



REPUBLIC OF ALBANIA
MINISTRY OF ECONOMIC DEVELOPMENT
TRADE AND ENTREPRENEURSHIP
DIRECTORY OF EUROPEAN
INTEGRATION

No. 880 Prot.

Tirana, on 30/1/2015

To:

Mrs. Romana VLAHUTIN ✓
Ambassador of the European Delegation to Albania

Address: ABA Business Center, Rr. Papa Gjon Pali II, kati i 17-të,

Cc:

Mr. Ditmir BUSHATI

Minister of Foreign Affairs

Mrs. Klajda GJOSHA
Minister of European Integration

Tirana

Subject: *Submission of the Albanian National Economic Reform Programme 2015-2017*

Dear Ambassador,

In response to the letter dated 21th October 2014 "National Economic Reform Programme 2015", I have the pleasure to transmit to you the Albanian National Economic Reform Programme 2015-2017, approved by Decision of Council of Ministers no. 71 date 28.01.2015.

According to the guidance sent by the European Commission, the Programme consists of two parts. The first part includes a medium-term macro-economic and fiscal policy framework as well as the supporting structural reform measures. The second part includes the sectorial flagship reform measures for enhanced competitiveness and growth.

I kindly request transmission of this document to the Mr. Johannes Hahn, EC Commissioner for European Neighborhood Policy and Enlargement Negotiations and to Mr. Pierre Moscovici, EC Commissioner for Economic and Financial Affairs, Taxation and Customs.

I take this opportunity to express my higher considerations for the European Union Delegation in Albania.

Yours faithfully,

Arben AHMETAJ

Minister of Economic Development, Trade and Entrepreneurship



REPUBLIC OF ALBANIA

**NATIONAL ECONOMIC REFORM
PROGRAM OF ALBANIA 2015 - 2017**

(PART I)

JANUARY, 2015

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1. OVERALL POLICY FRAMEWORK AND OBJECTIVES

The Albanian government has submitted to the European Commission its medium term Economic and Fiscal Program during the past eight years, in fulfillment of the requirements for pre-accession countries. Last year the country obtained candidacy status for EU membership. This entailed new requirements for reporting based on EU standards. In this context, Albania is required to annually submit to the European Commission the National Economic Reform Program (NERP).

NERP 2015-2017 presents the main priorities, policies and reforms of the Albanian government and the Bank of Albania on economic aspects. It is based on and in accordance with Law no. 160/2014 "For the Budget Year 2015" and with the Macroeconomic and Fiscal Framework 2016-2018¹. The program is also fully in line with the second National Strategy for Development and Integration 2014 – 2020 which is now close to finalization. This document was prepared by an inter-institutional working group with representatives and experts from relevant institutions of the Albanian government and Bank of Albania. The program was approved by the Council of Ministers on 28 of January 2015².

NERP 2015 - 2017 summarizes the main economic developments and emphasizes medium term prospects, alongside main economic policies and structural reforms planned by the Albanian government and the Bank of Albania in the medium term future.

Our economic policies seek to generate sustained medium term growth that results in tangible gains, including employment generation and a sustained improvement in the standard of living of Albanians. Achieving these goals will require sustained 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.

Fiscal policy will be clearly oriented toward fiscal consolidation in the medium term. We will aim to reducing the public debt ratio at below 60% in the medium term. We will tackle the root causes of high deficits through significant tax and expenditure policy measures and extensive Public Finance Management and revenue reforms.

Monetary policy will continue to support the weak economy by further modest monetary easing, provided inflation and exchange market pressures stay muted. We will continue as well with the reforms needed, including full payment of government arrears, to help reduce the level of NPL aiming to restore banks' confidence and revive credit to the economy.

We remain fully committed to continue implementing the ambitious agenda of structural reforms which is crucial to unlock structural constraints, boost investment, and unleash the full growth potential of the Albanian economy. The reforms directly related with the progress towards EU accession remain a key part of our structural reforms' agenda.

2. MACROECONOMIC FRAMEWORK

Global economy continued to improve during the first 9 month of 2014, though at moderate growth rates. Global inflation remained subdued, driven by the weak aggregate demand and stable primary commodity and energy prices. Financial market premiums decreased due to accommodative monetary policies and improved confidence indicators. The dynamics of preliminary and indirect indicators suggests that global activity is expected to strengthen in the coming quarters, supported by growth in advanced economies, which are benefiting from the

¹ Approved by the Council of Ministers dated 21.01.2015

² Approved by the Council of Ministers dated 28.01.2015, No. 71

accommodative monetary policy and favorable financial market conditions. However, the balance of risks to the global outlook remains on the downside due to heightened geopolitical tensions.

Eurostat's last estimate (September 2014) showed that, in 2014 Q2, euro area's economy slowed the growth pace (0.7% from 1%). Investments and net exports contributed negatively to GDP formation, whereas consumer spending increased. The GDP rate reflected the slowdown in some advanced economies (Germany, France and Italy) and the faster growth in the peripheral economies. In line with EC autumn forecast (November 2014), we expect economic growth in Eurozone and European Union to be weak for the second half of 2014 and to gradually accelerate in the next three years 2015 – 2017, reaching 2.3% growth in 2017 from 1.3% projected for this year.

ECB's continued accommodative monetary policy is expected to affect lending to the economy positively. Potential risks to the European economy mainly relate to geopolitical tensions and the performance of developing economies. Inflation has been low for several months, reflecting the performance of energy prices, spare production capacities and high unemployment rates. Forecasts show that inflation is expected to stay low until the end of 2014 (EC November 2014 forecasts), and increase gradually in 2015 and 2016.

Economic activity in Albania will be influenced by developments in the international economic environment. Albania's main trading partners include euro area member states like Italy and Greece with economic channels via exports (particularly Italy), remittances, as well as FDI. The Italian economy slipped back into recession in 2014 Q2, after two consecutive quarters of negative growth. The contraction was a result of the sharp fall in investments, despite the slightly increasing consumption expenditure and net exports. The main sectors of the economy, namely industrial production, agriculture and services, shrank in 2014 Q2. The Italian economy is expected to improve slowly for the rest of the year although remaining at a negative annual growth and expected to turn on positive territory in 2015 (at around 0.5%) with continuing gradual acceleration in 2016 and 2017.

The Greek economy contracted in 2014 Q2, though at moderate rates, nearing the positive territory. The increase in exports was the sole factor contributing positively to economic activity, whereas the higher imports and lower private investments continued to contribute adversely. As a slightly positive growth is expected to be achieved this year after a long recession for the last six years, it is expected that growth in Greece will pick up at relatively fast pace during 2015 – 2017.

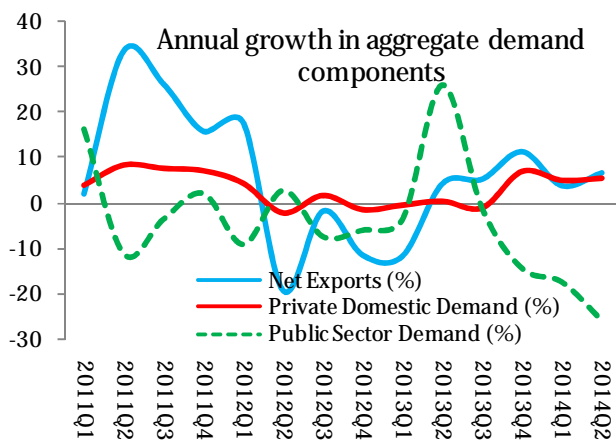
Assuming the relatively positive expectations for EU, particularly for the Italian and Greek economy, should materialize in the medium term ahead, we expect that to have a positive effect for the Albanian economy.

2.1. Recent economic developments

The Albanian economy has shown tentative signs of improvement during the first nine months of 2014. Value added in the economy recorded an annual increase by 1.3% during first nine months of 2014. The slight contraction which took place in Q2 was temporary, mostly linked to supply side shocks in specific sectors of the economy like construction, industry and transport contributing negatively to growth as well as base effects. On the other hand, the increase in value added in the services sector accounts for a positive contribution in the annual pace of the economic activity. The positive performance of services was led by activities in other services and trade branches.

From an aggregate demand standpoint, the growth during 2014 was mostly generated by domestic demand, while foreign demand is assessed to have had a negative contribution. However, the economic slowdown which took place in Q2 was largely driven by the public sector. This reflected the consolidation stance of fiscal policy as well as the base effect of higher fiscal stimulus injected into the economy in the 2013Q2. On the other hand, private sector demand

remained on a positive trajectory. Improved confidence and favorable financial conditions have supported the growth of private consumption and investment during the first half of the year. Private investment was positively affected by improved business confidence, increased utilization rate, the growth of new orders and the easing of credit conditions. Higher inflows of FDIs net off privatizations through foreign capital, especially in Q1, boosted investment growth. The recovery of the investment will depend on the sustainable growth of the consumer demand and the continued improvement of financial conditions.



Source: BoA, MoF

For 2014, growth is projected to be slightly higher than the previous year. This growth is expected to rely mainly on domestic demand. The easing of monetary conditions, the correction of the public and private sector balances, and the improving the economic agents' confidence is expected to fuel domestic demand.

The Albanian economy continues to operate below potential, which in turn is reflected in inflation below the target of the Bank of Albania. During January-September 2014, the annual inflation averaged 1.75%, slightly lower than in the same period of

2013. Based on inflation dynamics as well as on medium terms projections for inflation and economic growth, the monetary policy has remained strongly expansionary. It has aimed at supporting the domestic demand and at enabling the sustainable return of the inflation rate and inflation expectations to target. The key interest rate actually is at the historical low level of 2.25%. The Bank of Albania has continued to use forward guidance to steer the public and the financial markets expectations on the path for future monetary policy.

Monetary indicators have shown a weak dynamic during 2014, reflecting low financing needs of the economy. The annual growth of M3 has been especially sluggish in the second quarter of the year, and stands at 1.0% in September. Bank finance to the public sector has been low while the contribution of credit to economy has turned positive only in the third quarter of the year.

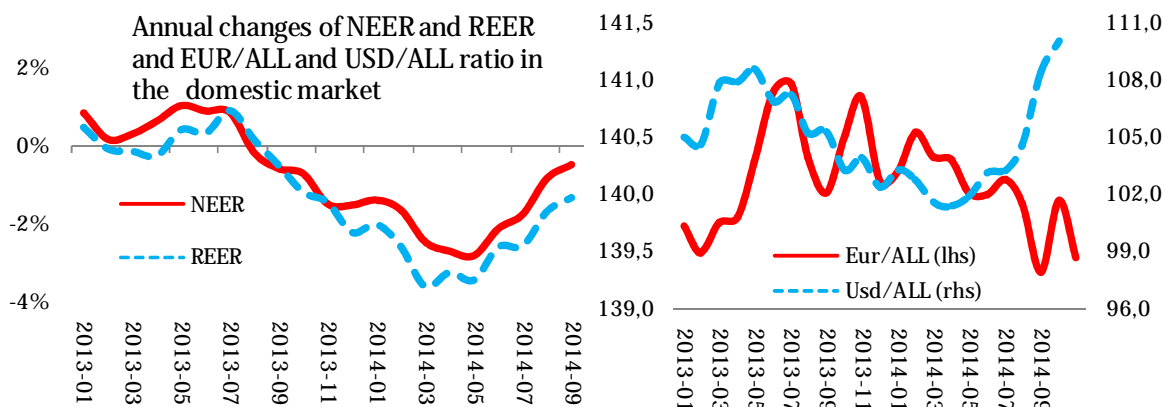
Credit to the private sector has registered positive annual growth in the third quarter of the year, following its contraction in the previous 12 months. However, this pick-up in credit remains fragile. Banks, businesses and households remain risk averse. Credit growth is segmented in terms of both banks activity in lending and also of sectors of the economy that are being financed. Credit growth has been driven by expansion of credit to private non-financial corporations. On the other hand, credit to households has been sluggish, registering near zero growth for the last 12 months. In 2014, credit growth continues to be supported by credit in domestic currency, while foreign currency credit continues to shrink.

The Albanian Lek appreciated by 1.7% yearly in nominal terms³ during the first 10 months of 2014. Lek has appreciated by 2.6% yearly in real terms⁴. The domestic and trading partners'

³ The nominal effective exchange rate index (NEER) is calculated against the currencies of our five main trade partners: Italy, Greece, Germany, Turkey and China. It takes into account a monthly series of shares for each partner country, based on the bilateral trade flows model and average monthly rates of the nominal exchange rate of ALL/EUR (for Italy, Greece, Germany), Turkish Lira (ALL/TRL exchange rate calculate by a cross-rate of TRL/USD exchange rate) and Chinese renminbi (ALL /CNY calculated by a cross-rate of the CNY /USD exchange rate).

⁴ The Real Effective Exchange Rate (REER) is measured as a geometric weighted average of domestic consumer prices, compared to our five main trading partners' prices and the NEER index. A decline in the index implies a real appreciation, whereas an increase in it implies a real depreciation of the Albanian Lek.

inflation differential has expanded, reflecting the low inflation rates in the Euro area trading partners.



The current account deficit expanded rapidly during the first half of 2014. During first half of 2014, the current account deficit reached 12.3% of GDP, increasing by around 21.3% annually. The expansion of the trade deficit was the main factor behind the higher current account deficit. Here, a general pickup in imports, the overturned net balance of the energy sector from net exporter last year to net importer this year and volatile oil prices in the international market were primary facets of trade developments. Concurrently, the terms of trade deteriorated on average by 3.3% points during the first half of the year. Net primary income registered a higher deficit linked to larger direct investment income outflows. Services performed better this year compared to the same period last year. After the 19.8% annual drop last year, secondary income inflows have increased only slightly this year. Remittances have stabilized at around 5% to GDP in 2014H1 and, following a continuous five quarter drop, increased slightly in 2014Q2. Latest evaluations project a higher current account deficit than last year's forecasts for 2014 due to lower than expected goods exports and secondary income outflows and higher than expected services imports and primary income outflows.

Net flows to the capital and financial accounts resulted in about EUR 488.6 million during the first six months of 2014, compared to EUR 403.6 million in 2013H1. As a ratio to GDP they were valued at around 9.7% from around 8.2% to GDP in 2013H1. In 2014H1, the capital account recoded a higher surplus in annual terms. The financial account showed a net increase in liabilities of around 15.8% annually. Net foreign direct investments decreased slightly, partly as a result of large FDI related public asset privatizations last year and partly as a result of higher direct investment abroad this year. Net portfolio investments and net financial derivatives (other than reserves) were lower this year compared to 2013H1. Net other investments fell by around 37% annually due to a sharp increase in currency and deposit assets in 2014H1 despite an increase in debt liabilities.

2.2. Medium-term macroeconomic scenario

Real sector

Economic outlook is expected to gradually improve in the medium term. Economic growth is expected to steadily accelerate reaching 4.5% in 2017 from 1.4% recorded in 2013. However, the economy is expected to continue operating slightly below its potential growth for 2015 and the gap is expected to close in the first half of 2016. Economic growth is forecasted 3% and 4% respectively in 2015 and 2016.

Private consumption and investment are expected to be the main growth generators. Exports of goods and services, particularly touristic services, are expected to perform well in the medium term, increasing by an annual average of 6%. Nevertheless, net foreign demand is expected to continue have a negative contribution on growth due to expected high imports of capital goods employed for the two main energy projects, respectively TAP and Statkraft-Devoll Hydropower. Therefore, private investment positive contribution on growth is expected to be higher as well.

Despite fiscal policy will clearly continue to be oriented toward consolidation in the medium and long term, the government budgetary policy to preserve a level of public investments at least 5% of GDP will additionally boost gross fix capital formation in the economy, which is crucial to sustain relatively high growth levels. On the other hand, the tight fiscal policy stance planned in the medium term ahead will be mostly reflected at stagnant level of public consumption. Whereas private consumption growth is expected to recover gradually as consumer confidence is expected to improve and the tax measures implemented in 2015 will be the last of this kind. At the same time, the accommodative stance of monetary policy foreseen for medium term, as long as the inflationary pressures are expected to remain at the bottom end, will support as well both private consumption and investment.

At the same time, private consumption growth over the projection horizon is expected to be supported by improvements in the labour market, reflected in a steady increase in employment and wages. This should stimulate growth of real disposable income of households. The increase in consumer loans is projected to be driven by improved financial conditions of households and by eased lending standards. On the other hand, precautionary behavior will still have some drag in the consumption growth.

The gradual resumption of investment demand is expected to be supported by improved capacity utilization rates and a recovery in economic climate over the projection horizon, both in Albania and in the external environment. Investment recovery in the coming years will be supported by four separate developments. Firstly, higher FDIs, especially in the energy sector, should be a boost to investment rates. Secondly, private investments are to benefit from expected improvements of financial conditions. Thirdly, the low interest rate environment, aided also by more relaxed financing conditions after the completion of the AQR assessment, is expected to support investment projects. And lastly, the arrears repayments will increase the liquidity in the private sector and improve its balance sheets.

Tab: Real growth (left, in %) and contribution to growth (right, in p.p.) by demand components

	2012	2013	2014	2015	2016	2017	2012	2013	2014	2015	2016	2017
			Proj.	Proj.	Proj.	Proj.			Proj.	Proj.	Proj.	Proj.
Final Consumption	0.7	0.0	3.1	1.1	2.5	2.2	0.6	0.0	2.7	1.0	2.2	1.9
Gross Fixed Capital Formation	-11.3	3.0	1.7	8.0	10.7	11.0	-3.3	0.8	0.4	2.1	2.9	3.2
Public	-15.7	9.0	-5.3	23.2	0.3	16.4	-1.0	0.5	-0.3	1.2	0.0	1.0
form which: central government	-12.8	5.7	-8.7	10.1	3.5	23.4	-0.7	0.3	-0.4	0.4	0.2	1.1
Privat	-10.1	1.5	3.5	4.3	13.7	9.7	-2.3	0.3	0.7	0.9	2.9	2.2
Domestic Absorption	-2.3	0.7	2.7	2.7	4.5	4.5	-2.7	0.8	3.1	3.1	5.1	5.1
Net export	-15.5	-3.4	5.4	0.5	6.0	3.3	3.5	0.6	-1.0	-0.1	-1.1	-0.6
Exports of goods and services (f.o.b)	-0.6	6.1	9.0	10.1	5.4	6.9	-0.2	2.0	3.2	3.8	2.1	2.7
Imports of goods and services (f.o.b)	-6.6	2.7	7.8	6.9	5.6	5.8	3.7	-1.4	-4.1	-3.9	-3.2	-3.3
Change in inventories	37.7	0.0	0.0	0.0	0.0	0.0	0.8	0.0	0.0	0.0	0.0	0.0
Statistical discrepancy	0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
GROSS DOMESTIC PRODUCT	1.6	1.4	2.1	3.0	4.0	4.5	1.6	1.4	2.1	3.0	4.0	4.5

Source: Ministry of Finance, INSTAT

The overall public sector demand will continue to be somehow constrained by fiscal consolidation. As such, it is not expected to be a growth driver over the medium term. However, fiscal consolidation will reduce the risk premia in the medium term and allow for crowding-in of the private sector. At the same time, the composition of planned budgetary policies are growth supportive and therefore are expected to offset at a certain extent the overall tightening effects of

fiscal consolidation. More specifically, public investments in the short and medium term are preserved, at least, at the level of 5% of GDP, which have a relatively high multiplier toward short term aggregate demand and are crucial to shift upwards the potential growth in the medium and longer term. The full payment of the accumulated government arrears to the private sector, which started in 2014, will continue steadily in 2015 and in 2016, which will improve financial situation of businesses. At the same time, stimulating measures are adopted for some critical employment-generating sectors of the economy.

As the Albanian economy continues on the recovery track, the negative output gap is expected to gradually close during the first half of 2016. The domestic disinflationary pressures will weaken in 2015 and 2016 and inflation is expected to gradually converge to its target. Yet, owing to the modest scale of the recovery and to the lagged response of prices to the closure of the output gap, the CPI inflation will remain relatively low, running below the BoA inflation target till the end of 2016. Factors conducive to weak inflationary pressures will also include: stable commodity prices and consumer prices in international markets; low inflation expectations; and reluctance of businesses to pass through higher costs and restore profit margins. As domestic demand grows stronger and the monetary stimulus is fully transmitted into the real economy, inflation will reach the BoA target within the medium term.

Tab: Real growth (left, in %) and contribution to growth (right, in p.p.) by supply components

	2012	2013	2014	2015	2016	2017	2012	2013	2014	2015	2016	2017
			Proj.	Proj.	Proj.	Proj.			Proj.	Proj.	Proj.	Proj.
Agriculture, hunting and forestry	5.4	0.6	3.8	3.4	3.7	4.2	1.0	0.1	0.7	0.7	0.7	0.9
Industry	0.9	7.9	9.6	6.3	7.8	8.4	0.1	1.0	1.3	0.9	1.1	1.3
- Extracting Industry	11.7	12.0	21.1	11.3	12.8	12.7	0.4	0.6	1.1	0.7	0.9	1.0
- Manufacturing Industry	-3.8	5.3	1.8	2.3	3.4	4.1	-0.3	0.4	0.1	0.2	0.3	0.3
Construction	-14.3	1.1	-4.2	1.2	4.7	5.4	-1.8	0.1	-0.4	0.1	0.4	0.5
Total Services	3.6	0.1	0.5	2.1	2.7	3.0	1.6	0.0	0.2	0.9	1.2	1.3
Trade, Hotels and Restaurants	4.0	0.6	1.7	2.3	2.9	3.5	0.5	0.1	0.2	0.3	0.4	0.5
Transport	-8.1	-8.1	-13.5	2.5	4.1	4.0	-0.3	-0.3	-0.4	0.1	0.1	0.1
Post and communication	4.4	-8.0	2.7	2.3	2.4	2.4	0.1	-0.2	0.1	0.1	0.1	0.1
Other Services	4.9	1.7	1.3	1.9	2.5	2.7	1.2	0.4	0.3	0.5	0.6	0.7
FISIM	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
GROSS VALUE ADDED AT BASIC PRICES	1.0	1.5	2.0	3.0	4.0	4.5	0.9	1.3	1.8	2.6	3.5	3.9
Taxes on products	0.8	1.7	2.7	3.1	4.1	4.6	0.1	0.2	0.4	0.4	0.5	0.6
Subsidies on products	-85.1	88.1	0.1	0.3	0.4	0.5	0.6	-0.1	0.0	0.0	0.0	0.0
GDP AT MARKET PRICES	1.6	1.4	2.1	3.0	4.0	4.5	1.6	1.4	2.1	3.0	4.0	4.5

Source: Ministry of Finance, INSTAT

Growth in the medium term ahead is expected to be more job – creating than historically as the most labor intensive sectors of production are expected to perform better than the others. More specifically, agriculture, textile and footwear industry as well as tourism related services are expected to be the best performers, reflecting also to some extent the priority focus of the government on these sectors for the medium term future. Therefore, increase in the total employment is expected to accelerate during 2015 -2017. Despite larger expected expansion of employment, the overall labor productivity is still expected to continue have a slight improvement in the medium term ahead. At the same time the baseline scenario assumes an increase in the labor force by an average of 3% per year during 2015-2017 which mainly reflects a higher participation rate reaching 64.5% in 2017 from 61.1 in 2014. The expected population growth has a minor effect as well in increasing the labor force. Consequently, the baseline scenario projects a gradual reduction of unemployment rate to 13.9% in 2017 from 17.3% in 2014.

Construction is at the same time expected to come back at positive growth rates during 2015 -2017, reflecting higher gross fix capital formation, however still way below the pre-crises growth rates. Extracting industry is expected to recover from one-off supply shocks experienced in 2014

due to the revocation of a number of mine licenses and return to its historical growth rates of the last years.

The risks surrounding the economic outlook for the Albanian economy remain on the downside. In the short run, the recovery is likely to continue to be dampened by: prevailing high unemployment; suboptimal capacity utilization and weak credit growth to the private sector. In the medium and long term, ongoing structural reforms should improve the business environment for firms and boost the economic potential.

Monetary and exchange rate policy and inflation

Given the conditions of the real economy and the outlook for inflation, the Bank of Albania extended the rate-cutting trend started in mid-2011. The key interest rate was cut twice since the beginning of 2014 by a total of 0.50 percentage points to 2.50%. Together with reducing the key interest rate, the Bank of Albania has continued to supply the banking system with liquidity via open market operations. Liquidity provision was done through fixed allotment of 7-day, 1-month and 3-month maturity. Interest rate bids have fluctuated very close to the policy rate and have not identified pressures for heightened liquidity risk premiums. The monetary policy has been successful in lowering the yields of government securities and the lek lending rates for the private sector. Nevertheless, the demand for credit continues to be hampered as a result of the ongoing uncertainties in the economy, of risk averse behaviour and of private sector balance sheets adjustments. Furthermore, the relatively high nonperforming loans ratio is hampering the easing of lending standards from the banking sector.

Looking ahead, the economic growth is expected to improve gradually and the negative output gap is forecasted to close around the first half of 2016. Accordingly, inflation is expected to increase gradually. The annual average inflation rate is forecasted at 2.5% and 2.8% for 2015 and 2016 respectively. As domestic demand increases gradually and the monetary policy transmission to the real economy improves, inflation is expected to reach the Bank of Albania's target in the medium term.

The monetary policy is expected to remain expansionary over the medium term. Given the expected fiscal consolidation, the policy mix creates a suitable economic and financial environment to support a gradual recovery of economic activity. The Bank of Albania thinks that the accommodative monetary conditions will be necessary until inflation expectations are entrenched around the inflation target. It will also aim to improve its transparency and communication strategy, as well as to undertake other necessary measures in order to improve the effectiveness of the transmission mechanism.

External sector and its medium-term sustainability

High trade deficits and lower remittances from abroad, have contributed to a deterioration of the current account deficit to GDP that peaked at about 15.7% in 2008 and 15.4% in 2009. A gradual reduction of the deficit was registered during the next four years where the current account to GDP reached 10.2% and 10.5% in respectively 2012 and 2013. Nevertheless, no significant correction of the deficit materialized. The last quarter of 2013 and first half of 2014 were marked by accelerated expansions of the current account deficit. For 2014H1, it averages 12.3% to nominal GDP. A substantial part of the deficit is attributable to its cyclical component with higher imports reflecting increased investment activity in the country and higher primary income outflows reflecting higher profitability of direct investments. The fall of current transfers is linked to the cyclical downturn in Italy and Greece but also to the structural change of the previous remitting base.

Going forward, we project an expansion of the current account deficit by around 18% in 2014, guided principally by a higher trade deficit and a negative primary income balance. For the whole of 2014, we expect the level of net current transfers to remain largely unchanged and net services to post a positive balance, as opposed to last year's deficit. In 2014, the current account deficit is

expected to be valued at about 12% to nominal GDP. Projections for 2015, 2016 and 2017 put the current account deficit at respectively 11.9%, 12.6% and 12.8% to GDP. The expected widening of current account deficit is mainly attributed to higher expected imports of capital goods related with big projects in the energy sector, TAP and Devoll Hydropower.

The trade deficit in goods is expected to increase by 12.1% in 2014 and thereafter expand by an average of 5.4% in the next three years 2015-2017. The exports of goods will remain largely based on the textile industry (textile and shoes) and on natural resources (crude oil), whereas imports are projected to pick up on the back of a slight improvement in domestic demand.

New policies focused towards the tourism industry in the country as well as a more stabilized environment in 2014, are expected to help the pick-up of the net service balance. We expect a small surplus of this account this year, from its overall deficit registered during 2013 to a larger surplus in 2014 - 2017.

The income account balance is projected to close in a deficit in 2014 due to a high direct investment income outflow. Concomitantly, the net worker compensation is also expected to decrease in annual terms in 2014 due to lower inflows from abroad. In 2015, we expect a slight acceleration in the repatriation of profits from FDIs and less pronounced increase in primary income inflows. Subject to increased FDIs, we expect the income account balance to deteriorate further in 2015 - 2017.

Current transfers are projected to remain almost at the same level in 2014. The economic hardship in Italy and Greece has directly affected financial transfers from Albanian immigrants living abroad. Similarly, a large number of émigrés to Greece⁵ have since returned thus reducing the number of the remitting population outside Albania. It is yet to be seen if this is a permanent loss of the remittance base or whether an improvement of economic conditions in Greece will be accompanied by remigration. Looking ahead, an expected pick-up of the Greek economy during the second half of the year and in 2015 is expected to affect the cyclical component of remittances. Thus, in total net current transfers are expected to remain broadly at the same level in 2015 - 2017.

In the first half of 2014, net foreign direct investments have registered a decline. Nevertheless, this performance mainly comes from high base effect of the FDI's performance in 2013, primarily due to the privatization of two large public hydro-power plants to foreign owned companies. Excluding the base effect, direct investments less privatization receipts have increased by 22.3% annually during H1 2014.

The FDI stock has increased progressively year by year, although at a slower pace during 2013. At the end of 2013, FDI's stock resulted in about Euro 4,187.5 million, about 7.6 % higher compared to 2012. By activity, the most attracting sectors were the "post and telecommunication", "financial intermediation" and "mining and quarrying". FDI's data by country of origin show that the three biggest investors were Greece, Canada and Italy representing about 57.0% of the total stock of FDI.

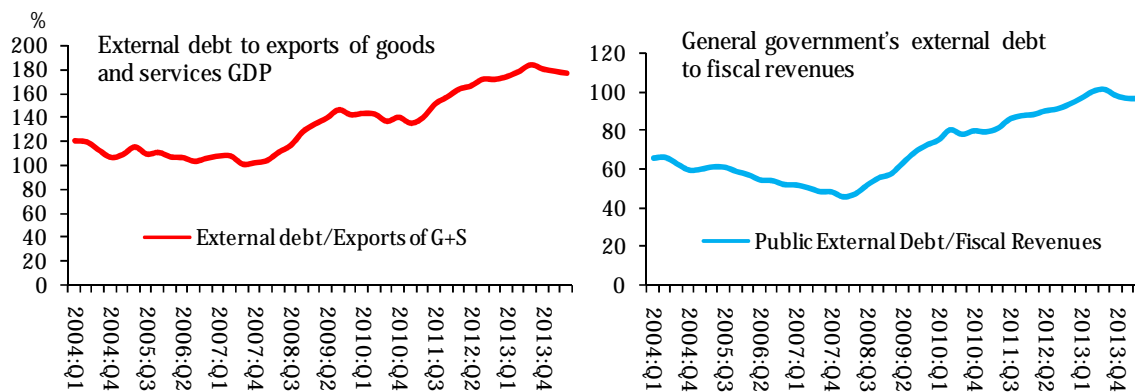
During the first six months of 2014, portfolio investment assets decreased by around EUR 77.2 million, after two years of continuous increase. The main reason behind this development is the reduction in the flow of assets invested abroad in the form of debt securities.

Debt-generating flows were valued at an average of 2.5% to GDP during the first half of 2014, decreasing by around 1.6 percentage points compared to 2013H1. It has to be noted that debt-generating flows increased rapidly during the first half of last year. Hence, when pitted against the second half of 2013, debt flows have been increasing.

⁵ A recent study by INSTAT and IOM puts the number of returnees from Greece to 133544 individuals. For more information: http://www.instat.gov.al/media/255790/migracioni_i_kthimit_dhe_ri-integrimi_2013.pdf

The net international investment position of Albania as a ratio to GDP is valued at approximately -47.7% at the end of 2013. It has improved annually compared to 2012 by around 2.4 percentage points to GDP in 2012. The stock of external financial assets reached 41.9% to GDP in 2013, increasing continuously since 2010. The stock of external financial liabilities reached 76.1% to GDP, decreasing by 5.8 percentage points to GDP and experiencing a reduction for the first time since 2005. Direct investments to Albania and other investments in the form of loans constitute the largest chunk of external liabilities. On the asset side, reserve assets in foreign exchange (mostly bond and notes) make up nearly 48.9% of the stock of total external assets. Net price changes resulted in 1.5% to GDP for 2013, increasing by around 1.2 percentage points compared to 2012 due to the revaluation of the assets of some foreign owned companies. In addition, net other changes were estimated at around 12% to GDP, increasing by around 4.2 percentage points in annual terms as a result of:

- High figures of other changes for drilling companies for which the value of transaction is recorded with “minus” as other changes, according to the methodology, for not affecting small values of stock.
- High value transactions for some companies, not necessarily due to their normal activity, which methodologically are recorded as “other changes” and not as “transactions”.



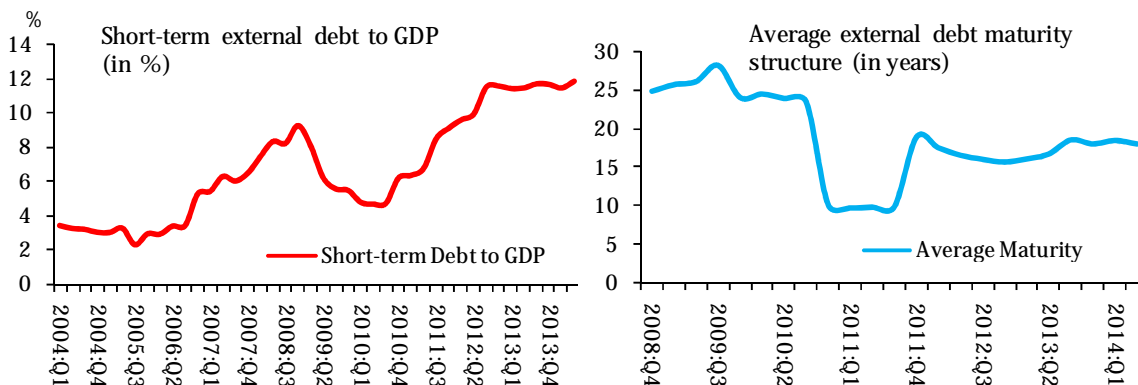
Source: BoA

The stock of the gross external debt of Albania reached EUR 6,371.8 million in the second quarter of 2014. Latest data show that the gross external debt is valued at around 63.5% to nominal GDP. Long term debt constitutes around 81.3% of the total gross external debt composed primarily of long term loans to the central government and other sectors. On the other hand, short term debt is valued at around 18.7% of the total composed largely of banks' external borrowing.

From a sustainability perspective, the long-term repayment capacity indicators of the external debt of Albania have deteriorated since 2008. At the end of the second quarter of 2014, the ratio of gross external debt to exports of goods and services is at around 177.5%. This ratio had been fluctuating within a band 100% to 120% until the last quarter of 2007 and thereafter has increased progressively. In addition, the stock of external debt to fiscal revenues is at around 258% whereas compared to the general government's external debt it is at around 96.6%. Both these indicators have deteriorated markedly since 2008. The stock of external debt to fiscal revenues at the end of 2007 was 110% whereas the ratio of the public external debt to fiscal revenues was 48.5%. On the other hand, indicators of liquidity adequacy show low liquidity pressures stemming from principal and interest repayments on the external debt. As such the ratio of reserve assets to the short term external debt is around 169% and the ratio of external debt amortization to exports of goods and services is at around 8%.

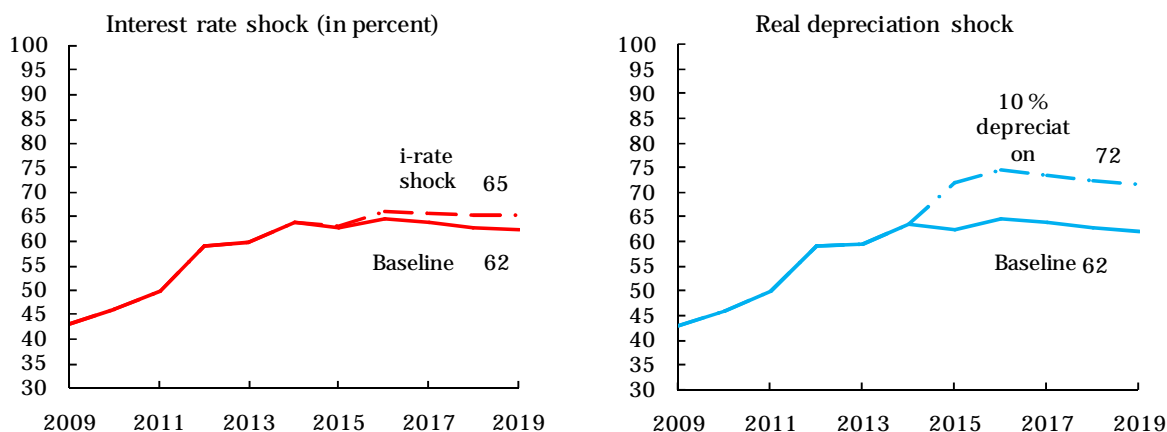
The short-term external debt stock of Albania reached 11.9% of GDP at the end of 2014Q2 and represented around 18.7% of total gross external debt. The average maturity of the gross external debt was 17 years in 2013. The latter has increased since the trough reached in 2010

where the average maturity of the gross external debt was 10.2 years. For 2014, the new external debt disbursements are expected to be of longer average maturity structure. As a result, the average maturity of the total gross external debt is expected to increase to 20.2 years in 2014.



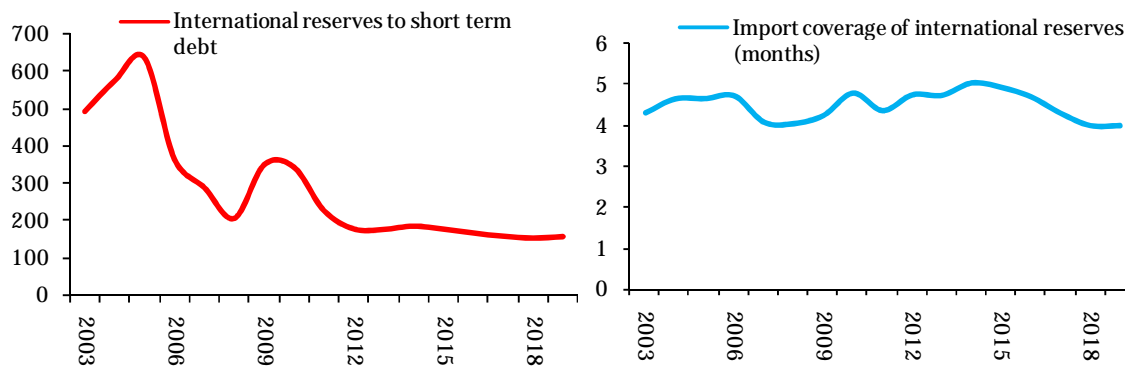
Source: BoA

Risks to external debt sustainability analysis show higher vulnerability to exchange rate shocks rather than interest rate shocks in the future. In the first simulation, the interest rate expected to be paid on the external debt on the future is shocked with a permanent increase of two standard deviations. The external debt at the end of the period is expected to increase slightly compared to the baseline if this scenario materializes. In the second simulation, the exchange rate is shocked with a one-time depreciation of 10% of the ALL in 2015. The resulting path of the projected external debt to GDP shifts up more markedly from the baseline and results in a larger gap at the end of period compared to the first simulation.



Source: BoA

The Bank of Albania is committed to maintaining an adequate stock of international reserves that can finance fully the short-term external debt and cover a minimum of 4 months in imports of goods and services. The latter is projected to remain within sustainable limits in the medium-term. The international reserve stock coverage of short-term debt is projected to not fall below 100% threshold in which the stock of available reserves is dangerously low. Similarly, with regards to import of goods and service coverage ratio, it is not expected to fall below the 4 months of coverage threshold.

