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

June 6, 2014

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, June 6, 2014

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 the rest of 2014 and first quarter of 2015.

2. Performance under the program has been satisfactory so far. All end-March quantitative performance criteria and structural benchmarks were met, except for the end May structural benchmark on contracting an external auditor to conduct risk-based audits of arrears payments, which was not met (but on which we are proceeding rapidly and expect to meet in the coming weeks). 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 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 was 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.

3. Policy priorities for the remainder of 2014 and early part of 2015 focus on pursuing fiscal consolidation while advancing the payment of arrears, safeguarding financial sector stability and reviving credit growth, and preparing the groundwork for growth-enhancing reforms. In this context, we are committed to pursuing, among other things, pension and energy sector reforms, 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 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 first review under the Extended Arrangement and modification of performance criteria, as described in Table 1 of the MEFP. The Albanian authorities also request: 1) removal of the arrears clearance adjustor for the performance criterion on the general government overall cash deficit because the definition of the deficit already excludes arrears payment, and 2) the purchase of SDR 23.55 million, following completion of the first review by the IMF's Executive Board.

8. 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 first review 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/  
Shkelqim Cani  
Minister of Finance

/s/  
Ardian Fullani  
Governor, Bank of Albania

/s/  
Arben Ahmetaj  
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, highlighting the key 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

2. Real GDP growth continued to slow in 2013, falling to 0.4 percent from 1.2 percent in 2012 and 3.1 percent in 2011. The fall in output growth reflected a further weakening in domestic demand, which was only partially offset by a modest improvement in net exports. From the production side, weaker growth reflected a sharp contraction in services output, despite modest growth in agriculture and industry and a rebound in construction activity that reflected the rise in public investment spending in the first half of the year. In line with the sharp slowdown in economic activity, the unemployment rate (as measured by the Labor Force Survey) jumped to 15.6 percent in 2013 from 13.4 percent a year before.

3. The current account deficit increased to 10.4 percent of GDP in 2013, and remains a source of vulnerability. The wider current account deficit partly reflected the rise in the fiscal deficit, but also included a temporary pull forward of imports during the fourth quarter in anticipation of increases in excise taxes. Remittances also dropped considerably in 2013, as Albanians working abroad continued to return home due to the weak economic outlook in the most popular destinations, Italy and Greece. This offset continued growth in exports from textiles and petroleum, as well as a rise in agricultural exports. The deficit was primarily financed through FDI inflows, which rose by 37 percent in 2013, partly due to the privatization of two hydroelectric plants. These nondebt creating sources of financing limited the increase in external debt, which amounted to 35 percent of GDP at year-end.
4. **Consumer prices have been relatively stable, in an overall economic environment conducive to low inflation.** Average CPI inflation rose to 1.9 percent (year-on-year) in the first quarter of 2014, up from 1.5 percent during the last quarter of 2013. The underlying trends point to a lack of both demand and supply side pressures, with weak aggregate demand and a negative output gap. In addition, low inflation in Albania’s main trading partners together with a stable exchange rate and well-anchored inflation expectations have helped limit inflationary pressures.

II. FISCAL CONSOLIDATION

5. **In 2014, the first quarter fiscal outturn was well within the program target.** Total revenues increased by 10.1 percent (year-on-year), boosted by a rebound in VAT receipts. Despite the first quarter revenue improvement, prevailing uncertainty over the economic outlook and the durability of the rebound in tax collection warrants caution in revising our projection for the full-year. Expenditures were well below the planned level in the first quarter, as a review of the investment budget resulted in a significant under-execution of capital spending. With this review process completed, capital spending is expected to accelerate in the second quarter in order to catch up with the full-year plan. As a result, we maintain the original full-year fiscal deficit target under the program; for program monitoring purposes, we will add a quarterly ceiling on public expenditure as a performance criterion. We will consult with Fund staff before revising the budget.

