a monthly basis with a lag of no more than thirty days.

B. Ceiling on Average Distribution Losses by OSHEE

Definition

30. Average distribution losses are defined as the amount of electricity billed to consumers by the energy distribution company (*Operatori i Shperndarjes se Energjise Elektrike, OSHEE*), as a share of the total amount of electricity entering the distribution system. These are measured on a cumulative basis for each calendar year.

Reporting

31. Data will be provided to the Fund by the Ministry of Energy on a monthly basis with a lag of no more than thirty days.

C. Ceiling on Contracting of Nonenergy Guarantees

Definition

32. Nonenergy guarantees are defined as new guarantees issued by the general government, excluding those issued for the benefit of the electricity operators KESH, OST, and OSHEE.

Reporting

33. Data will be provided to the Fund by the Ministry of Finance on a monthly basis with a lag of no more than thirty days.

D. Ceiling on Accumulation of Central Government Domestic Arrears

Definition

34. Central **government domestic arrears** consist of domestic expenditure arrears of the central government and domestic tax refund arrears. Domestic expenditure arrears are defined as payments to residents determined by contractual agreements that remain unpaid 60 days after the due date specified by the contract, or, in the absence of a contractual definition, as determined by the law.

35. Domestic **tax refund arrears** are defined as obligations on any valid tax refund claims in accordance with tax legislation that remain unpaid 90 days after the claim is submitted.

36. For the purpose of this target, the accumulation of domestic arrears will be monitored through MoF's quarterly survey on arrears accumulation. The first survey, to cover the period from January-March 2014, will include the following part of the central government: Ministries of Transportation, Health, Education, Defense, and Justice. The next survey, to cover April-June 2014, will be extended to cover the General Directorate of Taxation. The Ministries of Interior, Agriculture, Finance, Economy, and Social Welfare will also be added in the survey for October–December 2014. These surveys will continue to be conducted quarterly on a continuous basis, with all Ministries to be included in the survey, beginning with April–June 2015. Tables 1 and 2 below 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 with 2014:Q1. The MoF should verify that the invoices/refunded claims reported in the survey are not already included in the arrears clearance database.

Reporting

37. The MoF should send to the Fund the consolidated data from the survey with a lag of no more than 75 days after each quarter.

E. Clearance of Central Government Domestic Arrears

Definitions

38. Central government domestic arrears consist of domestic expenditure arrears of the central government and domestic tax refund arrears. Domestic expenditure arrears are defined as payments to residents determined by contractual agreements that remain unpaid 60 days after the due date specified by the contract, or, in the absence of a contractual definition, as determined by the law. Domestic tax refund arrears are defined as obligations on any valid tax refund claims in accordance with tax legislation that remain unpaid 90 days after the claim is submitted. For the purpose of this target, domestic arrears consist of arrears submitted before December 31, 2013, that fall into the following categories:

- central government contracts;
- central government utility bills;
- disability benefits from social assistance program;
- special funds, including payments for ex-persecuted prisoners and expropriations related to public construction work, and other special payments approved by the Council of Ministers;
- court orders, excluding cases in land restitution and compensation;
- local government contracts financed by central government;
- child registration subsidies;
- civil emergency;
- VAT refunds; and
- CIT returns.

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

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

Reporting

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

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

Definitions

42. **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, advance distribution of profits, other technical receivables, and holdings of the Bank of Albania pension fund. For the purpose of this target, government securities will be valued at their original purchase price.

43. This indicative target will be elevated to a quantitative performance criterion, starting with the end-April 2015 test date.

Reporting

44. 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. Additional details on selected measures are provided below.

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

46. **Contract an external auditor to conduct verification of arrears payments on tax refunds.** The MoF should submit the Terms of Reference for the external auditor to the IMF for review before starting the tendering process.

47. **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.

48. The GDT to develop a corporate strategy for medium- to long-term capacity building.

The strategy should be developed in consultation with IMF TA.

49. Establish and commence operations of a permanent Risk Management Unit (RMU) in

GDT. The RMU should be tasked with leading the tax administration's day-to-day work in two major areas: (i) identifying, analyzing, and prioritizing major taxpayer compliance risks that need mitigation through compliance efforts; and (ii) developing integrated compliance strategies for compliance efforts that are designed specifically to mitigate the major risks prioritized under (i).

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

- a) require that the calculation of the unit value represent the proportionate share of the aggregate market value of the underlying assets of the fund;
- b) introduce capital adequacy requirements aligned with relevant E.U. regulations; and
- c) introduce liquidity requirements consistent with recent E.U. regulatory developments and the current level of development of the Albanian market.

51. Rollout the AGFIS to 15 budget institutions (60 percent of budget).

52. The government will expand the AGFIS to the following institutions: Council of Ministers, Ministry of Transport and Infrastructure, Road Authority, Ministry of Finance, National Agency of Information Society, Municipality of Tirana, Ministry of Welfare, Ministry of Education, Ministry of Agriculture, Agricultural and Rural Development Agency, Ministry of Health, Ministry of Interior, Ministry of Justice, Ministry of Defense, and Ministry of Energy.

VI. MONITORING AND REPORTING REQUIREMENTS

53. 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; and

- (x) inflation forecast on a monthly basis.

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 and bonds 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; and
- (x) information on new energy and nonenergy guarantees issued by the general government.

The General Directorate of Customs will supply to the Fund:

- (i) detailed monthly data on customs revenues collected.

The General Directorate of Taxation will supply to the Fund:

- (i) detailed monthly data on tax revenues collected;
- (ii) information on progress in implementing business restructuring and IT reforms; and
- (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"; and
- (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 unobserved economy.