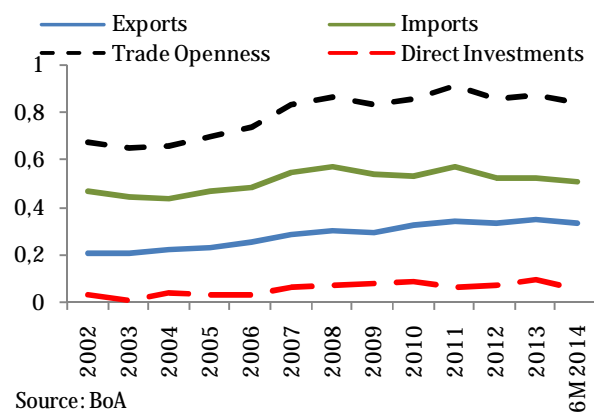


Source: BoA

Trade in goods over the first 8 months of 2014 point to a continuation of the positive growth trend, albeit at a slower pace compared to 2013. A significant change in the structure of Albanian exports by commodity and destination has been observed during the last couple of years. In addition to the positive contribution of “Textile and footwear” and “Construction materials and metals”, exports of “Mineral, fuels, electricity” played a major role in the overall increase of total exports. Agricultural products have also exhibited a positive trend.

At the same time, there was an increased positive contribution of exports of crude oil, generated mainly by the foreign direct investments made by Bankers Petroleum. We expect the oil exports to gain a further market share in the coming years as a result of increased production capacity and of initial positive exploration results in certain drilling operations in the country. Agriculture exports have proven resilient this year and there is no indication of a trend reversal during the rest of the year.

Trade openness, export and imports as a percentage to GDP and Net FDI as a percentage to GDP



Source: BoA

At the same time Albanian exports moved to new destinations or consolidated newly established market relationships such as with the CEFTA countries. Higher crude oil exports made it possible to also include new non-regional new markets, such as Spain and Malta, to the list of exporting partners. Nevertheless, reliance on a narrow range of exported products has made Albania vulnerable to external shocks. The indicator of trade openness during the period 2002-2014H1 peaked in 2011 and thereafter decreased slightly due to lower imports.

According to the Constant Market Share (CMS)⁶ decomposition of Albanian exports, increased competitiveness (residual component) has been leading the direction of export changes in 2013. This positive contribution the overall performance has continued since 2010. The commodity composition effect has shown negative signs in 2013 for both the exporting activity towards EU-15 markets and to CEFTA countries. The market distribution effect was positive only in exporting to CEFTA countries whereas it registered a negative effect in the trade with EU-15 countries. The rise of exports due to world export growth, which historically was the main contributor of the four components, registered a negative effect last year.

⁶ See <http://go.worldbank.org/KQCHUD4JN0> for a discussion on CMS.

Tab: Decomposition of Albanian Exports using the CMS methodology

	2013	
	EU -15	CEFTA
World Export Growth	-14.2	-2.4
Commodity composition	-7.8	-1.8
Market Distribution	-10.3	4.6
Competitiveness	121.9	6.3
Total	86.9	6.7

Source: Bank of Albania, INSTAT, UN Comtrade

Financial sector

The Albanian banking sector has remained stable during 2014. The volume of activity grew and the financial performance improved. The banking sector's liquidity and capitalization ratios were at an adequate level during the period. The loan portfolio quality though remained a concern. Loan loss provisions and collateralization of non-performing loans were at adequate levels. Regarding market risks, the banking sector appeared to be relatively hedged against direct risk from adverse exchange-rate and interest-rate movements, but the banks remain indirectly exposed to its clients' sensitivity to adverse exchange-rate and interest-rate movements.

The macroeconomic setting was stable, supporting the performance of the financial system. Fiscal and monetary policy actions were accompanied by an adequate functioning of financial markets and lower financing costs.

In June 2014, financial intermediation in Albania, estimated as the ratio of financial system assets to GDP, was 99.45%. The banking sector remains the main segment of financial intermediation in Albania, accounting for more than 90% of the total assets of the financial system.

Assets of the Albanian banking sector have increased by 3% from the end of 2013. The increased investment in securities dominated the asset performance during 2014. Banking sector investment in Government debt securities accounted for around 25% of total bank assets. They also accounted for 60% of debt issued by the Government⁷. The potential risk of the concentration of Government debt securities portfolio owned by banks is assessed as downward, given that: (i) Government's solvency improved due to the consolidated fiscal policy and the agreements with the IMF providing alternative income in foreign currency; (ii) banks are in good liquidity and capital conditions, and show preference to these forms of investment; (iii) the maturity structure of the Government securities has continued to show an increase in average maturity.

The lower pace of bank lending remains major concern for the outlook of the Albanian economy. Both supply-side and demand-side factors impacted this performance. The changes in parent bank policies, the increase in NPL's and the application of tightened lending standards were factors that contributed to the shrinkage of the credit supply. In parallel, the market agents' credit demand decreased, given the weakness of economic activity and high uncertainties.

However, there are signs of credit growth recovery, albeit sluggish – more evident during the third quarter of 2014. At the end of September 2014, annual credit growth turned positive, 2%. Private sector credit⁸ is increasingly oriented towards domestic currency. The share of foreign currency credit stands at 61% in September, 2 p.p. lower than one year ago and 8 p.p. lower than 5 years ago. Out of 9.6 billion of leks net flow of credit in the first 9 months of 2014, 9.1 billion was in domestic currency. This trend is caused by the rapid decrease of interest rate differential

⁷ As of June 2014.

⁸ Private sector credit accounts for 94% of domestic credit.

between loans in domestic currency and those in foreign currency, as well as by a higher awareness of the clients about the risk embedded in foreign currency borrowing.

The shift is more pronounced in household credit. Foreign currency credit to households is shrinking since three years now (4.5% in September). It accounts for 50% of household credit. Foreign currency credit to businesses turned to positive growth in the last two months, after shrinking for two years. It accounts for 66% of credit to private non-financial corporations.

The banking activity continued to be fundamentally financed by deposits, which accounted for about 82% of total assets. The loan-to-deposit ratio is around 55%. Deposits growth has slowed down during 2014, due to lower growth of household deposits. Business accounts grew at higher rates than in 2013, impacted by the payment of arrears from the government. Dependence of the banking sector to external sources of funding is very limited. Net position of banking sector to non-residents remained considerably on the crediting side, and continued to increase during the period, albeit at a slower pace. Borrowing from parent banking groups fell. The countercyclical measures⁹ taken by the Bank of Albania in May 2013 contributed to a slower increase in banking sector investments in non-resident assets. Their average annual growth fell to 14%, from 22% in 2013. The major part of liabilities consisted in liabilities to parent banking groups, mainly in the form of lines of credit. The used part of credit lines fell by 48% from the end of December 2013 and by 35% in annual terms.

The sound banking sector capitalization remains a distinguishing feature of the Albanian banking sector. The capital adequacy ratio of the sector, 17.54% in September 2014 and is well above the minimum required level of 12%. The current own funds of the Albanian banking sector is mostly comprised of Tier-1 capital, providing resilience against shocks. Credit risk and impairments to the bank lending channel are the biggest financial stability challenge for the Albanian banking sector, with market risks of an indirect nature still latent.

The quality of the loan portfolio deteriorated further during 2014, although at a slower pace, with the ratio of NPLs to total gross loans edging up to 25% in September 2014. This was mainly driven by developments in the corporate loan segment, which in turn suffers from a sluggish pace of liquidation of state arrears to businesses. Although provisions for impaired loans were up at 65%, NPLs net of provisions to capital still remained at around 50% in September 2014. Further efforts to foster workouts (particularly as regards collateral execution) thus appear necessary.

The banking sector appears to be well-hedged against direct risk from adverse exchange rate and interest rate movements, but the sensitivity to such changes has increased. The limited net open foreign exchange position in the balance sheet to the regulatory capital (at 6.8%), and their “long” position suggested limited exposure to the exchange rate risk. However, the exposure to indirect market risk from unhedged borrowing in foreign exchange remains relatively high, with such (unhedged) foreign currency loans composing around 29% of total loans.

The liquidity position of the banking system remained strong. The banking sector exposure to liquidity risk was low. Liquidity ratios (liquid assets to short-term liabilities), both in lek and in foreign currency, are above the minimum regulatory ratios. At the end of September 2014, the liquid assets accounted for 32.4% of total banking sector’s assets, 3 percentage points up from a year ago. The ratio of off-balance sheet transactions to assets, which has grown in recent years, has the purpose of hedging from financial risks.

⁹ In May 2013, the Bank of Albania adopted some regulatory amendments, which increased the capital requirements for new bank investments with non-resident institutions.

Tab: Banking Sector Overview

	2006	2007	2008	2009	2010	2011	2012	2013	Sept 2014
Main Aggregates									
Assets (Billion ALL)	624.28	742.86	834.14	886.31	990.63	1,120.17	1,187.98	1,235.32	1,271.88
Total Loans (Billion ALL)	197.96	292.46	396.77	449.89	490.87	566.22	577.82	567.16	577.29
Total Deposits (Billion ALL)	525.53	630.11	645.14	694.26	816.73	924.06	991.67	1,025.57	1,050.18
Performance Indicators									
Return on Assets (%)	1.36	1.57	0.91	0.42	0.72	0.07	0.33	0.54	0.93
Return on Equity Capital (%)	20.17	20.74	11.35	4.58	7.58	0.76	3.78	6.43	11.03
Loans / Total Assets (%)	31.71	39.37	47.57	50.76	49.55	50.55	48.64	45.95	45.4
Risk Indicators									
Capital Adequacy Ratio (%)	18.07	17.08	17.23	16.17	15.40	15.56	16.17	17.96	17.54
Non-Performing Loans / Gross Loans (%)	3.05	3.36	6.64	10.48	13.96	18.77	22.49	23.5	25
Securities Portfolio / Assets (%)	14.73	17.95	19.99	20.05	21.27	21.80	21.61	24.50	25.63
Off-Balance Sheet Transactions / T. Assets (%)	42.28	54.84	89.08	94.04	88.74	102.98	107.59	115.64	116.8

Source: Bank of Albania

*Preliminary figure according to Albanian Association of Banks

Profit in the system showed positive and encouraging values in September 2014, following this path throughout 2014. Nevertheless, the loan portfolio quality continued to deteriorate, thus a considerable amount of the sector's operating profit was used to create reserves for hedging against the credit risk, having a negative effect on profit in the banking system. RoA and RoE – profitability indicators – were positive in September 2014, respectively 0.9% and 11%, due to increased net profit. The system started to show positive values for these indicators in December 2013. The change in RoE 2014, was caused almost exclusively by an increase in the banking system's profit margin, as changes in risk-weighted assets and leverage levels had little impact. The same development is evinced for RoA, being considerably higher compared to the level of a year ago.

Bank of Albania's measures toward lending, in place since May 2013, have helped to contain the further increase of the NPL ratio and support lending in domestic currency. Nevertheless, there has been little impact on total lending due to the subdued lending demand and the overall uncertainties perceived.

The Bank of Albania has continued to apply the stimulating macro-prudential (countercyclical) policies towards lending that have been in place since May 2013. The macro-prudential measures have helped impeding the further rise of the NPL ratio. However, the impact on credit growth system-wise has been limited, due to the subdued credit demand and the overall uncertainties perceived. In more detail, since the set of measures entered into force, the targeted loan portfolio increased by 0.9 b.p. In addition, 7 banks have been positively impacted in their capital adequacy ratio since their loan portfolio increase was within the expected bands. The NPLs have remained at almost equal levels during the past 18 months. On the other hand, the non-residential investment increase has slowed down significantly since the application of the measures, going down from an average of +53.5% during 2012 to +14% in September 2014.

Incentives for early loan restructuring that allow a lower provisioning rate for potentially recoverable loans were also part of the package of measures. The data show that restructured loans increased by 28.5 per cent since the application of the measure, containing the NPL ratio level by at least 1 percentage point. With its decision no.70, date December 18, 2014, the Supervisory Council of BoA decided to prolong such measures until June 2015 (for credit positive

incentives) and until December 2015 (for the non-resident investments negative incentives). The component related with incentives for early loan restructuring will continue without any time limit.

To address properly the still high NPL ratio and related factors, several legislative and regulatory changes have been undertaken in different directions. In September 2013 the Parliament approved changes to the Civil Procedure Code improving the process of collateral Execution. Based on the proposal of BoA and of banks, the Ministry of Finance, by the beginning of 2014, sent to the Parliament the proposal to change the Law on Income Tax aiming to incentivize and facilitate the write off of bad loans and improve banks' financial activity. The BoA introduced obligatory measures on banks for the write off of bad loans which are expected to come in force at the end of the year. From the application of the changes in Civil Procedures Code in September 2013, there has been an increase of collateral execution success rate by almost 10 per cent. However, the full impact of these changes will take time to give results and its overall success will also depend on the real estate market's performance. According to the mandatory loan write-off as per the definition of the changes in the regulatory framework, preliminary estimates show that the NPL ratio would fall at 23 per cent by the end of March 2015 and at approximately 20 per cent by June 2015, all else equal.

All these measures are expected to have an impact, both in the resolution of NPLs and in the statistical improvement of its figure. In the short run, these measures are expected to influence negatively the credit portfolio by lowering it further, but in the medium to long run, they are expected to encourage banks to undertake more risks and improve their confidence in the macroeconomic development. This, in turn, will support lending activity, financial intermediation and higher growth.

Stress Test

The stress test exercise evaluates the resilience of the banking system to different macroeconomic shocks until 2015.

The analysis contains three scenarios:

- one baseline scenario, which is based on the forecasts of economic and financial indicators following mainly on their historical performance; and
- two adverse scenarios. The first adverse scenario, otherwise called “moderate scenario”, assumes both a decline in credit growth and a rise in interest rates. The second adverse scenario, otherwise called the “severe scenario” adds to these shocks also a marked depreciation of the domestic currency towards euro and dollar.

The baseline scenario does not incorporate the impact on the NPL ratio due to payment of arrears by the Government and possible write-offs of NPL by banks. Following the impact of the macroeconomic indicators, this scenario estimates a slower increase of the ratio of non-performing loans by 1.6 percentage points by the end of 2015. The materialization of the moderate scenario causes an increase of the NPL ratio by 2 percentage points and the severe scenario increases the ratio by 8.2 percentage points, when compared to the baseline at the end of 2015.

The results of the exercise in terms of risk weighted capital (RWC) indicate that medium size banks (belonging to G2) are affected by the severe scenarios at similar magnitudes to other banks, but due to their lower initial level of RWC they appear more exposed to suffer a breach of the regulatory minimum RWC requirements in 2015. For the baseline scenario, the overall need for additional capital is 334.54 million ALL (~ 2.4 million euro) at the end of 2015. In the case of adverse moderate scenario, the need for additional capital is 4,498.98 million ALL (~ 32.1 million euro) at the end of 2015. For the adverse severe scenario, the overall need for additional capital is 1,398.69 million ALL (~ 10 million euro) for 2014 and 12,607.21 million ALL (~ 90 million euro) for 2015. The need for additional capital constitutes around 12.9 % of net profit of the

banking sector for 2014 and 116% for 2015 while in terms of its capital, around 1.2% and 11.1% respectively.

Concerning the exposure of the banking sector to market risk, we conduct a stress test in terms of a reductive margin (haircut) to the value of investments in foreign securities' market value reported by the banks. The results indicate that exposure continues to be sensitive to private commercial debt securities, while the sector continues to be sensitive to the exposure of private commercial debt securities, while risk arising from the exposure to sovereign debt securities appears limited. Finally, contagion risk stress test which assesses the exposure of the banking sector towards their parents' banks abroad confirm that this exposure remains considerable, particularly for some individual banks.

Other segments of the financial system

Insurance Sector¹⁰. The share of insurance company assets in total financial assets has remained unchanged during the last years, to around 1.6%. Their activity in 2014 has been somewhat lower than in 2013, with gross written premiums falling by 34.6% annually. The indicator of insurance penetration in the market - the ratio of premiums to GDP - was 0.38%. The market continued to be dominated by Non-Life insurance, whose share was about 89% of the total premium volume.

Investment Funds¹¹. There are two investment funds operating in Albania, with an increased role in financial intermediation. Their assets account for 4.68% of GDP, up from 2.17% a year earlier. Their investments are dominated by those in Government debt securities, accounting for 80% of funds' assets. This considerable exposure increases the need to evaluate and address risks related to the fiscal performance of the Government on the one side, and the flexibility in this portfolio management according to the needs of funds, on the other.

Pension funds¹². There are three voluntary private pensions' funds operating in the market, with a very small role in the financial system, with a share of assets/GDP of 0.04%. Their activity has increased by 50% in 2014.

2.3. Alternative scenarios and risks

The baseline scenario is estimated to have a relatively high chance to materialize in overall. However the forecasting of alternative scenarios - assuming that a reasonable part of various risks surrounding the baseline scenario might materialize - are an important component of public finance planning. In order to increase the quality of planning, to have a more efficient management of public funds in any situation that has a certain probability to occur, below are briefly presented two alternative scenarios, specifically a "pessimistic" and an "optimistic" one.

Each of the alternative scenarios assumes that a set of negative (in case of a "pessimistic" scenario) or positive risks (in case "optimistic" scenario) will materialize. This set of risks assumes deviation from the respective forecasts of baseline scenario for some key macroeconomic indicators, including lending to the economy, the performance of the Eurozone economy with the consecutive effects on the exports of goods and services, on remittances, on various foreign capitals flows as well as exchange rate, the measures of the comprehensive impacts and the pace of the structural policy reforms planned for the medium term period ahead, etc. The overall net effect of all the assumed risks, negative or positive, is quantified and

¹⁰ Based on Albanian Financial Supervisory Authority Publication "Albanian Insurance Market developments for the period January-July 2014"

¹¹ 30 June 2014, Based on Albanian Financial Supervisory Authority Publication.

¹² AFS "Private Voluntary Pension Market Developments, 31 July 2014".

introduced in terms of a single variable, real economic growth¹³. Therefore, the alternative scenarios are based on different economic growth assumptions from the baseline for each year 2015 – 2017. The implications of different macroeconomic scenario on the fiscal framework are explained in section 3.6.

Tab: Alternative assumptions in each scenario

	2009	2010	2011	2012	2013	2014	2015	2016	2017
						Est.	Proj.	Proj.	Proj.
Real GDP growth (%)									
Baseline	3.4	3.7	2.5	1.6	1.4	2.1	3.0	4.0	4.5
Pesimistic							1.0	2.0	2.5
Optimistic							4.0	4.4	4.9
Nominal GDP (in billion Lek)									
Baseline	1,144	1,240	1,301	1,335	1,365	1,414	1,492	1,596	1,718
Pesimistic							1,463	1,535	1,621
Optimistic							1,507	1,617	1,748
Revenue (% of GDP)									
Baseline	26.1	26.2	25.4	24.7	24.0	25.9	27.8	27.8	27.9
Pesimistic							27.3	27.3	27.4
Optimistic							27.8	27.8	27.9
Overall fiscal deficit (in billion Lek)									
Baseline	-80.9	-38.0	-45.8	-45.9	-66.9	-72.0	-58.2	-41.9	-22.6
Pesimistic							-65.9	-54.3	-40.2
Optimistic							-56.2	-39.0	-18.4

Source: Ministry of Finance

3. FISCAL FRAMEWORK

3.1. Policy strategy and medium-term objectives

Fiscal policy in the medium term will be strictly oriented toward fiscal consolidation. The fiscal consolidation and reduction of public debt is essential to lower debt-related vulnerabilities that hamper growth and cause macroeconomic instability. The baseline fiscal scenario is to target a fiscal deficit at the level of 3.9% of GDP in 2015, down from a deficit of 5.1% in 2014. Fiscal consolidation will continue in 2016 and 2017 targeting fiscal deficit of respectively 2.6% and 1.3% of GDP.¹⁴.

Doing so will make possible to bring down public debt as a share of GDP starting in 2015 - for the first time since 2010 – and steadily continue its reduction in the following years. Public debt is expected to reduce at 71.6% of GDP in 2015, 68.8% in 2016 and 65.6% in 2017. This path would be achieved despite the significant energy-related new guaranties, which have already been taken into account for next three years (accounted for 1%, 0.6% and 0.5% of GDP respectively in each year 2015 – 2017). Therefore, in our baseline macro-fiscal scenario we are committed to

¹³ The main shocks introduced in the alternative scenarios are: (i) exports of goods and services assumed to have a real growth rate of 3 p.p. less than “the baseline” in the case of “pessimistic” for each year and 2 p.p. higher in the case of “optimistic”; (ii) credit growth in “the pessimistic” is assumed at a range of 3-4 per cent during 2015-17 down from 7-10 per cent expected in “the baseline” or 8-12 in the case of “the optimistic”; (iii) FDI in “the pessimistic” are shocked by a reduction of 3.5 p.p. of GDP relative to “the baseline” which projects net inflow of FDI at an average of 10.1 per cent of GDP during 2015-17 and positively shocked by 2 p.p. of GDP in case of “the optimistic”; (iv) remittances as well as household consumption were shocked symmetrically in the alternative scenarios respectively by 5 p.p. and 1.5 p.p. alteration in the growth rate relative “the baseline”.

¹⁴ These fiscal deficit figures do not include the possible need for additional guaranties in the energy sector for the medium term ahead. However, such fiscal implications are fully factorised in evolution of public debt dynamics and therefore have a one-to-one implication for the targets of fiscal deficits required to achieve the targeted path of public debt. More specifically, the overall projected stock of public debt explicitly accounts for additional net flows of publicly guaranteed debt due to energy sector needs of 15.5 billion Lek (1% of GDP) in 2015; 9.4 billion Lek (0.6% of GDP) in 2016; and 8.4 billion Lek (0.5% of GDP) in 2017.

lowering the public debt-GDP ratio (including guarantees and local government debt) to less than 66% over the medium term (by 2017). To achieve the fiscal deficit objectives, we have adopted a package of fiscal adjustment measures, on the revenue as well as on the expenditure side which are explained in section 3.3.

At the same time, we are implementing several budgetary policies to support growth and offset tightening effects of fiscal consolidation. Public investments in the short and medium term are preserved, at least, at the level of 5% of GDP, which is important to fuel aggregate demand in the short run and shift potential growth in the medium and longer term. The full payment of the accumulated government arrears to the private sector, which started in 2014, will continue steadily in 2015 and in 2016, which will improve financial situation of businesses. At the same time, stimulating measures are adopted for some critical employment-generating sectors of the economy. In particular, the government has exempted from custom duties some agricultural inputs and increased subsidies to the textile sector. In addition, employment in public administration (e.g., police, teachers) will increase to meet pressing needs.

Public financial management reforms are crucial to increase the efficiency of budget spending as well as create space for more productive spending in the medium and long term. We have embarked on several PFM reforms, some of which are close to finalizing, and remain fully committed to finalize them all. The current status of PFM reforms is explained in section 3.8.

At the same time, reforms in the pension system and energy sector are indispensable for having sustainable and growth-promoting public finances. The actual and contingent burden of pension system and energy sector on the public finance, and consequently on the entire economy, is huge and must be tackled. We have embarked on deep reforms in both of them.

3.2. Budget implementation in 2014

Revenues

At the end of 2014, consolidated budget figures showed 366.7 billion ALL in revenues. This was 0.3 percent less than the period plan but still 12.1 percent more compared to the previous year.

- Income from taxation and customs duties stood at 253.5 billion ALL, or about 7 billion less than forecasted, yet 10.7 percent more on a year-to-year comparison;
- Local government revenues totaled 12.5 billion ALL from 12.8 billion projected for this period and the annual rise was 15 percent;
- Income from special funds totaled around 69.9 billion ALL, from 63.5 billion forecast and 16.5 percent annual growth;
- Non-tax revenues for this period were approximately 20.7 billion ALL with forecasting decline of about 8.6 percent and 4.1 percent annual decline;

Value Added Tax revenues collected for the period were 10.6 percent more on an annual basis. The revenues collected from imports were 97.4 billion ALL from 97.8 billion VAT projected. For this period, revenues from VAT to customs comprise about 78.6 percent of the total revenues from VAT.

Revenues collected on domestic supplies were 26.5 billion ALL for the period from January to December. VAT refund reached 9.6 billion ALL.

Excise revenue, from January to December, amounted 40.9 billion ALL; compared to same period of 2013, excise revenues increased by 7.2 percent. Excise is entirely administered by the Customs Administration.

The following table shows the annual imports by major commodity group and the comparison with the 12-month period of the previous year. Data show a decline in imports of major commodities, except for oil and coffee, which increase respectively by 4.8 and 3.7 percent.

Table: Imports of main excise goods

Item	Fuel (ton)	Beer (000 liter)	Cigarette (ton)	Cafe(ton)
12 month 2013	459,829	27,962	3,694	7,148
12 months 2014	481,776	26,102	2,976	7,413
Percentage (%)	4.8	-6.7	-19.4	3.7

Source: GDC

Personal Income Tax: Revenue from personal income tax totaled 28.85 billion for January – December 2014, or 2.4 percent less compared to the same period of previous year

Taxes on Profits: Revenue from tax on profits for the 12 months of 2014 amounted 21.5 billion ALL from 15.1 billion collected a year ago, with a 42.1 percent growth due to change in profit tax from 10 percent to 15 percent, and 0.2% less than the period forecast.

Revenue from tax on small businesses totaled 1.7 billion ALL, with an annual decline of 13.5 percent; compared to the projection this tax over performed with a 13.9 percent increase.

Property Tax: These include taxes on buildings and agricultural land. For 2014, this tax amounted about 3.7 billion ALL or 49.9 percent more compared to the previous year; The main reason was the doubling of the tax level for the properties used for business purpose.

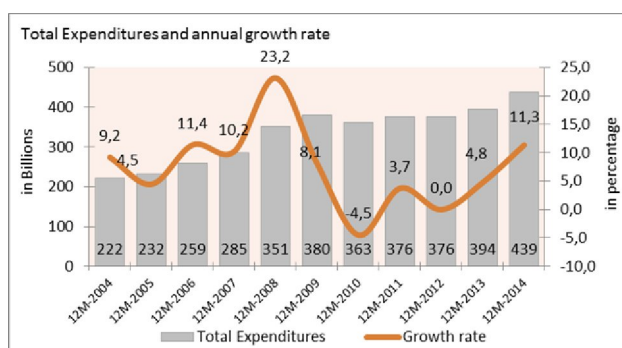
National Tax: Income from fees and other national taxation totaled 32.6 billion during 2014 with an annual growth of 14.6 percent.

Custom duties: Income from customs duties for the period January - December 2014 were about 5.85 billion ALL; compared to the same period of 2013, revenues from this tax increased by 0.9 percent.

Revenues from Local Government: The revenues from local taxes for the period January - December totaled 12.5 billion ALL, while compared to the same period of the previous year, revenues increased by 1.6 billion (about 15 percent). Other local taxes (without small business tax and property taxes that are mentioned above) collection stood at the level of 7 billion. In comparison with the same period of last year these taxes increased by (10.4%) percent.

Revenues from Special Funds: Income from special funds for the period January - December 2014 amounted to 69.9 billion, an increase of 16.5 percent compared to the same period of the previous year and 10 percent more compared with the forecast. This income group accounts for about 20.8 percent of total tax revenues for this period; 61.4 billion of total income from special funds came from social security contributions, 8.2 billion from health insurance, while 315 million from property compensation.

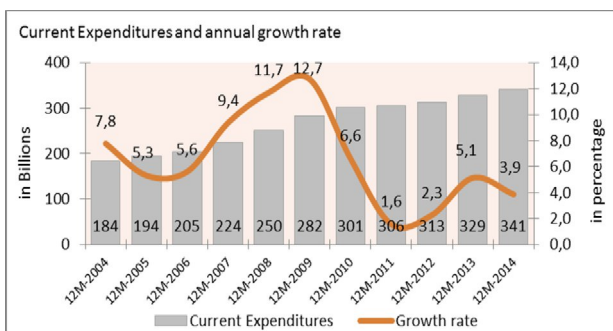
Expenditures



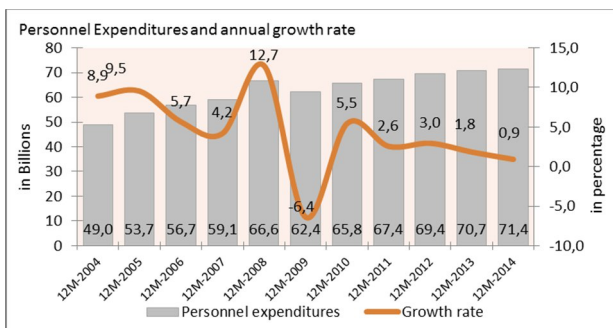
linear growth rate are given in the chart.

Total budget expenditures, as of end 2014, amounted to 438.8 billion ALL, from about 456.4 billion ALL planned for this period, with a realisation level 96.1 percent, or with a shortfall of about 17.6 billion ALL from the projected figure. Expenditures for 2014 were 44.7 billion lek or 11.3 percent higher than te previous year.

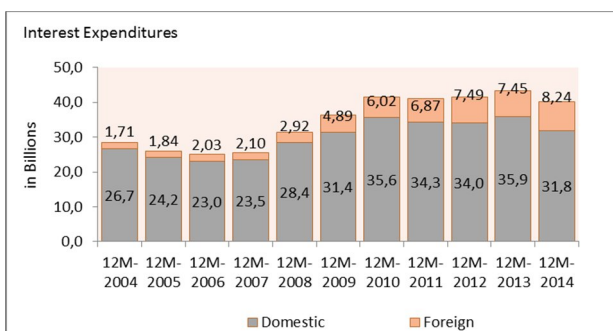
Performance of budget expenditures in absolute terms during the period January – December, in the last ten years, and their



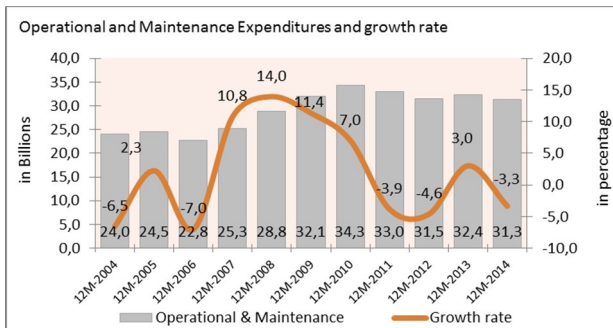
Current expenditures at the end of December 2014 were 341.3 billion ALL, from 349.4 billion planned for the period, showing a shortfall of about 8 billion All. Compared with the initial annual plan these expenditures were realized at 97.7 percent, while compared to the same period of last year, these expenditures result in approximately 12.7 billion ALL more or about 3.9 percent higher.



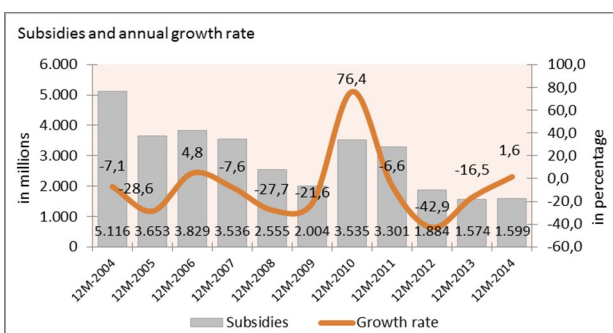
Personnel expenditures, at the end of December were at 71.4 billion ALL, or 1.8 billion ALL more less than the period plan of 73.2 billion. In annual terms, personnel expenditures show a realization of 97.5 per cent for the 12-month period. Expenditures for wages, consisting in some 61.4 billion ALL, were 48 million higher than the period plan, or 329 million more than the same period of last year.



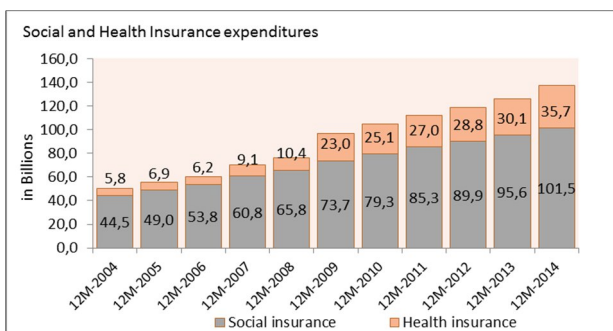
Interest payments expenditures, for the period January - December 2014, result in 40 billion ALL, with a realization level of 99.9 percent. As of end December 2014, interests paid were 3.2 billion ALL or 7.5 per cent lower than the same period last year. Performance of interest expenditures during the first ten months, in years, is illustrated in the graph.



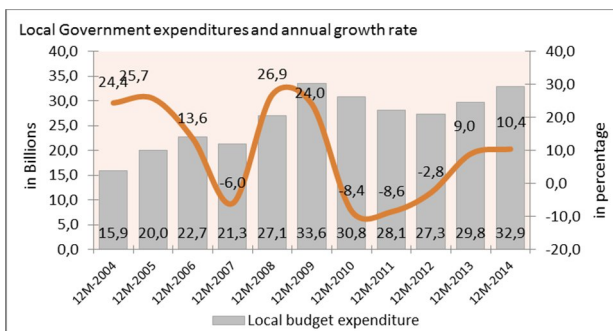
Operational and maintenance expenditures during the period January-December 2014 amounted to 31.3 billion ALL, or 5 billion ALL below the projected figures. When compared to the same period of 2013, these expenditures result 1 billion ALL or 3.3 per cent lower. At the same time, their realisation for 2014 is 85.9 per cent of the annual plan.



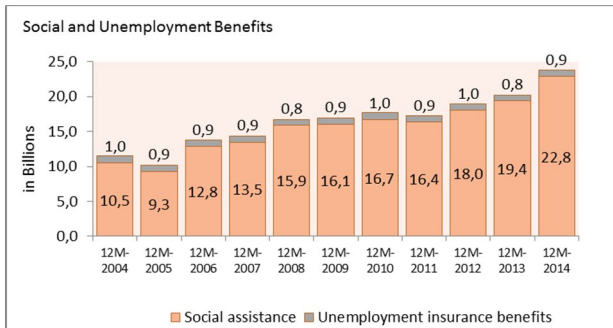
Expenditures on subsidies at the end of December 2014 were 1.6 billion ALL, with an annual realisation of 99.9 per cent. Compared to the last year these expenditures result about 25 million ALL more, or about 1.6 percent higher.



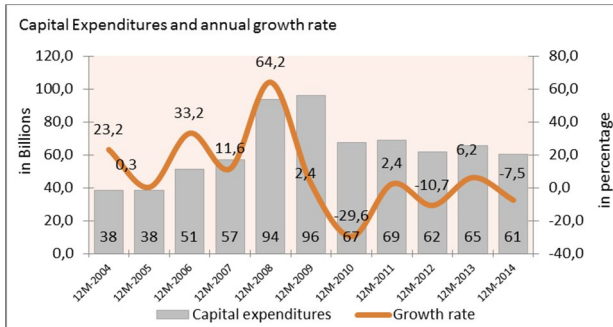
Expenditures for the Social and Health Insurance Funds during 2014 were 138.54 billion ALL, or 2.7 billion above the period plan. In annual terms, special funds expenditures were realized at 102% per cent, of which social insurance expenditures were realized at 100.9 percent of the annual plan, health insurance expenditures at 108.6 percent and expenditures for ex-owners compensation at around 94.1 percent of the plan. Compared with 2013, social security and health insurance expenditures result in 5.9 billion ALL and 5.6 billion ALL more respectively.



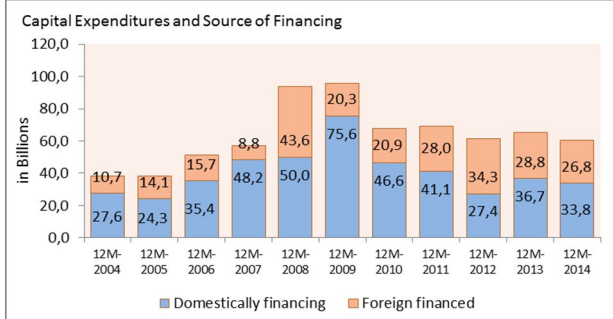
Local government expenditures for the period January-December 2014 were at 32.9 billion ALL, or 4.3 billion ALL less than the forecasted figure for the period plan. These expenditures show a realisation of 88.4 per cent of the 2014 budget. Compared with last year, these expenditures are about 3.1 billion ALL or about 10.4 percent higher.



Unemployment Benefit expenditures, as of end December 2014 are executed at around 102.2 percent of the period plan. At the same time they result in 2.4 billion ALL or about 10% percent higher than the same period of last year. Social benefits for January-December 2014 result in 1.8 billion ALL more or at about 8.8 percent above the period plan.



Capital expenditures by the end of December 2014 were executed at 91.7 per cent of the annual plan. Within these expenditures, domestic financing investments were realized at 93.5 percent, while foreign financed investments are realized at 89.6 percent of the annual plan. Capital expenditures, for the period January-October, in the last ten years is shown below. Compared with the previous year, domestic investments are 2.9 billion ALL lower, while foreign investments are 1.9 billion ALL lower. Consequently, total investments at the end of December 2014 were about 7.5 percent lower or about 5 billion ALL less than the same period last year. The lower level of investments execution is related also to the procurement procedures, which need to be followed for public expenditures. The



composition of the executed capital expenditures for the 12 months period of 2014 is shown in the figure.

3.3. Medium-term budgetary outlook

In order to achieve the fiscal deficit objectives presented in section 3.1, we have adopted a package of fiscal adjustment measures. On the revenue side, the main measures include:

- increase in the excise tax on cigarette from 90 ALL to 110 ALL (savings of 4 billion ALL, including VAT impact),
- increase in the circulation tax (national tax) on gasoline and diesel by 10 ALL per liter (savings of 6.7 billion ALL, including VAT impact),
- increase in the withholding tax for interest, rent, dividends, and capital gains from 10% to 15%, in line with the tax on (other) personal income (savings of 5 billion ALL),
- effect of new VAT law (e.g., removal of deferral scheme for machinery and equipment; 0.3 billion ALL), and
- introduction of a 3% tax on insurance premiums (national tax), except for life and travel insurance (savings of 0.2 billion ALL).

With regard to the improvements in tax policies, the government shall undertake the following actions for 2015:

- The new Law “On Value Added Tax” will start enforcement on 1 January 2015. The Law “On Value Added Tax in the Republic of Albania” adopted in 2014 and instructions for its application are aligned with the Directive 2006/112 EC, 28.11.2006, “On the Common System of VAT”. It consolidates and ensures that rules of applying VAT in Albania comply with those of EU member states; in order not to distort the conditions of competition and not to prevent the free movement of goods and services by eliminating many factors that affect these conditions not only at the domestic level but also to precede the intra-community one.

With regard to the direct tax on income for companies and individuals, there have been changes as following:

- From January 2014, the rate of profit tax in Albania increased from 10 percent to 15 per cent. This is in compliance with the targets of the government to shift from the flat tax of 10 percent to a progressive tax system. Increasing this tax rate with 15 percent is also in compliance with the effective rate of progressive tax on wages.
- From January 2014, Tax on Personal Income from the wages is a progressive tax, with a tax rate as follows:

Taxable Income (ALL/ month)		Percentage
From	To (including)	
0	30,000	(0%) Zero percent
30.001	130,000	+ 13 % of the amount over 30,000 ALL
130.001	More than 130,001	13,000+ 23 % of the amount over 130,000 ALL

In this way, the tax on personal income for wages is reformed, by replacing the flat tax of 10% on wages with their progressive taxation.

- Starting from 1 January 2015 all the other types of personal income, such as dividends income, deposits interests’ income, intellectual properties and copyright income, incomes derived from the transfer of property right on immovable property, etc. will be taxed with a unique rate of 15% as compared to the 10% taxed until the end of 2014.

On the spending side, the main measures include:

- The reform on the disability system (savings of 1.1 billion ALL).
- Modification of the royalty sharing arrangements (national tax) with local governments, which results in a reduction of unconditional transfers to local governments (savings of 0.4 billion ALL)

The total savings as a result of these measures amount to around 21 billion ALL. From this amount, 2.3 billion ALL are measures already adopted under the 2014 budget law. At the same time, fiscal space is created from the downward revision of interest spending projections over the MT as compared to previous fiscal framework, reflecting more accurately the interest spending needs over the medium term. In addition, local government debt will stay at the 2014 level during 2015-17 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 the Parliament in December 2014.

Forecasts of main tax revenues in the medium term ahead are based on the baseline macroeconomic scenario projections and assumptions on the expected tax collection improvement in for each fiscal year. In addition, revenue forecast take into account the net effects of revenue measures foreseen to be implemented in 2015 as well as expected one-off revenues.