6. **We will implement further fiscal consolidation in 2015 in order to begin to bring down public debt.** Over the medium-term, we aim to lower public debt from 72 percent of GDP at the end of this year to 69 percent by the end of the program with the IMF in 2016 and to well below 60 percent by 2019. We have already begun to identify possible measures to achieve the fiscal savings that will be needed next year, in order to ensure that the budget is prepared well in advance of the required timeline for submission to Parliament. We will work closely with our international partners, including the IMF, to strengthen our medium-term fiscal framework.

7. **An external consultant has been hired to support customs administration, and began work in February.** The first phase of the work has focused on a comprehensive review of existing procedures, and identified several key target areas where it will be working with customs staff to strengthen processes and ensure that regulations are consistently and properly applied. Over the medium-term, a key priority will be to move away from reference pricing and introduce transaction value as a basis of assessing customs duties, in line with international best practice in this area. We
will also be moving forward with several initiatives to rein in corruption, including the introduction of a code of ethics for staff, with criminal penalties for those in violation, as well as electronic monitoring and reporting systems to limit scope for corruption during inspection procedures.

8. **We are in the process of implementing a series of measures to increase tax compliance and reduce fraud.** We will launch a public awareness campaign beginning in June 2014 through media on the importance of paying taxes. We also plan to implement lotteries on sales receipts in the second half of the year to give consumers more incentives to request receipts in market transactions. To reduce fraud in VAT and CIT refunds, we have started to 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. The successful rollout of the new IT system remains a top priority in improving the efficiency of tax administration. Finally, we have also introduced a number of steps to simplify tax procedures and lower administrative costs for taxpayers, based on recommendations from a joint project with the IFC.

9. **We are preparing an updated VAT law, which we expect will be approved by Parliament to take effect at the beginning of 2015.** The revised law has been prepared in cooperation with the European Commission, and is intended to harmonize the VAT regime in Albania with EU directives and comply with accession requirements under the *acquis communautaire*. VAT receipts remain our primary source of fiscal revenue, and we are committed to a broad-based and simple VAT system with few exemptions, in line with the EU directive.

10. **We are implementing measures to curb abuse of social assistance and disability benefits.** The rapid expansion in claims for these benefits in recent years has become a growing fiscal burden, with insufficient means-testing and verification procedures in place to ensure that the benefits are limited to those who qualify. In order to reduce abuse of the system, we are in the process of introducing an electronic database that allows us to cross-check claims for social benefits against public filings, including tax records, in order to verify eligibility. In addition, we have introduced the penalty of criminal prosecution for fraud in order to deter false claims, and intend to prosecute those who have abused the system at the expense of those truly in need. We are already seeing a decline in claims for social benefits as a result of these measures to curb fraud, and expect to achieve a reduction of 10 percent for 2014 as a whole. There has also been a small decline in
disability claims in 2014, although so far it appears likely to be less than the large decrease envisaged in preparing this year’s budget.

11. **We have accelerated our work on pension reform in order to ensure that the plan can be introduced from the beginning of 2015.** The pension reform strategy was presented for public consultation in April; we intend to draft a new law on social insurance following consultation with key stakeholders, and submit to Parliament for approval by July, to ensure that the new scheme will be able to go into effect at the beginning of 2015. The proposal, developed in cooperation with the World Bank, envisages a number of key changes in order to close the large financing gap in the current scheme:

- Replacing the current basic pension plus 1 percent of own earnings base, subject to a relatively low ceiling on the maximum pension, with a smaller social pension plus 1 percent of own earnings base, with no maximum ceiling. This will provide a living minimum pension for those without sufficient years of contributions to qualify for a regular pension, but remove the ceiling on benefits that currently serves as a disincentive for higher income earners to declare their full salary.
- Indexing increases in the level of pensions strictly to inflation, and eliminating the scope for discretionary changes by the government.
- Increasing the minimum contributory wage to the official minimum wage for all contributors and indexing the ceiling for contributions to average wage growth.
- Gradually increasing the retirement age for both men and women to 67 by 2056;
- Equalizing the contribution in rural areas with that of urban areas by 2017.
- Replacing the supplemental schemes currently attached to pensions with targeted social assistance.

12. **We recognize that the cost to pay compensation owed for expropriated land is not fiscally sustainable under the current scheme.** This issue needs to be addressed quickly in order to resolve the growing uncertainty over the fiscal implications. We are seeking an extension of the current moratorium at the European Court of Human Rights on qualifying cases pertaining to the pilot judgment until June 2015. This would provide a sufficient window to allow us to review the law and the existing scheme, undertake a comprehensive review of the claims that have been filed, and complete ongoing work on the cadastre update that is essential in order to fairly assess the claims that have been brought forward. An inter-agency working group headed by the Deputy Prime Minister is working to identify available land for compensation in-kind. We are committed to finding
an equitable solution that provides a fair settlement to those owed compensation, within the scope of Albania’s fiscal capacity to meet these obligations.

13. **The large stock of project commitments outstrips our capital spending envelope and raises the prospect of a recurrence of arrears in the future.** A particularly large stock of projects has accumulated in the transport sector. We intend to carry out a review of these outstanding commitments and establish a clear prioritization by the end of 2014, with lower priority projects to be legally postponed or cancelled in order to align existing commitments with our medium-term expenditure envelope. Until this process has been completed, there is very little, if any, scope for new investment projects to be undertaken.

14. **We are also moving forward with local government reform to consolidate the large number of small local units into a more efficient structure.** Weakness in local government administration adds to fiscal risks and hampers the effective delivery of services. The reform will be based on an analysis of the optimal size and functions of local government units, with a goal to have the required legislative changes passed through parliament by mid 2015, so that next year’s local government election can be organized according to the new local government structure.

15. **We have initiated the preparatory work to move toward a valuation-based property tax reform.** We are working with our international partners to conduct an assessment of the technical work required in advance. The key challenge is the establishment of the fiscal cadastre, which will assign a unique number to every property, as well as the appraised value, which will be used as the basis for assessing property tax. The establishment of the fiscal cadastre will be facilitated by the digitization of property records by the office of immovable properties, a process which is ongoing with the support of the World Bank.

### III. PREVENTION AND CLEARANCE OF GOVERNMENT ARREARS

16. **We have begun to clear arrears, adhering closely to the arrears prevention and clearance strategy (APCS) approved in January.** Although there was some delay early in the year, the oversight function of the High State Audit has been established as envisaged under the strategy. In addition, we intend to engage the internal auditor of the Ministry of Finance to verify the arrears payments. Through May 2, 13.1 billion lek have been approved for payment, of which 8.7 billion lek have so far been paid. Roughly 2/3 of these relate to unpaid VAT refunds, with the remainder...
pertaining to capital investment projects. 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).

17. **We are working with the EU to contract an external auditor (structural benchmark, end May, 2014) and to perform ex-post risk-based audit of randomly chosen cases.** The tender for an auditor to review contractor arrears is already in process, and we expect the auditor to be in place and in a position to complete its first audit by July 15 (structural benchmark, July 2014). The tender for an auditor to review tax arrears will be launched soon; we expect this to be finalized by the end of September (structural benchmark, September 2014). We intend to move as quickly as we can with arrears clearance once these auditors are in place, while fully respecting the due diligence and verification process specified in the APCS. We will align the pace of arrears clearance with the work of the external auditor in the interim, in order to ensure that they are able to perform their intended function in verifying that the repayment process adheres to the APCS. As a result, we will limit the amount of arrears cleared to 25 billion lek by the end of August 2014 to ensure that arrears clearance proceeds in accordance with the APCS, and to safeguard the integrity of the process; we will consult with Fund staff should arrears clearance exceed this amount. Any VAT refund claims submitted after 2013 for VAT paid before December 31, 2013 will be subject to full ex-ante audits.

18. **We have introduced several measures to improve reporting and approval procedures for multi-year commitments, as required under the program.** An instruction issued in February obliges all local government units to report new procurement orders with three-year ceilings (structural benchmark, March 2014). We will also begin introducing multi-year commitment limits with the 2015 budget (structural benchmark, December 2014). The MoF issued an instruction in March requiring line ministries and central institutions to submit their planned commitments for 2015 in line with the 2015–17 medium-term budget ceilings. The terms of reference for the changes to the Treasury system to include multi-year commitments (spending unit levels) are to be finalized and effective by September 2014 and operational starting from the beginning of 2015 (in full compliance with the 2015 budget implementation). We will also amend the relevant laws in 2014 to legally enforce the commitment limits.