Personnel Expenditures by the end of the period 2015-2017 are foreseen to decrease at the level of 4.5 percent of GDP, from 5.1 percent of GDP in 2015 budget law. During this triennial period, the Government's policy will mainly focus on increasing the efficiency and effectiveness of public administration in service delivery. To this end, important investments in the ICT are foreseen to be undertaken during the 2015-2017 period. The aim is to assure faster and better quality services to the citizens and the community, while decreasing the incidence of abusive/corruptive cases. In order to support the abovementioned reforms, there would be a slight increase in the number of public employees, accompanied by the respective increase, in nominal terms, of the personnel expenditures from 64.2 billion ALL in the 2015 budget law, to 65 billion ALL in 2017.

Operational and Maintenance Expenditures for the period 2015-2017 are foreseen to decrease in real terms from 2.7 percent of GDP in the 2015 budget law, to 2.4 percent of GDP in 2017. However, in nominal terms, its level shall be increased from 39.7 billion ALL in the 2015 budget law, to 42 billion ALL in 2017. This is due to the increased support for road maintenance, farmers' subsidies, ICT, health and education.

Subsidy expenditures: The policy regarding the Government subsidies aims at decreasing the financial support for the state-owned enterprises (e.g. water supply, railways, etc.), while devoting a special attention to the newly introduced financial support scheme for the manufacturing industry, which aims at enhancing the existing workers' skills and providing the necessary basic skills for the apprentices. Both, in real and nominal terms, the level of subsidies shall remain constant at 1.76 billion ALL or close to 0.1 percent of GDP, for the whole period 2015-2017.

Expenditures for Economic Assistance and Disability Benefits: During the period 2015-2017, expenditures for economic assistance and disability benefits are foreseen to slightly reduce at the level of 1.2 percent of GDP, mainly as a result of the scheme's foreseen legal and administrative improvements.

Reserve Fund of CoM and Contingency Fund: By the end of the period 2015-2017, its level shall increase to 7 billion ALL, from 5.5 billion ALL in the 2015 budget law. These increased levels are mostly due to the increase of the Contingency Fund, and fully in line with the projections to assure/ increase the "safety measures" for any unforeseen shortfall in the budget revenue side. While in real terms, its level shall remain unchanged close to 0.4 percent of GDP.

Interest expenditures: The estimation for interest expenditures has been based on the debt strategy of Ministry of Finance and the levels foreseen for domestic and foreign financing of this debt. For the period 2015-2017 these expenditures are foreseen to decrease in real terms from 3.3 percent of GDP in the 2015 budget law, to 3.0 percent of GDP in 2017. Thus, reflecting the firm Government's policy to continuously reduce the fiscal deficit and public debt levels, over the medium and long-term period.

The local budget expenditures by the end of the period 2015-2017 shall decrease, both in real and nominal terms, at 2.4 percent of GDP in 2017 from 2.8 percent of GDP in the 2015 budget law. This is mainly due to the foreseen decrease of the Regional Development Fund level, given the new territorial and administrative reform, starting its implementation from the second half of 2015. This important reform aims at increasing the efficiency and effectiveness in the use of funds devoted to the local government units, while providing more incentives to substantially increase their own revenues from tax and fees collections.

Capital Expenditures: During the 2015-2017 period, the level of capital expenditures shall increase, both in real and nominal terms, passing from 4.6 percent of GDP in the 2015 budget law, to 5.3 percent of GDP in 2017. We will still prioritize those projects which continue from previous years, as well as those defined as strategic for country's economic and social development, in accordance with the Government Program and sector strategies.

Payment of arrears: According to the new Strategy for the Arrears' Prevention and Payment, being approved by the end of January 2014, the arrears amount foreseen to be disbursed is respectively, 20 billion ALL in 2015 and 16.5 billion ALL in 2016.

3.4. Structural balance (Cyclically adjusted fiscal balance)

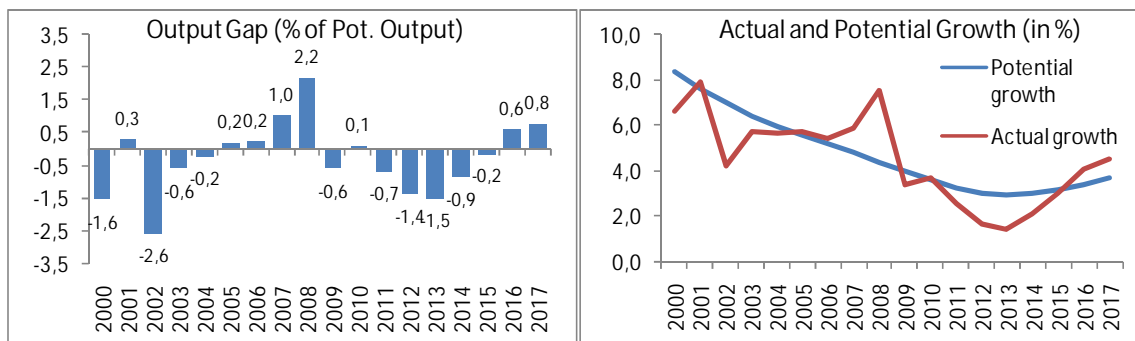
Standard methodologies and techniques were deployed to gauge cyclically adjusted fiscal balance in the case of Albania. However, due to data limitations their relatively low level of disaggregation and relatively short time span, the following analysis is prone to several caveats and limitations and therefore should be considered with caution.

Estimating potential GDP and output gap

The HP filtering technique was deployed to estimate a series of potential GDP. Applying the HP-filter directly on the actual level of GDP or its log-level in order to extract a series for the potential GDP, yielded some economically counterintuitive results related to the output gap (OG). Specifically, we obtained a positive output gap for 2009, 2010 and 2011. Despite a restructuring process taking place in the economy since the hit from the global financial crisis (2009), which probably led to lower output potential, it seemed not plausible to experience positive output gaps during these years.

Therefore, an HP-filter was applied on the actual annual real growth by considering the most advocated values for the parameter lambda in the case of annual data, namely $\lambda = 100$; $\lambda = 30$; $\lambda = 6.5$. The potential GDP growth was then derived as an average of the HP-filtered series based on those three different lambda parameters. Based on the obtained potential growth, the level of potential GDP was then derived and the output level is calculated accordingly. The projections of IMF WEO (October 2014) for 2018 and 2019 were utilized to address the end-point problem common with this filtering technique.

The output gap $OG_t = \frac{GDP_{t,actual} - GDP_{t,potential}}{GDP_{t,potential}}$ is presented on the left side of figure below.



The results indicate that the actual output has been below potential for the 2000 – 2003 period and remained almost at its envisaged potential level during the 2004 – 2006 period. The economy started to operate above the potential in 2007, while considerably overheating in 2008. Since the hit of the global crises in 2009 the economy has been operating below its potential.

Estimating elasticities and budget sensitivity to output gap

After removing one-off items present in the fiscal indicators, the revenues' and expenditures' elasticities are estimated based on both the disaggregated (OECD 2005 approach) and aggregated approach (IMF 2010 approach). However, the final overall elasticities obtained from each approach were quite similar. More specifically, the overall revenue elasticity derived from specific revenue items' elasticities estimated through the disaggregated approach was 1.03, while the revenue elasticity estimated from the aggregated approach was 1.45.¹⁵ Total revenues were adjusted for cyclical effects by applying the average elasticity obtained from both approaches, namely $\varepsilon_{R,Y} = average(1.03, 1.45) = 1.24$.

Regarding the expenditure's elasticities, they also didn't differ from the zero level. The regression analysis yielded expenditures elasticities with a negative sign based on both approaches but none of them was significant at conventional levels, implying an elasticity coefficient equal to zero, $\varepsilon_{G,Y} = 0$. Therefore, total expenditures were not adjusted for cyclical effects. Applying straightforward the formula of the budget balance's sensitivity to the output gap (or the so called semi-elasticity) we obtained the following value:

$$\sigma_B \equiv r(\varepsilon_{R,Y} - 1) - g(\varepsilon_{G,Y} - 1) = 0.251(1.24 - 1) - 0.261(0 - 1) = 0.321$$

Where: $r = 0.251$ is the average ratio of total revenues to GDP (excluding one-offs) for the last five years (2009 – 2013); $g = 0.261$ is the average ratio of primary expenditures to GDP (excluding one-offs) for the last five years (2009 – 2013). The estimated parameter of budget sensibility implies that for each percentage point of negative (positive) output gap the overall primary fiscal balance will deteriorate (improve) by 0.32 percentage points of potential GDP.

Calculating the cyclically adjusted fiscal balance and assessing the fiscal policy stance

Based on estimated output gaps (OG) and the budget sensibility parameter (σ_B) the cyclical component of the primary fiscal balance (CPB) in terms of potential GDP is calculated as: $CBT_t = \sigma_B * OG_t$. Whereas, the automatic stabilizers are defined as the change in CPB in two consecutive years (AS), as: $AS_t = CPB_t - CPB_{t-1}$

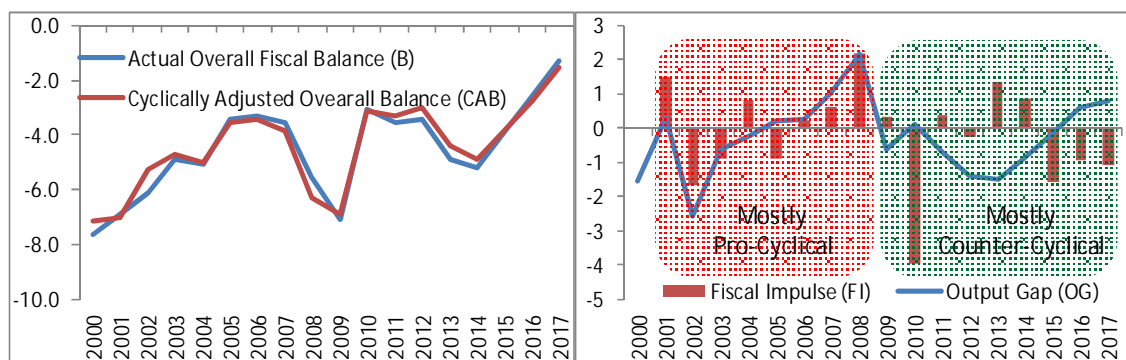
¹⁵ Due to lack of data and relatively short series, in the case of disaggregated approach some of the estimated elasticities / coefficients were not significant at conventional levels and several assumptions were imposed.

The cyclically adjusted primary balance (CAPB) is calculated as the difference between the actual primary fiscal balance (PB) and its cyclical component (CPB): $CAPB_t = PB_t - CPB_t$. The overall cyclically adjusted balance (CAB) is derived after subtracting interest expenditures (INT) to the cyclically adjusted primary balance: $CAB_t = CAPB_t - INT_t$.

Fiscal impulse (FI) in terms of potential GDP is the change of the cyclically adjusted primary balance at each year relative to the previous one: $FI_t = CAPB_{t-1} - CAPB_t$.

Based on the direction of fiscal impulse (tightening or easing) and output gap (negative or positive) a simple assessment as regards the nature of fiscal policy stance is presented, whether it has been pro-cyclical, counter-cyclical or neutral. The obtained results are presented in the following table and graph.

Year	Output Gap (OG)	Actual Overall Fiscal Balance (B)	Actual Primary Fiscal Balance (PB)	Cyclical Primary balance (CPB)	Cyclically Adjusted Primary balance (CAPB)	Interest Expenditures (INT)	Cyclically Adjusted Overall Balance (CAB)	Automatic Stabilizers (AS)	Fiscal Impulse (FI)	Fiscal stance relative to output gap
2000	-1.6	-7.6	-2.0	-0.5	-1.5	5.7	-7.1	-	-	
2001	0.3	-6.9	-2.9	0.1	-3.0	4.0	-7.0	0.6	1.5	Pro-cyclical
2002	-2.6	-6.1	-2.1	-0.8	-1.3	4.0	-5.3	-0.9	-1.7	Pro-cyclical
2003	-0.6	-4.9	-0.6	-0.2	-0.4	4.3	-4.7	0.6	-0.9	Counter-cyclical
2004	-0.2	-5.1	-1.3	-0.1	-1.2	3.8	-5.0	0.1	0.8	Counter-cyclical
2005	0.2	-3.5	-0.3	0.1	-0.3	3.2	-3.5	0.1	-0.9	Counter-cyclical
2006	0.2	-3.3	-0.5	0.1	-0.6	2.8	-3.4	0.0	0.2	Neutral
2007	1.0	-3.5	-0.9	0.3	-1.2	2.6	-3.9	0.3	0.6	Pro-cyclical
2008	2.2	-5.6	-2.7	0.7	-3.4	2.9	-6.3	0.4	2.2	Pro-cyclical
2009	-0.6	-7.1	-3.9	-0.2	-3.7	3.2	-6.9	-0.9	0.3	Counter-cyclical
2010	0.1	-3.1	0.3	0.0	0.3	3.4	-3.1	0.2	-4.0	Counter-cyclical
2011	-0.7	-3.5	-0.4	-0.2	-0.1	3.2	-3.3	-0.3	0.4	Counter-cyclical
2012	-1.4	-3.4	-0.3	-0.4	0.1	3.1	-3.0	-0.2	-0.3	Pro-cyclical
2013	-1.5	-4.9	-1.7	-0.5	-1.2	3.2	-4.4	0.0	1.4	Counter-cyclical
2014	-0.9	-5.2	-2.4	-0.3	-2.1	2.8	-4.9	0.2	0.9	Counter-cyclical
2015	-0.2	-3.9	-0.6	0.0	-0.6	3.3	-3.9	0.2	-1.6	Pro-cyclical
2016	0.6	-2.6	0.6	0.2	0.4	3.1	-2.7	0.2	-0.9	Counter-cyclical
2017	0.8	-1.3	1.7	0.3	1.5	3.0	-1.6	0.1	-1.1	Counter-cyclical



This simple empirical analysis shows that during the 2000 – 2008 period fiscal policy in Albania has been mostly pro-cyclical, relative to the dynamics of the economy, therefore amplifying its cyclical movements. The pro-cyclicality of fiscal policy has been particularly obvious in 2002 and 2008. As the performance of the economy sharply shifted from a positive output gap in 2001 to a considerably negative gap in 2002, the cyclically adjusted primary balance contracted significantly in 2002 relative to the previous year. The opposite happened in 2008 when fiscal impulse peaked to 2.2 percentage points of GDP while the economy was clearly overheating with a positive output gap of the same magnitude.

Since the hit of the global crises in 2009, the discretionary component of fiscal policy seems to have had mostly a counter-cyclical nature, therefore playing its due role of stabilizing the economy and mitigating the cyclical movements. The same countercyclical path of fiscal policy is broadly foreseen for the medium term ahead as well. If we check 2015, the consolidating adjustment of structural balance (including arrears) seems somehow of a pro-cyclical nature since the output gap, although narrowing, is yet projected to remain negative. However, the fiscal consolidation planned to take place in the outer years is well-fitted with the forecasted acceleration of the economy.

3.5 Debt levels and developments, analysis of below-the-line operations and stock-flow adjustments

Debt stock development

Central Government Debt at the end of September 2014 was estimated at 960.801 million ALL or 67.98% of GDP, where domestic debt stands at the level of 39.26% of GDP and external debt at 28.72 % of GDP. At the end of 2014 this debt is estimated to stand at the level of 69.06% or 71.64% by talking arrears into account.

Tab: Stock of total debt, domestic and external

In million ALL	2010	2011	2012	2013	Sht-14	Dec-2014 (Estimate)
Total Debt Stock (without arrears)	715,371	772,517	827,981	884,692	960,801	976,472
I. Domestic Debt Stock	407,372	438,582	470,358	520,786	554,934	564,674
-Government	401,821	429,925	454,695	500,868	533,820	538,641
-Guaranteed	5,551	8,657	15,663	19,918	21,114	26,033
II. External Debt Stock	307,999	333,935	357,622	363,906	405,867	411,798
-Government	268,124	294,276	319,833	332,500	376,268	383,291
-Guaranteed	39,875	39,659	37,790	31,406	29,599	28,507
GDP	1,239,645	1,300,624	1,335,488	1,364,782	1,413,931	1,413,931
Total Debt Stock/GDP	57.7%	59.4%	62.0%	64.8%	68.0%	69.1%
Domestic Debt Stock/GDP	32.9%	33.7%	35.2%	38.2%	39.2%	39.9%
External Debt Stock/GDP	24.8%	25.7%	26.8%	26.7%	28.7%	29.1%
Total Debt Stock+ Arrears/GDP				70.1%	71.2%	71.6%

Source: Ministry of Finance

The following table shows the change in the composition of debt from 2010 up to September 2014 and also includes an estimate for the end of 2014.

The level of debt was increased during 2014 in accordance with the government policy for clearing arrears from the previous years, but starting from the next year it will be consolidated by reaching the target of 60% at the end of 2019.

At the end of September domestic borrowing stands at the level of ALL 32.95 billion or 72% of the planned domestic borrowing requirement for the year 2014. However, if we refer to the revised budget for the year 2014 where domestic borrowing requirement was increased by ALL 5.3 billion, than domestic financing is realized at the level of 65%.

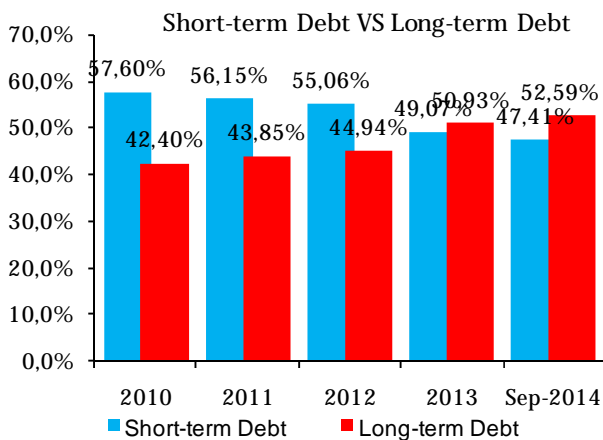
During the year 2014 domestic financing was realized mostly through the issuing of T.Bonds, at the ratio of 78% versus 22% in favor of long term instruments. Domestic borrowing during this year was not fully conducted through long-term instruments due to some difficulties encountered in the market. Investors, mainly banking sector, have been less active than in the previous year (2013) and their willingness of exposure toward long-term instruments was lower, due to compliance constrains related to new liquidity ratios, as well as capital burdens and risk weighting on sovereign risk exposures in accordance with Basel III implementations.

During the last 2 years (2013-2014) domestic net financing was conducted mainly through long

term instruments and this factor has been significant for the improvement of domestic debt structure and extending the average maturity of domestic debt.

However, it is worth mentioning that the portfolio remains still exposed to the refinancing risk and the structure requires further improvement.

Domestic Debt Portfolio



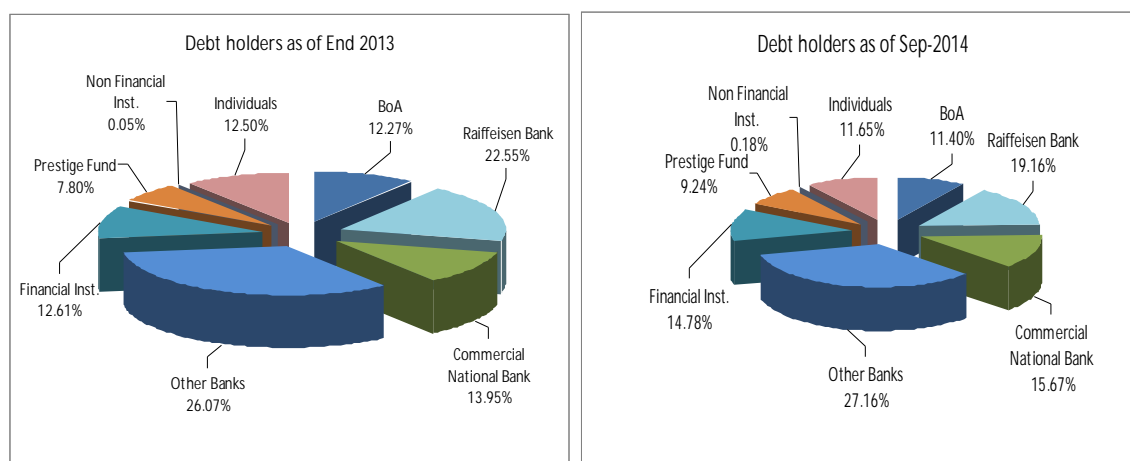
During 2014 the ratio of short-term instruments has decreased from 49.07% at the end of 2013 at the level of 47.41% in September 2014. Meanwhile, the weight of long term instruments in the portfolio has been increased by 161 basis points. During this period, it is noted an increasing tendency toward long term instruments by making the structure of domestic debt more sustainable and at the same time decreasing the refinancing risk.

Source: Ministry of Finance

Debt Holders

During 2014 the number of participants in the primary market for government securities has been increased by contributing in a better portfolio diversification. Is observed a reduction in the share of the Bank's of Albania portfolio and in Raiffeisen's portfolio and at the same time an increase in the share of other banks and in non-banks institution.

Specifically, during 2014 has occurred a decrease in the share of Bank of Albania and Raiffeisen Bank portfolio, respectively with 87 basis points and 339 basis points. Meanwhile, the individual's portfolio during 2014 (as well as during 2013) has shown a decrease by 85 basis points and the same time a shift toward long-term instruments that offer higher interest rates.



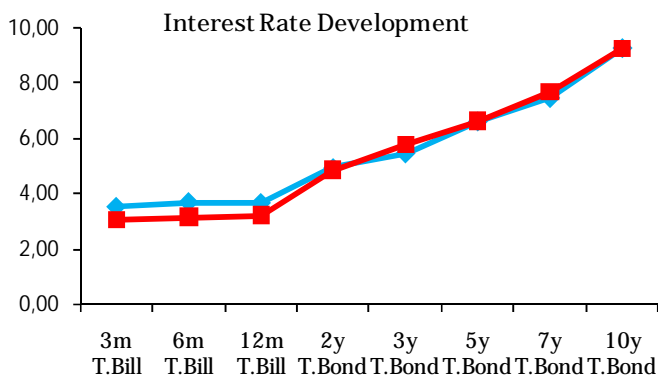
Source: Ministry of Finance

The decrease on the weight of individuals is explained by the fact that recently individuals are using as intermediaries mutual funds such as the Prestige Fund. According to that argument the share of individuals in net basis has been increased compared to 2013.

The diversification of the investor’s base significantly affects the development of the domestic primary market but until now more than 75% of domestic debt portfolio is kept by the banking system, thus constituting a significant risk to the long-term performance and in the limitation of crediting the private sector.

Interest rate development

In the primary market, the interest rates for the governmental short-term instruments have experienced a sharp decline compared to the end of 2013 by standing on the lowest historical values, while the interest rates for long-term securities (excluding bonds 2 years) have experienced an increase. This trend has started since January and has continued during the year.



The demand and liquidity provided by participants in the primary market for the short-term government securities was higher compared with long-term securities. Meanwhile, the bond auctions failure has put pressure in the interest rates and created an upward shift in the interest rate curve for long-term securities.

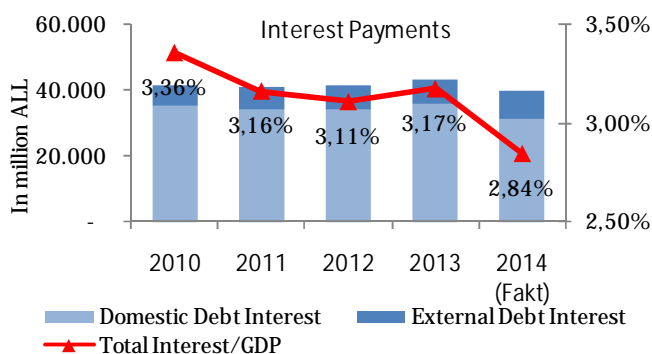
During this year the instruments that have experienced the largest decline in interest rates are the 3-month and 12 months treasury bills and their rates have been decreased respectively by 48 and 46 basis points compared with the end of 2013. Meanwhile, the instruments which rates have experienced an increase are the 3 year and 7 year bond, respectively with an increase of 34 and 22 basis points.

The decline in interest rates in the segment of treasury bills is associated with several factors in the market of financial instruments, such as:

- The increase in demand for these type of instruments because of high risk perception on the segment of long term securities and an increase in the liquidity of the banking system as a result of limitations on crediting the private sector due to the increase of Non-performing Loans (NPL).
- The reduction of the base interest rate by the Bank of Albania due the low inflationary pressures and low domestic demand.

Debt service

Domestic debt service at the end of 2014 is estimated to decrease by ALL 4.5 billion compared to the previous year due to the downward shift of interest rates in the segment of short-term instruments that are issued during the second half of 2013 and during 2014.

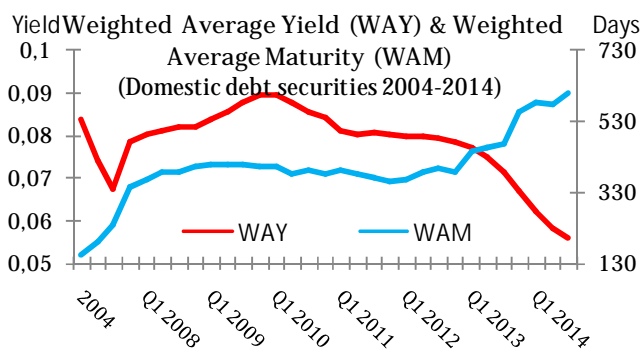


As regards external debt, the interest payments are estimated to increase by ALL 860 million as result of the increase in disbursements. For the above mentioned reason also the external debt repayments during 2014 are estimated to increase by about ALL 5.8 billion. In the long-term vision it is an important commitment the reduction of debt stock in order to manage the costs associated with borrowing.

In the chart is illustrated the medium-term development of government debt service (excluding repayments) in nominal value and in relation to GDP.

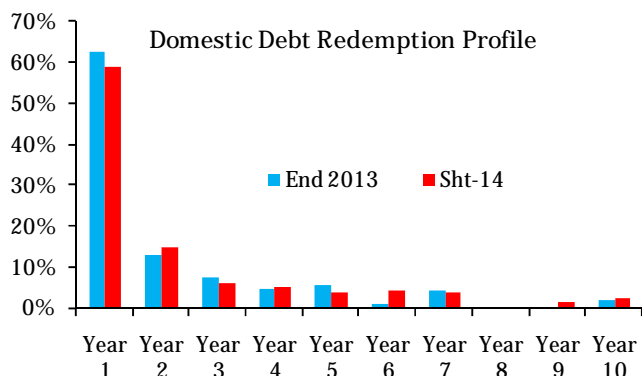
Risk indicators

As regards the risk indicators, during 2014 they continued to experience a positive trend as a result of the issuance of long-term instruments and mainly as a result of the 10-year bond, issued 3 times during this year. The amount of issuance of this instrument during 2014 has been about



ALL 9.7 billion, 2.7 times more than a year ago. The average maturity (WAM, average life of domestic debt portfolio) has experienced significant improvement during this year, reaching the level of 612 days at the end of September compared with 559 days at the end of 2013. This increase is linked mainly to the increase in share of long-term instruments (bonds 10 and 7 years). The weighted average yield (YMP, the average cost of domestic debt portfolio) has also been an improvement

over 2014. This indicator has decreased from 6.72% at the end of 2013 to 5.61% at the end of September 2014 by improving the average cost of debt in the domestic market.



However, the portfolio continues to be sensitive to fluctuations in interest rates, because the decline in interest rates is attributed to the temporary increase of liquidity by banking sector due the restrictions on crediting the private sector, and as well by the decline in the base interest rate by Bank of Albania as part of its monetary policy. Another reason why domestic debt portfolio remains sensitive to the interest rate fluctuations is because of the high level of debt that needs to re-fixed during a single

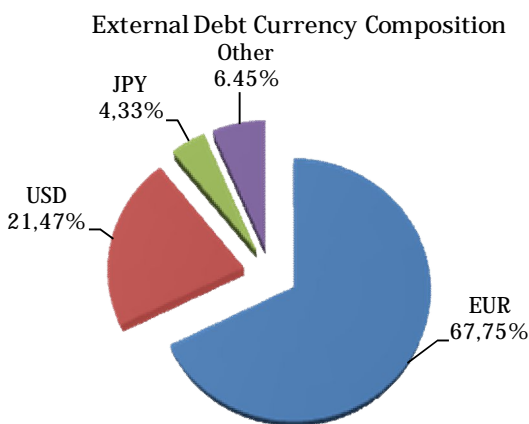
year and that stands in the level of 72%¹⁶. The domestic debt portfolio other than the interest rate risk is exposed also to the refinancing risk, although its improvement during 2014. Refinancing risk is associated with the high level of instruments that mature during a year. For a much clear view below is presented a redemption profile chart for domestic debt as end of September 2014 in comparison with the previous year.

It is worth mentioning that the development of risk indicators has been positive recently but the sustainability in long-term horizon is still a challenge for the domestic debt market of securities.

¹⁶ Are included also short term instruments because they are re-fixed on average every 0.7 years

External debt

At the end of September 2014 stands at the level of EUR 2.9 billion from which EUR 2.7 billion is Government Debt and the rest EUR 0.2 billion is Guaranteed Debt. As regards the currency composition of external debt, it is composed by 3 main currencies EURO, USD, and YEN and the largest share is held by Euro currency (67.75% of external debt portfolio).



Compared to the previous year currencies such as Euro and USD have experienced decline in their weights, accordingly with 44 and 10 basis points. On the other hand an increase is experienced in the YEN currency by 43 basis points. The large share of EURO denominated debt characterizes external debt portfolio by a relatively high foreign exchange risk, which for sure in the future should be mitigated through portfolio diversification.

Disbursement

During the nine months of 2014 were disbursed EUR 323.5 million, of which 323 million belong to sovereign debt. Compared to the previous years, 2014 is characterized by a considerable increase in disbursements, which is attributed to the budgetary support in an amount of EUR 218.7 million, while disbursements of foreign financed projects remain relatively low.

The main sectors of economy that are characterized by the highest rate of disbursement are: Transportation (13.4%), Water Works and Supply (9.00%), and Energy Sector (6%). The amount contracted but net yet disbursed stands in the level of EUR 800 million (excluding the undisbursed amount of Budgetary Support).

Because of the relatively high amount of undisbursed debt it is important to be paid special attention by the Ministries of Line as regards the commitment of new projects and the efficiency of the existing ones.

Market Risks

During 2015 is expected a moderate increase in the interest rates of domestic financial instruments. Higher growth is expected in the segment of long-term instruments, due to restructure of the investor's portfolio (mainly banking sector) and orientation towards short-term instruments.

On the other hand, borrowing in Euro currency in international markets during 2015 it is expected to be cheaper or at the same levels as during 2014. This is according to some forecasts of international financial institutions and due to the expectations of a possible cut in the base interest rate by Central European Bank in order to help the European banking sector.

Even though, on the long run the interest rates can change drastically, so in order to minimize the interest rate risk debt management will tend to orient debt mostly toward fixed interest rate instruments and toward instruments that offer low interest rates, but in the mean time without infringing the objective of increasing the average maturity of debt. Specifically, debt management will aim to keep the share of floating rate instruments within the range of 15-17% of the domestic debt portfolio.

As regards foreign exchange rate risk, as we mentioned before external debt portfolio is vulnerable to fluctuations in exchange rates and especially against the EUR currency fluctuations. The depreciation of the national currency against the Euro currency and other currencies that

occupy significant weight in the portfolio of external debt can influence the budget by increasing debt service costs and also increasing the level of debt. In order to manage this kind of risk, debt management has as medium term objective to maintain the level of external debt not higher than 47%.

Medium-term debt financing

Objectives and borrowing guidance

Debt Management Strategy in order to reduce the risks associated to debt portfolio in the medium and long-term has set some borrowing objectives and guidelines.

In domestic market:

- In order to keep under control and improve the maturity profile, the new domestic borrowing requirements are aimed to be realized through long-term instruments and in cases when domestic financing is low to replace short-term instruments with long-term ones.
- Issuance policy¹⁷ with the aim to define key benchmarks for the long term instruments.
- The implementation of the necessary reforms for the development, and increase liquidity in the secondary market as well as expanding the investor base.

In external market:

- Provide the necessary funds to refinance Eurobond with at least EUR 300 million and with favorable cost.
- Lending abroad through the use of the partial guarantee (PBG)¹⁸ in order to reduce domestic borrowing and to facilitate lending to the private sector.
- Providing foreign borrowing based on the expected financing of projects and being supplemented by the budgetary support in accordance to the agreement with the IMF and the World Bank, as regards the overall liquidation arrears.

Risk control objectives

General objective:

- Decrease public debt under 60% of GDP at the end of 2019

Within the framework of refinancing risk management:

- Realization of domestic financing at least with 70% long-term instruments and in periods when domestic financing is relatively low 100% and maturing of short term instruments.

Within the framework of interest rate risk management:

- Reduction of short-term instruments in the domestic debt portfolio up to 43% at the end of 2017 and up to 40% at the end of 2019.
- Reduction of floating interest rate instruments up to 12% of domestic debt portfolio at the end of 2017 and up to 10% at the end of 2019.

¹⁷ Increase of issuance frequency of the 5 and 7 year bonds in addition to defining a minimum target benchmark size for the 5-7, and 10 year bonds with the systematic use of reopening auctions

¹⁸ It is a partial guarantee that will be issued by World Bank with the purpose to guarantee partially a loan that will be received by the Albanian Government. This partial guarantee gives the opportunity to Albanian Government to lend money with at least 1 percentage point lower than the market rate.

Within the framework of foreign exchange rate risk management

- Keeping under control external debt by not exceeding 47% of the total debt until the end of the medium-term period 2015-2019
- Diversification of currency composition in the portfolio of external debt and reducing of Euro share, through financing the projects with currencies other than Euro or with composite currencies.
- Increase of foreign reserves in Euro currency.

Within the framework of liquidity risk management:

- Switching auctions aimed to reduce the refinancing risk at redemptions of large issues. Mainly it can be applied at 12 months T.Bills of the first quarter.
- Applying Buyback and SWAP transactions
- Maintaining funds on interest-bearing accounts at Bank of Albania and interest-bearing currency deposits.

Within the framework of operational risk management:

- Updating the debt record system (DMFAS)
- Adopting by the World Bank and IMF analytical tools for data analysis and forecast of debt risk indicators.
- Developing and implementing a detailed procedure manual for the Public Debt Department.
- Increasing the capacity of human resources through additional specific trainings.

Financing instruments evaluated for the medium-term period 2015-2019

Within the framework of meeting the need for borrowing requirement, Medium Term Debt Strategy (MTDS) has analyzed and assessed the conditions of the domestic market and international capital markets, determining the financial instruments available for Albania.

In the medium term 2015-2019, MTDS estimates that Albania is able to exploit the following funding options:

Domestic Market:

- Treasury Bills
- Treasury Bonds

In the domestic market, the liquidity offered by the banking system is at satisfactory levels and the credit risk perceived by investors is low. This allows Albanian to refinance the existing debt and domestic deficit through the instruments listed above.

Even though, during 2015 the banking sector within the framework of restructuring the portfolio and because of the mother's bank orientation will tend more to be oriented in the segment of short term instruments.

External Market:

- EuroBond
- Credit Line¹⁹
- Loans for project financing
- Loan partially guaranteed by the World Bank (Policy Based Guarantee)

¹⁹ It is a line of credit similar to a syndication loan that can be exploited in case of the Eurobond failure.

Medium Term Debt Financing

MTDS for the year 2015, by taking in consideration the orientation of investors in the domestic market, mainly toward short-term instruments and in the mean time the low level of crediting the private sector, has decided to decrease domestic financing by expanding external borrowing through the use of the Policy Based Guarantee offered by World Bank. The use of PBG will allow Albania to exploit a loan around EUR 250-300 million with favorable interest rate.

The decrease of domestic net financing with this amount will allow debt management to finance new debt entirely through long term domestic instruments and if it is possible to mature some of the short term debt. On the other hand, this reduction of domestic financing associated with the initiative of the Government to liquidate arrears will give the opportunity to the banking sector to increase lending to the private sector. This may cause an increase in consumption and private investments, thus stimulating the economy to a certain degree.

Another important objective for the year 2015 is the refinancing of the existing Eurobond with an amount of at least EUR 300 million. Eurobond will be refinanced by the same instrument in the international capital markets. In the mean time the Ministry of Finance is taking all the necessary steps in order to conduct another successful issuance of this kind of instrument.

Foreign financing will be realized through borrowing in the form of loans for the implementation of government priority projects and will be supplemented by additional funding by IMF and World Bank under the agreement for repayment of arrears. The value of foreign financing will be in accordance with the value determined in macro-fiscal framework 2015-2017.

Tab: Gross financing in relative terms by type of instrument

Financing	Financing Instrument	2015	2016	2017
Domestic	Treasury Bills	60.0%	70%	70.0%
	Treasury Bonds	17.0%	21%	24.0%
	Total	77.0%	91.0%	94.0%
Foreign	Eurobond	8.5%		
	PBG	6.5%		
	Foreign Financing	8.0%	9.0%	6.0%
	Total	23.0%	9.0%	6.0%

A successful implementation of the financing strategy according to the above table and the realization of the most of the objectives mention in upper sections will led to an increase in the average maturity of domestic debt and increase the ratio between long and short-term instruments from 53/47 on September 2014 to 57/43 at the end of 2017, thus improving significantly the refinancing risk and the structure of domestic debt. For a better view the following charts make a comparison between actual redemption structure and the one after applying the above mentioned strategy of financing.

This financing strategy, also improves the interest risk by decreasing the share of floating rate debt from 54.43% of total debt stock to 51.48%

Sensitivity analysis

One of the main vulnerabilities of this financing strategy in the medium run is foreign exchange rate risk because of the increase of foreign debt share up to the level of 45%-47 % of total debt stock. A possible devaluation of domestic currency against the main currencies that compose external debt portfolio such as Euro or USD can increase the level of debt, external debt servicing, and borrowing requirements.

Specifically, a devaluation of domestic currency in average by 15% against the currencies that

compose external debt stock could increase the level of debt to GDP up to 4 percentage points and in the mean time debt servicing up to 12 basis points.