19. **We have also introduced measures to avoid delays in payment of VAT refund claims.** In February, the Ministry of Finance issued the instruction on the new system for payment of VAT refund claims through the Treasury. According to this instruction the Tax Administration Department
(TAD) within 5 days of receiving the VAT refund claim, sends the notification and the respective information to the Treasury. Based on this information, the Treasury insures that the necessary funds to make the payment are available. After the Tax Administration assessment, within 25/55 days, the VAT refund payment order is send by TAD to Treasury for payment. All VAT refund payments are regularly published on the MoF website upon execution.

20. **We will continue to strengthen financial data reporting of government agencies.** The quarterly survey of arrears accumulation, conducted for the first time in April 2014 to collect information on all unpaid obligations of five central government ministries will continue in August, and be expanded to include the GDT (continuous structural benchmark). We will continue to provide a consolidated survey of the report to the IMF, within 75 days after the end of each quarter. The survey will be expanded further in October to cover an additional 5 ministries (continuous structural benchmark, beginning in October). The results of the survey for March showed 360 million lek (about 0.03 percent of GDP) of new arrears during this period; these largely reflected delays on the part of these institutions in registering the bills with the Treasury in sufficient time to receive payment. Instructions have been issued that should avoid these delays in the future, and we expect that any arrears discovered through this process will be cleared promptly. There were no new government external arrears outstanding at the end of March, in line with the continuous performance criteria under the program.

**IV. MONETARY AND EXCHANGE RATE POLICY**

21. **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).

22. **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 of monetary policy. The BoA will also aim to maintain adequate reserve coverage over the program. Net international reserves were higher than the floor specified under the program for March, with reserve coverage comfortably 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.

23. **The lack of inflationary pressure expected over the medium-term has provided scope for further monetary easing.** Since October 2013, we have reduced the main policy rate by a cumulative 1 percent, to a new historical low of 2.5 percent. The easing of monetary policy aims to support domestic demand, in line with our commitment to price stability and to maintain inflation expectations anchored to our CPI inflation target of 3 percent. However, the transmission to long term interest rates and to credit growth remains hampered by uncertainty over the economic outlook and banks’ risk aversion. Credit to the private sector contracted by 2.1 percent in the twelve months through March. (Excluding several transactions where a package of loans was sold to nonbanks, the level of credit was unchanged). In order to improve the transmission of monetary policy, we have refined and extended our communication framework, by adopting a forward guidance with regard to the future of monetary policy. The BoA will continue to exercise caution on further monetary easing, and remain cognizant of possible exchange market pressures and financial market stability.

24. **The inflation-targeting framework continues to successfully anchor inflation expectations.** In spite of large disinflationary shocks to the economy, inflation has remained just outside the inner band of our inflation consultation performance criteria, and we expect a gradual convergence of inflation to its 3 percent target rate in the medium term.

V. SAFEGUARDING FINANCIAL SECTOR STABILITY

25. **Several measures have been introduced to accelerate collateral execution procedures and encourage the write-off of nonperforming loans.** The early results from the changes in the Civil Procedures Code that were introduced in September 2013 have been encouraging, with increase of 8.9 percent (year-on-year) in recovered amounts realized through the collateral execution
process. In addition, on February 27, the BoA approved a change in the regulation on credit risk management, specifying when a loan should be classified as “loss,” and requiring banks to write-off all the loans that have been in the ‘loss’ category for more than 3 years. These changes will enter into force on January 1, 2015. These measures are expected to facilitate more proactive management of NPLs by banks and encourage them to clean their balance sheets. In addition, a project with the World Bank to facilitate the restructuring of problem loans continues to move forward.

26. **The MoU on operations of the FSAG was revised in line with the recommendations from the recent FSAP** (structural benchmark, March 2014). The MoU was adjusted: to remove ‘development of the financial market’ as an objective of the FSAG (and focus FSAG in ‘systemic risk management’); to introduce a requirement for organizing regular meetings of the FSAG every three months; to introduce the Technical Supporting Group (along with its functioning procedures, as an Annex of the MoU) which will meet monthly; to include as an Annex to the MoU the functioning procedures of the FSAG’s Secretariat; and to streamline the content of the document (compared to the previous one).