Fig: Debt level sensitivity to exchange rate shock

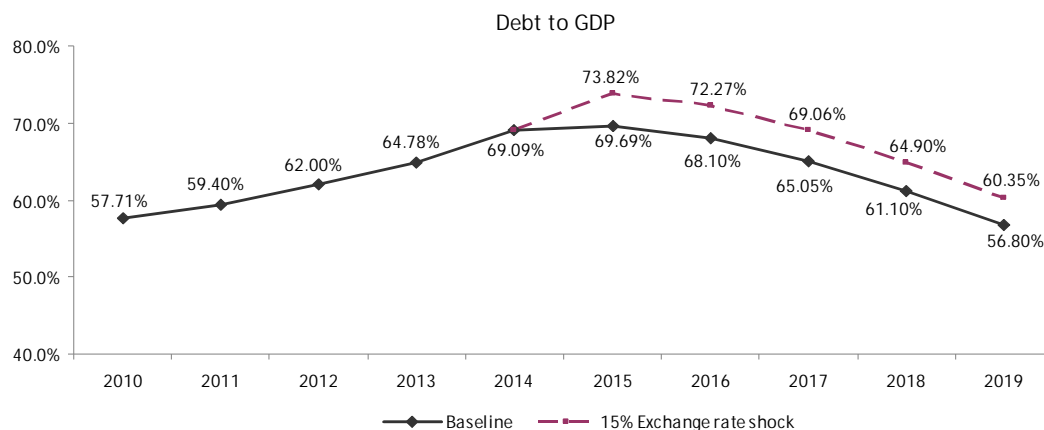
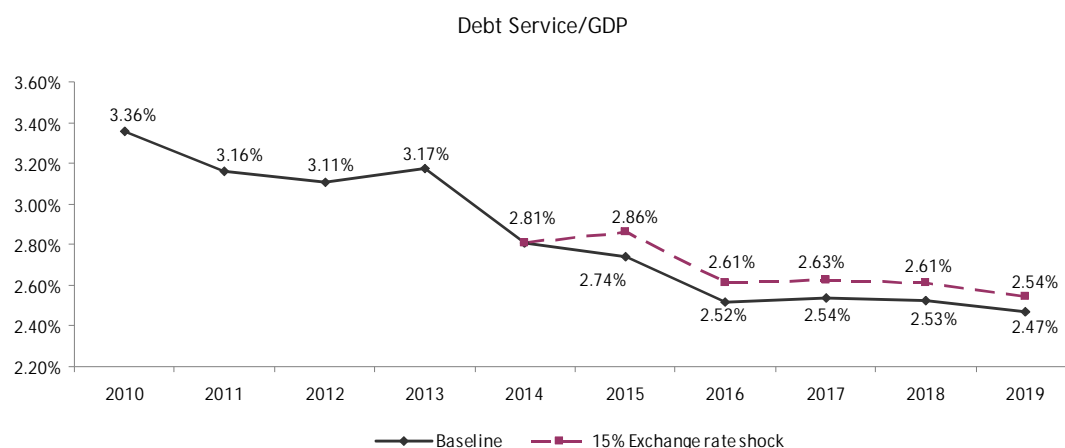


Fig: Debt service sensitivity to exchange rate shock



On the other hand, another risk which has significant effects on the level and mainly on debt service is the interest rate risk of both domestic market and external. An increase in the interest rates in domestic and foreign markets by 25% would have the following effects:

Fig: Debt service sensitivity to interest rate shock (combined domestic and external shock)

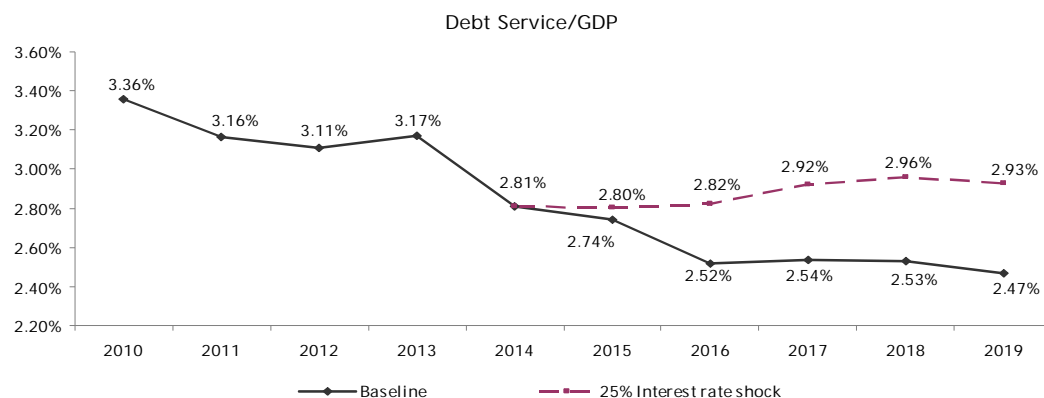
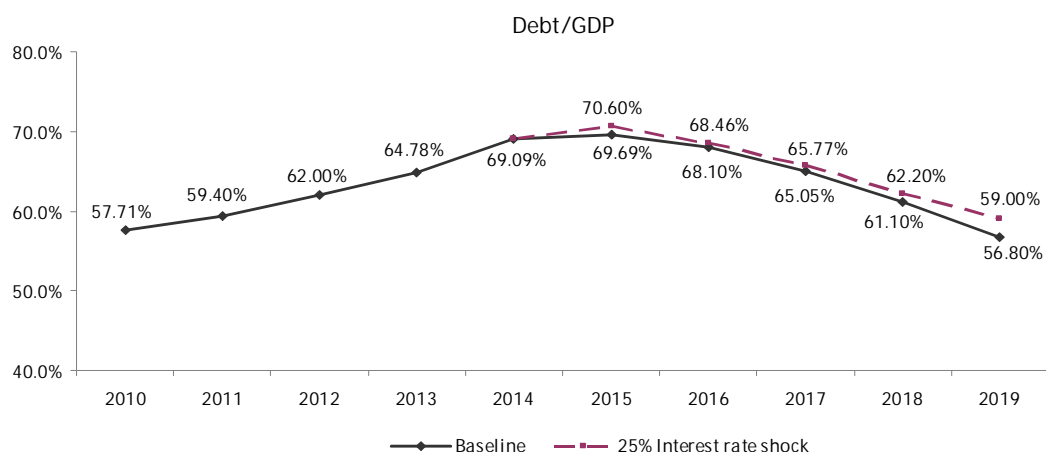
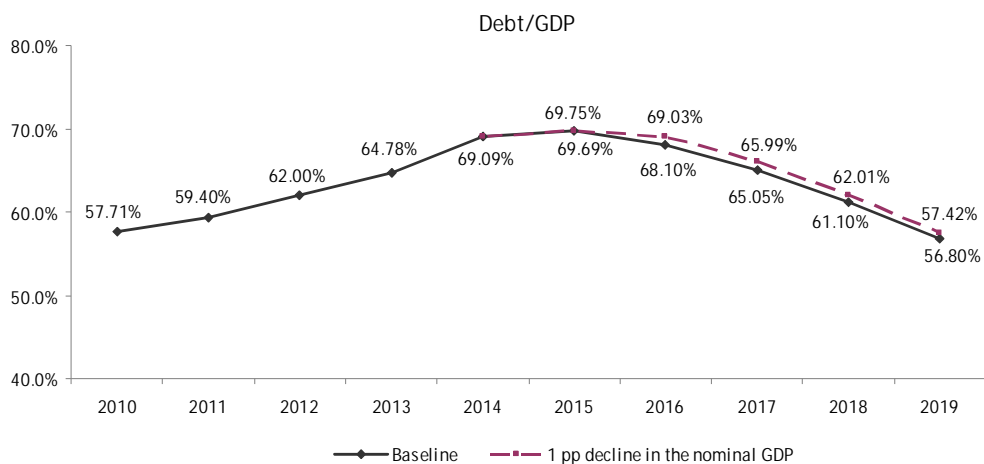


Fig: Debt level sensitivity to interest rate shock (combined domestic and external shock)



Other than the factors mentioned above, in the analysis is also taken in consideration the risk of not experiencing the desired economic growth during the medium- term period. A negative change in the economic growth could have impact on the level of the debt and putting risk on the main objective for decreasing debt under 60% of GDP at the end of 2019. In the analysis it is supposed a decline of 1 percentage point in the nominal value of GDP.

Fig: Debt level sensitivity to GDP shock



The graph shows a moderate impact in the level of debt, because it is a simplified analysis but we should take in consideration that a decline in GDP in reality could effect also revenues and other macro economic factors, which indirectly can have effect on primary deficit, thus increasing borrowing requirement and level of debt in a certain degree more than the one shown in graph.

Also the situation can get more difficult within the framework of obtaining the objectives set in the strategy in cases when can occur scenarios with combination of all the factors mentioned in the above section.

In that context, in order to improve debt sustainability and to limit the sensitivity of the movements that were described above fiscal consolidation is required. Fiscal consolidation can lead to increase in revenues and decrease or balance borrowing requirements during the medium term 2015-2019.

Expected risk indicators

The implementation of the medium Term Debt Strategy in accordance with the assumptions of the baseline scenario at the end of 2017 will generate the following risk indicators:

Constraint	Measure	Value		Importance
		2014	2017	
Refinancing Risk	Average Maturity (years)			
	Domestic Debt	1.8	1.76	High
	External Debt	7.52	7.38	
	Total Debt	4.11	4.28	
	Maturities within 1 year			
	Domestic Debt	59.18%	56.40%	High
	External Debt	16.92%	5.98%	
Total Debt	41.74%	33.92%		
Interest Rate Risk	ATR			
	Domestic Debt	1.62	1.68	High
	External Debt	4.48	3.47	
	Total Debt	2.8	2.47	
	Debt re-fixing in 1 year			
	Domestic Debt	72.11%	65.30%	High
	Foreign Debt	56.75%	54.20%	
	Total Debt	65.80%	60.36%	
	Fixed Debt Ratio			
	Domestic Debt	37.70%	46.40%	High
Foreign Debt	56.77%	48.80%		
Total Debt	45.57%	47.50%		
Foreign Exchange Rate Risk	External Debt/Total Debt	41.26%	44.60%	High

3.6 Sensitivity analysis and comparison with the previous program

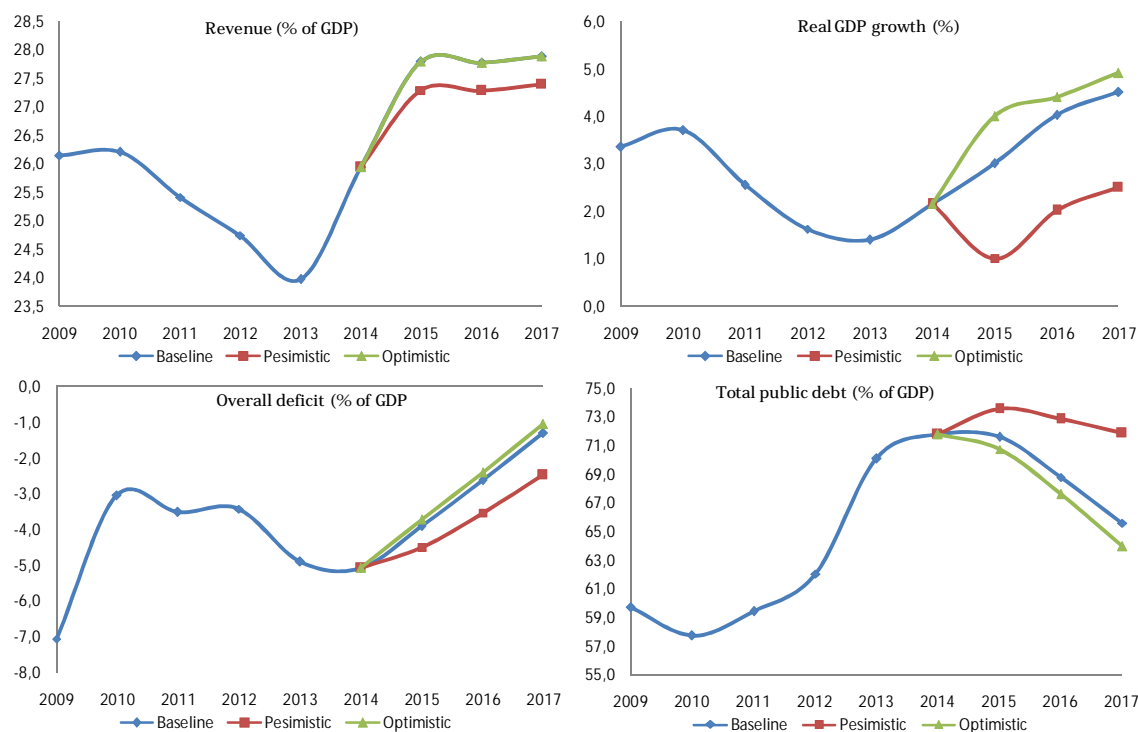
This section presents the expected implications on the fiscal framework as well as fiscal policy possible adjustments. It is in line with the two alternative macroeconomic scenarios presented in section 2.3.

In the case of the "pessimistic" macroeconomic scenario, which assumes a significantly lower growth than the projected baseline during each year, the respective fiscal framework will be based on lower tax elasticity than the baseline. This assumption reflects the rationale that generally a significantly lower economic growth level is expected to lead at lower tax collection efficiency for a number of the major tax components. While in case of the "optimistic" macroeconomic scenario, the revenue to GDP ratio is assumed at the same level as in the baseline scenario.

The overall consolidating fiscal policy is planned to be preserved in each macroeconomic scenario. However, the quantitative target of annual fiscal deficit differs slightly in each scenario reflecting a countercyclical adjustment toward different assumed dynamics of the economic cycle. That is in line with the actual IMF program provisions. More specifically, it is foreseen a relaxation of the fiscal deficit target in case of the "pessimistic" scenario and a stronger fiscal consolidation in the case of the "optimistic" scenario. The amount of loosening (tightening) of the nominal deficit target in the "pessimistic" ("optimistic") scenario equals half of the deviation of total revenues in each of the alternative scenarios versus the baseline. Public debt is expected to be reduced in each scenario. However, contrary to the baseline macro-scenario, the public debt continues to slightly increase in 2015 in the case of "pessimistic" scenario and begins to reduce only in 2016. On the other hand, in the case of "optimistic" scenario it curbs down quicker than in the baseline.

The main items of the expenditures which are planned to absorb most of the fiscal effects in the case of each alternative scenarios are “contingency for safeguarding deficit target”, "contingencies for capital expenditures with domestic financing", and "capital expenditures with domestic financing". Specifically, 2015 budget has accommodated a contingency in the event of revenue shortfalls (contingency for safeguarding deficit target), while 2016 and 2017 in addition to that include other contingency within capital expenditures, which could be easily saved if revenues underperform to safeguard the overall fiscal policy targeted consolidating trajectory. The higher needs for deficit financing in the case of “pessimistic” scenario are expected to be covered by higher "budgetary support from the IFIs", which is part of the foreign borrowing. However, we assess that the additional financing need in this case could be normally raised from the domestic market as well. The fiscal implications of the alternative macro-scenarios are presented in the following table and graphs.

Fig: Dynamics of main indicators under different scenarios



Source: Ministry of Finance

Tab: Main fiscal indicators in each scenario

	2009	2010	2011	2012	2013	2014	2015	2016	2017
						Est.	Proj.	Proj.	Proj.
Total Revenue (in billion Lek)									
Baseline	299.0	324.7	330.5	330.4	327.2	366.7	414.5	443.1	479.0
Pesimistic							399.1	418.5	443.7
Optimistic							418.5	449.1	487.3
Total expenditures (in billion Lek)									
Baseline from which:	379.9	362.8	376.3	376.2	394.1	438.7	472.7	485.1	501.6
(% of GDP)	33.2%	29.3%	28.9%	28.2%	28.9%	31.0%	31.7%	30.4%	29.2%
Current expenditures	283.9	300.9	305.6	312.6	328.6	341.3	364.1	375.2	391.3
(% of GDP)	24.8%	24.3%	23.5%	23.4%	24.1%	24.1%	24.4%	23.5%	22.8%
Capital expenditures from wich:	95.9	67.5	69.1	61.7	65.5	60.5	80.1	82.1	99.3
(% of GDP)	8.4%	5.4%	5.3%	4.6%	4.8%	4.3%	5.4%	5.1%	5.8%
Domestic financing	75.6	46.6	41.1	27.4	36.7	33.8	30.2	23.6	32.4
Contingency for domestic CapEx	0.0	0.0	0.0	0.0	0.0	0.0	0.0	8.7	20.0
Foreign financing	20.3	20.9	28.0	34.3	28.8	26.8	37.8	39.8	38.9
Reg. Dev. Fund Domestic CapEx	0.0	0.0	0.0	0.0	0.0	0.0	12.1	10.0	8.0
Contingency for deficit protection	0.0	0.0	0.0	0.0	0.0	0.0	4.0	4.5	5.5
Pesimistic from which:							465.0	472.7	483.8
(% of GDP)							31.8%	30.8%	29.9%
Current expenditures							364.1	375.2	391.3
(% of GDP)							24.9%	24.4%	24.1%
Capital expenditures from wich:							76.4	74.2	87.0
(% of GDP)							5.2%	4.8%	5.4%
Domestic financing							26.5	23.6	32.4
Contingency for domestic CapEx							0.0	0.8	7.7
Foreign financing							37.8	39.8	38.9
Reg. Dev. Fund Domestic CapEx							12.1	10.0	8.0
Contingency for deficit protection							0.0	0.0	0.0
Optimistic from which:							474.7	487.9	505.6
(% of GDP)							31.5%	30.2%	28.9%
Current expenditures							364.1	375.2	391.3
(% of GDP)							24.2%	23.2%	22.4%
Capital expenditures from wich:							82.1	85.0	103.3
(% of GDP)									
Domestic financing							32.2	23.6	32.4
Contingency for domestic CapEx							0.0	11.6	24.0
Foreign financing							37.8	39.8	38.9
Reg. Dev. Fund Domestic CapEx							12.1	10.0	8.0
Contingency for deficit protection							4.0	4.5	5.5
Overall deficit (% of GDP)									
Baseline	-7.1	-3.1	-3.5	-3.4	-4.9	-5.1	-3.9	-2.6	-1.3
Pesimistic							-4.5	-3.5	-2.5
Optimistic							-3.7	-2.4	-1.1
Financing of overall deficit (in billion Lek)									
Baseline from which:	80.9	38.0	45.8	45.9	66.9	72.0	58.2	41.9	22.6
Net domestic borrowing	43.3	11.3	28.2	24.8	46.3	38.2	39.9	24.5	23.4
Net foreign borrowing from wich:	10.2	24.9	19.8	19.4	10.8	29.9	16.9	17.4	-0.8
Budgetary support from IFIs	0.0	0.0	0.0	0.0	0.0	30.5	14.0	14.0	0.0
Other foreign borrowing	9.6	26.6	17.6	21.6	9.6	1.3	2.9	3.4	-0.8
Pesimistic from which:							65.9	54.3	40.2
Net domestic borrowing							39.9	24.5	41.0
Net foreign borrowing from wich:							24.5	29.8	-0.8
Budgetary support from IFIs							21.7	26.3	0.0
Other foreign borrowing							2.9	3.4	-0.8
Optimistic from which:							56.2	39.0	18.4
Net domestic borrowing							37.8	21.5	19.2
Net foreign borrowing from wich:							16.9	17.4	-0.8
Budgetary support from IFIs							14.0	14.0	0.0
Other foreign borrowing							2.9	3.4	-0.8
Total public debt (% of GDP)									
Baseline	59.7	57.7	59.4	62.0	70.1	71.8	71.6	68.8	65.6
Pesimistic							73.5	72.8	71.8
Optimistic							70.7	67.6	63.9

Source: Ministry of Finance

Other fiscal risks

We are addressing emerging risks to the baseline fiscal framework. More specifically:

- Electricity sector: Notwithstanding the energy sector reform, the prospect of uncertain rainfalls would continue to pose fiscal risk. We will continually assess the situation, any eventual downside and upside risks, through the appropriate revisions in the annual and medium term budgets.
- Property compensation: In addition to payments of 1.0 billion ALL during 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 ALL. 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 (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 include 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 in the event of revenue shortfalls. Appropriations allocated under this category will be saved if revenues underperform to safeguard fiscal policy targets.

3.7 Sustainability of public finances

Fiscal sustainability of the pension system is considered one of the most important elements of public finance stability. A priority measure in improving the sustainability of the pension system has been the implementation of a major long-term reform in the entire social insurance system, but particularly in the pension scheme. The reform focuses on the improvement of the scheme's contributory principle, on the consolidation of the link between paid contributions and benefits provided by the scheme, which based on the conclusions drawn from the current situation, is expected to bring improved coverage rates and an increase in the number of contributors, as well as encourage people to pay contributions upon their full wages, thus avoiding contribution evasion. Such measure, accompanied with improved contribution collection practice, is expected to increase social insurance scheme's revenues.

In addition, the reform comprises several other measures in terms of costs reduction, such as, gradual increase of retirement age, improvement of pension indexation method, harmonization of contributions with contributive subsidy for the self-employed in agriculture in favor of gradual reduction of the related subsidy. The legal framework supporting pension reform has already been adopted by the Parliament, and relevant administrative measures for its implementation have been taken as of 1 January 2015. The reform aims to strengthen long-term financial stability of the pension scheme, and especially to reduce pension scheme's deficit, which is projected to improve from 1.67% of GDP in 2013 to 1.4% in 2015 and gradually decline to around 1% in

2018.

Current situation, projections and some conclusions on long-term development

Social Insurance Reform has anticipated a deep analysis on the situation of the pension scheme indicators. Based on a series of economic and demographic data and on indicators of pension scheme, a long-term projection on the pension plan performance until 2080 has been developed this year. In terms of long-term analysis of pension indicators, the baseline scenario forecasts related to benefits are based on legislation applicable till 2014, the system performance indicators till years 2012-2013 and forecasts of responsible institutions related to demographic and economic developments. From above, it is evidenced:

- The tendency of Albanian population aging will continue in the coming years. It needs to be highlighted that the population over the retirement age versus the total population figure is going to increase from 14.9% to 35.0% in 2080. Also, the dependency coefficient of the elderly is expected to increase up to 68.9% in 2080. Such demographic phenomena and foreseen emigration in the coming years are accompanied by changes in indicators of social insurance scheme.
- In the 50 coming years it is forecasted that there will be more pensioners than contributors, and the latter representing the working age population will support the former group. According to the projections done, pensioners/ contributors ratio will reach the highest percentage by 2060, about 128%.
- The Replacement Rate is expected to decline during almost entire forecasting period. This indicator is forecasted to decline from 36.0% in 2012 to 6.2% in 2080. Such figure indicates the weak link between the pension amount and contributory wage.
- The scheme provides lower benefits. Long-term projections indicate that benefits will be declining even further, if not interfering with reformation, and thus they will not be responding to the mission i.e. providing sufficient incomes for a large number of the future pensioners.
- The system continues to be financially unsustainable and state subsidy remains indispensable and significant.

Distribution

The actual scheme contains unfair elements and is highly distributional. There are contributors paying upon the average till the maximum contributory wage and receiving low pensions due to the administrative pension ceiling determined under the relevant legislation.

Because of the fragile transitional economic developments and high informality rates, part of the working age population is not currently insured. This has substantially weakened the link between contributors and beneficiaries and makes you guess that in the future many of the elderly will not be receiving old age pensions at all.

Financial situation of the scheme will get more difficult demanding higher subsidy from the government. It is obvious that expenditures are growing faster than revenues, creating a deficit, which from around 1.67% of GDP at present goes to 2.3% of GDP in 2027.

Given the analysis on the pension system's situation as well as the anticipated indicators, some pension reform options were drafted and direction to undergo reformation were addressed. Therefore, a forecasting scenario with reformed indicators was projected upon the reformation elements described in details under section 4.2.4. This scenario makes evident:

- Improvement in terms of the population over retirement age versus total population due to increase of the retirement age. Compared to the baseline scenario, this indicator improves in 2080 by about 5.5%. Meanwhile, the decreased number of population over retirement age versus the total population, compared to the baseline scenario, is accompanied with the

increase of the population from 15 years of age to retirement age versus the total population, which goes to 56.3% in 2080 and the decrease of the dependency coefficient of the elderly compare to the baseline scenario, which in 2080 goes to 52.4%.

- Dependency rate in terms of old age pensioners grows until 2034, but at slower rates compared to the baseline scenario. Thus, if during this period till 2034, in the baseline scenario, such ratio differs by 24.7 points, in this scenario, the increase is only 4.8 points. Later, there is a decreasing tendency, reaching 55.7 by the last forecast year.
- Replacement rate substantially improves compared with the baseline scenario. The reform guarantees keeping benefits at normal levels and leads to a significantly improved replacement rate compared with the current scheme. Strengthening the contribution-benefit link by introducing a new pension calculating formula brings about preservation of the replacement rate at almost the same level, i.e. 31.1% by the end of the forecast period compared with 6.2% in the baseline scenario.
- Financial indicators produced indicate significant improvement in comparison to the current scheme. Strengthening the contribution-benefit link makes the scheme more attractive to the citizens, and consequently more people are going to join the scheme. The increased minimum contributory wage and maximum wage indexed to the average wage brings about sufficient revenues to cover the increasing benefits. Therefore, the reform will lead to the reduction of the deficit, which becomes zero in 2042. The reform undertaken reflects gradual amelioration of the financial situation until 2053. Though the financial balance is positive after 2053, the surplus of revenues starts declining, but quite reasonably.

3.8 Institutional features

Several important reforms aiming to significantly improve critical institutional features of public finances are currently underway and others are planned to be implemented in the near to medium term future. The Strategy of Public Finance Management (PFM) 2014 – 2020, which is the result of successful cooperation between the Ministry of Finance, the national and international partner institutions including EC, WB and IMF as well as civil society active in the field of public finance, was recently approved by the Council of Ministers. It is a comprehensive document which makes clear the main underlying problems in the management of public finances and lays down what are the necessary reforms planned to be implemented until 2020 to address the most costly inefficiencies in public finances.

The Strategy clearly specifies objectives, actions, and monitoring indicators for each of the planned reforms. It will serve as the main guideline as well as monitoring document toward PFM reforming process. This document, bears a significant importance, as it not only paves the ground for reinstating the public finances in the long-term sustainability trajectory, thus creating the prerequisites for economic growth, but also constitutes an obligation arising from agreements with international partners, in particular EC, WB and IMF.

The vision of the PFM reform strategy is to ensure a public finance system that promotes transparency, accountability, fiscal discipline and efficiency in the management and use of public resources for improved service delivery and economic development. In the perspective of EU integration, Albania has adopted the EU principles for good public finance management and fiscal prudence, as expressed in the EU 2011 directive on budgeting. The Public Finance Management Reform vision of Albania is to comply with this directive so that its provisions will be met when Albania accedes to the EU.

The overall objective of the PFM reform strategy is to achieve a better balanced and sustainable budget with a reduced debt ratio through stronger financial management and control and audit processes and where budget execution is properly linked to Government policies.

Safeguarding macroeconomic stability and sustainability is the top priority as it will help unlock

Albania's significant untapped growth potential. To ensure stability, the Government will strengthen the overall fiscal framework, create mechanisms to ensure that forecasting is realistic, and tighten the three-year MTBP preparation process.

Prevention of arrears accumulation in the future constitutes a key objective of PFM reforms. Safeguards against a new build-up of arrears have already been put in place, and are further being enhanced. The Ministry of Finance has already adopted the Arrears Prevention and Clearance Strategy in 2014, which envisages clearing the existing stock by end 2017, and specific measures to prevent new build-up of arrears. In this regard, other important measures regarding commitment controls are being further developed as planned in this document. As from January 2014, all procurement orders for goods, services and investments must be controlled for compliance with the procurement plan submitted to the Treasury and must be stamped by the district Treasury branch before procurement can proceed. Multi-year limits for investment projects and other longer term contractual arrangement will be introduced in the mid-term budget document for 2015 and beyond, and these limits will be approved by Parliament as a part of the annual budget law. Severe sanctions will be applied to those entities and officers not respecting these provisions.

The overall fiscal framework will be ensured by a range of legislative measures that will provide clarity and certainty regarding the steps that must be taken. We acknowledge, however, that legislative amendments in and by themselves will not be insufficient to ensure discipline. It also requires strong political commitment and leadership to ensure compliance with existing and new legislation and enforce management responsibility and accountability across the whole public administration.

Efforts will continue to strengthen revenue management, by revising tax policy and reforming the tax and customs administrations to increase its efficiency in the collection of revenues, decrease the tax gap, fight tax evasion and the informal economy. Debt and cash management will be improved.

But it is also of paramount importance that public spending is structured in a way that maximizes the positive impact on the national economy. Priority will be given to projects and programs with a strong impact on economic growth and employment. To improve the quality and effectiveness of government spending in general and capital investment projects in particular, the administration's capacity to appraise projects and to carry out broader sector reviews will be enhanced.

More emphasis will be put on monitoring the government programs. The reporting to Parliament and the public will be greatly improved, in terms of content as well as access. Discussion will be held with Parliament on how to enrich the reviews of the MTBP and its execution and how to hold individual ministers clearly accountable for the programs for which they are responsible.

A prerequisite for good reporting is good accounting. Over the present plan period, accounting standards will be gradually revised with the ambition of eventually becoming fully compliant with the EPSAS accounting standards, as they are finally defined, which is likely to be only in the next plan period. The internal control systems in central and local government institutions will be strengthened to ensure compliance and propriety but also as a means to enhancing the effectiveness and efficiency of the public sector. In parallel with the efforts of the Government, external audit by the High State Control will be strengthened with the objective of aligning its role, set-up, and modus operandi with the standards set by INTOSAI. Actually, the high State Control has been actively involved in the preparation of the Strategy, and is a key member of the PFM Reform Steering Committee, which will, inter alia, monitor progress of the measures and formal commitments that are given in the Strategy.

Modern financial management requires modern and well-integrated systems support. Considerable resources will, therefore, be devoted to designing and implementing an integrated financial management system, an IFMIS supporting all major processes involved in the

management of the government's finances and operations. A unified command for developing the conceptual design for the IFMIS, for coordinating, and for financing the different activities involved in implementing the IFMIS will be set up in Ministry of Finance. The Government will solicit basket funding from its partners for the purpose.

Nevertheless, laws, regulations and IT-systems are not sufficient for achieving our vision of a professionalized public financial administration. Besides political commitment, the integrity, competence and dedication of the public servants that will be responsible for the different functions at the core PFM institutions as well as in the line ministries and spending units is key to accomplishing these reforms. Much effort will therefore be put into developing the capacity of the relevant public administration and in particular budget users both at central and local level through systematic training. Programs to increase capacity in the PFM area will need to be, and will be, supported by measures to modernize the management culture, giving more authority to line managers while strengthening the mechanisms to ensure accountability.

To ensure that the ambitious reforms spelt out in this document are actually carried through, a three-tiered management structure will set up which will guide and monitor the reform actions carried out by the respective responsible entities. A PFM Reform Steering Committee, chaired by the Minister of Finance with high-level participation from the main government institutions concerned including the High State Control and Parliament, will provide the overarching guidance of the implementation process and will decide on any reorientation and restructuring of it. The Steering Committee will be supported by a Secretariat. Pillar Co-ordination Committees will co-ordinate the components of the respective pillars and Component Leaders will drive the implementation of the reforms in each component. In parallel to the activities of the three-tiered management structure, each budget user will be required to identify potential for freeing up resources by highlighting existing shortcomings in terms of meeting its objectives such as technical capacities of staff in its directorates, duplication of activities across directorates, duplication of responsibilities across budget users, identifying obsolete or non-priority directorates etc.

Albania's external partners have an important role in the development of the country's public financial management system. Not least through its financial support for the substantial investment needed in IT and human capacity, but also through the experience and technical expertise that they can provide.

Not all planned reforms can be carried out at once; financial and human resources are limited and creating an understanding of their necessity may take time. They will therefore be implemented in a phased manner over the plan period.

Most urgent is putting in place a legal and procedural framework that will ensure the short- and long-term sustainability of the public finances. The Government will therefore prepare amendments to the Law No.9936 from 2008 on the Management of Budgetary System in the Republic of Albania, the Organic Budget Law (OBL) for short that will provide safeguards against short-term political expediency jeopardizing the long-term sustainability of Albania's public finances. The law will be presented to Parliament by mid-year 2015 with the objective of having it passed before the end of the year.

The other reforms spelt out in this strategy, such as those concerning budget documentation, accounting principles, reporting, performance management, and the design and implementation of the IFMIS, will be phased and implemented over the whole plan period.

More specifically, the six main pillars of PFM reforms which are going to be implemented mostly in the medium term future, while few of them would take a longer term, are briefly outlined as following:

1. Sustainable and prudent fiscal framework, which includes:
 - Establishing legally binding procedural rules that will seek to eliminate the risk of systematic optimistic biases in the forecasts of GDP and budget revenues, forecasts that, in the past, have led to unsustainable expenditure budgets. Several options are presented in the PFM strategy in this regard and the most optimal one will be adopted. Depending of the option chosen, either the Organic Budget Law (OBL) will be amended accordingly or other institutional settings will be established within 2015.
 - Establishing a fiscal rule within 2015 that will guide fiscal policy toward long-term sustainability of public debt, leaving reasonable room for counter-cyclical fiscal policy to smooth strong economic cycles and shocks. The Government will endeavor to have the fiscal rule approved by a qualified majority in Parliament in order to lay a lasting, prudent foundation for the future development of Albania's public finances.
 - Establishing legal rules that, in the years of parliamentary elections, will prevent early exhaustion of approved deficit and borrowing limits. Within 2015, the OBL will be amended stipulating that not more than 30, 55 and 80 per cent of the budget can be executed respectively in the first three, six and nine months of the electoral fiscal year, except for urgent and unforeseen cases, in conformity with the legal framework in force.
 - Restricting the use of privatization proceeds to retiring debt and/or to capital investment. Within 2015, the OBL will be amended accordingly in order to insure that, in future, windfall revenue resulting from privatization and other forms of financial transactions will only be used for debt reduction and/or for public investments of national and socio-economic interest.
 - Strengthening fiscal risk monitoring and management. Within 2017, the risk management function will be strengthened for assessing and proposing measures to mitigate fiscal risks. This responsible unit will prepare risk assessments for inclusion in the budget documentation, advice MoF on risk mitigation actions and monitor risks.
2. Well-integrated and efficient planning and budgeting of public expenditure, which includes:
 - A restored and strengthened process for strategic sector policy development and review. Costed strategies for core sectors that fit within expenditure envelopes will be developed for future NSDIs. This expenditures envelope would be allowed to grow at the rate of projected revenue growth. The sectorial strategies will, in the MTBP, be translated into sectorial ceilings for the triennial. Measures to ensure the relationship between priorities as laid out in the sector strategies and budget allocations will be taken. When warranted because of a change in policy or in the external environment, in-depth sector reviews will be carried out to support the reorientation of the sector strategies. The latter will require a strengthening of the analytical capacity, in numerical as well as competence terms, particularly in MoF but also in some key sector ministries. These actions are planned to be fully completed within 2018.
 - Strengthened processes and institutional capacity for initiating, appraising, prioritizing, and approving capital investment projects. Within 2015 the OBL will be amended to include articles summarizing the principles to apply and the procedures to follow in preparing, appraising and approving major government capital investment projects. The capacity to carry out socio-economic cost-benefit analysis of capital investment projects will be strengthened in numerical as well competence terms. In addition, as a part of the future IFMIS, will be set up a computerized repository for financial as well as substantive information on investment projects. These actions are planned to be fully completed within 2017.
 - Prudent and stringent procedural framework for the preparation of the MTBP. We plan to prepare and submit to Parliament proposals for amendments to OBL with the objective of

tightening the MTBP process. More specifically, these will include: (i) empowering the Parliament to vote on and approve the MTBP ceilings at the program level; (ii) Make the ceilings for the three years of the MTBP binding; (iii) stipulate that MTBP request clearly show which funds are effectively already committed and which are new expenditure under the ceiling; (iv) Ensure the line Ministers/Head of central budget institutions accountability towards the Parliament, throughout the entire budget cycle; (v) Include the policy objectives, on institution/program level, in the Annual Budget Law (2016-2020); (vi) Effectively implement and manage Gender-based budgeting (2014-2020). These actions are planned to be fully completed within 2017.

- Introduce multi-year commitment control for multi-year expenditures. For each year of multi-year capital investment projects and for recurrent expenditure contracted for more than one year, a pre-commitment will be made for the planned level of expenditure in that year. These pre-commitments, which may go beyond the three years of the MTBP, will be recorded in a pre-commitment registry in the AGFIS. In the MTBP preparation process, the record of these commitments will serve as input into, and a cross-check against the requests by the responsible government entities. Therefore, A capital project will only be approved for inclusion in the MTBP if the planned expenditure fits under the ceilings for each of the three years of the MTBP. The amendment of the OBL and other relevant actions in this regard will be completed within 2015
 - Prudent, effective, and efficient financial management of the local governments. The new law on local government financing will clarify the fiscal relations between the central government and local government, and strengthen coordination and the consolidated management of general government operations. The AGFIS will be implemented even at the local level, in order to integrate revenues and local expenditures, at the national level, by increasing the speed and availability of information. This and several relevant actions in this regard are planned to be completed within 2016.
3. Efficient execution of the budget including revenues, expenditures, borrowing, liquidity, external funds, public procurement and public assets management. More specifically:

Revenues

- Reengineer and computerize core tax administration processes. GDT is in the process of implementing a new tax administration IT-system that will manage taxpayer registration, returns filing, revenue payments, tax refunds, tax arrears collection, audit, and taxpayer appeals. The new system will allow a simplification of processes and reduce the opportunities for fraud and corruption. Taxpayers will no longer be required to pay at a bank situated in the region where the taxpayer is registered but will be able to do it through any bank in Albania. In this regard, 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.
- 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 adopted to ensure that the Refund Unit/Directorate has the final authority to decide on refunds.

- Overhaul the tax administration's organizational structures and staffing at headquarters and at field level. As the amount of manual processing will be sharply reduced, personnel can be switched to more value-adding activities such as taxpayer services, audit, and tax fraud investigations. Responsibilities will also be shifted across regional offices to make better use of available staff, centralizing to fewer sites key activities such as tax arrears enforcement. GDT is, presently, working on the new organization in order to full exploit the potential of the new IT-system and to align it with the amended legislation.
- Implement compliance risk management of tax collection. The compliance risk management implemented will be aligned with the model advocated by the IMF, the OECD, and the EC. The GDT will make use of a broad spectrum of methods (e.g. media and compliance marketing, cooperation with industry group representatives, taxpayer education and services, audit, and arrears enforcement) in order to over time increase voluntary compliance. Tax services will be improved to make it easier to comply.
- Strengthen audit capacity of GDT. The professional capacity of the tax inspectors will be enhanced through continuous training. Their efficiency will be increased by providing them with IT equipment for accessing the new tax administration system when in the field.
- Revise the system of the fiscal cash registers and encourage their use. GDT is revising the system of fiscal cash registers to make it possible to capture the fiscal information in real time. To encourage citizens to ask for payment checks at the time of purchase, a lottery based on fiscal coupons is being set up. The first draw will be made in April 2015.
- Establish a fiscal cadaster of properties. In order to lay the information basis for the new property tax, a fiscal cadaster will be established. The purpose of the cadaster will be to consolidate all existing data on land, buildings and owner/occupants, and to calculate the annual tax obligation associated with each property.
- Strengthen the professional capacity of the GDT staff through continuous training. A Training Centre for Tax and Customs Administration has been established under the auspices of the Ministry of Finance. The center will provide training tailored to the evolving needs of the two authorities. The Centre will also support merit-based recruitment of new staff through qualification exams, which will become mandatory for all prospective employees of the tax and customs administrations. GDT has developed the training strategy for different fiscal areas and target groups for the period 2014-2015 and beyond.
- Eliminate procedural ambiguities to create a clear framework for the interaction between the private sector and the Customs Administration. Guidelines are, and will continue to be, issued on customs requirements and the obligations of companies. The objective is to improve the dialogue with the businesses and to standardize to the greatest extent possible all operations.
- Make service delivery at the border-crossing checkpoints more efficient. A single wicket and 24/7 services at the border posts will be introduced to speed up customs clearance
- Unify of a number of important rules and practices into a coherent set of guidelines. The New Customs Code unifies certain important rules and practices which, until now, could have been applied on a case by case basis. A coherent set of guidelines for applying the new Code will be prepared.
- Introduce customs procedures for Authorized Economic Operator. The New Customs Code introduces the concept of Authorized Economic Operator (AEO). For companies granted this status the clearing process will be considerably simplify through a reduction of controls by customs authorities, access to the centralized clearance procedure, on-line

verification of an individual's authority to file a customs declaration, a simplified declaration process, self-assessment, deferral of payments, etc.

- Expand opportunities to appeal decisions by the customs authorities.
- Define the rules for the use of a single guarantee covering many transactions
- Ensure the prompt release of goods when the economic operator provides advance information necessary for conducting audits based on risk analysis.
- Take measures to stamp out fraud
- Improve IT systems and procedures at central and local levels of GDC
- Establishment of the National Valuation Database. A National Valuation Database will be established at the GDC to provide a basis for risk-based transaction analysis.
- 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.

Expenditures

- Fully transparent and efficient recording and control of the government' spending and accrued financial obligations. AGFIS will gradually be made available to all major budget entities. The plan is to roll it out up to 15 institutions by 2015 (responsible for 60% of the state budget); up to 50 institutions by 2018 (responsible for 90% of the general budget); and up to 100 until 2020 (responsible for 95% of the general budget).
- Implement stricter internal controls in AGFIS at the phase of pre-commitment of public funds. In order to prevent the creation of arrears, additional internal controls at commitment phase will be designed within AGFIS. In addition the AGFIS will be configured so as to allow tracking operational expenditures by project code
- Analyze the possibility to introduce an electronic invoice (e-invoice) to foster timely recognition of expenditures.

Borrowing and liquidity

- Minimized costs for meeting Government funding needs for a chosen level of risk and given Albania's credit rating. In this regard the following actions are planned to be implemented within 2017: (i) Review current institutional arrangements, internal organization, and staff responsible for debt and cash management; (ii) Develop a comprehensive debt management strategy; (iii) Develop a strategy for Government securities market development; (iv) Integrate the debt management system with AGFIS and the future AFMIS; (v) Improve liquidity forecasting; (vi) Seek agreement with the external partners to channel all grant and loan funds through the TSA; (vii) Create interfaces with the tax and customs management systems

External funds

- Effective and transparent use of the Government's management and control systems for all external funds, including EU funded projects under IPA programs in Decentralized mode. In this regard we plan to take the following actions during 2015 – 2020: (i) Integrate the management of external funds through the AGFIS/AFMIS; (ii) Increase the predictability of donor flows; (iii) Transparent and effective management and control systems of EU funded projects under IPA programs in Decentralized mode; (iv)

Public procurement

- A modern, sound and effective system for public procurement and concessions harmonized with the legal and institutional framework of the Acquis and EU standards and good practices. To ensure this we intend that during 2016 – 2020 take the following actions: (i) Prepare amendments to the PPL, and to the supporting regulations; (ii) Further align the public procurement and concession laws with the Acquis (new EU directives) and with EU good practice and implement the defense and security directive; (iii) Strengthen the review and remedies system to ensure legality, transparency, coherence and effectiveness; (iv) Further improve the functionality of the public procurement system; (v) Establish mechanisms to control the availability of funds prior to procurement

Public assets management

- Complete asset registry including values and depreciation rules. To improve the management of public assets we intend to carry the following actions by 2020: (i) Initiate and complete the process of full public assets inventory in General Government institutions and Local Government; (ii) Further complete the process of public assets transfer to the Local Government; (iii)
4. Transparent government financial reporting, which includes:
- Within 2015, the preparation of a budget document that, in an accessible format, provides ample information on the macro-fiscal framework, the Government's general policies, sector policies, spending priorities, and descriptions, past results and future objectives of government programs as well as the ceilings for the out-years of the MTBP and the detailed appropriations for the coming years for these programs.
 - Within 2020, improvement of Financial Reporting Standards and the Quality of Financial Reporting through increase of professional capacities and the IT infrastructure. And beyond 2020, as a long term objective in this regard, we intend that accounting and reporting is done in compliance with EPSAS.
 - During 2015 – 2020 we intend to take several actions which will ensure timely, ample and accessible financial and substantive reporting on the execution of the budget.
 - Within 2017 we aim an efficient execution of large investment projects in line with available financial resources and existing implementation capacity.
5. Effective internal controls, which includes:
- Several planned actions which will ensure an effective managerial accountability in local and central governance units as well as a successful implementation of modern management practices at all local and central governance institutions by 2020.
 - Improving the functionality and efficiency of the Internal Audit in the public sector within 2017, as well as of the public financial inspection by 2018.
6. Effective external oversight of the public finances. In this regard we intend to significantly strengthen the external oversight function by bringing it in line with INTOSAI standards by 2017.

4. REFORMS UNDERPINNING THE MACRO/FISCAL STRATEGY

4.1 Obstacles to growth and the macroeconomic structural reform agenda

- Macroeconomic vulnerabilities and high risk premia related with high public debt level
- High government arrears to the private businesses, which have hampered confidence of the private sector
- High level of NPL, which is constraining banks to expand lending activities
- Rule of law and a not so friendly business environment
- Large informality still reigning in the economy and hampering competition.
- Structural problems in the energy sector with otherwise has great growth potential
- Rigid labor market potential linked also with the low quality level of private universities;
- The increase of the economic competitiveness throw the reduction of the regulatory restrictions for the business operations;

4.2 Key areas of macroeconomic structural reforms

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 and supported by the IFC, worked on a range of reforms, including paying taxes, starting a business, access to electricity, and registering property. Because 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.

4.2.1 Product markets and business environment

The main objective of government’s policy for the development of the private sector consisted in the entire reforming of the regulatory framework in the field of business, aiming particularly to the improvement of the business environment, reduction of red tape, as well as implementation of a Small Business Act (SBA).

Doing Business reform:

In the latest "Doing Business" report for 2015, Albania showed significant improvement in the overall ranking, especially on the ease of doing business. From 108th in DB2014 (revalued in the mid of 2014) Albania has reached 68th in DB2015. Especially scores for the following indicators showed significant improvements: starting a business +4; dealing with construction permits + 32; getting electricity +1; registering property +18; and paying taxes + 13; Also it has been lower compared to the previous year in ranking for the indicators like: Getting Credit -17; trading across borders -2; and resolving insolvency -3.

Overall ranking of Albania in “Ease of Doing Business”										
Year	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Ranking	117	120	136	86	82	82	82	85	108	68

Note: ranking of 2014 reflects the adjusted data

Source: <http://www.doingbusiness.org/data/exploreeconomies/albania/>

Improvement of the Doing Business Indicators is at the core of reforms, introducing new initiatives while deepening the already ongoing ones. An inter-ministerial working group, chaired by the Minister of Economic Development, Trade and Entrepreneurship was established to assess and improve on permanent basis the Doing Business indicators.

This working group has prepared the national action plan 2014-2016, proposing measures relating to each indicator. The plan was consulted with the private sector and was approved by the Council of Ministers Decree no. 591, date 10.09.2014. The plan for the period 2014-2017, will be monitored periodically for any possible update allowing for the introduction of new measures and/or reforms.

Sub-groups for each indicator are also established and a deep and thorough analysis is carried out.

Business entry:

The main remaining problem regarding “business entry” as an indicator is not related to business registration but to start-up. Therefore streamlining of the procedures among many institutions involved in this process aims at an effective implementation of the simultaneous registration principle for all public institutions. It will assure the removal of unnecessary requirements as identified (i.e. employee registration, getting company seal, etc.). Moreover, online registration remains at the core of the measures proposed. Investment in the IT system of NRC is at the final stage, allowing full e-registration and electronic notification of the financial statements.

Business registration is offered within a day at the National Registration Centre functioning as a one-stop-shop, costing only 100 ALL. During the reporting period, there were no amendments to the legal framework regulating business registration.

Ministry of Economic Development Trade and Entrepreneurship is in the final stages of finalizing some amendments of the NRC law nr.9723, date 3.05.2007. This new draft aims to:

- make further harmonization of legislation for business registration with Directive 2009/101 / EC. This will directly impact the profitability of businesses, enabling on-line application for business registration and its implementation without additional cost;
- improving procedures for starting a business that will bring another 2 step reduction to the "Starting a Business" indicator;
- improving the legal basis regulating the organization and operation of the NRC and the single windows open at the local government units and other organizations defined by law.

Business exit:

From February 2013 to September 2014, the following bylaws have been approved:

- National Standards for Administration of Bankruptcy Rate, approved by the Decision of Council of Ministers No. 124, dated 06.02.2013;
- “Code of Ethics”, approved by the Decision of Council of Ministers No. 125, dated 06.02.2013;
- Order of Minister No. 159, dated 09.04.2013 “Setting the date of the qualification exam for the bankruptcy administrators”;

- Order of the Minister of Justice, No.26, date 14.01.2014 for Regulation “On determination of detailed rules for bankruptcy and inspection procedures of Bankruptcy Administrators”, approved by the Minister of Justice;

The Strategic Plan of the Bankruptcy Supervisory Agency (BSA) was prepared and is being implemented. In the meantime other legislative changes are in process.

Supported by IFC, the law on Bankruptcy is being amended.

Licensing:

The main problem with regard to licensing is issuing of authorization that are still handled through line ministries. The reform undertaken envisages (i) preparation of the inventory of all authorizations in force, (ii) screening of the necessity for all authorization and propose removal where possible; (iii) introduction of the inclusion of the authorization into NLC system. In addition, based on the practice to date some improvements for the licenses handled by NLC are considered aiming at the removal of the licenses for each “no practice” applies.

National Licensing Centre (NLC) functions as a one-stop-shop for issuing licenses, permits and authorizations.

Regarding the legal framework, the government adopted Decision No 421 of 15.05.2013 “On some amendments to Decision of Council of Ministers No 538 of 26.05.2009 “On licenses and permissions, that are issued by or through the National Licensing Centre (NLC) and some other common sublegal regulations” as amended. The Decisions lays down the rules on the issuing of license and permits by or through NLC related to certain activities such as driving schools, international maritime transport of vehicles and/ or passengers, port services, railway services, and airport services.

The Ministry of Economic Cooperation, Trade and Entrepreneurship is also in process of amending the existing law nr.10081, date 23.02.2009. The draft law aims the harmonization of the name change for the institutions and the Inclusion of treatment authorizations within the NLC law.

The Fason Package:

The measures of the fason package entail streamlining of numerous administrative procedures, mainly tax procedures. Proposals are provided by the industry and encompassed main obstacles faced by business operators. Among them we can mention, effective implementation of VAT reimbursement (i.e. immediately for the industry, within 30 days for lows risk exporters, within 60 days for others), shortening of tax administrative appealing timing, increasing the list of machinery and equipment benefiting VAT exemptions when imported for investment purposes, etc.

The results of the implementing measures under the so-called fason package could be summarized as follow:

- Export growth by 26.08% compared with a year ago,
- Increased share of exports from this industry to 49%,
- Job creation with over 5,000 new jobs,
- 60% of jobseekers were employed in the fason industry;

Given the importance and contribution of the inward processing in production for export as well as employment, the government cooperating closely with the inward processing companies has adopted a package of concrete measures. Out of 46 proposed measures, 32 of them have been approved or are on the way of implementation by the year 2014.

This supportive package represents a group of legal and administrative measures, coordinated with financial support, will enable also technology development as well as a series of quality

services for the development of this industry sector.

This package of measures will help to double within three years the value of exports and the number of employees in this sector.

Support provided by AIDA in this respect includes also:

- A fason help desk was opened to provide information and explanatory notes on the legislative package approved.
- Delivering information campaign through telephone to provide support for fason package. About 150 subjects have been contacted in the framework of this campaign.
- Building of the fason database through a door to door Campaign. 206 undertakings has been identified and contacted and relative data has been updated

Financial and crediting facilities:

The SMEs lending scheme in the framework of the Italian – Albanian Program is being implemented smoothly. In the period 1 February 2013 – September 2014, fourteen projects initiated by Albanian SMEs were supported in the following sectors: dairy and food products processing, olive oil production, production of security doors and accessories, production of prefabricated construction elements, furniture production, poultry meat production etc. Total support for these projects was 3,223,083 Euro.

The second component, the guarantee fund, started to be implemented in April 2011, after the signing of the Albanian Guarantee Fund (AGF) agreement between the Ministry of Economy and eight private commercial banks. The Guarantee Fund, worth Euro 2.5 million, aims to counter effect the main obstacle to bank crediting, lack or insufficient guarantees, as requested to SMEs by commercial banks.

The European Fund for Southeast Europe (EFSE) is one of the largest creditors of the Albanian micro and small enterprises finance sector. EFSE has provided a loan of EUR 20 million to the National Commercial Bank (BKT). Until September 2014, BKT has 29.7 million Euro approved in loans to 465 customers and has disbursed 26.3 million Euro covering 408 customers.

Strengthening the technological capacity of SMEs:

Strengthening of technological capacities of SMEs is carried out in the framework of the Strategic Program on the Development of Innovation and Technology of SME for the 2011 – 2016 period, approved by the Decision of Council of Ministers No 795 of 11.7.2007. Several financial instruments are in place.

Competitiveness Fund, managed by AIDA, for the period 2013-2015 has a yearly allocation of 20 million ALL. It provides grants of up to one million ALL covering up to 50% of the costs of the project presented.

Innovation Fund, managed by AIDA, has a total allocation of 40 million ALL for the period 2011-2014. It provides financial support to (i) hire an expert auditor for innovation and technology and (ii) identify international technology in the form of subsidies up to 400,000 ALL, covering 30% - 50% of eligible cost

Creative Economy Fund, managed by AIDA, has a total allocation of 40 million ALL, 10 million per year, covering the 2013-2016 period. It provides support for (i) product development, (ii) marketing, (iii) qualification and capacity building in crafts sector.

Women Entrepreneurship Fund, managed by AIDA, aims to create facilitated conditions and facilities, as well as direct financial support for this category in order to improve the business climate and operating conditions of female entrepreneurship. Fund consists in the payment of interest on loans taken by women and to be used for business investment. Fund will cover 50% of the interest rate, for four consecutive years, but no more than 1,000,000 (one million), for a loan.

Start-up Fund, managed by AIDA, aims to provide grants for newly created businesses. The Fund will apply for a period of 4 years, with a total amount of 25 million ALL. The scheme covers 70% of eligible costs approved by the Commission and Assessment Fund, within the above limit, and no more than 300,000 (three hundred thousand).

Addressing informality:

Since the transformation of the economic system in the '90, a significant weakness of the Albanian economy has been the high level of informality. It creates significant efficiency losses in the economy and impedes competition. Therefore, we remain determined to continue our efforts toward minimizing such an obstacle for economic growth.

Up to now, the measures taken by the government against informal economy are focused in three main directions, as following:

- The doing business reform, contributing to the business climate and friendly environment and helping the private sector towards formal activities.
- The General Directorate of Taxation (GDT) considers addressing the informal economy as a priority aiming to: (i) increase tax revenues; (ii) eliminate inequality/distortion of competition among taxpayers.
- The State Labor Inspectorate has implemented the following measures to fight informal labor:
 - (i) strengthened the control to the economic operators aiming to eliminate all forms of employment in violation of the labor law, elimination of employment situations without written contracts, and/or disrespecting the legal form required by labor legislation;
 - (ii) increased institutional cooperation with different institutions at central and regional levels, in order to exchange information and conduct joint inspections.

The intention of the government for 2015 is to undertake a specific reform in fighting informal economy.

Main directions for private sector development 2014 – 2016:

- The approval of the Business and Investments Strategy for the period 2014 – 2020, with a Gov. Decree Nr.635, date 1.10.2014.
- The approval of the action plan with Gov. Decree. Nr.611, date 17.09.2014 “on the implementation of the SEE 2020 objectives”.
- Each year performance of the action plan will be monitored for each dimension. This will be done by ensuring close cooperation with relevant institutions. The National Action Plan provides 420 measures, out of which 158 are considered as short-term measures to be implemented in the period 2014-2015.
- The implementation of the action plan 2014-2020, in support of woman entrepreneurship;
- Supporting the growth of social businesses and corporate social responsibility.
- Implementation of the Women Entrepreneurship Fund, covering the payment of interest rate of loans, 50% of interest rate, and max. amount of credit 1 million ALL.
- Implementation of the Start-up Fund, aims to provide grants up to 300.000 ALL, to the newly created businesses.
- Improve SME lending - development of the venture capital schemes and participation to EDIF;

- Implementation of the triple helix method through the adoption and development of the innovation voucher scheme;
- Implementation of the 3-year long Italian program to support SMEs through the soft line credit and credit guarantee fund.
- The development of technology incubators and clusters;
- Strengthening the dialogue with business community.

Progress in the privatization program is as following:

The privatization in the non-strategic sectors

During 2014, we revised the privatization policy of the small and medium non-strategic sector with 100% state capital. The companies with poor economic & financial performance will go into liquidation and some of them will merge. Unused assets of other enterprises with poor economic performance will be offered to foreign and domestic investors to be leased for 1 Euro.

During the January to November period, there were 10 request examinations from investors. In two cases, the contracts were approved by the Council of Ministers. For two others cases, the examination is completed and procedures for the approval of the contracts by the Council of Ministers have been initiated. In three cases, premises leased out to inward processing enterprises under general civil law provisions will be leased to the same enterprises for 1 Euro according to the Decision of the Council of Ministers No 54 of 5.02.2014 "On defining the criteria, procedures and mode to lease, provide under emphyteutic lease or other contracts on state property". Two cases are being procured and one case is under examination.

In 2014 – 2015, we plan the sale of stock in 20 enterprises where the state owns less than 50% of the shares, aiming to generate around 9.4 million Euro in revenues for the state. Sale will be carried out through public auctions as stipulated by Law No 9874 of 14.02.2008 "On public auction" giving pre-emptive right to pre-existing shareholders. The privatization of assets will be carried out through public auction, as well.

The privatization situation in strategic sectors

Regarding privatization in the strategic sectors, a working group, with technical assistance of IFC, is studying the possibility of restructuring the large state-owned company AlbPetrol. The scope is to identify the proper form of sale or public-private partnership (concession, joint venture, etc.) in order to maximize efficiency in the interest of the state and the public (to increase production, employment, investment in the oil sector, etc.).

Regarding Albtelecom, we are analyzing the reasons that halted the sale of the state-owned shares last year. This is done in order to design an adequate framework for another attempt to sell the remaining share package of 16.76%.

The remaining share package by 14.9% of ARMO sha. is planned to go to auction during the 2015-2016 period.

State-aid main policy priorities for 2015-2017:

- Ensure an effective and transparent system of state aid control in Albania.
- Continued compliance with Articles 70 and 71 of the Stabilization Agreement and with the Law on State Aid of 21.05.2005 as amended by Law 10163 of 29.10.2009.
- Continued alignment with community law and guidelines on State Aid, state aid law and regulations updated.
- Effective monitoring and reporting of State Aid measures.
- Continued and increased awareness raising activities on State Aid issues to all State Aid granting authorities.

- The development and implementing of a simplified system of monitoring of State Aid including de-minimis aid, with support from experts from the United Kingdom.
- Drafting and approval of the annual reports on State Aid.
- Awareness raising activities, including regional workshops, delivered with support of experts from the United Kingdom.

Reforms in the energy sector

Electricity Sector

In addition to addressing the fiscal risks in the energy sector which are completely factorized in the fiscal framework, 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. 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%, 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.

These reforms in the energy sector are in line with the European Union directives. The objectives of EU policy on energy are competitiveness, security of supply and sustainability. The liberalization of the energy market and the introduction of private operators in the market is one of the main challenges of the energy sector under European Union directives.

Albanian has done progress in aligning its legislation with the EU acquis in the field of energy. The law no. 9072, date 22.5.2003 "On power sector" is revised in order to be further aligned with the EU general principles and the acquis on award of energy sector. These changes are reflected in accordance with energy sector development, affecting the improvement of energy supply and energy market opening, but diversification of electricity sources is still lacking.

During 2014, is prepared the new Law "On the Power Sector" in full compliance with the Directives of European Union and the inclusion of the Third Package of the Internal Market, which is expected to be approved soon. Upon adoption of this law, it will be opened the road towards adoption of other legal acts, the preparation of the new design of the Electricity Market and the further liberalisation, with the aim to achieve an efficient and complete market opening.

During the 2015-2017 period, will continue the implementation of the program for development of the National Energy strategy for the period 2015-2030. The main challenges during 2015-2017 period and beyond, are linked to the improvement of the structure of supply with primary energy sources, building of the new generation capacity of the country, reduction of network loss, further building of energy exchange capacities with the countries of the region etc.

In the context of liberalisation of the energy market and entry of private operators into the generation market, so far, there have been concluded 169 concession contracts for the construction of 450 hydro-power plants, with a total installed power of 2.9 GW, and an overall investment value amounting to approximately EUR 2.615 milliard. Actually 104 hydro-power plants are productive, with a total installed power 210 MW, which generate 0.8 TWh/year.

The priorities of the 2015-2017 period are part of the long-term priorities of the government for the development of the energy sector and are connected to the implementation of the following programmes and projects:

- Construction of big, medium and small hydro-power plants: investment is expected to have a considerable impact on both the balance of production and exchange of energy and budget revenues. Main investment is linked to: construction of HPP in Devoll river (280 MW), Osum river (152 MW), Vjosa river (350 MW), Drin/Skavice river (200 MW). The measures taken for successful implementation of the above-mentioned projects are linked with the creation of fiscal and procedural facilities, including schemes to facilitate the crediting of small HPPs.
- The main Albanian Projects for the increase of interconnection capacities are: The construction of the Albania-Kosovo interconnection line, which is expected to be concluded within 2016 year. During the period 2015-2017, we will work to prepare the technical specification for the construction of the interconnection line with FYROM, Albania-Macedonia, and identifying the financing source. Along with the building of interconnection capacities, work is focused even on the strengthening of the national transmission system,

through investments in the strengthening of existing lines and building of new lines, thus increasing the transmission capacity and the supply stability in the country.

- The main Albanian project in the construction of transmission lines are : project of the south ring, the line 220 kVTirana2-Rrashbull, the line 220 kV Elbasan -Fier , project of Tirana Ring.

With the passing of the Distribution System Operator Albanian in state-owned, we will develop the master plan for this sector. This project will be financing with a loan of USD 150 million from the World Bank, of which USD93 million will be invested in the distribution system to strengthen the distribution network and several substations, as well as supplement with electricity meters of customers, where OSHEE Jsc will co-finance about USD 45.3 million for this project, as part of the obligations arising from the loan agreement.

Hydrocarbon sector

Hydrocarbon sector is very important in Albania Economy. The Albania is producer of oil and gas and has the high potential for discover the new oil and gas fields. The consume of oil by-productions currently is about 60-65% of the total energy consumption in Albania. The preparations for the approximation of the third Energy Package are at finale stage.

In the oil and gas sector, the following legal acts were adopted:

- Law No 71/2014, dated 07.10.2014 "On some amendments to Law no. 8450, dated 24.2.1999, "On the processing, transportation and trading of oil, gas and their by-products", as amended.
- Law No 183/2013 of 28.12.2013 "On an amendment to the Law 7811 of 12.04.1994 "On the approval with some amendments of the Decree No 782 of 22.02.1994 "On the fiscal system in the hydrocarbons sector (exploration – production)".

Activity development and production of oil and gas carried through the Petroleum Agreements between the parties (Albpetrol and other companies) approved by Decision of the Council of Ministers. Currently are in force 16 Hydrocarbon Agreements. Exploration for oil and gas on exploration blocks have been done by the Petroleum Agreements between the parties (NANR / Albpetrol and other companies)and have been approved by Decision of the Council of Ministers. Currently, there are in force 7 Hydrocarbon Agreements.

The oil production increased by 18% in 2013 compared to 2012 (The total crude oil production in Albania in 2013 reached at 1,205,538 tons from 1,021,031 tons produced in 2012) and it is foreseen to continue with the same rate during the next 5 years. Petromas Albania GmbH and Shell International are carrying out exploration in Blocks 2 and 3. In January 2014, the companies declared a new exploration in well Shpiragu 2 located near Berati. The well was tested and it produced around 250 tons crude oil daily accompanied by about 100,000 m3 gas daily.

Regarding the Oil Stock obligation, as regulated by Article 9 of Law No 8450 of 24.02.1999 "On the processing, transport and trade of oil, gas and their by-products", as amended, 50 Orders of Minister of Energy and Industry were issued on 30.12.2013, based on the average selling reports of 2012 prepared by wholesale trades company. In 2014, the wholesale companies are obligated to store as Oil Stock reserve the fuel quantities of about 170 000 tons, by-productions and some significant quantity of crude oil.

Upon the Order of Prime Minister No 233 of 2.12.2013 "On establishing an inter-institutional work group for the review of the legal and institutional framework on keeping and managing the oil, gas and their by-products safety reserves", a work group was set up to prepare the legal amendments for the full transposition of the Council Directive 2009/119/EC of 14 September 2009 imposing an obligation on Member States to maintain minimum stocks of crude oil and/or petroleum products.

The quality of oil products which is consumed by the internal market have to be according to EU standard, since 2011 for Gasoline and Diesel. There are two Decision of Council Ministers (nr.147, dated 21.03.2007 and nr.781, dated 14.11.2012) by which the Standard of oil products are

obligated to be according to EU standard (Gasoline – SSH EN 228, Diesel – SSH EN 590, and the sulfide content of certain liquid fuels have to be according to Directive 1999/32/EC)

The following strategies/ laws are being prepared:

- Draft National Energy Strategy is being prepared by a work group set up by the Order of Minister of Energy and Industry No 29 of 17.01.2014. The new Strategy aims to define the main challenges, goals and actions for the period 2015 – 2030. The draft Strategy shall take into account the construction of TAP Pipeline, as well;
- Draft amendments to Law No 9946 of 30.06.2008 “On Gas Sector” are being prepared in order to transpose the Third Energy Package.

For the next years hydrocarbon sector will be focused in:

- Ensuring a safe supply of hydrocarbon energy resources of Albania market by the diversification of the supply with hydrocarbon energy sources
- Increase the domestic crude oil production
- Modernization of the existing refinery in order to increase the real refining capacity and the quality of by-products which will go to the internal market have to be according to the Albanian legal framework.
- Increase the monitoring role of the Albanian authority in order to guaranty the transparency, competition and fair of the hydrocarbon activity in Albania as well as increasing the efficiency for exploitation and using of the hydrocarbons domestic natural resources.
- Realization of the master plan for gasification for Albania and encourage the regional integration projects in order to connect the Albania with international gas pipeline network such as TAP project, IAP project etc.
- Development the gas sector under the Third Energy Package.

4.2.2 Financial stability

Progress in strengthening the stability of the banking system

During the October 2013 – September 2014 period, the Bank of Albania has continued the revision process of the regulatory framework in accordance with the provisions of the banking law, the Basel Committee recommendations, EU directives and developments in the Albanian banking system. In this regard, the Supervisory Council (SC) of the Bank of Albania has approved several regulations and amendments. The document²⁰ “On Supervisory Policy” includes the necessary instruments of planning in order to allow for a dynamic supervisory process based on the risk profile of the supervised institutions. The new document, defines a risk based supervisory policy for banks and banking or financial groups, supervised by the BoA. In the previous supervisory model, the determination of the banks risk profile was based on the CAMELS system. Currently, the risk profile of banks shall be evaluated using the Risk Assessment System (RAS).

The document²¹ “On Risk Assessment Manual” brings significant improvements to the existing examination manual. It introduces new procedures for the examination and assessment of new additional risks. The addition of these examination procedures shall contribute to further strengthening of the supervisory process and a more comprehensive treatment of the full range of risks assumed by the banking system. It introduces a new risk assessment system that provides a structured algorithm to determine the bank’s overall risk assessment based on individual assessments on each risk. It brings about an overall improvement of examination

²⁰ ²⁰ Approved by decision no. 09, dated 26.02.2014 of Supervisory Council of Bank of Albania

²¹ ²¹ Approved by the order no.590, dated 27.02.2014 of the First Deputy Governor of the Bank of Albania and enters in force by 1st January 2015.

procedures, providing tools that are more effective for the supervisors to use during onsite and offsite supervision.

Regulation²² “On the risk management from large exposures of banks” is fully revised, intending fair alignment with the rules and concepts of the new Bank of Albania regulation on capital adequacy and the new EU regime on large exposures (Regulation “On prudential requirements for credit institutions and investment firms” - Part III/Large exposures). This regulation provides for some more qualitative requirements for banks. It also addresses the Steering Council responsibilities, in particular, for decision making process in cases of creation and restructuring of exposures to large borrowers. Furthermore, it provides requirements dealing with:

- a) risk analysis (underwriting practices) of exposures to large borrowers on an on-going basis, which should be based on certified (audited) financial statements;
- b) development of large borrowers’ recovery and resolution plans and their revision with a frequency of, at least, once a year;
- c) coordination and participation of banks in collective recovery and resolution plans with other banks, in case of exposures to the same large borrower (or group of connected borrowers), even when the exposure is not considered large, on an individual bank level.

This regulation shall enter into force in December 31, 2014.

The Supervisory Council approved the new guideline²³ “On Recovery Plans for banks”. It determines the core principles, as well as supervisory requirements, on the structure and contents of the Recovery Plans, and reporting requirements for banks. According to the requirements, banks are obliged to submit the first Recovery Plans prepared in accordance with the guideline, within the first quarter of 2015.

The Supervisory Council approved amendments to the regulation²⁴ “On Credit Risk Administration”. These amendments provide for some obligatory requirements for banks related with the write-off process (according to these, banks are obliged to write-off the nonperforming loans not later than 3 (three) years after they have been classified in the “loss category”).

The Supervisory Council approved amendments to the regulation²⁵ “On the licensing, organization, activity and supervision of foreign exchange bureaus”. These amendments aim at strengthening the supervisory processes and at increasing market discipline regarding consumer protection in the field of foreign exchange activity.

Due to several measures taken by the Bank of Albania (BoA) and the Government to address the high level of Non-Performing Loans (NPL) we have managed to stabilize the potentially further increasing of the NPL level. We believe that the agile progress in the payment of arrears has contributed positively and significantly to avoid a further deterioration. Some positive developments have already taken place, especially related to the crediting levels in the economy.

We plan to undertake additional measures to facilitate problematic loan restructuring. These include cooperation with FinSAC/WB 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, with IMF technical assistance, in order to facilitate private balance sheet restructuring.

We remain committed to implementing the amendments of the Albania Financial Supervisory Authority’s (AFSA) law to ensure its independence. We will move quickly with the nomination of

²² Approved by decision no. 10, dated 26.02.2014 of Supervisory Council of Bank of Albania.

²³ Approved by decision no. 11, dated 26.02.2014 of Supervisory Council of Bank of Albania.

²⁴ Approved by decision no. 22, dated 27.02.2014 of Supervisory Council of Bank of Albania.

²⁵ Approved by decision no. 31, dated 30.04.2014 of Supervisory Council of Bank of Albania.

a new Board to ensure that it is in place by January 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.

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.

Reporting system (COREP)

Meanwhile, the Bank of Albania has already approved and presented the accompanying COREP templates to the banking industry. The Bank of Albania has also started a parallel reporting process (testing of the new supervisory reporting framework) regarding capital requirements based on the new regulation, in order to facilitate its smooth adoption. The process started in the second quarter 2014 and shall last until the end of 2014.

Medium term potential regulatory changes and developments

In general: Further alignment with the requirements of the following documents:

- DIRECTIVE 2013/36/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, and
- REGULATION (EU) No 575/2013 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012

Specific issues/fields:

- Strengthening of the corporate governance regulation and supervision (addressing remuneration issues, etc.);
- Revision of the consolidated supervision regulatory framework;
- Introduction of the liquidity indicators in the regulatory framework according to the Basel III;
- Supervisory review process (ICAAP and SREP).

4.2.3 Labour market

With the proposition of the Ministry of Social Welfare and Youth, the Council of Ministers has approved a National Strategy on Employment and Skills 2014-2020 to address the critical issues of unemployment and skills mismatch. Inspired by the overall objective of Europe 2020 Agenda for smart, sustainable and inclusive growth, the aim of the Strategy is to have a competitive economy and inclusive society grounded on high skills and better jobs.

The National Strategy for Employment and Skills focuses on four strategic priorities: i) foster opportunities for decent jobs through efficient (active) labour market policies; ii) provide qualitative vocational education and training to youngsters and adults (VET); iii) promote social inclusion and territorial cohesion; and iv) enhance the governance of the labour market and qualification systems.

To address the skills mismatch problem an overall reform of the VET system is under process. The first step of the reform was to transfer all vocational schools under the authority of the Ministry of Social Welfare and Youth. A second step will be the introduction of the dual model according to which students spend at least 30% of their classes practicing in local businesses and enterprises. Moreover, to better connect the skills that the schools provide with the needs of the local economy, the National Employment Service (NES), assisted by the ILO-IPA 2010 HRD project, has begun to conduct a study of the private sector needs for skills and vocational training. In 2015, the results and recommendations of this study will serve as a guide for the VET system in opening new study programs or re-processing the curricula in accordance with the needs of the labour market.

With the assistance of the ILO-IPA 2010 HRD Project, a reform of the employment service system is under way. To improve job mediation new employment offices are being opened in areas with high visibility. These offices offer a new model, which categorizes employment services in three levels: job mediation, vocational training and specialized employment services for disadvantaged groups. Until November 2014, ten new jobs offices were opened and the process will continue in 2015 until all 36 existing offices have been replaced.

The Active Labour Market Policies in Albania are composed by six programs focusing on on-the-job training, employment for women from special groups, employment for disabled, employment for vulnerable groups, employment for the youth as well as internships for jus-graduated. In 2014 the Active Labour Market Programs' Fund increased by 300% while in 2015 it will double. It is expected that in 2015 at least 5,000 unemployed jobseekers will be employed through this programs, 60% of which will be in the 15-29 age group.

4.2.4. Public finance reforms

Pension reform

Last year was marked by a full Social Insurance System reform. During the first half of 2014 a Policy Paper related to pension schemes was drafted and discussed with stakeholders and experts. Pension Reform was approved during the last trimester of 2014 and it entered in force on 01.01.2015. Key elements of the social insurance reform consist as following:

- Gradual increase of retirement age, starting in 2015 and ending in 2056. Thus, women's retirement age will increase by two months a year, to reach 63 in 2032. As of 2032, retirement age for men will increase by one month a year, while for women by two months a year, reaching 67 years for both genders in 2056.
- Merging the two existing schemes (urban and rural) in a unique national scheme until 2018. Until now, the pension system has operated with the two parallel urban and rural schemes, with the latter highly subsidized by the Government Budget to cover a considerable part of farmers' contributions. The reform is supposed to cut the subsidy for the rural sector. Rural contribution rate will gradually increase until equalizing with urban contribution rate. In addition, the pension formula for the rural scheme will also improve.
- Unification of the minimum contributory wage to the official minimum wage. To the end of 2014, the minimum contributory wage of the self-employed persons was about 12% lower than the respective minimum wage of employees, while the minimum pension under the same conditions is equal. As of 01.01.2015, contributory wages will become equal. Increase of the contributory wages will be taken correlated with decisions related to the minimum wage increase.
- Change of the pension-calculating formula, aiming to reinforce the contributory principle. The pension will consist of a base amount equal to the social pension amount and an increment equal to 1% of the assessment base for each insurance year. The assessment base

is the average social insurance contributory wage during the entire work career, indexed to the coefficient of the average annual contributions increase.

- Removal of the ceiling for calculation of the maximum pension. This has been a discouraging factor since it incentivized individual either not to contribute or to contribute on minimum wage. It increases the minimum contributory wage to the level of the official minimum wage for all contributors and indexation of the maximum contributory wage with average wage growth.
- Increase of the contribution period for the purpose of entitlements to the full base pension. An increment, in case of deferred retirement date, from 35 to 40 years by 2025.
- Establishment of the social pension for all individuals over 70 years of age, who do not qualify for a pension compulsory scheme. These individuals shall be entitled to a social pension, provided they have been resident in Albania during the last 5 years. This pension will not be higher than the minimum partial pension and shall be accorded on the condition that incomes are verified. It will be funded from the State Budget.
- Improvement of the pension-calculating method for mothers with many children and for survivors as well as increase retirement for this category from 50 to 55 years.
- Establishment of firm adequate rules on pension indexation, i.e. apply indexing to follow only the price index.
- To introduce de-motivating elements in terms of early retirement, but on the other side encourage postponed retirement.
- Removal of the existing privilege (acknowledgement of unpaid university period as insurance period) for the women with a university degree after 2032.
- Provision of the requirement that current pensions shall not be subject to recalculation, except for indexation to pursue price index.
- Provision of conditions that lead to reduced costs for state supplementary pensions for political officials, professors, military personnel etc. The prepared draft-acts are under discussion. They provide an increase of retirement age for top officials (MPs, ministers etc.) from 55 to 60 years of age as well as an increase of the supplementary contribution rates for all categories. Indexation of such pensions will be the same as for the other pensions. There will be no recalculation if the reference wage is changed.
- Drafting provisions on establishment of occupational pension schemes and incentives to promote their development. These schemes aim to guarantee incomes for individuals who retire earlier than the official retirement age. They are contributory schemes where employers and employees equally share contributions. They are established upon collective agreements. Supervision of these schemes shall be a responsibility of the Financial Supervisory Authority.
- Improving the performance of private pension funds, which will continue to be established on the free will of their contributors.

To conclude, this reform aims to increase the number of contributors and therefore increase the number of protected persons in mid-term, but mainly in long-term period, provide state financial support for the elderly over 70 years, reduce to a certain degree the high redistribution, improve financial sustainability of the scheme in the long-term. In addition, this reform creates incentives for higher participation rates, payment of contributions for longer periods, payment of contributions upon the real contributory wages, continuation of employment beyond retirement ages provided, simplification of calculating method and increase transparency to the public.

Important steps will be taken with regard to improving the financial management system of the Social Protection Scheme. The Social Assistance Modernization Project, drafted and implemented

with the assistance of the World Bank, has as its core goal the sustainability of the Social Protection Program which provides direct cash transfers to the poor and the disabled. The main problem of this Program has been informality and the fact that in many occasions the cash transfers were benefited from non-eligible individuals. The reform digitalizes the whole process from application to assignment and introduces a unified scoring formula thus leaving no room for abuses or human mistakes and ensuring that the cash transfers are benefited only from eligible persons. With regard to the disabled, a re-commissioning of all beneficiaries has started and will continue throughout 2015 which by using a new model of evaluating the disability will remove all abusers from the scheme.

Health insurance system reforms

The new health insurance law, that was enforced during last year, envisioned new contribution rates that increased the level of revenues. In addition, all the activities planned under last years' PEP on Health Insurance Scheme were executed according to plan. Furthermore, the removal of the salary ceiling on the payment of contributions, eliminated regression on the calculation. In comparison with the previous year, during 2014 total contributions to the scheme increase by 7.5%. furthermore, we had a 14% increase in hospital funding directed to oenology and cardiology, a 2% budget increase for primary care, focusing on providing free check-ups to people aged 40 to 65 years.

During 2015 and further we project an annual growth of health insurance contribution as part of public finance, with a drastic growth especially during 2016-2017 by 10% each year.

This growth is projected to bring about a reduction in the contribution of the state budget for the inactive population, which is projected to be 9,782,000 thousand ALL or 14 % more compared with figures programmed for 2014 (according to the reviewed budget of 2014).

Expenditures for health insurance scheme constituted about 2.3 % of GDP for 2015. That level of expenditure is foreseen to be more or less stable as a percentage of GDP, but with increase in real value. For 2015, we foresee a 3% increase on health insurance contributions. By the year 2016 this increase is expected to become 10%, due to the growth of economic activities, employment, salaries level and tax evasion avoidance.

Projected revenues from contributions during 2016-2017 is based on projections for increased economic activity, employment, wage levels, reduce continued informality in the labor market and the expected effect of removing the ceiling level calculation of health contributions.

Reforms on health services

Enforcement of the new law on compulsory healthcare insurance has made the Health Insurance Fund face major challenges concerning universal health coverage and health services benefits not only in the public system, but also in the private one.

The Fund will purchase the health services for the first time, according to the health services packages offered by the service providers and according to a well-defined price level for each of them.

The financing of healthcare services packages materializes the new role of the Fund, as well as Government's priority to finance health services based on their real value. All this is done in order to achieve better funds management and their effective usage according to patient needs.

To date, 10 health service packages for the hospital sector are approved by the government as well as the basic medical control package, which will be offered free of charge to people from the 40-65 age group . Implementation of basic medical check-up started by the end of 2014.

This new approach creates the necessary conditions in order to switch gradually from the previous hospital budgeting form into the new one based on real needs and a transparent administration of the funds.

Health services will be financed for the first time under well-defined costs. The public sector will have the priority in this reform. Furthermore, we are preparing the new contract models and defining the criteria for public purchase of services from private service providers.

The Fund has signed new contracts with three private hospitals providing specific service packages and two other private hospitals will be contracted soon. In the cases when the public hospitals have no capacities for certain services, like dialysis or coronary diseases, the insured persons may use private services offered by hospitals that have contractual relations with the Fund. The costs of these packages would be reimbursed 100% by the Fund.