27. **The regulatory framework on collateral eligibility for monetary operations was also revised in line with recommendations from the FSAP** (structural benchmark, March 2014). The purpose of the changes was to expand collateral eligibility for monetary operations to include government securities of all maturities, as opposed to only those with a maturity of one year or less under the previous regulation. To this end, the relevant regulations were amended to change the definition and establish the eligibility of government bonds to be used as underlying securities in repo and reverse repo transactions and determine appropriate haircuts for these securities.

28. **Changes to strengthen the supervisory framework for the nonbank financial sector are moving forward, as recommended by the FSAP.** Legislation to improve the supervisory and operational independence of the Albania Financial Supervisory Authority (AFSA) has been submitted to Parliament (structural benchmark, March 2014). We firmly support the importance of an independent and capable AFSA as essential to ensure proper oversight of the fast-growing nonbank sector in Albania, and will work to ensure that the full package of laws (the amended AFSA law, new insurance law, and amendments to the Civil Servant Law and the Law on Salaries of Independent Institutions) are approved by Parliament with no substantial changes from what was originally submitted. In addition, work has begun on changes to the regulatory framework for investment funds to introduce liquidity and capital requirements and mark to market calculations for net asset
value, with the new regulations expected to be in place by mid-year (structural benchmark, September 2014).

29. **In line with the latest recommendation of the FSAP, the BoA has adopted a number of changes to strengthen their stress-testing toolkit.** These include more stringent assumptions in the adverse scenarios used in top-down stress-testing, and more elaborate simulations for credit and market risk in the bottom-up stress tests. In addition, where banks appear to have persistently underestimated NPL performance in their own stress testing exercise, the BoA will provide stricter guidelines on the required assumptions. Finally, a new stress-testing methodology to be applied for liquidity risk has been developed by the BoA in cooperation with the FSAP team.

30. **We will strengthen audit, financial internal control and other procedures in line with recommendations of the recent IMF safeguards mission.** The BoA will take steps to harmonize the bank’s internal audit procedures with leading international governance practice, as recommended by the safeguards mission. Also in line with the advice of the safeguards mission, the BoA will discontinue the practice of advanced distributions of monthly profits to the MoF, in order to align with international best practice.

### VI. STRUCTURAL REFORMS

#### A. Business Climate

31. **The government is moving forward with several initiatives to improve the business climate and streamline registration procedures in Albania.** A MoU has been signed with the EBRD to create an Investment Council, under the National Economic Council, which will work with foreign investors to improve communication with the government and ensure timely resolution of problem issues. The IFC is also currently conducting a thorough analysis of the Doing Business Report on Albania, which will identify the key problems of the respondents. As a second stage, in June, a cross-institutional working group will be established to address the specific issues and suggest any necessary legal and procedural changes. In addition, we are also moving forward with the creation of a “virtual service window” at the National Registration Center that will allow businesses to register online, which should result in a significant reduction in the time needed to register. The private sector has responded favorably to our initiatives to improve the business environment. The upgrade of the cadastre and formalization of land registration is also essential to...
attract foreign investors, who are often deterred by the uncertainty over property rights and land ownership in the current system.

B. Energy Sector

32. The failure to resolve longstanding problems in Albania’s electricity sector has resulted in growing risks to both the budget and growth. Albania’s electricity generation is almost entirely dependent (98 percent) on hydropower. Variations in rainfall cause enormous variation from year to year in the costs of meeting electricity demand and pose a major risk to electricity supply. Beyond weather, the energy sector’s problems have been compounded by several other factors: high distribution losses; a lack of adequate and timely tariff adjustment; and an ongoing law suit between the former private owner of the distribution company and the government. The very low rate of collection from consumers has resulted in a liquidity shortfall throughout the sector, with reliance on either government guarantees or direct financing from the budget to finance import needs.