Some reforms were undertaken in the area of reimbursement of medicines, as foreseen in PEF 2014. 56 new drugs were added in the reimbursement list with the new 10% price reduction level. Efforts are being made to redraw the rules how the list is compiled.

In the coming period:

The Fund will enter into contracts with foreign hospitals and/or health institutions to meet needs that are not met within the country. Another objective should be the protection of specific social groups, like the victims of human trafficking. For this category the Fund will provide free health insurance.

2.4.5. Other related reforms

Property rights reforms

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. We plan to prepare a strategy to clarify the legal environment and verify ownership in the land registry and cadastre.

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 reputational risks, and are currently preparing an action plan to be finalized by end of June 2015. This will be done 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

Local government reform is proceeding as planned. The Parliament approved the new local government law in July 2014. According to the Law, the number of local government units will decrease to 61 from the current number of 373. The number of regional councils will remain unchanged at 12 regions. This reform is expected to be implemented after local elections in mid-2015, and once in place, it could result in savings of about 3 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.

Statistical reform

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 prepare the statistical product that would meet requirements of EU ESA 2010 Transmission Program and Special Data Dissemination Standard of the IMF.

4.3 Budgetary implications of major macroeconomic structural reforms

Implications of energy sector reform

During the last years, this sector has experienced numerous problems, both in structural and financial terms. In order to address its emergent issues, the Government has undertaken several measures with the aim to improve the difficult financial situation of the three operators of the energy system (generation, transmission and distribution). It should be noted that the deep reform of this strategic sector needs time and considerable financial resources, as well as a continuous institutional support. Starting from 2015, the energy sector will go under a full reformation, with the aim to improve its efficiency and effectiveness. For this purpose, in the 2015 annual budget the following is planned:

- a portion of about 3 billion ALL of the total financial support of about 150 million USD from the World Bank, which will be mainly allocated for investments, measurements systems, distance measurements and as a support for the start-up of market liberalization for the Transmitting System Operator (OST);
- 1.6 billion ALL as a full compensative measure for the marginalized categories, because of the recent abolishment of the 300KW band of energy consume.
- a total budgetary financial support for this sector of about 20 billion ALL for 2015, if we count here the guaranties that might be issued during 2015 for the sector's eventual borrowings.

The final aim is to progressively reduce the budget support for the energy sector, throughout making the sector financially self-sustainable, both in the medium and long term.

The implementation of the ambitious set of structural reforms in the sector (see section 4.2.1) 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 the flow of energy guarantees to 15.5 billion LEK in 2015, 9.4 billion in 2016, and 8.4 billion LEK in 2017. We expect the gap will continue to reduce and become zero in 2019. 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.

Implications of pension reform

During 2015 the Government will continue to intensify the efforts for the further improvement of the pension scheme's financial sustainability, aiming to minimize the subsidy from the State Budget. The procedures and practices of contributions collection are going to be further improved, guaranteeing the coverage of the population with social insurance elements at acceptable levels.

Pension reform, approved by Parliament in July 2014, is becoming effective in 2015. Key features include equalizing the minimum contributory wage with the official minimum wage, increasing the contributory period and retirement age, while removing the benefit ceiling. The new law also indexes of pension benefits to inflation. Persons above the age of 70 who do not qualify for pension, would receive a social pension (means tested).

Key objectives of Mid-Term Budget 2015 – 2017

The following are some of the key objectives of the mid-term social insurance budget:

- Better coverage of population with elements of the compulsory social insurance in accordance with the ILO requirements on social insurance, financially guaranteed as well as keeping benefits at reasonable levels.
- Implementation of reform and increased institutional efforts to improve financial sustainability of the social insurance scheme.
- Increase the SII efficiency in managing social insurance fund, put much more focus to the clients: insured persons and provide better service for them.
- Add to the efforts and work for the SII institutional consolidation so that it is ready to integrate and apply the EU standards.

Pension Reform brings about significant improvements in the public finances, which is also its main focus, both in the long-term and mid-term perspective. Financial balance as a percentage of GDP reaches 1.4% in 2015, 1.2% in 2016, 1.1% in 2017 and 0.8% in 2020.

Increase of revenues from contributions plays an important role in improving the financial situation. Increase of revenues comes as a result of increase in the number of contributors over years 2015 -2018 by about 2.5% every year, unification of minimum contributory wage by increasing contributory wage of self-employed persons at about 12%, general increase of contributory wages approximately by the minimum wage in the national level or at about 2 - 2.5%, collection of arrears due to unpaid contributions and significant improvement of controlling and collecting contributions practices and procedures. On this basis the revenues from contributions are expected to increase by over 6% each year.

In 2015, there will start provision of the Social Pension for the Albanian citizens over 70 years of age, who do not get any other incomes from personal and real estate, inheritance, personal investments, etc. During the first years of implementation, the beneficiaries' number of the abovementioned category shall be around 5,000 people, with an annual cost of about 400 million ALL.

At the same time, 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 new bio-psycho-social model, the establishment of a new multidisciplinary commission for the determination of disability, and the use of 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 is 1.1 billion LEK.

5. IMPLEMENTATION OF THE 2014 TARGETED POLICY GUIDANCE

The measures taken by Albania toward the implementation of each specific targeted policy guidance set out by the European Commission are as following²⁶

- 1) Policy guidance: Enhance macroeconomic stability by putting the public debt-to-GDP ratio on a downward path as from 2015, and bring it down to around 69% of GDP by 2016 from around 72% in 2014; in this context, preserve the fiscal space for growth-enhancing public investment; take concrete steps towards adopting a quantitative fiscal rule which will effectively ensure the sustainability of public debt in the long run.

²⁶ The letter from Vice-President Rehn of 30 June 2014

Measures taken: We have taken the necessary fiscal measures in the 2015 Budget, which includes the budget for 2016 and 2017, to achieve debt targets in line with European Commission policy guidance. More specifically, the fiscal measures taken both on revenues and expenditures ensure that the level of total public debt will begin to reduce in 2015, for the first time since 2010, and will reach a level below 69% in 2016. These measures are explained in details in section 3.3. The baseline fiscal scenario explained in this section, in addition of accounting for the fiscal risks of the energy sector, accommodates a relatively high level of capital expenditures (public investments) at around 5% of GDP per year.

The establishment of a fiscal rule that would last for a long period is one of the main objectives of the Public Finance Management Strategy which was approved by the Council of Ministers in end-2014. As explained in details in section 3.8, we are planning to establish an appropriate fiscal rule which is foreseen to be approved by the Parliament with a qualified majority within 2015.

- 2) Policy guidance: Strengthen the efficiency of tax administration and tax collection, implement budgetary mechanisms which will prevent the accumulation of arrears in the future, and prioritize public investment projects on the basis of cost-benefit evaluations.

Measures taken: We have already taken several reforms to improve tax administration and tax collection as well. More specifically, as explained in details in section 3.8:

- We are in the process of implementing a new tax administration IT-system that will manage taxpayer registration, returns filing, revenue payments, tax refunds, tax arrears collection, audit, and taxpayer appeals. The new system will allow a simplification of processes and reduce the opportunities for fraud and corruption;
- 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 tax 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;
- The compliance risk management of tax collection implemented is being aligned with the model advocated by the IMF, the OECD, and the EC. The GDT will make use of a broad spectrum of methods (e.g. media and compliance marketing, cooperation with industry group representatives, taxpayer education and services, audit, and arrears enforcement) in order to over time increase voluntary compliance. Tax services will be improved to make it easier to comply;
- We are revising the system of fiscal cash registers to make it possible to capture the fiscal information in real time. To encourage citizens to ask for payment checks at the time of purchase, a lottery based on fiscal coupons is being set up. The first draw will be made in April 2015;
- In order to lay the information basis for the new property tax, we are establishing a fiscal cadastre. The purpose of the cadastre will be to consolidate all existing data on land, buildings and owner/occupants, and to calculate the annual tax obligation associated with each property;
- We are eliminating procedural ambiguities in order to create a clear framework for the interaction between the private sector and the tax administration. The objective is to improve the dialogue with the businesses and to standardize to the greatest extent possible all operations;

- We are going to establish the National Valuation Database at the customs office in order to provide a basis for risk-based transaction analysis;
- We are strengthening the coordination between tax and customs offices in order to enhance tax administration efforts. To leverage each other's potential and thus improve tax compliance, the GDC and GDT are taking 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.

Prevention of arrears accumulation in the future constitutes a key objective of PFM reforms. Safeguards against a new build-up of arrears have already been put in place, and are further being enhanced. The Ministry of Finance has already adopted the Arrears Prevention and Clearance Strategy in 2014, which envisages clearing the existing stock by the end of 2017, and specific measures to prevent new build-up of arrears. In this regard, other important measures regarding commitment controls are being further developed as planned in this document. As from January 2014, all procurement orders for goods, services and investments must be controlled for compliance with the procurement plan submitted to the Treasury and must be stamped by the district Treasury branch before procurement can proceed. Multi-year limits for investment projects and other longer term contractual arrangements will be introduced in the mid-term budget document for 2015 and beyond, and these limits are being approved by Parliament as a part of the annual budget law. Severe sanctions will be applied to those entities and officers not respecting these provisions.

- 3) Policy guidance: Implement a reform of the pension system: adopt, as a first step, a strategy with the aim of ensuring the sustainability of the scheme in the long run as well as the required amendments to the existing legislation.

Measures taken: Pension Policy Paper was drafted and discussed with stakeholders and different experts in 2014. Pension Reform was approved by Law No. 104/2014, dated 31.07.2014 "On some amendments to law no. 7703, dated 11.05.1993 "On Social Insurance in the Republic of Albania", amended, which comes in force on 01.01.2015. The key elements of the social insurance reform are explained in details in section 4.2.3. In overall, the reform aims to increase the number of contributors and therefore increase the number of protected persons in mid-term, but mainly in long-term period, provide state financial support for the elderly over 70 years, reduce to a certain degree the high redistribution. Therefore, the reform ensures the long-term financial sustainability of the scheme. In addition, the reform creates incentives for higher participation rates, payment of contributions for longer periods, payment of contributions upon the real contributory wages, the continuation of employment beyond retirement ages provided the simplification of the calculating method and increased transparency to the public.

- 4) Policy guidance: Pursue measures in the energy sector aimed at reducing losses and improving bill collection, and take steps towards reforming the sector in order to improve its financial position and eliminate high risks it poses to public finances.

Measures taken: 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 2018, beginning with 35KV customers on January 1, 2016 (on completion, in end 2018, the share of de-regulated consumption would increase from 13% to 40%). 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.

ERE approved the new tariffs for the three public power companies which are into effect since the beginning of 2015. The retail tariff for household was restructures by eliminating the subsidized lower block. This will avoid the distortions induced by the old formula of pricing for households. At the same time, an increase in the average tariff for commercial users was approved by ERE. In addition, the purchase price for electricity from independent power producers was adjusted to reflect current import prices, based on a benchmark price from the Budapest power exchange.

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.

In order to improve 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 electricity system infrastructure punishable by imprisonment rather than just an administrative offence. As a result, we were able to significantly reduce electricity distribution losses in October 2014 as compared to October 2013. We are committed to further reducing distribution losses by 5 percentage points per year, to 15% by 2019. We are also committed to improving our collection rate on amounts billed from 83.4% in January-October 2014 to 93% 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 and non-budgetary institutions make timely payment of electricity bills, and at the local level.

- 5) Policy guidance: Improve the overall business environment, in particular by simplifying and enhancing the predictability of the regulatory business environment, such as procedures for business registration and construction permits. Make progress in the area of property rights, in particular by speeding up the completion of first registration of properties and by reviewing the compensation policy with the aim of creating a realistic, transparent, and sustainable framework for compensations.

Measures taken: We have established the National Economic Council, as an advisory body for the government, which includes representatives from the business community, key ministries and multilateral partners. We are 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 and supported 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.

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. We plan to prepare a strategy to clarify the legal environment and verify ownership in the land registry and cadastre.

Reform of the property compensation system is essential. We 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.

- 6) Policy guidance: Together with the Bank of Albania and all other relevant actors, take all the necessary measures to address the issue of non-performing loans with a view to achieving a sustainable reduction of their level.

Measures taken: At its meeting of 27 March 2013, the Supervisory Council of the Bank of Albania discussed and approved some amendments to the regulatory framework seeking to improve banking sector credit supply and support the loan restructuring process as early as borrowers' concerns first emerge. More specifically, in order to boost lending, the regulatory amendments provide for the removal of capital requirements for the annual growth of lending to the economy if it ranges between 4-10%. The regulatory amendments also provide for the increase in capital requirements for the additional banking sector investments with non-resident financial institutions.

In order to tackle the increasing non-performing loans, the regulatory amendments allowed the loan restructuring when it is classified as standard but the borrower begins to show the first signs of loan repayment-related concerns. The new terms and conditions following the loan modification process aimed at preserving borrower's solvency and loan quality. This loan will continue to be classified as standard but will require higher provisioning of 10%. In order to encourage banks to undertake the loan restructuring process, the regulatory amendments reduced the maintenance of the loan in the same category to six months.

The change in capital requirements for the annual growth of credit and banking sector investments with non-resident financial institutions are counter-cyclical and transitory, and were initially planned until end 2014. The periodical analysis of BoA on the effectiveness of such measures showed that banks were making increasing use of them. For this reason, on December 2014 the Supervisory Council of the Bank of Albania decided to prolong the application of these measures, until end of June 2015 for credit growth incentives and until December 2015 for disincentives of investments with nonresident financial institutions.

In September 2013, several changes of Civil Procedures Code, aiming at facilitating the credit collateral execution process, were approved by Parliament. Following those changes, the recovered amounts realized through the collateral execution process increased by 3.6% in the fourth quarter of 2013, and by 8.9% in annual terms.

In order to facilitate loan write-offs by banks, the Ministry of Finance proposed changes in the law "On income tax", to facilitate the recognition of loss loans as unrecoverable debt and recognize related provisions as "deductible" for tax purposes. Such changes were approved by Parliament in early 2014.

Following the changes in the law "On income tax", on February 27, 2014, the Supervisory Council, the Bank of Albania approved a change in the "Credit Risk Management" regulation which clarify when a loan should be classified as "loss" and imposes an obligation for banks to write-off all the loans that have been in the "loss" category for more than 3 years. These changes entered into force on 1st of January 2015.

The measures undertaken by the BoA and other public authorities, regarding incentives for credit growth and restructuring, credit write-off and collateral execution, have created better opportunities for banks to proactively manage their problem loan portfolios and act to clean their balance sheets. They are expected to positively affect this mutual relation between the real and financial sectors of the economy. However, restoring economic growth in order to

support healthy lending to the economy is an essential factor that would help curb the problem loans portfolio in a consistent and stable way.

- 7) Policy guidance: Implement measures aimed at improving education and vocational training outcomes and address mismatches in skills demand and supply.

Measures taken: We have drafted and approved a National Strategy on Employment and Skills 2014-2020 to address the critical issues of unemployment and skills mismatch. Inspired by the overall objective of Europe 2020 Agenda for smart, sustainable and inclusive growth, the aim of the Strategy is to have a competitive economy and inclusive society grounded on high skills and better jobs. The Strategy focuses on four strategic priorities: i) foster opportunities for decent jobs through efficient labor market policies; ii) provide qualitative vocational education and training to youngsters and adults; iii) promote social inclusion and territorial cohesion; and iv) enhance the governance of the labor market and qualification systems.

To address the skills mismatch problem an overall reform of the VET system is being carried through. The first step of the reform was to transfer all vocational schools under the authority of the Ministry of Social Welfare and Youth and then to introduce the dual model according to which students spend at least 30% of their classes practicing in local businesses and enterprises. Moreover, to better connect the skills that the schools provide with the needs of the local economy, the National Employment Service, assisted by the ILO-IPA 2010 HDR program, has begun to conduct a study of the private sector needs for skills and vocational training. In 2015, the results and recommendations of this study will serve as a guide for the VET system in opening new programs of study or re-processing the curricula in accordance with the needs of the labor market.

The Active Labor Market Policies in Albania are composed by six programs focusing on on-the-job-training, employment for women from special groups, employment for disabled, employment for vulnerable groups, employment for the youth as well as internships for just-graduated. In 2014 the Active Labour Market Programs' Fund increased by 300% while in 2015 it will double. It is expected that in 2015 at least 5,000 unemployed jobseekers will be employed through this programs, 60% of which will be in the 15-29 age group.

6. SUMMARY DATA

Table 1a: Macroeconomic prospects

	ESA Code	2013	2013	2014	2015	2016	2017
		Level (€)	Rate of change				
1. Real GDP at market prices	B1*g	9.510	1.4	2.1	3.0	4.0	4.5
2. GDP at market prices	B1*g	9.609	2.2	3.6	5.5	7.0	7.6
Components of real GDP							
3. Private consumption expenditure	P3	7.349	0.0	3.5	0.2	2.7	2.4
4. Government consumption expenditure	P3	1.032	0.1	0.1	8.2	0.9	1.0
5. Gross fixed capital formation	P51	2.439	3.0	1.7	8.0	10.7	11.0
6. Changes in inventories and net acquisition of valuables (% of GDP)	P52+P53	0.489	0.0	0.0	0.0	0.0	0.0
7. Exports of goods and services	P6	3.163	6.1	9.0	10.1	5.4	6.9
8. Imports of goods and services	P7	4.961	2.7	7.8	6.9	5.6	5.8
Contribution to real GDP growth							
9. Final domestic demand		10.8	0.8	3.1	3.1	5.1	5.1
10. Change in inventories and net acquisition of valuables	P52+P53	0.5	0.0	0.0	0.0	0.0	0.0
11. External balance of goods/services	B11	-1.8	0.6	-1.0	-0.1	-1.1	-0.6

Table 1b: Price developments

		2013	2014	2015	2016	2017
1. GDP deflator	%, yoy	0.8	1.4	2.5	2.8	3.0
2. Private consumption deflator	%, yoy	1.1	1.7	2.8	3.0	3.2
3. HICP	%, yoy	:	:	:	:	:
4. National CPI change	%, yoy	-0.1	-0.3	0.9	0.3	0.2
5. Public consumption deflator	%, yoy	0.5	0.5	0.5	1.0	1.5
6. Investment deflator	%, yoy	0.5	1.3	2.0	2.5	2.5
7. Export price deflator (goods & services)	%, yoy	1.5	1.5	1.5	1.5	1.5
8. Import price deflator (goods & services)	%, yoy	1.5	1.5	1.5	1.5	1.5

Table 1c: Labour markets developments

	ESA Code	2013	2014	2015	2016	2017
		Rate of change				
1. Population (thousands)		2,895.9	2,910.4	2,925.0	2,939.6	2,954.3
2. Population (growth rate in %)		-0.1	0.5	0.5	0.5	0.5
3. Working-age population (persons) ²⁷		1,976.7	1,982.2	1,990.7	1,999.1	2,007.7
4. Participation rate		59.9	61.1	61.9	63.1	64.5
5. Employment, persons ²⁸		992.8	1,002.0	1,030.6	1,068.9	1,114.5
6. Employment, hours worked ²⁹		:	:	:	:	:
7. Employment (growth rate in %)		-9.3	0.9	2.8	3.7	4.3
8. Public sector employment (persons)		163.9	162.9	161.9	161.9	161.9
9. Public sector employment (growth in %)		-0.3	-0.6	-0.6	0.0	0.0
10. Unemployment rate ³⁰		16.1	17.3	16.4	15.3	13.9
11. Labour productivity, persons ³¹		11.8	1.2	0.1	0.3	0.2
12. Labour productivity, hours worked ³²		:	:	:	:	:
13. Compensation of employees	D1	:	:	:	:	:

²⁷ Age group of 15-64 years

²⁸ Occupied population, domestic concept national accounts definition

²⁹ National accounts definition

³⁰ Harmonised definition, Eurostat; levels

³¹ Real GDP per person employed

³² Real GDP per hour worked

Table 1d: Sectoral balances

% of GDP	ESA code	2013	2014	2015	2016	2017
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	-10.6	-12.0	-11.9	-12.6	-12.8
of which:						
- Balance of goods and services		-17.8	-18.4	-17.8	-17.9	-17.5
- Balance of primary incomes & transfers		6.7	5.7	5.2	4.7	4.2
- Capital account		0.5	0.7	0.7	0.6	0.5
2. Net lending/borrowing of the private sector	B.9/ EDP B.9	-5.5	-8.1	-9.3	-11.3	-12.8
3. Net lending/borrowing of general government		-5.1	-3.9	-2.6	-1.3	0.0
4. Statistical discrepancy		0.0	0.0	0.0	0.0	0.0

Table 1e: GDP, investment and gross value added

	ESA Code	2013	2014	2015	2016	2017
GDP and investment						
GDP level at current market prices (in domestic currency)	B1g	1364.8	1413.9	1492.0	1596.0	1717.9
Investment ratio (% of GDP)		26.2	26.0	27.1	28.8	30.5
Growth of Gross Value Added, percentage changes at constant prices						
1. Agriculture		0.6	3.8	3.4	3.7	4.2
2. Industry (excluding construction)		7.9	9.6	6.3	7.8	8.4
3. Construction		1.1	-4.2	1.2	4.7	5.4
4. Services		0.1	0.5	2.1	2.7	3.0

Table 1f: External sector developments

Euro mill. unless otherwise indicated	2013	2014	2015	2016	2017
1. Current account balance (% of GDP)	-10.6	-12.0	-11.9	-12.6	-12.8
2. Export of goods	1.8	1.8	2.0	2.3	2.5
3. Import of goods	3.5	3.8	4.1	4.4	4.7
4. Trade balance	-1.7	-1.9	-2.0	-2.2	-2.3
5. Export of services	1.7	1.9	2.2	2.2	2.4
6. Import of services	1.7	1.9	2.0	2.1	2.3
7. Service balance	0.0	0.1	0.1	0.1	0.1
8. Net interest payments from abroad	0.0	0.0	-0.1	-0.1	-0.1
9. Other net factor income from abroad	0.0	0.0	0.0	0.0	0.0
10. Current transfers	0.7	0.7	0.7	0.7	0.7
11. Of which from EU	:	:	:	:	:
12. Current account balance	-1.0	-1.2	-1.3	-1.4	-1.6
13. Capital and financial account	0.8	1.1	1.2	1.3	1.5
14. Foreign direct investment	0.9	0.9	1.0	1.2	1.4
15. Foreign reserves	2.0	2.2	2.4	2.6	2.9
16. Foreign debt	6.2	6.6	:	:	:
17. Of which: public	2.4	2.7	:	:	:
18. O/w: foreign currency denominated	6.2	6.6	:	:	:
19. O/w: repayments due	:	:	:	:	:
20. Exchange rate vis-à-vis EUR (end-year)	140.2	139.0	142.5	142.5	142.5
21. Exchange rate vis-à-vis EUR (annual average)	140.3	139.9	141.0	141.0	141.0
22. Net foreign saving (lines 21-25: percentages of GDP)	10.6	12.0	11.9	12.6	12.8
23. Domestic private saving	14.9	13.3	12.6	12.5	13.0
24. Domestic private investment	20.7	20.9	21.1	23.0	24.0
25. Domestic public saving	0.6	0.7	2.7	3.7	4.7
26. Domestic public investment	5.5	5.1	6.0	5.8	6.4

Table 1g: Sustainability indicators

	Dimension	2010	2011	2012	2013	2014
1. Current Account Balance	% of GDP	-11.3	-13.2	-10.2	-10.6	-12.0
2. Net International Investment Position	% of GDP	-37.9	-46.6	-49.8	-46.7	:
3. Export market shares	%, yoy	16.5	4.8	1.3	18.7	:
4. Real Effective Exchange Rate ³³	%, yoy	5.2	0.4	1.1	-0.3	-2.0
5. Nominal Unit Labour Costs	%, yoy	8.2	-3.1	2.3	12.7	7.9
6. Private sector credit flow	% of GDP	0.3	0.4	0.5	-0.5	0.9
7. Private sector debt	% of GDP	:	:	:	:	:
8. General Government Debt	% of GDP	57.7	59.4	62.0	70.1	71.8

³³ Please explain the methodology used (deflators, trade weighing, etc)

Table 2a: General government budgetary prospects

	ESA code	2013	2013	2014	2015	2016	2017
		Level	% of GDP				
Net lending (B9) by sub-sectors							
1. General government	S13	-66.9	-4.9	-5.1	-3.9	-2.6	-1.3
2. Central government	S1311	19.3	1.4	1.1	2.9	3.8	4.8
3. State government	S1312	:	:	:	:	:	:
4. Local government	S1313	-19.0	-1.4	-1.4	-1.9	-1.6	-1.5
5. Social security funds	S1314	-67.3	-4.9	-4.8	-5.0	-4.8	-4.7
General government (S13)							
6. Total revenue	TR	327.2	24.0	25.9	27.8	27.8	27.9
7. Total expenditure ³⁴	TE	394.1	28.9	31.0	31.7	30.4	29.2
8. Net borrowing/lending	EDP.B9	-66.9	-4.9	-5.1	-3.9	-2.6	-1.3
9. Interest expenditure	EDP.D41	43.3	3.2	2.8	3.3	3.1	3.0
10. Primary balance ³⁵		-23.6	-1.7	-2.3	-0.6	0.5	1.7
11. One-off and other temporary measures ³⁶		:	:	:	:	:	:
Components of revenues							
12. Total taxes (11 = 11a+11b+11c)		205.0	15.0	16.0	17.3	17.5	17.7
12a. Taxes on production and imports	D2	157.9	11.6	12.2	13.0	13.3	13.4
12b. Current taxes on income and wealth	D5	32.0	2.3	2.3	2.6	2.6	2.7
12c. Capital taxes	D91	15.1	1.1	1.5	1.6	1.6	1.6
13. Social contributions	D61	58.5	4.3	4.9	4.5	4.6	4.6
14. Property income	D4	0.9	0.1	0.1	0.1	0.1	0.0
15. Other (15 = 16-(12+13+14)) ³⁷		62.8	4.6	4.9	5.9	5.6	5.6
16 = 6. Total revenue	TR	327.2	24.0	25.9	27.8	27.8	27.9
p.m.: Tax burden (D2+D5+D61+D91-D995) ³⁸		263.5	19.3	20.9	21.8	22.1	22.2

³⁴ Adjusted for the next flow of swap-related flows, so the TR-TE = EDP.B9.

³⁵ The primary balance is calculated as (EDP.B9, item 8) plus (EDP D41 + FISIM recorded as intermediate consumption, item 9).

³⁶ A plus sign means deficit-reducing one-off measures

³⁷ P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91).

³⁸ Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D995), if appropriate.

Table 2a (continued)

	ESA code	2013	2013	2014	2015	2016	2017
		Level	% of GDP				
Selected components of expenditures							
17. Collective consumption	P32	122.8	9.0	8.7	9.0	8.6	8.2
18. Total social transfers	D62 + D63	150.8	11.0	11.6	11.3	11.0	10.8
18a. Social transfers in kind	P31 = D63	0.0	0.0	0.0	0.0	0.0	0.0
18b. Social transfers other than in kind	D62	150.8	11.0	11.6	11.3	11.0	10.8
19 = 9. Interest expenditure	EDP.D41	43.3	3.2	2.8	3.3	3.1	3.0
20. Subsidies	D3	1.6	0.1	0.1	0.1	0.1	0.1
21. Gross fixed capital formation	P51	74.8	5.5	5.1	6.0	5.8	6.4
22. Other (22 = 23 - (17+18+19+20+21)) ³⁹		0.8	0.1	2.7	2.0	1.8	0.7
23 = 7. Total expenditures	TE ⁴⁰	394.1	28.9	31.0	31.7	30.4	29.2
p.m. Compensation of public sector employees	D1	:	:	:	:	:	:

³⁹ D.29+D4 (other than D.41) + D.5+D.7+D.9+P.52+P.53+K.2+D.8

⁴⁰ Adjusted for the next flow of swap-related flows, so the TR-TE = EDP.B9.

Table 2b: General government budgetary prospects

	ESA code	Level	2013	2014	2015	2016	2017
			Bn NCU				
Net lending (B9) by sub-sectors							
1. General government	S13		-66.9	-72.0	-58.2	-41.9	-22.6
2. Central government	S1311		19.3	16.1	43.9	61.1	82.9
3. State government	S1312		:	:	:	:	:
4. Local government	S1313		-19.0	-20.4	-27.6	-26.2	-25.3
5. Social security funds	S1314		-67.3	-67.6	-74.5	-76.9	-80.3
General government (S13)							
6. Total revenue	TR		327.2	366.7	414.5	443.1	479.0
7. Total expenditure ⁴¹	TE		394.1	438.7	472.7	485.1	501.6
8. Net borrowing/lending	EDP.B9		-66.9	-72.0	-58.2	-41.9	-22.6
9. Interest expenditure	EDP.D41		43.3	40.1	49.2	49.6	52.0
10. Primary balance ⁴²			-23.6	-31.9	-9.0	7.7	29.4
11. One-off and other temporary measures ⁴³			:	:	:	:	:
Components of revenues							
12. Total taxes (11 = 11a+11b+11c)			205.0	226.3	257.5	279.9	303.7
12a. Taxes on production and imports	D2		157.9	172.3	194.6	212.1	230.5
12b. Current taxes on income and wealth	D5		32.0	32.5	39.3	42.3	45.6
12c. Capital taxes	D91		15.1	21.5	23.5	25.5	27.6
13. Social contributions	D61		58.5	69.6	67.8	72.8	78.5
14. Property income	D4		0.9	1.4	0.8	0.8	0.8
15. Other (15 = 16-(12+13+14)) ⁴⁴			62.8	69.4	88.4	89.6	96.0
16 = 6. Total revenue	TR		327.2	366.7	414.5	443.1	479.0
p.m.: Tax burden (D2+D5+D61+D91-D995) ⁴⁵			263.5	295.9	325.3	352.7	382.2

⁴¹ Adjusted for the next flow of swap-related flows, so the TR-TE = EDP.B9.

⁴² The primary balance is calculated as (EDP.B9, item 8) plus (EDP D41 + FISIM recorded as intermediate consumption, item 9).

⁴³ A plus sign means deficit-reducing one-off measures

⁴⁴ P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91).

Table 2b (continued)

	ESA code	Level	2013	2014	2015	2016	2017
			Bn NCU				
Selected components of expenditures							
17. Collective consumption	P32		122.8	123.6	134.3	136.9	140.4
18. Total social transfers	D62 + D63		150.8	164.1	168.2	175.7	185.2
18a. Social transfers in kind	P31 = D63		0.0	0.0	0.0	0.0	0.0
18b. Social transfers other than in kind	D62		150.8	164.1	168.2	175.7	185.2
19 = 9. Interest expenditure	EDP.D41		43.3	40.1	49.2	49.6	52.0
20. Subsidies	D3		1.6	1.6	1.8	1.8	1.8
21. Gross fixed capital formation	P51		74.8	71.8	90.1	92.7	110.6
22. Other (22 = 23-(17+18+19+20+21) ⁴⁶			0.8	37.6	29.1	28.4	11.7
23 = 7. Total expenditures	TE ⁴⁷		394.1	438.7	472.7	485.1	501.6
p.m. Compensation of public sector employees	D1		:	:	:	:	:

Table 3: General government expenditure by function

Percentage of GDP	COFOG Code	2013	2014 Budget	2015	2016	2017
1. General public services	1	5.8	1.8	2.2	1.9	1.8
2. Defense	2	0.9	0.8	0.7	0.7	0.6
3. Public order and safety	3	1.5	1.6	1.6	1.5	1.4
4. Economic affairs	4	3.8	2.4	2.4	2.3	2.4
5. Environmental protection	5	0.0	0.1	0.1	0.1	0.1
6. Housing and community amenities	6	1.7	1.8	1.6	1.2	1.2
7. Health	7	2.6	2.8	2.7	2.7	2.7
8. Recreation, culture and religion	8	0.3	0.2	0.2	0.1	0.1
9. Education	9	3.2	2.8	2.7	2.7	2.6
10. Social protection	10	9.0	9.1	8.8	8.6	8.4
Others unclassified*		0.0	7.7	8.5	8.5	7.8
11. Total expenditure (item 7 = 23 in Table 2)		28.9	31.0	31.7	30.4	29.2

* This item includes: (i) debt service payments, (ii) contingency for wages&pensions policies, (iii) reserve fund, dhe (iv) local government expenditures, (iv) arrears, (v) energy net lending.

⁴⁵ Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D995), if appropriate.

⁴⁶ D.29+D4 (other than D.41)+ D.5+D.7+D.9+P.52+P.53+K.2+D.8

⁴⁷ Adjusted for the next flow of swap-related flows, so the TR-TE = EDP.B9.

Table 4: General government debt developments

Percentages of GDP	ESA code	2013	2014	2015	2016	2017
1. Gross debt ⁴⁸		70.1	71.8	71.6	68.8	65.6
2. Change in gross debt ratio		8.1	1.7	-0.2	-2.8	-3.2
Contributions to change in gross debt						
3. Primary balance ⁴⁹		1.73	2.3	0.6	-0.5	-1.7
4. Interest expenditure ⁵⁰		3.18	2.8	3.3	3.1	3.0
5. Stock-flow adjustment		3.2	-3.4	-4.1	-5.4	-4.5
of which:						
- Differences between cash and accruals ⁵¹		:	:	:	:	:
- Net accumulation of financial assets ⁵²		:	:	:	:	:
of which:						
- Privatisation proceeds		0.0	0.0	0.0	0.0	0.0
- Valuation effects and other ⁵³		:	:	:	:	:
p.m. implicit interest rate on debt ⁵⁴		5.2	4.2	4.8	4.6	4.7
Other relevant variables						
6. Liquid financial assets ⁵⁵		:	:	:	:	:
7. Net financial debt (7 = 1 - 6)		:	:	:	:	:

⁴⁸ As defined in Regulation 3605/93 (not an ESA concept).

⁴⁹ Cf. item 10 in Table 2.

⁵⁰ Cf. item 9 in Table 2.

⁵¹ The differences concerning interest expenditure, other expenditure and revenue could be distinguished when relevant.

⁵² Liquid assets, assets on third countries, government controlled enterprises and the difference between quoted and non-quoted assets could be distinguished when relevant.

⁵³ Changes due to exchange rate movement, and operation in secondary market could be distinguished when relevant.

⁵⁴ Proxied by interest expenditure divided by the debt level of the previous year.

⁵⁵ AF1, AF2, AF3 (consolidated at market value, AF5 (if quoted in stock exchange; including mutual fund shares).

Table 5: Cyclical developments

% of GDP	ESA Code	2013	2014	2015	2016	2017
1. Real GDP growth (%)	B1g	1.4	2.1	3.0	4.0	4.5
2. Net lending of general government	EDP.B.9	-4.9	-5.1	-3.9	-2.6	-1.3
3. Interest expenditure	EDP.D.4 1	3.2	2.8	3.3	3.1	3.0
4. One-off and other temporary measures ⁵⁶		:	:	:	:	:
5. Potential GDP growth (%) ⁵⁷		3.0	3.0	3.2	3.4	3.7
Contributions:						
- labour		:	:	:	:	:
- capital		:	:	:	:	:
- total factor productivity		:	:	:	:	:
6. Output gap		-1.5	-0.9	-0.2	0.6	0.8
7. Cyclical budgetary component		-0.5	-0.3	0.0	0.2	0.3
8. Cyclically-adjusted balance (2-7)		-4.4	-4.8	-3.9	-2.8	-1.6
9. Cyclically-adjusted primary balance (8-3)		-1.2	-2.0	-0.6	0.3	1.5
10. Structural balance (8-4)		:	:	:	:	:

Table 6: Divergence from previous programme

	2013	2014	2015	2016	2017
1. GDP growth (% points)					
Previous programme	0.7	2.1	3.3	4.2	:
Current programme	1.4	2.1	3.0	4.0	4.5
Difference	0.7	0.1	-0.3	-0.1	:
2. General government net lending (% of GDP)					
Previous programme	-6.1	-6.5	-4.8	-3.4	:
Current programme	-4.9	-5.1	-3.9	-2.6	-1.3
Difference	1.2	1.4	0.9	0.8	:
3. General government gross debt (% of GDP)					
Previous programme	70.5	72.1	71.7	69.2	:
Current programme	70.1	71.8	71.6	68.8	65.6
Difference	-0.4	-0.4	-0.1	-0.4	:

⁵⁶ A plus sign means deficit-reducing one-off measures

⁵⁷ Until an agreement on the Production Function Method is reached, countries can use their own figures (SP).

Table 7: Long-term sustainability of public finances

Percentages of GDP	2007	2010	2020	2030	2040	2050	2060
Total expenditure	:	:	:	:	:	:	:
of which: age-related expenditures	:	:	:	:	:	:	:
- Pension expenditure	5.0	5.3	5.6	5.6	5.3	4.8	5.2
- Social security pension	5.0	5.2	5.4	5.4	5.1	4.6	5.1
- Old-age and early pensions	4.2	4.3	4.5	4.6	4.3	3.8	3.9
- Other pensions (disability, survivors)	0.8	0.9	0.9	0.9	0.8	0.9	1.1
- Occupational pensions (if in general government)	0	0	0	0	0	0	0
- Health care	:	:	:	:	:	:	:
- Long-term care (this was earlier included in the health care)	:	:	:	:	:	:	:
Education expenditure	:	:	:	:	:	:	:
Other age-related expenditures	:	:	:	:	:	:	:
Interest expenditure	:	:	:	:	:	:	:
Total revenues	:	:	:	:	:	:	:
of which: property income	:	:	:	:	:	:	:
of which: from pensions contributions (or social contributions, if appropriate)	3.2	3.2	4.7	5.1	5.0	5.0	5.0
Pension reserve fund assets	0.3	0.3	0.3	0.3	0.3	0.4	0.4
of which: consolidated public pension fund assets (assets other than government liabilities)	0.3	0.3	0.3	0.3	0.3	0.4	0.4
Assumptions							
Labour productivity growth	:	:	:	:	:	:	:
Real GDP growth	5.9	3.8	4.5	4.0	4.0	3.3	3.0
Participation rate males (aged 20-64)	:	:	66.2	66.2	66.2	66.2	66.2
Participation rates females (aged 20-64)	:	:	49.7	49.7	49.7	49.7	49.7
Total participation rates (20-64)	:	:	57.9	57.9	57.9	57.9	57.9
Unemployment rate	:	:	11.8	11.2	10.6	10.0	10.0
Population aged 65+ over total population	:	:	15.0	21.2	24.8	26.3	29.6

Table 7a: Contingent liabilities

% of GDP	2014	2015
Public guarantees	4.1	5.2
Of which: linked to the financial sector	:	:

Table 8: Basic assumptions on the external economic environment underlying the programme framework

	Dimension	2013	2014	2015	2016	2017
Short-term interest rate ⁵⁸	Annual average	0.7	0.6	0.3	0.5	0.5
Long-term interest rate	Annual average	1.9	1.5	1.7	2	2.1
USD/EUR exchange	Annual average	1.3281	1.3324	1.1521	1.005	1.005
Nominal effective exchange rate	Annual average	:	:	113.8	113.9	114.1
Exchange rate vis-à-vis the EUR	Annual average	140.27	139.88	141	141	141
Global GDP growth, excluding EU	Annual average	3.8	3.7	4.3	4.5	4.5
EU GDP growth	Annual average	0	1.3	1.5	2	2
Growth of relevant foreign markets	Annual average	-0.5	-0.3	0.9	1.4	1.8
World import volumes, excluding EU	Annual average	3.4	2.9	4.9	5.6	5.6
Oil prices (Brent, USD/barrel)	Annual average	108.8	102.6	91	92.8	92.8

⁵⁸

If necessary, purely technical assumption.



REPUBLIC OF ALBANIA

NATIONAL ECONOMIC REFORM PROGRAMME OF ALBANIA 2015 - 2017

**SECTORIAL STRUCTURAL REFORMS TO PROMOTE COMPETITIVENESS
AND GROWTH**

(PART II)

JANUARY 2015

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I. Introduction

The National Economic Reform Programme 2015-2017 (NERP part II) lays out a roadmap for countries in the region to adopt policy reforms that will lead to growth and competitiveness, as well as contributing to eventual integration in the European Union (EU).

The EU itself has emphasized the importance of enhanced economic governance for both Member States and Accession countries, with a focus on competitiveness. In this context, the Western Balkan countries, inter alia, need to prioritise structural reforms in order to enhance competitiveness and growth. Structural reforms which underpin the competitiveness of the economy are described in the National Economic Reform Programme for 2015-2017.

Albania had a relatively strong growth in the first decade of the 21st century, and has also resisted remarkably to the recent crisis. However, recent years have seen a slowdown in economic growth. Structural reforms are therefore necessary to ensure the realisation of the full growth potential. Improvements in Physical capital will ensure basic infrastructure as a prerequisite for the development of business. Improvements in human capital will provide the necessary skills, contributing to the growth of productivity and the gradual evolution towards a knowledge-based economy. Better industrial structures will provide specific measures aiming to support the development of sectors with specific competitive advantages, and SMEs as the backbone of the Albanian economy. A good business environment will ensure operational conditions for efficient conduct of business, and trade integration will ensure improved integration into global value chains, as well as the attractiveness to foreign investment.

The objective of the NERP 2015-2017 for Albania is to present national priorities, (measure and actions), which will contribute to achieving the headline targets and pillar indicators of the SEE2020 National Action Plan and objectives of the National Strategy for Development and Integration (NSDI) which provides the strategic framework for all sector and cross-sector strategies and is the backbone of the Integrated Planning System (IPS) – a set of operating principles to ensure that government policy planning, budgeting and monitoring are linked and operate efficiently. The NSDI guides the Medium-Term Budget Programme (MTBP) as well as annual budget allocations by providing policy objectives leading the budget allocation process. In this context, closer link between the SEE 2020 strategic objectives and NSDI 2014-2020 will be important in order to ensure that Albania meets its objectives and contributes to the implementation of the NERP objectives and meeting the regional targets. The NERP 2015-2017 also indicates the timing and institutional responsibility, expected outcomes as well as a source of finance. Where relevant, a link to regional programmes or an indication where regional programme/obligations will complement national efforts is set out.

The Albanian NERP 2015-2017 is not a standalone document. It reflects the national priorities, which will contribute to meeting the SEE 2020 headline targets and objectives. It ensures synergies between SEE 2020 strategic goals and the GoA's strategic priorities linked to the Stabilisation and Association Process (SAP) and reflected in several national and sector related strategies and recommendations from the National Progress Reports 2014. The NERP 2015-2017 includes also several actions that Albanian government is undertaking in its efforts to contribute to the regional inter-connectivity and cooperation, thus meeting the preconditions for opening the negotiation process with the EU.

The macroeconomic context and scenario presented in the exercise was realised with the contribution of Ministry of Finance.

As regards the reforms included under physical capital, contribution was given by the Ministry of Transport and Infrastructure, Ministry of Energy and Industry, Ministry of Environment,

Ministry of Urban Development and Tourism, Minister of State for Innovation and Public Administration and the respective subordinated institutions.

As regards the reforms included under human capital, contribution was given by the Ministry of Social Welfare and Youth, Ministry of Education and Sport and the respective subordinated institutions.

As regards the reforms included under better industrial structures, contribution was given by the Ministry of Economic Development, Trade and Entrepreneurship, Ministry of Agriculture, Ministry of Tourism and the respective subordinated institutions.

As regards the reforms included under good business environment, contribution was given by the Ministry of Economic Development, Trade and Entrepreneurship and the respective subordinated institutions.

As regards the reforms included under trade integration, contribution was given by the Ministry of Economic Development, Trade and Entrepreneurship and the respective subordinated institutions.

II. Macroeconomic context and scenario

The baseline macroeconomic scenario foresees a gradual improvement of the economic outlook in the medium term. The baseline projection of economic growth stipulates a steadily acceleration during the next three years. The acceleration of economic activity is expected to start from the next year with a forecasted growth of 3%, gradually continuing in 2016 and 2017 with a forecasted growth of 4% and 4.5% respectively. However, the economy is expected to continue operating below its potential growth for 2015 and close the gap during the first half of 2016.

The medium term growth is expected to be primarily driven by higher private consumption and investment mainly reflecting an improvement in consumers' and businesses' confidence as well as better expected financial conditions. Several and deep structural reforms which are being carried forward (i.e. business environment, energy sector, labor market, financial sector, public finance management as well as other sector oriented reforms) are expected to begin support the economic growth in the medium term. Despite exports of goods and services are expected to have a robust growth in the medium term, net foreign demand in overall net terms is expected to continue have a slight negative contribution on economic growth due to expected high imports of capital goods utilized for the two main energy projects, respectively TAP and Statkraft-Devoll Hydropower.

The acceleration of economic growth is expected to be reflected on the labor market. Growth in the medium term ahead is expected to be more job – creating than historically as the most labor intensive sectors of production are expected to perform better than the others. More specifically, agriculture, textile and footwear industry as well as tourism related services are expected to be the best performers, reflecting also to some extent the priority focus of the government on these sectors for the medium term future. Therefore, increase in the total employment is expected to accelerate during 2015 -2017. Despite larger expected expansion of employment, the overall labor productivity is still expected to continue have a slight

improvement in the medium term ahead. At the same time the baseline scenario assumes an increase in the labor force by an average of 3% per year during 2015-2017 which mainly reflects a higher participation rate reaching 64.5% in 2017 from 61.1 in 2014. The expected population growth has a minor effect as well in increasing the labor force. Consequently, the baseline scenario projects a gradual reduction of unemployment rate to 13.9% in 2017 from 17.3% in 2014.

The performance of the Albanian economy will continue to be effected at a considerable extent by the economic activity in the external environment, particularly Italy and Greece which are the main economic partners of Albania through several economic channels (i.e. exports, remittances, foreign direct investments and other capital flows). Despite the recent recorded recession in Italy during the first half of 2014, in line with the latest European Commission forecasts, we assume that these two economies, as well as the whole Euro area and EU economies are going to have a slow improvement in the next three years. Therefore, in the baseline macroeconomic framework we assume slightly better conditions from the external environment in the medium term ahead relative to the last couple of years.

The baseline macroeconomic scenario takes into account that fiscal policy in the medium term will be strictly oriented toward fiscal consolidation, whereas monetary policy is expected to remain expansionary over the medium term as far as the economy operates below potential and inflationary pressures remain relatively low. However, the baseline scenario assumes that the tightening effect of targeted fiscal consolidation in the medium term, in addition to the accommodating monetary policy, will also be somehow offset by the government budgetary policy to preserve a level of public investments at least 5% of GDP.

At the same time, private consumption growth over the projection horizon is expected to be supported by improvements in the labour market, reflected in a steady increase in employment and wages. This should stimulate growth of real disposable income of households. The increase in consumer loans is projected to be driven by improved financial conditions of households and by eased lending standards. On the other hand, precautionary behaviour will still have some drag in the consumption growth.

The gradual resumption of investment demand is expected to be supported by improved capacity utilization rates and a recovery in economic climate over the projection horizon, both in Albania and in the external environment. Investment recovery in the coming years will be supported by four separate developments. Firstly, higher FDIs, especially in the energy sector, should be a boost to investment rates. Secondly, private investments are to benefit from expected improvements of financial conditions. Thirdly, the low interest rate environment, aided also by more relaxed financing conditions after the completion of the AQR assessment, is expected to support investment projects. And lastly, the arrears repayments should increase the liquidity in the private sector.

We project a slight expansion of the current account deficit in the medium term mainly due to higher imports of capital goods which at the same time is expected to be financed by higher flows of foreign direct investments. New policies focused towards the tourism industry in the country as well as a more stabilized environment are expected to help the pick-up of the net service balance. Therefore, the baseline macroeconomic scenario projects positive balance of payments and a stable level of international reserves in terms of months of imports needs.

The baseline scenario is considered to have a relatively high likelihood to materialize in overall. However, several downside and upside risk surround the baseline scenario. We have considered these risks and factorized them in two alternative macroeconomic scenarios which supplement the baseline scenario. More specifically, in the case of “pessimistic scenario” is projected a lower growth of 2 p.p. in each outer year 2015 – 2017, whereas the “optimistic scenario” assumes a more quick impact of structural reforms and therefore a higher level of growth. The budgetary effects of the alternative macroeconomic scenarios are reflected in the respective alternative fiscal frameworks. In the worst case, namely in the case that the economy performs more or less as assumed in the “pessimistic scenario”, the vast majority of negative budgetary effects (i.e. revenue shortfall) is covered by different contingency lines incorporated in the baseline fiscal framework. Therefore, in such circumstances, the overall agenda of structural reforms would not be hindered or even slow down due to budgetary constraints.

III. Sectoral reform measures being implemented and planned to achieve economic policy objectives 2014-17

PILAR 1 – PHYSICAL CAPITAL

1.1 Transport

In the next four years transportation and infrastructure will serve to achieve the major objectives of economic and social development of the country, but also it will be a direct contributor to economic growth and employment. The projects implemented in recent years, have reduced the distance between Tirana and major cities, regional centers and beyond. Such projects are designed to integrate the national road network in the regional and Pan-European network.

The main objective in the field of transport is accelerating the integration of the transport system, the establishment of an integrated market, consisting of transport infrastructure by land, by sea and inland waterways that efficiently supports the demand for transport development. To achieve this objective, the first step is the finalization of Sectorial Strategy of Transport, and the National Plan of Transport, EU legislation should be transposed into national legislation, harmonizing the rules on safety, environmental preservation, and transportation services. This plan will include the completion of construction of the national road network.

The objectives of the Albanian government in transport infrastructure are focused on:

Finalisation and Approval of the Sectorial Strategy of Transport 2016-2020 and its Albanian National Transport Plan (action plan), within 2015, which contain all transport sectors: road, rail, air and maritime.

Actually, it has been realized a request for IPA funds for the support related to the drafting of this strategy and the Albanian National Transport Plan with the respective costs: 300.000 Eur and 1.000.000 Eur.

1.1.1. Road Transport

The ANTP has three priorities:

(i) The connectivity between regional administrative centers within Albania

Measure 1: Completion of Tirana - Elbasan segment¹, which significantly eases traffic to Greece and Macedonia. The project will be finalized within 2015 and has a cost of 300 mil USD dollars (222.7 mil from IDB loan; 50 mil, Abu Dabi Fund loan; 20.4 mil OFID OPEC; 7mil Gov of Al).1.2 Completion of Arberi road, by a concession agreement. Construction of Tirana-Elbasan Road will effectively enhance economic and social development in the regions of Central, South and South East Albania. It will improve and facilitate the movement of traffic and especially the heavy traffic, in the road segment Tirana - Elbasan, which is part of the South Central axis, thus fulfilling the requirements of the traffic on this highway. Date of commencement of works is April 2011 and the date of completion of the works is foreseen December 2015. The road is divided in three segments. Two of the three segments are finished on August 2014 and now this part of the road is opened to the traffic. The third segment that is still under construction is foreseen to finish within the first half of 2015. Challenges are represented by some geotechnical problems.

Measure 2: Completion of Arberi road, by a concession agreement.

The Arberi Road will enhance economic and social development in the region of North East Albania. It will improve and facilitate the movement of traffic and will reduce the time travel, vehicle operating costs and the number of accidents. The completion of this road will give access to the hardly accessible regions that this road passes through, aiding the local population and foster economic development with Eastern region.

Arbëri Road Two carriage way roads, with a total of 72 km, linking Tirana to Macedonia through Peshkopia, would give access to the entire region east of the capital. 21 km have already been finalized (Bulqize-Peshkopi) and 16 others have already started construction. Due to financing issues, the roughest terrain segment of 35 km has not yet started. The project has an estimate financial need of 270-300 Million USD.1.3 Construction and maintenance will be realised as PPP. To this regard, negotiations with a Chinese company are in its final phase. The last segment is foreseen to be in function on 2018.

(ii) The connectivity of Albanian regional administrative centers with the road network of the Balkan region.

Measure 1: The construction of the “Blue Corridor”, a seaside corridor linking the Montenegro coast to the Greek coast. The Albanian section of this corridor is 350 km long, starts in Velipoje and ends in Butrinti. In addition to being a regional priority contained in the SEETO regional development plan, its importance to the development of tourism in Albania is paramount. The feasibility study is foreseen to be completed in 2015. A formal request for fund has been presented to WBIF.

(iii) Road safety in Albania

Road safety In Albania, has taken on greater importance because of its high social and economic cost to the nation. Improving road safety is a complex undertaking because the responsibility for it is divided among several governmental agencies The Albanian government has adopted a road safety strategy in February 2011. In January 2014 the Albanian government in the inter-ministerial road Safety Committee, has approved a package of measures to road safety, such as: Review of speed limits according to the road category; Completion of road signalling with all elements of road safety; Intervention to improve the 10 black spots according to the priority list of black spots; Elimination of level crossings along the national axis; More information and awareness for the Albanian society; Severing of the administrative measures for offenders. These measures aim to reduce road fatal accidents in 50% within 2020, compared with 2009. During the last year 2014, fatal accidents were reduced by 20%. Improvement of road safety will be realized by allocating more funds, even via forms of public private partnerships.

¹ Part of VIII Corridor

1.1.2. *Rail Transport*

The railway situation is difficult as a result of the priority given to the construction of the national road network. However, Albania can improve this service. The total length of the main line is about 420 km. Besides, it has 200 km of secondary lines. The efforts have been focused on transposing European legislation, as a precondition for comprehensive institutional reform, profiling and strengthening the administrative capacity. The first priority in this sector is the finalization of the National Strategy of Railways, which is a part of the Sectorial Strategy of Transport within 2015

Part of the National Strategy of Railways, which also will be finalized within 2015, is "The Railway Code of the Republic of Albania". During the coming years, a great number of by laws will be adopted in order to implement the Strategy.

A comprehensive restructuring program is being undertaken using the EU model. It is directed to improve the overall efficiency of the railways by increasing traffic through aggressive marketing, to restore its condition and to reduce its deficit. Restructuring is foreseen to take the form of creating a holding company overseeing separate business units that are process based:

1. Cargo unit for transport of goods;
2. Passenger unit for transport of passengers;
3. Infrastructure unit for the construction, maintenance and operation of infrastructure;
4. Workshop unit for repair and maintenance of rolling stock.

Part of the problem is the nimbleness of the very competitive road transport industry in adjusting the pricing and scheduling of its services.

1.1.3. *Maritime Transport*

Albania has a considerable coastal line therefore ports constitute an extraordinary economic resource because it can be a transport hub for the Adriatic region. The Albanian government has paid great attention to port infrastructure construction.

(i) Durres Port rehabilitation. During the first phase of the project (in 2013) was concluded the passenger terminal and the ferry sites. Currently it is working at full capacity. The second phase of the project includes the rehabilitation of the 7-th and 8-th quay. The cost foreseen is 18 Mil. Eur and will be funded by EIB and EBRD. This second phase will be concluded within 2015.

(ii) Vlora Port rehabilitation, within 2016. Includes the construction of two quays for civilian traffic (ferries length up to 120 ml) and one for cargo ships, the passenger terminal, as well as the reconstruction of port facilities. Financing of 15,3 Mil Eur is secured through Cooperazione Italiana per lo Sviluppo.

(iii) In Saranda Port the quay for cruise ships is in its final phase and will end within 2015. The project, worth 4.2 mil USD, is funded at 70% by World Bank and 30% by Albanian Government. Because of its close proximity to Corfu Island in Greece, there is considerable passenger traffic during the summer months. The Saranda Gateway project, aims at protecting the value and productivity of Albanian coastal and cultural assets and its marine environment and promoting sustainable economic development.

(iv) The deepening of the basin at the Port of Shëngjini is in process, planned to finish within 2015 and financed by State budget, 150 milion ALL.

1.2 Waste management and Urban Planning

1.2.1. *Waste management*

Waste management is in charge of local government units. Ministry of Environment is responsible to draft the legislation, to monitor/control the implementation of legal acts, to issue the waste permits. Ministry of Transport is responsible to the investments by budget state.

The priorities on waste management are: **a) establishment and function of an integrated waste management system; b) increasing the recycling percentage of waste; c) starting the separation at the source of waste.**

The issues that obstacle accomplishment in the short term of those priorities, are: Lack of capacities at local government, inadequate funding to achieve the goals and lack of public awareness. Some legal acts in waste management field have been harmonised with EU directives, complementing in this way, the Albanian legal framework. However, there are still some other bylaws that are to be adopted in a short term future. Three of them should be adopted by 2015.

There are five regional waste management plans developed, respectively: Tirana, Vlora, Elbasani, Durrësi and Korça. Each region shall prepare the regional waste management plan for the territory under their jurisdiction according to the law no. 10463, dated 22.09.2011 “On integrated waste management”. Ministry of Environment, supported by EU projects, because of the capacities lack and required financing of the local government, has prepared seven remaining regional plans of waste management, respectively for the regions: Berat, Dibër, Fier, Gjirokastrë, Kukës, Lezhë, Shkodër. Plans of Tirana, Dibra Shkodra are approved by the county council. All the regional plans have to be revised by Ministry of Environment in cooperation with the county council after the decentralization reform. Then, it is responsibility of county council to send the plan for adoption to the Council of Ministers. The regional plan which will be adopted in 2015-2016, put the targets on reduction, separation of waste at source and recycling in accordance with the environmental protection’s principals.

The implementation of regional plans in the upcoming three years, will achieve the objectives of recycling and composting.

Regarding to **waste recycling** there has been some progress. It is established the Albanian recycling association, which has invested about 120 million Euro on construction of recycling plant in compliance with European standards and about 35.000 employees are employed. Even in the future, it will continue to give priority to promote public-private partnership, especially to the recycling sector.

Separation of waste at source should be started by 2016. It will undertake some awareness activities by 2015 in public and private schools, in public institutions for separation of waste at source. Up to now, it has started the collection of lead acid batteries, used oils. Separation in source should be reached by December 2018.

The Ministry of Environment, based on its priorities regarding integrated waste management and based on social and economic development programme of government (2013-2017), has started a cycle of workshops at districts level (12). The purpose of these workshops is to acquaint representatives of local government with legislation in the waste field, with duties and responsibilities as well as the objectives that should reach the deadlines set out in the National Strategy and Plan of Waste Management. Some other workshops will develop after the decentralization reform to increase the capacity building of local government. After the decentralization reform will change the tasks of central and local government as well as the

territory of any region. As a result, the Ministry of Environment will continue the training into 12 new regions by 2016 to present with the update legislation on waste management area.

Currently, there are only two landfills that meet EU standards. The construction of the landfill in Maliq/Korça has not started yet, while the construction of the landfill in Bajkaj/Saranda is done. The Ministry of Environment cooperates with domestic and foreign investors for granting with concession for the construction of landfills, but seeing the landfill as the last resort of the hierarchy. The waste burning is almost completely eliminated. The rest of regional landfill will be constructed by 2020 in compliance with the EU criteria.

Six autoclaves, funding from the World Health Organization are donating at some public hospitals for treatment of hazardous healthcare waste. In the hospitals where there are no facilities for the healthcare waste treatment, it carried out by two private licensed companies. Actually there is only one way for the management of hazardous waste; to export them outside the territory of our country, as far as to be built a landfill or incinerator.

In relation to the procedures for the management and control of landfills, they are clearly defined in DCM no. 452, dated 11.07.2012 "On waste landfills".

In the next three years should be constructed a landfill for hazardous waste. The feasibility study is planned in 2015 the tender in 2016 and construction in 2017. New investments in this area should focus more on the separation and recycling of waste.

In the framework of IPA 2013 project will be funded 2 Mil Eur on integrated waste management area, for regions Fier and Durres.

There are scheduled to draft three feasibility studies for closure of existing dumpsites in the cities of Durres, Vlora and Saranda by state budget in 2014 and 2015.

Pursuant to the objectives of the National Strategy and Plan of Waste Management, has been initiated three projects:

(i) Establishment of a system to return the packaging waste and the commitment of producers to promote the collection and recycling system.

The Ministry of Environment collaborates with "Reverse Logistics GmbH" company for the design of this project. After the design, the project will implement in all over the country.

(ii) Encourage the cooperation on Private-Public Partnership (PPP) for integrated waste management (concessions).

There are designated areas where you can apply for public-private partnership (PPP).

Feasibility studies have been prepared on: 1. management of end of life vehicles 2. construction of landfill on waste management for the district of Durres, 3. development a scheme for the electrical and electronic waste management 4. used oils. Currently, for the first two procedures have begun the concession procedures: 1. on management of end of life vehicles and 2. on construction of a regional landfill. For both of the above procedures, the contracting authority is defined. The construction of the landfill for Durresi district and the management of end of life vehicles should be started by 2016. For the point 3 and 4 it have to establish the working group

by 2015. It depends on the quality of the feasibility study the duration of a concession's procedure.

(iii) It is started the implementation of the project: Reduction of the amount of waste and promotion 3 R activities (Reduce, Reuse, Recycle), funded by Japanese Government (JICA)

For the implementation of this project were selected three local government units: Tirana, Lezha and Bushat. The project will last three years.

IPA 2013 and JICA projects will finish by 2017 and will help to prepare a national guideline on 3R, and train the central and local government

- Creation of GIS database as a new initiative

Creating a GIS database and map system of waste deposition in order to track crucial historical data on these old waste dumps, (for the purpose of rehabilitation), and provide planning provisions for the creation of new landfills, is a pilot initiative taken by the Ministry of Urban Development and Tourism in order to increase engagement from Local Authorities on issues of waste management and increase transparency with stakeholders. Furthermore the MUDT plans to set out regulation that will guide regional authorities and municipalities for developing studies-design for the rehabilitation of old waste dumps and the construction of new landfills, in accordance with international standards." This is important for boosting initiatives in land rehabilitation which in the long run will lead to redevelopment. Additionally projects on landfill construction will lead to waste reduction initiatives and this will directly affect the growth of the recycling market and increase competitiveness among these companies.

1.2.2. Urban planning

Urban planning is essential for competitiveness since it defines the basic conditions for business, including possibilities to construct new facilities, get access to basic utilities and local transportation infrastructure.

Challenges and priorities in urban development and planning sector are:

1.2.2.1 Drafting of General National Territory Plan (GNTP)

This Plan is the most strategic project of national interest which will: guide investments; regulate territory control; ensure environmental protection; and boost social-economic development. General National Plan (GNP), will harmonize the sectorial strategies to the benefit of economic and social recovery for the citizens by making planning an integrated joint effort / function.

Law on Territorial Planning and Development (No: 107 / 2014) has been approved in October 2014. In the field of legalization the Parliament approved on May 2014 the last changes of the Law 9482, dated 03.04.2006, "On the legalization, urbanization and integration of illegal construction" amended has made clear the effect of restoring legality and making transparent in the field of property rights, through the effect of legalization procedures of builders or possessors of illegal buildings, thus contributing to the establishment of control on the territory.

1.2.2.2 *Urban regeneration and social and economic integration of informal areas:*

Measure 1: Elimination of informal land development and complete the process of legalization. The measure will build capacity, simplify and accelerate the legalization process, to finally conclude the era of informality in the territory. This will open the way to further to urbanization and integration of informal areas/settlements in the territory.

Measure 2: The urbanization of informal areas is expected to have a powerful and positive impact in the planning and development of the territory, and to resolve the crisis on the right of ownership in the country. It is expected to increase the quality of life of the community of informal areas, and foster its sustainable development of these areas.

1.2.2.3 *Drafting of the Integrated Economic Plan for Tirana-Durrës and Integrated Cross sectorial Plan for the Coast*

Measure 1: Drafting of the Integrated Economic Plan for Tirana-Durrës: The region of Tirana-Durrës is one of the most important regions in Albania in terms of economic productivity. Thus, in order to further facilitate its economic development and to increase its competitiveness in the international setting the government sees is as a tool which will enable further economic prosperity in the area, as well as in the whole country.

Measure 2: Drafting of the Integrated Cross sectorial Plan for the Coast during. The coastal area of Albania is one of the most valuable assets of the country which due to the current development model is under great risk. Thus, the plan aims to give a general vision for the sustainable development of the coast by protecting its values and enhancing economic development. This plan will also create opportunities and conditions for the development of tourism.

Expected contribution to the budget for the period 2015-2017 is 2.6 Mil USD, while, for the year 2015, budget planning is 1.6 Mil USD.

1.2.2.4 *Urban Services and Housing*

Social Housing:

Due to the housing needs of the most vulnerable population in Albania, this sector, by means of various PPP schemes, has prioritized as its main priorities (i) encouraging the private sector to increase the sale of their units and make them available for the of social housing programmes, (ii) redevelop degraded areas and buildings for the purpose of turning them into social housing. There is no planned budget value at the moment for these two measures because it is dependent on the needs that local authorities submit to the ministry, for the years 2015-2017.

Two other **programmes** to be implemented till 2017 are the Housing Renovations for about 0.5% of multifamily buildings privatized before 1993, in order to increase their energy efficiency and their market value. The budget foreseen till 2017 for the Housing Renovation is 649,904 Eur; Improving the Housing Conditions for about 80% of the currently identified Roma and Egyptian community in Albania including building reconstructions and improved access to water and sanitation, the total planned budget for this item till 2017 is 2,228,578 Eur.

The vision of the **Strategy on Social Housing 2015-2025** has an overall goal to “realize the housing needs of a large proportion of the Albanian population, which cannot afford a housing solution in the market or suffer from housing exclusion due to a number of vulnerability indicators will be addressed by implementing an integrated social housing policy that prioritizes housing needs of low income and vulnerable groups and provides a conducive policy environment that aims at the availability, accessibility and affordability of minimum standard housing solutions to the target population.”

The drafting of this strategy was made possible through a project financed by UNDP, which started in the first quarter of 2014 and is expected to be finalized in May 2015. It is introducing a new model from the previous, is marking a shift from a universal model with the public sector making provisions for all citizens, to a more targeted model with a multi-stakeholders. The abovementioned programmes and strategy are therefore oriented toward a targeted model with a multi-stakeholders focus on vulnerable population, offering them qualitative improvements that meet national standards for housing, while striving to reach EU standards.

The expected added value of this sector to the general economic growth and competitiveness is that it will find solutions to increase the number of social housing units and to encourage the development of programs of social housing in Albania.

Regional Development Fund (RDF) for Urban Transformation Projects:

RDF is a competitive grant fund, financed from the budget of the Albanian Government with the aim to promote regional development and to reduce regional disparities. The Ministry of Urban Development and Tourism is responsible for managing the funds in the local infrastructure sector. These projects consist in (i) reconstruction and rehabilitation of main city centers that play a central role in their region; (ii) intervention in the reconstruction of main roads that connects different cities and rural areas aiming to boost regional socio-economic development; (iii) reconstruction of urban parks, urban plazas, street facades and promoting pedestrian streets in touristic cities with the scope of increasing the quality of life, the environmental urban patterns and boost sustainable touristic development;

1.3. Improve energy security and diversify energy supply

Increase in Power Generation Capacity via investments in Hydro Power Plants, in Thermal Power Plant with natural Gas from TAP Project, and potential conversion of Vlora Thermal Power Plant from oil to natural gas, Investments in Interconnectivity Capacity.

1.3.1 Energy Security and Diversification

Based on the directives of the European Union, 20/20/20 Initiative of the European Union and the Treaty of the Energy Committee, the main objectives are to increase security of electricity supply to all customers and the diversification of energy sources for electricity production in the country. Currently 100% of the Electrical Power is produced from Hydro Sources. Work continues to increase manufacturing capacity in waters through the construction of Hydro Power Plants Concessions. Diversification can currently be achieved through the import of electricity, and through the construction of Thermal Power Plants to be supplied with natural gas through the TAP project, expected to become efficient after 2020.

This should be achieved by increasing the production capacity, increasing the transmission capacity and distribution, by improving the legal framework of the sector and the change of the Penal Code.

Administrative instruments/receiver is:

- Existing law for the energy sector Nr. 9072. Date 22.05.2003
- “New Law for the Energy Sector”, adopted by the Council of Ministers on 01/14/2015, adoption by Parliament expected by end of first quarter of 2015.

During 12 months in 2014:

- “The New Law for the Energy Sector” was drafted;
- Amendments to the Penal Code for theft of electricity, who has given very good results so far.
- Initiated construction of 400 kV interconnection line Albania-Kosovo;
- Started construction of the project 110 kV southern Albania.

Steps to be taken during 2015-2017:

- During 2015, drafting and approval of National Energy Strategy, with foreign assistance grant.
- Completion of 400 kV interconnection line Albanian-Kosovo expected in 2016, financed by a loan of 28.9 million Eur from “KfW”.
- Completion of the project 110 kV interconnection South Albania, expected in 2016, financed by a loan of 37.75 million Eur from “KfW Germany”.
- Stimulations for constructions of New HPP, with investments of companies. Will continue during 3 years.

Stimulation will be ensured through various policies for the purchase of part of the electricity produced from renewable sources, as well as through higher fees than production from other sources.

As mentioned above, diversification can currently be achieved through the import of electricity, and through the construction of Thermal Power Plants to be supplied with natural gas through the TAP project, expected to become efficient after 2020.

Matching points with the Action Plan SEE 2020:

- Awareness campaign in order to change consumer behavior in the use of electricity.
- Simplification/facilitation of procedures and shortening of the times for handling requests for the issuance of permits for construction of power generation facilities.
- Develop a study for a return to "qualified customers" to consumers supplied at 20 and 35 kV voltage.
- Review of Model electricity market "in order to reflect recent developments in this sector with the adoption of the “Law on Power Sector ”.
- Increased security of supply of electricity will attract more foreign investments, which viewed through concrete investment:
 - 28.9 million EUR from “KfW Germany” for the construction of 400 kV Interconnection line “Albania – Kosovo”

- 37.75 million EUR from “KfW Germany” for the construction of “110 kV Project South Albania”
- US \$ 150 Million from “World Bank” for the "Recovery of Energy Sector.

Potential risks to the achievement of the objectives are delay in the adoption of adoption of legal acts, lack of enforcement capacity, lack of financial capacity, climate change, price changes on a global scale, etc.

Benefits and impacts to be achieved through these measures and investments will be: increased security of supply uninterrupted power to all customers; increased performance of the electricity sector; increased competition in the market and benefit for the consumers.

PILLAR 2 – HUMAN CAPITAL

2.2. Vocational education and training

Regarding vocational education and training (VET), a draft 2014-20 national strategy for jobs and skills (“Employment and Skill Strategy 2014-2020”) and a related action plan were finalised and - are awaiting adoption, while a monitoring plan still needs to be prepared.

2.2.1 Offer quality vocational education and training for youth and adults

Investments in human capital and the quality of the education and training system are at the core of an innovative and competitive economy with more and better jobs.

Access to high quality education and training is a central element to determine the employability of the labour force and influencing the investment climate. Increasing men’s and women’s employability involves making sure that they acquire the skills, knowledge and attitudes that will allow them to find work and scope with unpredictable labour market changes throughout their working lives.

Lifelong learning and training is instrumental to foster enterprise competitiveness and enhance labour productivity, as well as improve job quality. Therefore, access to quality lifelong learning opportunities will be expanded to ease the participation of individuals of all ages, including those with special needs and disadvantaged groups.

The targets to be achieved by 2020 are to increase the share of female and male students attending VET programmes to a minimum of 20%; to increase the employment share of vocational education graduates to 40 %, out of which 25% are girls; increase the share of the adult population participating to lifelong learning to 4 per cent and increasing the employment rate of participants to short vocational training courses to 55%, out of which 75% are women; increasing the annual share of PWD VET students by 1 p.p. This will be attained by increased the vocational education and training investment by 30 per cent in 2020.

A main policy objective is to **offer quality vocational education and training for youth and adults** with the respective measures:

- 2.2.1.1 **Optimizing the VET providers network and improving the image, quality and adequacy of VET inputs** (labs and equipment, curricula, teaching materials) and its processes, by:
 - Assessment and reorganisation of the main VET providers at regional level;

- Maintaining the database and quality assurance of training provision by private VET providers country-wide.
- Analysis and upgrading of buildings, workshops and equipment available in VET providers, including facilities for girls/women amenities, and required amenities responding to the needs of PWD;
- Create a National Catalogue of Vocational Qualifications and revision of all VET frame curricula and design of a public interactive, searchable web portal/database on qualifications, curricula and training offers by VET providers for national and international activities.
- Definition and implementation of quality assurance criteria of VET system (at providers' level) and changing the internal and external verification of VET curriculum implementation (inspection), previously done by REDs.

2.2.1.2 Strengthening the linkages between learning and work and facilitating the transition to work, by:

- Introduction of an already tested model in all VET institutions to organise links between VET institutions and businesses;
- Establishment of agreements with companies and/or business associations that meet the criteria for offering training;
- Organisation of elements of a dual system approach, including internships of VET students as part of the VET curriculum;
- Promotion of entrepreneurial learning and women's entrepreneurship as a key competence;
- Development of learning materials related to the transition to work skills.

2.2.1.3 Improvement of the legal framework and regulatory framework in vocational education and training focusing on competences of VET teachers and teacher trainers (incl. pre service training and continuous professional development), actors in charge of regional management, school or centre directors, by:

- Assessment of competences of VET teachers in public VET institutions and carrying out of an analysis of the demand for VET teachers and instructors, nationwide and by sectors;
- Review of the teacher preparation model;
- Induction of training for all potential VET teachers that includes obligatory modules on gender equality and social inclusion/diversity issues;
- Organisation and delivering of massive training for all VET teachers (in-service), including obligatory capacity development on gender equality and social inclusion/diversity matters;
- Organisation and delivering of training for managers of public VET human resources (regional managers, directors, Board members, VET inspectors);

2.3. Improve quality in higher education

According to the programme of the current government, within the next four years improvements in education and scientific research will serve as the main directions of social and economic developments in Albania.

Higher education and scientific research are both directly linked to competitiveness and economic growth. Within the framework of sectoral and structural reforms that aim to promote competitiveness and growth envisaged in this document, the Ministry of Education and Sport is involved mainly in measures that relate to development of human capital aiming to create competitive research and education.

Within this framework, the following measures compatible with this strategy are envisaged.

2.3.1 *Ensuring qualitative Higher Education system by:*

Measure 1: Improvement of legal framework for higher education.

Measure 2: Continuously monitoring implementation of their legality and strengthening control regarding procedures for their accreditation.

2.3.2 *Enhancing Competitive scientific research*

Under scientific research the following measures will be undertaken:

Measure 1: Within the framework of the reform in scientific research the Agency for Research, Technology and Innovation will be re-structured and set as a dependent institution of the Ministry of Education and Sport specifically in charge for assisting researchers in EU framework programme Horizon 2020.

PILAR 3 - BETTER INDUSTRIAL STRUCTURES

3.1 Support business innovation and competitiveness²

The main objective of this reform initiative is *to increase innovation capabilities and technological changes for SME-s*. This objective is in compliance with the recommendations of the EC, under Sub Committee for Trade, Industry, Taxation and Customs 2014 (SC TITC 2014 recommendation), to *encourage competitiveness in all policy areas affecting SME-s*. The SME sector has a substantial contribution to the economic growth and employment, respectively 80% of GDP and over 70% of total employment.

Strengthening technological capacities of SMEs is part of the Business and Investment Development Strategy 2014-2020 and in full compliance with SEE 2020 National Action Plan. That it contributes to Smart Growth pillar, and will contribute to headline target about increasing GDP per person employed through enhanced value added and productivity gains.

3.1.1 Effective implementation of the Competitiveness Fund and Innovation Fund

This measure concerns effective implementation of the "Competitiveness Fund 2013-2015" with private sector to benefit from the funds, permanent monitoring of the impact, and increase awareness through dissemination of best examples/practices.

The progress over the last 12 months on this measure is linked with some supportive programmes like; Competitiveness Fund, and Innovation Fund managed by AIDA. Such funds are part of the public grants to SMEs, aiming to support SME competitiveness in the market. In January – November 2014, for Competitiveness fund AIDA approved 21 applications with a total amount disbursed of 23 Million ALL. For the innovation Fund, 24 project ideas are approved with disbursed amount of 8.7 Million ALL.

² Innovation in this part does not include R&D

The main challenges/ risks for the implementation of this measure is: i) Availability of financial means from the state budget; ii) Possibilities to combine public funds with donor financial support and iii) Private sector capacities to absorb public funds.

Regarding the activities for the period 2015-2017, are the approval of the Government Decree "Innovation Fund 2015-2017" and the renewal of the Competitiveness fund for 2016-2018. During 2015 awareness campaign and door to door meetings with business organization and individual companies will continue to be carried out by AIDA. In addition, an evaluation report for the implementation of the fund 2013-2015 will be prepared by December 2015 to allow the preparation of the Fund for 2016-2018. During 2016-2017 year will be a permanent monitoring and awareness campaign will be executed. This measure contribute also for the implementation of the national action plan under SEE strategy 2020, which is linked with competitiveness, with dimension K3, K6 this action plan.

Regarding the budgetary implications the budget forecast for competitiveness fund is financial 58 Million ALL; and for Innovation Fund is 40 Million ALL. This measure is expected to have a positive impact in increasing exports by 9% per year. Also for the diversification of exporting products, technology improvements and increase of production capacities; Increasing the number of SMEs by 1.7% yearly and increase employment by 5% yearly.

3.1.2 Increase knowledge about community programs In support of competitiveness.

It is important the effective participation to COSME and monitoring of selected applications/projects, through AIDA under its regular annual budget. For the participation on this community program there is the Government Decree 781, date 19.11.2014, and the upcoming activity during 2015 is the signature of this agreement with European Commission. Benefits from the program including, COSME requirements and guidelines, will be introduced through a series of awareness activities, targeting all interested stakeholders. In addition, the setup of a new consortium to participate in COSME will be stimulated. During 2015-2017 is important the permanent monitoring of the winning projects.

The participation in COSME is also linked with the dimension "Increasing Competitiveness" of the national Action Plan under SEE 2020. The participation in COSME is a challenge because there is a lack of knowledge on COSME and its criteria; also the lack of capacities in preparing business proposals. The contribution from state budget to COSME is with 235 thousand EUR annually till 2017.

The COSME winning projects will have a positive impact on technology improvements and increase of production capacities, and it is a challenge to have at least one winning application for the first year 2015.

3.1.3 Introduction of innovation voucher schemes program

The implementation of this measure seeks to introduce innovation voucher schemes to increase SMEs capacities for innovation. It aims to provide grants and outsource technical expertise for innovative SMEs. The implementation of this measure is based on the BIDS Strategy adopted with Gov. Decree nr.635, date 1.10.2014. During the last year has been prepared the concept assessment to set up the innovation voucher scheme.

In 2015 year will be organised consultative meetings on the concept and objectives of innovation schemes, the adoption of the government decree for innovation voucher scheme and the implementation of the pilot phase. During 2016-2017 year will be permanent monitoring and assessment on effectiveness of the innovation scheme. The setup of innovation scheme is also linked with the dimension E 3, business innovation support under SEE 2020. The challenge of the implementation of the innovation voucher scheme, is closely linked with the availability of public funds and the contribution of the donors; the availability of TA and administrative capacities to implement the scheme as well. Regarding the budgetary implications for the period 2015-2017 there are planned 9 million ALL. Through the implementation of this scheme will strengthen the tripartite cooperation private sector, academia and Government, and during the pilot phase 25 SME-s will benefit.

3.2. Access of SME-s and new start-ups to financing

Increase financing possibilities and lowering cost for credit, is one of the important objectives in support of competitiveness for SME-s. This objective is also in compliance with the recommendations of the EC progress report 2014, stressing to stimulate access to finance.

3.2.1 Oversee the implementation of the program of integrated assistance for the Albanian SMEs and support for their participation.