33. Our goal is to secure Albania’s energy supply and security over the medium term. This will require increased domestic power generation, reduced distribution losses, and improved integration with regional and European energy systems. Under the arrears clearance strategy approved in early April, the government has netted off 4.4 billion lek in inter-company debts that have accumulated between the government and the generation and distribution companies and retained external, independent auditors to audit disputed energy sector arrears. We have established a Task Force for energy sector reform, which is not only taking immediate actions to reduce energy losses, but also developing a strategy in cooperation with the World Bank to phase out explicit and implicit fiscal support of the electricity sector by the end of 2016.

- Short-term measures: (i) The Task Force in collaboration with other law enforcement agencies is identifying the consumers who are receiving illegal electrical services and cutting them off the grid until there is a request to re-connect legally. (ii) As a stop-gap measure to contain the financial losses in the sector, the energy regulator has introduced a flat tariff for non-metered consumers. (iii) The authorities will issue a regulation to move high voltage commercial customers to the open market subject to technical and economic assessment by June 2014. Through these measures, we intend to achieve an improvement in collections by the distribution company (CEZ) of 10–15 percent this year, with a reduction in electricity
losses to 35 percent of total production, from 50 percent in 2013. This would also mitigate the need for budgetary financing for imports in 2014.

- **Medium-term measures:** The short-term measures will be followed by specific investments to reduce losses (e.g., installation of smart meters and grid), and amendments to the Power Law and the Renewable Energy Law. These amendments will change the market model, update the regulatory tariff framework to bring energy tariffs closer to cost recovery in the sector and revise the prices for feed-in energy produced by small private hydro-electric companies. This will be supported by an ongoing study by the government to clearly identify the types of customers that require subsidies for electricity. The Task Force will recommend changes in all laws relating to the power sector, including all the necessary supporting regulations, in order to have a revised market model ready by December 31, 2014.

- **Longer-term measures:** Several new important generation projects, such as the Devolli HEC and Skavica HEC, are beginning to move forward, while several others are almost finished and are soon expected to be fully operational, such as Ashta 1 HEC and Ashta 2 HEC. We will undertake 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. We intend to closely collaborate with the World Bank on the medium and long-term reform measures through an investment operation in coordination with other IFIs.

**C. Statistics**

34. **INSTAT is working to strengthen data sources and dissemination procedures.** In line with the European Statistics Code of Practice, INSTAT has started to implement the system of country-wide administrative data exchange for statistical purposes. The Joint Directive for inter-agency data sharing, which provides a framework for data exchange and collaboration among government bodies, has been drafted with support from IMF technical assistance, and initial bilateral technical discussions have been conducted. The next step is for INSTAT to submit the Directive to the Council of Ministers to launch the procedure to establish inter-government data sharing protocols. We are working to shorten the production cycle of national accounts statistics, and plan to disseminate a monthly industrial production index.
35. **We will take steps to improve the quality of fiscal data.** The MoF will introduce internal controls before releasing fiscal data, and will align the definition of external and domestic public debt across all departments within the MoF. In addition, the MoF and the BoA will strengthen interagency cooperation in compiling external debt statistics.

**VII. PROGRAM MONITORING**

36. We anticipate that the second, third, fourth, and fifth reviews will take place on or after September 15, 2014; December 15, 2014; March 27, 2015 and June 28, 2015, respectively. These reviews will require observance of the conditionality for end-June 2014, end-September 2014, end-December 2014 and end-March 2015, respectively.
Table 1. Albania: Quantitative Performance Criteria and Indicative Targets for 2014–15 1/
(In billions of leks, unless otherwise indicated)

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<td>I. Quantitative Performance Criteria</td>
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<td>1. Floor on net international reserves of the BoA (EUR million)</td>
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<td>2. Ceiling on general government overall cash deficit excluding arrears payment (cumulative)</td>
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<td>3. Ceiling on general government expenditure, excluding arrears payment (cumulative)</td>
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<td>II. Continuous Performance Criteria</td>
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<td>4. Accumulation of new external payment arrears by the general government (EUR million)</td>
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<td>III. Inflation Consultation</td>
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<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
</tr>
<tr>
<td>Lower outer band</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
</tr>
<tr>
<td>IV. Indicative Targets</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. Ceiling on the increase of Bank of Albania credit to the general government (cumulative)</td>
<td>...</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>7. Ceiling on accumulation of central government domestic arrears (as reported by MoF’s quarterly survey on arrears accumulation)</td>
<td>...</td>
<td>0.0</td>
<td>0.4</td>
</tr>
<tr>
<td>8. Floor on clearance of central government domestic arrears 2/</td>
<td>...</td>
<td>0.0</td>
<td>1.0</td>
</tr>
</tbody>
</table>

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

1/ All adjustors are described in the Technical Memorandum of Understanding (TMU).
<table>
<thead>
<tr>
<th>Conditionality</th>
<th>Test Date</th>
<th>Status</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Structural Benchmarks</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Arrears Clearance</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>I. Public Financial Management</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Publish a report on arrears paid (on a quarterly basis) on the MoF website (starting in June, 2014).</td>
<td>Continuous</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. The external auditor to complete first audit of arrears payment.</td>
<td>July 15, 2014</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Contract an external auditor to conduct verification of arrears payments on tax refunds (see TMU).</td>
<td>End-Sept. 2014</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. MoF to purchase a new IT server for the treasury system.</td>
<td>End-Sept. 2014</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Arrears Prevention</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. MoF to issue instructions to all local governments to report all new procurement orders to MoF starting September, 2014.</td>
<td>End-March 2014</td>
<td>Met</td>
<td></td>
</tr>
<tr>
<td>2. 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).</td>
<td>Continuous</td>
<td>Met</td>
<td></td>
</tr>
<tr>
<td>3. 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).</td>
<td>Continuous</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. 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.</td>
<td>End-December 2014</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Conditionality</td>
<td>Test Date</td>
<td>Status</td>
<td>Remarks</td>
</tr>
<tr>
<td>-------------------------------------------------------------------------------</td>
<td>--------------</td>
<td>--------</td>
<td>---------</td>
</tr>
<tr>
<td><strong>II. Tax Administration</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. The GDT to develop a corporate strategy for medium to long term capacity building.</td>
<td>End-Dec. 2014</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Establish and commence operations of a permanent Risk Management Unit (RMU) in GDT (see TMU).</td>
<td>End-March 2015</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>III. Expenditure Policy</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Establish a Pension Reform Commission to devise a reform strategy of the pension system.</td>
<td>End-March 2014</td>
<td>Met</td>
<td></td>
</tr>
<tr>
<td><strong>IV. Financial Sector</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>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.</td>
<td>End-Mar. 2014</td>
<td>Met</td>
<td></td>
</tr>
<tr>
<td>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.</td>
<td>End-Sept. 2014</td>
<td></td>
<td></td>
</tr>
<tr>
<td>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.</td>
<td>End-Mar. 2014</td>
<td>Met</td>
<td></td>
</tr>
<tr>
<td>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).</td>
<td>End-Mar. 2014</td>
<td>Met</td>
<td></td>
</tr>
</tbody>
</table>
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 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 in 2014 is lek 60 billion.

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:

<table>
<thead>
<tr>
<th>CASH BALANCE</th>
<th>Code</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financing (Cash)</td>
<td></td>
</tr>
<tr>
<td>Domestic</td>
<td></td>
</tr>
<tr>
<td>Privatization receipts</td>
<td>B/1160000-116ZZZZ</td>
</tr>
<tr>
<td>Domestic borrowing</td>
<td></td>
</tr>
<tr>
<td>Central</td>
<td>000-009/1600000-169ZZZZ</td>
</tr>
<tr>
<td>Local</td>
<td>010-999/1600000-169ZZZZ</td>
</tr>
<tr>
<td>Other</td>
<td></td>
</tr>
<tr>
<td>Change in balance of TSA bank account</td>
<td>001/010-ZZZ/5120100/TH000; 001/5120100/TH008; 001/5120100/TH009; 001/5120100/TH010; 5120100/TH011</td>
</tr>
<tr>
<td>Change in balance of S&amp;HII's bank account</td>
<td>5000000-54ZZZZZZ/5800000-58ZZZZZZ</td>
</tr>
<tr>
<td>Trust accounts (3020)</td>
<td>4660000-466ZZZZ</td>
</tr>
<tr>
<td>On-Loan's Principal (3030)</td>
<td>2500200</td>
</tr>
<tr>
<td>Liability to SSI (3015) (receipts (3016) minus payments (3017))</td>
<td>4351291; 4351298-4351299</td>
</tr>
<tr>
<td>Variance Accrual-Cash [4030=4019 (4011-&gt;4018)-4029(4021-&gt;4028)]</td>
<td>More detailed codes submitted to staff</td>
</tr>
<tr>
<td>Float (3060)</td>
<td>001/5200000/B0000-52ZZZZZZ/BZZZZ</td>
</tr>
<tr>
<td>Transitory accounts - Guaranties on Custom Duties (3021)</td>
<td>4701100</td>
</tr>
<tr>
<td>Others-Float (mean time)</td>
<td></td>
</tr>
<tr>
<td>Foreign</td>
<td></td>
</tr>
<tr>
<td>Long-term Loan(Drawings) (1010=2600(00/1700000-99/174ZZZZ)/1030/1040)</td>
<td>More detailed codes submitted to staff</td>
</tr>
<tr>
<td>Change of statistical account (1040)</td>
<td>More detailed codes submitted to staff</td>
</tr>
<tr>
<td>Repayments 1030= (2081-&gt;2082)</td>
<td>More detailed codes submitted to staff</td>
</tr>
<tr>
<td>Memo: arrears clearance</td>
<td></td>
</tr>
</tbody>
</table>
10. 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.

11. 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**

12. 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 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**

13. **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.

---

2 All cash balance data come from Treasury.
C. Cumulative Ceiling on General Government Expenditure Excluding Arrears Payment

Definitions

14. 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

15. 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.

II. Continuous Performance Criteria

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

Definitions

16. 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);

- 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

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

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.

17. 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.

18. 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.

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

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

**Reporting**

21. 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**

22. 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**

23. 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**

24. **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.

25. **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.

26. 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. 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

<table>
<thead>
<tr>
<th>(1) Economic Code</th>
<th>(2) Name of Supplier/creditor</th>
<th>(3) Commitment number from Treasury System</th>
<th>(4) Commitment amount</th>
<th>(5) Invoice/claim details</th>
<th>(6) Age of Invoice (Due date)</th>
<th>(7) Reason for delayed payment</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Number (from Treasury System)</td>
<td>Date</td>
<td>Amount</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>30-59 days</td>
<td>60-90 days</td>
<td>+90 days</td>
</tr>
</tbody>
</table>

**Invoices recorder in the Treasury System**

<table>
<thead>
<tr>
<th>Number</th>
<th>Date</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
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<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Invoices not in the Treasury System**

<table>
<thead>
<tr>
<th>Number</th>
<th>Date</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Totals**

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
</table>

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

<table>
<thead>
<tr>
<th>(1) Name of company</th>
<th>(2) Tax identification number</th>
<th>(3) Date of Assessment</th>
<th>(4) Refund details</th>
<th>(5) Age of claim Enter Amount:</th>
<th>(6) Reason for delayed payment</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>Number</td>
<td>Date</td>
<td>Amount</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>30-59 days</td>
<td>60-90 days</td>
<td>+90 days</td>
</tr>
</tbody>
</table>

**Totals**

<p>| | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
</table>

### Reporting

27. 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.
B. Clearance of Central Government Domestic Arrears

Definitions

28. *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 31st, 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
- CIT returns

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

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

Reporting

31. 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

32. **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.

Reporting

33. 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.

34. **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.

35. **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.

36. **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.

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

38. **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; (II) developing integrated compliance strategies for compliance efforts that are designed specifically to mitigate the major risks prioritized under (I).
39. 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;
   c) Introduce liquidity requirements consistent with recent E.U. regulatory developments and the current level of development of the Albanian market.

VI. MONITORING AND REPORTING REQUIREMENTS

40. 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 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.

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;
(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 nonobserved economy.