This measure is going to be realised based on the approval of the financial agreement Programme that entered into force on 12 July 2014. This programme, with the support of Italian government provides a financial support of 15 Million EUR, from which 11 Million EUR are credit line for SME-s, 2,5 Million EUR for the Guarantee Fund and the rest technical assistance in support of SME-s.

During the year 2014, under the Italian – Albanian Programme has been financed 17 projects in different economic sectors like dairy and food processing, oil of olive production, production of prefabricated construction elements, furniture, poultry etc.

In terms of challenge for the implementation of this financial programme is still considered low absorption of funds from private sector, and lack of capacities to prepare projects proposals.

Under this measure, during 2015-2017, will be realized a permanent monitoring of the effectiveness of the program and assessing the impact for SMEs. Also the implementation of the financial programme is in line of the national action plan under SEE 2020, under the dimension of “Increasing Competitiveness”. The implementation of this programme will have positive impact on the increase of production capacities for SME-s, aiming at having around 25 winning projects per year.

3.2.2 Provision of financial support to women entrepreneurs and start-ups

The objective for the implementation of this measure is to increase financing possibilities for special groups of SMEs, in particular women and start-ups, subsidizing interest loans for women and grants for start-ups, aiming to reduce market entry barriers for this group of SMEs.

The Women Entrepreneurship Fund was set up with a gov. decree No. 592 of 10.09.2014 “On establishing the Women Entrepreneurship Fund”. The fund aims to provide direct financial support to women entrepreneurs through microfinance institutions. Fund will cover 50% of the interest rate of credits.

The Start-up Fund was set up with a Government Decree No. 593 of 10.09.2014 “On establishing the Fund to support new start-up enterprises”, aiming to provide grants to newly created businesses. During 2014, has been adopted both regulation for the functioning of the funds, and AIDA is responsible for the disbursement of the funds, has initiated the awareness campaign for both funds in different regions of the country.

The real challenge for the success of both programmes is low absorption of funds from women entrepreneurs and star-ups, and lack of capacities to prepare project proposals.

The upcoming activities during 2015-2017, are effective implementation of both funds and permanent monitoring of the effectiveness of implementation during the whole period.

Both funds are included also in the national action plan of SEE 2020, under dimension “Increasing Competitiveness”

The budgetary implications for the period 2015-2017, for the Women entrepreneurship fund is 24 Million ALL; and for the start-up fund is 23 Million ALL. The disbursement of both funds will have positive impact: Increased possibilities for women and start-ups to ease access to credits; Around 400 women entrepreneurs will benefit credit from non-financial institutions for the whole period of the fund; Increase the number of enterprises led by women from 28% in 2013 to 32% in 2017.

3.2.3 Improve bankruptcy procedures

The objective for the realization of this measure is streamlined and improved procedures for bankruptcy. The Bankruptcy Surveillance Agency aims to facilitate the work of bankruptcy administrators, encouraging the fast functioning and in compliance with the law, but it shall also ensure the transparency on the bankruptcy situation in Albania through periodic reports.

The existing legal act is the law No. 8901 of 23.05.2002 “On bankruptcy and implementing regulations of upcoming legal acts”.

During 2014, 109 applications for bankruptcy have been evaluated. In the same time has been organized consultations and roundtable discussions on the implementation of the existing law and the initial draft of the amendment are in place.

For the upcoming period 2015-2017, is the adoption of the legal changes and the implementing regulations for bankruptcy procedures. The challenges for the implementation of the bankruptcy law are: delay in approval process; lack of knowledge from the private sector and lack of administrative capacities of bankruptcy administrators as well.

There is no financial implication from the state budget. TA will be provided by IFC. The expected outcome of this measure is (i) reorganization of the companies, (ii) maximization value of the

assets for full distribution to creditors, (iii) reduction of the duration of the bankruptcy procedure (iv) reduction of the administrative costs, (v) discovery of the abusive actions in bankruptcy procedure.

3.3. Foster the competitiveness of the tourism sector

Tourism is one of the most important sectors for the Albanian economy contributing 4.8% of GDP and 41,000 direct jobs, according to World Travel and Tourism Council (WTTC). The development of this sector that generates economic development and guarantees employment and self-employment opportunities will come through an integrated vision of cross – sectorial coordination and a balanced management of tourism resources.

Main challenges in the framework of tourism development will be focus on: making tourism a priority area of sustainable development of the country; making Albania an attractive and favorite destination in international tourism maps and markets; making Albania an attractive, sustainable and qualitative tourism destination, and creating a perennial integrated, active and social tourism model focusing on cultural – natural – ecologic dimension.

During 2015 the approval the legal framework of tourism and the Strategy of Tourism Development 2014-2020 is except following a wide consultation process, with various stakeholders, and guided by UNWTO and EU best practices.

The main objective is to improve image of the Albanian tourism in the region and widely, through the participation in international fairs, promotional materials publications, ads, info tours with representatives of media, international touristic operators etc.

Through this measure we expect to increase the number of visitors from main international markets, the duration of stay of foreign visitors, the income to the Albanian economy and generate employment in the tourism industry

The total expenditures planned in the budget planning for the period 2015-2017 is 340 billion ALL, while, for the year 2015, budget planning is 114 billion ALL.

The foreseen impacts of the measure during 2015 are the improvement of tourism services, the improvement of market segmentation and product design, better definition and prioritization of targeted markets, entry in new niche markets.

i. Establishing a database of updated information for touristic enterprises and to collect information from them.

Through this measure will achieve the reduction of informality, growth in tourism investment and growth in the supply of touristic activities.

The total expenditures planned in the budget planning for the period 2015-2017 is 7 billion ALL, while, for the year 2015, budget planning is 2 billion ALL;

The foreseen impacts of the measure during 2015 are: incentives to the formalization of the tourism sector; improvement of the regulation and supervision of touristic activities, improvement of the quality of services, improvement in consumer protection.

ii. Building tourist destination with a consolidated touristic product.

The main objective is to develop tourist destination and resources with the intention of offering competitive products such as: three products of nature tourism, three products of cultural tourism with services and attractive activities of cultural tourism and two products of coastal tourism.

Through this measure will achieve growth in jobs creation, in international arrivals, in international receipts and in tourism investments.

The total expenditures planned in the budget planning for the period 2015-2017 is 48 billion, while, for the year 2015 the budget planning is 16 billion ALL.

The foreseen impacts of the measure during 2015 are development of new touristic destinations and products, development of new market niches, improvement in coordination, implementation and planning of projects in the sector, sustainability of tourism development.

3.4. Boost competitiveness in agriculture

The main Agriculture Policies for the period 2015-2017 provides the framework for the operational interventions needed to develop a viable and competitive agricultural and food processing sector and to foster a balanced economic development in rural areas, paving the way for integration of the agricultural and agro-processing sector in the EU as a basis for the increasing standards of living in rural areas and thus reducing poverty.

The objectives of the Inter-sectorial Agriculture and Rural Development Strategy (ISARD) will be achieved through a number of support measures as well as several national actions, primarily selected to complement measures funded under the IPARD II Rural Development Programme and to establish the institutional and regulatory framework conditions needed for the sector to adapt to the new international competition.

In order to facilitate the EU integration process the Albanian agricultural and rural development policy will be designed and implemented in accordance with the following guidelines:

- New support measures will be designed in accordance with the principles of the EU Common Agricultural Policy (CAP), rural development and pre-accession policy for the period 2014-2020.

One of these measures is *'Investments in physical assets concerning processing and marketing of agricultural and fishery products'*.

Under this measure the priority is given to; **investments in establishment of food safety standard systems** which are of key importance for supplying local market with safe food products and for the successful improve of trade balance with agricultural products and developing export potential.

The impact of this measure aims increasing production capacities through achievement of EU standards.

The general objectives of the measure are:

(i) Enhancing farm viability and competitiveness of agriculture and food processing while progressively aligning with Union standards; (ii) addressing climate change challenges and (iii) supporting economic, social and territorial development.

Legal bases for this measure are:

- Article 2 (1) of IPA Regulation (EU) No 236/2014 of the European Parliament and of the Council of 11 March 2014 laying down common rules and procedures for the implementation of the Union's instruments for financing external action;
- Article 27 (1) (c) of the Sectoral Agreement;
- Annex 4 of the Sectoral Agreement.

Until now these measures has been supported from IPARD-like (IPA 2011). During January – December 2014 has been made 81 applications from which 34 in the first call, 19 applications in the second call and 28 applications in the third call. EU fund for these three calls for this measure has been 13.8 M Euro

For the period 2015-2017 it is foreseen to support 95 projects, with a total value of 35.5 M Euro, 95 enterprises performing modernization projects and 95 enterprises progressively upgrading towards EU standards. Is the impact foreseen is the creation of up to 300 jobs.

Indicative yearly budgeted of EU and Albanian contribution is 5.3 M Euro from EU and 1.3 M Euro from Albanian Contribution.

PILAR 4 - GOOD BUSINESS ENVIRONMENT

4.1 Reduce regulatory burden to business

Improving business climate through a deep deregulation reform with the aim of reducing regulatory burden lies at core of the initiatives undertaken by the Government of Albania. This will contribute to the enhancement of competitiveness and growth. The reforms undertaken during June 2013- May 2014 improved substantially Albanian ranking in Doing Business 2015 by 40 places. An inter institutional Working Group, chaired by the Minister of Economic Development, Trade and Entrepreneurship is established by the Order of Prime Minister No 30, date 30.01.2014. In addition, the National Action Plan 2014-2016, comprising measures for each area is approved by the Government Decree no. 591, date 10.09.2014. This flagship reform is in line EC recommendation to business environment (EC Progress Report 2014), SEE2020 National Action Plan and Strategy for Business Development and Investment 2014-2020.

4.1.1. Merge National registration Center (NRC) and National Licensing Center (NLC) to allow single window service for registration and licensing and provision of full e-registration

NRC and NLC function as separate institutions and provide registration and licensing through one stop shop. Merging of registration and licensing process providing one single window application will improve the quality of services and reduce administrative cost for businesses. During 2014 the assessment on the potentials for merging NRC and NLC and the model to follow are prepared while the Action Plan on next steps is being prepared. Moreover, IT investment at NRC to allow e-registration, are at the final stage.

During 2015 all legislative changes will be carried out and the interface for e-registration through a web based application will be finalized. The physical investment for the new institution is expected to be completed during 2016-2017. In 2017, the assessment on the impact to SMEs will be prepared to allow any potential improvement. The whole reform will be consulted with the private sector while the awareness campaign for the new institution, procedures and requirement will accompany the whole initiative. This measure is complaint with the dimension “Integration to the global markets” of the SEE2020 National Action Plan. The TA for legal changes and institutional restructuring will be financed by GIZ. The estimated cost for physical investment for the new institution is around 70 million ALL, not committed yet though.

The expected impact is (i) reduction by 30% of visits in NRC headquarter and 10% in the regional windows, (ii) online provision of different documents for businesses, upon request, up to 50% of applicants in 2015 and 100% in following years, (iii) online filing of the financial reports, (iv) reduce registration from 24 hours to 8 hours within 2015.

4.1.2. Review the authorisation schemes.

Licenses and permits are regulated by the Law no.10081, date 23.22.2009, "On licencing, permits and authorisations in the Republic of Albania" and it's implementing regulations. Establishment of NLC and provision of licences through one-stop-shop practice reduced the number of licenses from 300 categories and subcategories to 65. This initiative will be deepened further during 2015-2017. Authorisations schemes will be reviewed and streamlined with the aim of inclusion to NLC system. The main objective of this measure is to simplify authorisation procedures and reduce cost for businesses. During 2014 the Working Groups is set up through the Order of Minister of MEDTE no 461 of 2014. Moreover, the preliminary inventory of authorisations currently issued by line ministries is prepared.

During 2015 full screening will be carried out. For this (i) the inventory of all authorizations in force will be finalized, (ii) screening of the necessity will be based on the proportionality test, (iii) recommendations on the removal of unnecessary authorisation, where appropriate, or inclusion to NLC system will be proposed. The legal drafting is envisaged to be finalized within 2015. This measure is compliant with the dimension "Integration to the global markets" of the SEE2020 National Action Plan and has no financial implications for the state budget. TA for screening and legislative changes will be supported by GIZ.

Although this reform may encounter institutional resistance to change and potential delays in legal drafting due to limited administrative capacities for the reform, the expected outcome is to remove up to 10 authorisations and streamline other 20.

4.1.3. Permanent monitoring of national plan 2014-2016 to ease doing business

Reforms to facilitate business environment and reduce regulatory and administrative costs to business are carried out on permanent basis. Monitoring and evaluating the impact remains a challenge and represent the weakness in the policy-making process. The Inter-institutional Working Group established by the Order no. No 30, date 30.01.2014 for the reform of better business environment monitors the implementation of the National Action Plan 2014-2016. It report regularly to the Prime Minister Cabinet and National Economic Council.

This measure aims to establish a permanent and sustainable mechanism to allow proper monitoring and evaluation of the reform. During 2015 all legal changes affecting the main areas of economic activities for business will be finalized. Monitoring of the implementation of the activities as stipulated in the Action Plan will be carried out twice a year. The monitoring report with progress achieved and necessary changes to the action plan will be proposed. Consultation with private sector and awareness campaign will be carried out permanently. In addition, reform results will be made publicly available for all interested parties. Concrete steps for 2016-2017 are dependant to the evaluation carried out the first half of 2015.

This measure is compliant with the dimension "Integration to the global markets" of the SEE2020 National Action Plan and has no financial implications for the state budget, except for

public administration costs. The expected results of the first M&E report encompass: (i) only 5 procedures and 60 days for the getting the construction permit; (ii) e-filing of taxes not more than 10 times per year and simultaneous tax e-filing and e-payment, (iii) only 3 procedures and 45 days in getting a new point of electricity connection, (v) one stop shop property registration service, within maximum 4 days.

PILAR 5 - TRADE INTEGRATION

5.1 Boost trade integration

During the period 2009-2013 trade volume annual average growth was 3.6% while the trade deficit decreased yearly by 3.4%. In 2013 export increased by 15.7% and imports decreased by 2.1%. In 2013 EU represented 63% of total imports and 76% of exports. This flagship reform is compliant with the commitment deriving from article 12 of Albania-EU SAA and CEFTA EC recommendation to participate and implement CEFTA in a constructive way. It is also compliant with the National Strategy for Business Development and Investment 2014-2020 and the SEE 2020 National Action Plan.

5.1.1. Reduce administrative costs and the elimination of non-tariff trade barriers:

Reduction of tariffs alone is not sufficient to realise the full potential of trade. Existing of NTBs is undermining the tariff liberalization. Removal of NTBs barriers is a priority for Albania, focusing simultaneously in the regional trade and bilateral trade with EU. Reducing trade barriers will be focused in 3 main directions: (i) reduce documents accompanying exports and import, (ii) improve procedures for export and import, (iii) introduce risk management for agriculture products. Specific measures are part of the National Action Plan 2014-2016 for ease of doing business. This measure provides also for the establishment of the Single Window in customs.

During 2014 analyses with regard to the number of documents and procedures in import-export is carried out. Concrete recommendations were prepared and approved. During 2015, legal drafting will be finalized to allow for removal of 2 documents in import and 1 in export. The establishment of Single Window in customs will start in 2015 with the objective to finalize it by 2017. During 2016-2017, risk management will be introduced for agriculture products.

This measure is compliant with the dimension “Reduction of administrative cost and removal of NTBs” of the National Action Plan and aims at reducing trade barriers by reducing number of documents in import and export up to 5 and reducing administrative cost through streamlined procedures in borders. As a result we expect to have an increase in exports of goods by 9% yearly and an increase in export share per GDP from 13% in 2013 to 19% in 2017. The implementation of this measure will be supported by IFC, 90 million ALL till 2017, state budget 9 million ALL till 2017, not committed yet and 42 million ALL for Single Window in 2015.

5.1.2. Liberalization of service trade with the countries of the region and Turkey

Albania has liberalized fully trade in goods with CEFTA countries while it still has a limited number of agriculture products under MFN tariff. The free trade agreements with the region and Turkey provides for the liberalization of trade in services with these countries. Negotiating team is set up and preliminary analyse on the level of commitment is prepared. Albania’s objective is to

reach a uniform regional openness based on reciprocity. The goal is to meet a GATS+ level of openness for both CEFTA and Turkey. This measure will contribute to the increase of the export potentials for Albania in services.

During 2015 official negotiations with CEFTA started and the conclusion will vary on the developments in CEFTA. The objective is to conclude negotiation by 2016. During 2016 negotiations with Turkey will be also finalized and finalization of internal legal procedures is foreseen to be completed within 2017. This measure is compliant with the dimension “Further liberalization of trade in services” of the SEE National Action Plan. This measure has no financial implications for the state budget. However, successful completion of it will depend on the mutual understanding and will to have a greater level of liberalization and political constraint for signing within CEFTA.

5.1.3. Reduce obstacles in trade logistics and harmonization of procedures in bilateral trade with Kosovo.

Albania and Kosovo signed on 11 January 2014 the agreement to promote and facilitate trade between the two countries. Kosovo is among the main trading partners for Albania and therefore particular focus is given to this market. The agreement set concrete objectives to eliminate non-tariff barriers and other administrative barriers that concern the bilateral trade. This measure will among others aim at harmonising standards conformity assessment procedures and facilitate border procedures for products with mutual interest. It will contribute to reduce cost for business in the bilateral trade and provide a good experience to be replicated with other strategic partners.

During 2014 the joint action plan covering (i) technical barriers to trade (TBT), sanitary and fit-to sanitary Measure (SPS) and administrative barriers, is prepared and being implemented. Joint working groups for the three dimensions of the action plan are already set up. During 2015, preparation of the agreement for recognition of conformity assessment procedures with Kosovo for products with mutual interest will be at core of the activities. During 2016-2017 an assessment to the impact in the reduction of administrative and regulatory cost will be prepared.

This measure is compliant with the dimension “Reduction of administrative cost and removal of NTBs” of the SEE 2020 National Action Plan and has no financial implication for the state budget. It will contribute to the reduction of trade barriers in the bilateral trade and increased level of cooperation among border agencies. As a result, the expected outcome will be an increase of trade volume by 10%, yearly.

5.1.4. Promote "Made in Albania" products

This measure aims to promote "Made in Albania products" through participation in trade fairs, conferences, regional and European round tables etc. It includes the strengthening of promotional action abroad by increasing the intensity of representation and institutional following of Albanian companies exporting through an active commitment of diplomatic network, or through AIDA's representation within the diplomatic network abroad. In addition, effective implementation of Competitiveness fund for 2016-2018 will be in support of this measure.

During 2014, under the competitiveness fund, 36 (thirty six) applications are examined, from

which, 21 are approved, corresponding to 23 Million ALL disbursed. During 2015, the renewal of the Competitiveness fund for 2016-2018 will be completed, preceded by the final monitoring report for the period 2013-2015. During 2015-2017 participation in trade fair, exhibitions and other export promotional activities is planned. The amount of the competitiveness fund 2016-2018 is 60 million ALL and the budget for trade fairs and exhibition for 2015-17 is 133 million ALL.

This measure is compliant with the dimension “Increasing Competitiveness” of the SEE 2020 National Action Plan. The outcome of this measure, complemented by other measures of this flagship reform will contribute to increase in exports of goods by 9% yearly and an increase in export share per GDP from 13% in 2013 to 19% in 2017.

5.2. Strengthen FDI policy and promotion

The promotion and development of this strategic priority requires continuous improvements in the legal and institutional framework, further improvements and modernization of infrastructure as well as further improvements in the business and investment environment. As for 2014 year, the preliminary data from the Bank of Albania shows that, by the end of September 2014, the value of foreign investments amounted to 590.6 Million EUR or 117 Million EUR less than the period January to September of last year. The decline in FDI-s arises as a result of the euro zone economy, which is going through a difficult economic situation, and at the same time is one of the main economic partners, which affects the FDI inflow in our country.

5.2.1. *Implementation of a special law for strategic investment and a new law on PPP*

The objective of this measure is to promote green field investments in strategic sectors; and the development of economic zones (industrial parks). The realization of this measure is to stimulate new investment in strategic sectors through implementation of a special law for strategic investment and a new law on PPP and improve customer relationship management (CRM) through AIDA. The basic legal framework for the implementation of the FDI policy and promotion is the Strategy for Business and Investment development, approved with Government Decree no.635, date 1.10.2014; Law no 7764 of 2.11.1993 “On Foreign Investment” Law no. 125/2013 “On concessions and private public partnership” and Low no 88/2014 “for some amendments in the law 125/2013”; Law no. 9789 date 19.07.2007 “On the establishment and functioning of economic zones”.

One of the main problems identified so far is the fact that foreign direct investments in Albania, are considered capital intensive and didn’t properly justify job creations, or have not promoted local entrepreneurship through the value chain. For this reason during this period of 2014 year the focus of the work was on the identification of strategic sectors; Drafting the law on strategic investment; the draft law on PPP was prepared and the setup of the working group for amendment of the law for development of the economic zones. At AIDA the database of foreign investors was established.

The strategic sectors, on which the Government will focus on attracting foreign investments, are: infrastructure; energy, tourism and agriculture with the aim of opening of new jobs, increase economic growth and supporting local entrepreneurship through the value chain.

For the upcoming period in 2015 are the approval of the new law on strategic investment and the Approval of the new law on PPP. Through AIDA and other public institutions an awareness campaign is going to be realized on benefits deriving from the new laws. Another important objective is the approval of the amendment of the law on economic zones and the transformation of AIDA as a One Stop Shop for CRM. This measure is expected to Increase of FDI inflows by 5% per year Increase of FDI as share of GDP from 8.3% in 2013 to 9% in 2017

5.2.2. Promote Albania in international events with the aim to attract FDI

Related with the FDI promotion, the AIDA's services will cover all stages of investment: a) pre-investment, including information dissemination, contacts with relevant institutions, cooperation with partners (match-up), assistance to visits of investors, etc., b) investment, including investment assistance through all phases and procedures of the investment location and c) post-investment, including support during their operation and /or consolidation of their activity.

In the medium term, AIDA's function will include a "one-stop-shop" service for foreign investors, which in addition to initial support and related services will also be able to support investors during the investment phase as well as during their operation. There is no financial implication for the implementation of the measure.

The strategy of promoting foreign investments will focus on two main areas: building of the country's image as an investment destination, highlighting the advantages of Albania's business climate and promote investment opportunities to investors and about specifics advantages linked with the needs of target investors. Organizing activities; such as participation in international conferences or business investment forums in different European countries, to present Albania as an attractive place for investment.

During 2016-2017 year the effective implementation of the new laws and the work to assess the impact on FDI increase. The real challenges for the implementation of the FDI policy are: Increased competitiveness from other countries of the region; the slowdown of FDI during the last year; the potential delays in the approval process for investments; and the lack of administrative capacities to monitor the implementation of the laws.

The realization of this measure is included also in the national action plan of SEE 2020, under the dimension "Integration to the global markets". State budget will contribute to this measure by 133 million ALL. The expected outcome of this measure will contribute an increase of FDI inflows by 5% per year and increase of FDI as share of GDP from 8.3% in 2013 to 9% in 2017.

IV. Institutional issues and stakeholder involvement

Stakeholder engagement is considered as an important part of the economic development of the country. To this purpose, during 2014 was created the National Economic Council (NEC).

NEC, which is convened every three months, is raised for the first time to institutionalize the dialogue between the government and entrepreneurship, in view of the restructuring of the Albanian economy. The Council is attended by representatives of the government and the

Albanian Central Bank, representatives of international organizations like the IMF, WB, IFC, EU as well as the main Chambers of Commerce and major businesses operating in Albania.

With same logic, all key documents/strategies mentioned in the exercise have been drafted with participation in the round table of stakeholders according to each area of interest.

NERP is realized with the contribution of various public institutions. To support the process of political engagement and emphasise the government commitment, this document was presented to the Council of Minister for approval before the delivery to the European Commission. By this way, NERP was approved by Decision of Council of Ministers no. 71 date 28.1.2015

After delivery to the European Commission, NERP will be published on the webpage of line ministries in order to be consulted by all stakeholders. For future documents, will the debit time at our disposal, all exercises will be previously consulted with a wide range of stakeholders on the contents of the draft NERP including representative of civil society, regional representatives, representatives of employers, trade unions and chambers of commerce etc.

Where possible and appropriate, their comments and suggestions will be reflected in the specific text. This will be the common practice of any future Nation Economic Reform Programme.

Annex:

**Table 1: REPORTING TABLE
ON SECTORAL STRUCTURAL REFORM MEASURES**

Recommendation/ country-specific policy guidance (1)	Number and title of the measure and the sector (2)	Description of main measures of direct relevance to support competitiveness and growth, and to address country-specific policy guidance (if applicable)					Link to SEE 2020 targets	Challenges/ Risks	Budgetary implications/ including committed IPA funds	Qualitative elements
		Main policy objectives and relevance for competitiveness and growth (3)	Description of the measure (4)	Legal/ Administrative instruments (5)	Timetable on progress achieved in the last 12 months (6)	Timetable on upcoming steps (up to three years) (7)				
Government's programme 2013- 2017 SEETO 2020	Pillar 1 Physical Capital 1.1 Transport/ Finalisation and approval of the Sectorial Strategy of Transport and Albanian National Transport Plan (ANTP)	Accelerate the integration of the transport system, the establishment of an integrated market, that support the demand for transport development, in:	1. - Drafting Sectorial Strategy of Transport	Decision of Council of Minister	Partially drafted	Finalisation within 2015		None	appx. 300.000 Euro (IPA)	Both documents foresee the sectorial policies and the measures to achieve the main objectives
			- Drafting of ANTP (plan)	Decision of Council of Minister	Partially drafted	Finalisation within 2015		None		
			1.1.1 Road Transport (i) The connectivity between regional administrative centers within Albania: <u>Measure 1:</u> Completion of Tirana-Elbasan segment <u>Measure 2:</u> Completion of Arberi road concession agreement	Physical Investment		2015		None	300 million USD (222.7 mil from IDB loan; 50 mil, Abu Dabi Fund loan; 20.4 mil OFID OPEC; 7mil Gov of Al).	
				Physical Investment		2017	None	PPP- The project has an estimate financial need of 270-300 Million USD.		

Recommendation/ country-specific policy guidance (1)	Number and title of the measure and the sector (2)	Description of main measures of direct relevance to support competitiveness and growth, and to address country-specific policy guidance (if applicable)					Link to SEE 2020 targets	Challenges/ Risks	Budgetary implications/ including committed IPA funds	Qualitative elements
		Main policy objectives and relevance for competitiveness and growth (3)	Description of the measure (4)	Legal/ Administrative instruments (5)	Timetable on progress achieved in the last 12 months (6)	Timetable on upcoming steps (up to three years) (7)				
			(ii) The connectivity of Albanian regional administrative centers with the road network of the Balkan region: <u>Measure 1:</u> The construction of the “Blue Corridor”/Feasibility study	Physical Investment	Ongoing	2015		None	(around 1.5 M Euro) Official request presented to WBIF	
			(iii) Road safety	Administrative measure	Ongoing	2017		None	Reduce road fatal accidents in 50% within 2020	
			1.1.2 Rail Transport 1.1.3 Maritime Transport:	Law	Ongoing	2015		None	Responsibility divided among several gov. agencies	
			(i) Durres Port rehabilitation	Physical Investment	Ongoing	2015		None	4.2 mil USD (funded at 70% by World Bank. and 30% by Albanian Government)	Improving traffic-Incentive economy
			(ii) Vlora Port	Physical Investment	Ongoing	2016		None	18 M Euro	Improving traffic-Incentive economy
			(iii) Saranda Port	Physical Investment	Ongoing	2015		None	15.3 million Euro (Italian Cooperation)	Improving traffic-Incentive economy
			(iv) Shengjini Port	Physical Investment	Ongoing	2015		None	150 million ALL (Albanian State Budget)	Improving traffic-Incentive economy

Recommendation/ country-specific policy guidance (1)	Number and title of the measure and the sector (2)	Description of main measures of direct relevance to support competitiveness and growth, and to address country-specific policy guidance (if applicable)					Link to SEE 2020 targets	Challenges/ Risks	Budgetary implications/ including committed IPA funds	Qualitative elements
		Main policy objectives and relevance for competitiveness and growth (3)	Description of the measure (4)	Legal/ Administrative instruments (5)	Timetable on progress achieved in the last 12 months (6)	Timetable on upcoming steps (up to three years) (7)				
Government's programme 2013- 2017	1.2.1 Waste Management Creating a GIS database and map system	Making transparency in territorial planning and development and legal proceedings that regulate the planning and development of the territory. Improve accountability and transparency	Creation of a GIS database and map system, will track crucial historical data on old waste dumps (for the purpose of rehabilitation), and provide planning provisions for the creation of of new landfills	The database/map system is planned to be finished by April 2015 and will be updated as the situation on the field changes.	Ongoing		Availability of data from municipalities. Quality and verity of data from municipalities Lack of capacities of municipalities to upkeep with the reporting for the update and upkeep of the database and map system.		Painting a clear picture of the actual situation and planning rehabilitation of land as well as increasing planning capacities for future landfill building.	
Albania 2014 Progress report	1.2.2 Urban Planning 1.2.2.1 Drafting of the General National Territorial Plan	National and regional planning instruments shall help define or guide the future development across the entire or a part of the national territory, the conditions for the development of structures which will guide investments;	Itself this plan is a legal measure.	During 2015 and 2016 will be designed and approved the General National Urban Plan.	The process of designing the General National Urban Plan has started October 2013	Ongoing during 2015 – 2016	Lack of qualified staff Long and complicated procurement procedures	2. 6 million USD		

Recommendation/ country-specific policy guidance (1)	Number and title of the measure and the sector (2)	Description of main measures of direct relevance to support competitiveness and growth, and to address country-specific policy guidance (if applicable)					Link to SEE 2020 targets	Challenges/ Risks	Budgetary implications/ including committed IPA funds	Qualitative elements
		Main policy objectives and relevance for competitiveness and growth (3)	Description of the measure (4)	Legal/ Administrative instruments (5)	Timetable on progress achieved in the last 12 months (6)	Timetable on upcoming steps (up to three years) (7)				
		regulate territory control; ensure environmental protection; and boost social-economic development. Ending the informality through the legalization process, and in the development of the territory, land, urban and rural spaces, and establishing an institutional, economic and social								

Recommendation/ country-specific policy guidance (1)	Number and title of the measure and the sector (2)	Description of main measures of direct relevance to support competitiveness and growth, and to address country-specific policy guidance (if applicable)					Link to SEE 2020 targets	Challenges/ Risks	Budgetary implications/ including committed IPA funds	Qualitative elements
		Main policy objectives and relevance for competitiveness and growth (3)	Description of the measure (4)	Legal/ Administrative instruments (5)	Timetable on progress achieved in the last 12 months (6)	Timetable on upcoming steps (up to three years) (7)				
	1.2.2.2 Urban regeneration and social and economic integration of informal areas		<p><u>Measure 1.</u> Elimination of informal land development and complete the process of legalization.</p> <p><u>Measure 2.</u> The urbanization of informal areas is expected to have a powerful and positive impact in the planning and development of the territory, and to resolve the crisis on the right of ownership in the country</p>	During 2015 and 2016 will be designed and approved the General National Urban Plan.	The process of designing the General National Urban Plan has started October 2013	Ongoing during 2015 – 2016		Lack of qualified staff Long and complicated procurement procedures	Complementary component of the General National Territory Plan	

Recommendation/ country-specific policy guidance (1)	Number and title of the measure and the sector (2)	Description of main measures of direct relevance to support competitiveness and growth, and to address country-specific policy guidance (if applicable)					Link to SEE 2020 targets	Challenges/ Risks	Budgetary implications/ including committed IPA funds	Qualitative elements
		Main policy objectives and relevance for competitiveness and growth (3)	Description of the measure (4)	Legal/ Administrative instruments (5)	Timetable on progress achieved in the last 12 months (6)	Timetable on upcoming steps (up to three years) (7)				
		The increase of the competitive capability of the coast and region Tirane-Durres	Measure 1: Drafting of the Integrated Economic Plan for Tirana-Durrës: The region of Tirana-Durres is one of the most important regions in Albania in terms of economic	Improvement of the quality of environment in these two zones	In process of drafting within 2015	Ongoing		Lack of qualified staff Long and complicated procurement procedures	Complementary component of the General National Territory Plan	
	1.2.2.33. Drafting of the Integrated Economic Plan for Tirana-Durrës and Integrated Cross sectorial Plan for the Coast	This plans aims to give an overall vision for a sustainable development of the coast by protecting its values and the increase of the economic development.	Measure 2: Drafting of the Integrated Cross Sectorial Plan for the Coast. The coastal area of Albania is one of the most valuable assets of the country which due to the current development		In process of drafting within 2015	Ongoing		Lack of qualified staff Long and complicated procurement procedures	Complementary component of the General National Territory Plan	

Recommendation/ country-specific policy guidance (1)	Number and title of the measure and the sector (2)	Description of main measures of direct relevance to support competitiveness and growth, and to address country-specific policy guidance (if applicable)					Link to SEE 2020 targets	Challenges/ Risks	Budgetary implications/ including committed IPA funds	Qualitative elements
		Main policy objectives and relevance for competitiveness and growth (3)	Description of the measure (4)	Legal/ Administrative instruments (5)	Timetable on progress achieved in the last 12 months (6)	Timetable on upcoming steps (up to three years) (7)				
	1.2.2.4 Urban Services and Housing Housing renovations of multifamily buildings privatized before 1993	Renovations for about 0.5% of the multifamily buildings privatized before 1993, the purpose of increasing their energy efficiency and thus their market value.	Improvements include building reconstructions and improved access to water and sanitation infrastructure.	Strategy on Social Housing 2015-2025	1 pilot project implemented for Energy Efficiency in Lezha city	Ongoing 2 projects in Korca and Lushnje Cities		Lack of qualified staff from the Local Authorities	649,904 Euro	Improvement of energy efficiency, reduced losses of energy, increased value of the housing stock privatized before 1993.
	Improving the housing conditions of the Roma and Egyptian community in Albania.	Improving the housing conditions for about 80% of the currently identified Roma and Egyptian community in Albania.	Improvements include building reconstructions and improved access to water and sanitation infrastructure.	Strategy on Social Housing 2015-2025	5 pilot projects for improving the housing conditions for the Roma and Egyptian communities in Lushnje, Lezha, Permet, and Otlak.	Ongoing 7 pilot projects in Elbasan, Rogozhine, Permet, Vlora Otlak, Lumas and Lushnje.		Lack of qualified staff from the Local Authorities	2,228,578 Euro	Improvements to the housing conditions, increased access to water and sanitation.

Recommendation/ country-specific policy guidance (1)	Number and title of the measure and the sector (2)	Description of main measures of direct relevance to support competitiveness and growth, and to address country-specific policy guidance (if applicable)					Link to SEE 2020 targets	Challenges/ Risks	Budgetary implications/ including committed IPA funds	Qualitative elements
		Main policy objectives and relevance for competitiveness and growth (3)	Description of the measure (4)	Legal/ Administrative instruments (5)	Timetable on progress achieved in the last 12 months (6)	Timetable on upcoming steps (up to three years) (7)				
EU Directives, 20/20/20 EU initiatives Energy Community Treaty	1.3. Improve Energy security and diversify energy supply	1.3.1 Energy Security and Diversification	<ul style="list-style-type: none"> - Increase performance of the sector - Increase production capacity - Increase transmission and distribution capacity - Improve the legal framework of the sector 	Existing: Law Nr. 9072 dated 22.05.2003 for the energy sector Upcoming: The new law for the energy sector adopted by the Council of Ministers on 14.01.2015	The process has started during 2014 Preparation of the draft law for the energy sector adopted by the Council of Ministers on 14.01.15 Changes in the Penal Code for theft of electricity Beginning of construction of the 400 kV interconnection line Albania- Kosovo Beginning of construction of 110 kV project in southern Albania	During 2015 Drafting and adopting of the National Energy Strategy Attendance and completion of 400 kV interconnection line Albania- Kosovo. Attendance and completion 110 kV project in southern Albania. Stimulations for construction of new HPP	Improving the performance of CEZ for reducing losses and increasing collections in the sector of electricity distribution in the national and local level. Awareness campaign in order to change consumer behaviour in the use of electricity. Simplification / facilitation of procedures and shortening of the times for handling requests for the issuance of permits for construction of power generation facilities. Develop a study for a return to "qualified customers" to consumers supplied at 20 and 35 kV voltage.	<ul style="list-style-type: none"> Active publication toward interested parties and imposing institutions will be needed - Not timely adoption of legal acts - Lack of enforcement capacity/administrative - Lack of financial capacity - Climate change - The price difference on a global scale 	KfW Germany 28.9 million EUR for the 400 kV line Albania-Kosovo - KfW Germany 37.75 million EUR for the 110 kV project line southern Albania - World Bank 150 Million \$ for recovering the energy sector expected to end in 2016	

Recommendation/ country-specific policy guidance (1)	Number and title of the measure and the sector (2)	Description of main measures of direct relevance to support competitiveness and growth, and to address country-specific policy guidance (if applicable)					Link to SEE 2020 targets	Challenges/ Risks	Budgetary implications/ including committed IPA funds	Qualitative elements
		Main policy objectives and relevance for competitiveness and growth (3)	Description of the measure (4)	Legal/ Administrative instruments (5)	Timetable on progress achieved in the last 12 months (6)	Timetable on upcoming steps (up to three years) (7)				
<p>Albania 2014 EU Progress Report: All responsibilities for VET have been brought under the responsibility of the Ministry of Social Welfare and Youth Regarding vocational education and training (VET), a draft 2014-20 National Strategy For Jobs And Skills and a related action plan were finalised to be further adopted</p>	<p>Pillar 2: Human capital 2.2.Vocational education and training</p>	<p>2.2.1 Offer quality vocational education and training for youth and adults</p>	<p>2.2.1.1Optimizing the VET providers network and improving the image, quality and adequacy of VET inputs.</p> <p>2.2.1.2Strengthening the linkages between learning and work and facilitating the transition to work,</p> <p>2.2.1.3 Improvement of the legal framework and regulatory framework in vocational education and training focusing on competences of VET teachers and teacher trainers</p>	<p>Decree of Council of Ministers, VKM 818 date 26/11/2014, on Approval of "Employment and Skill Strategy 2014-2020"launched on February 2014.</p> <p>Law Nr. 63/2014 "For some amendments in the Law Nr. 8872, dated 29.3.2002, "For Vocational Education and Training in the Republic of Albania" amended which was approved by the Albanian Parliament on 26.06.2014.</p>	<p>Need assessments and prioritized action plan based on the Baseline Study of VET schools/ facilities and programs supported by European Training Foundation and GIZ (German International Development Agency)</p> <p>An update of the Demand-oriented, interactive, user-friendly database, searchable portal by region/ location, sector/ qualifications and VET offers, incl. links to providers' web</p> <p>Official bilateral agreements between the line ministry and the relevant business and service institutions focused on enhancing skills and training to VET students</p>		<p>More coordination amongst institutions in charge for education, VET and economic development is required through a monitoring plan.</p>	<p>The budgetary implications from: IPA 2013- 3.45 mil EUR State and Budget 1.323.570.000 ALL GIZ project</p>	<p>In the framework of "Employment and Skill Strategy 2014-2020", this measure will aim at improving the quality of life and social development of the country, through a better quality vocational education and training for youth and adults, respectively (increase the share of female and male students attending VET programmes to a minimum of 20%; increase the share of the adult population participating to lifelong learning to 4%)This measure will aim to improve the links of education with the labor market and reduce youth unemployment (by increasing the employment share of vocational education graduates to 40%, out of which 25% are girls) foreseen by 2020</p>	

Recommendation/ country-specific policy guidance (1)	Number and title of the measure and the sector (2)	Description of main measures of direct relevance to support competitiveness and growth, and to address country-specific policy guidance (if applicable)					Link to SEE 2020 targets (8)	Challenges/ Risks (9)	Budgetary implications/ including committed IPA funds (10)	Qualitative elements (11)
		Main policy objectives and relevance for competitiveness and growth (3)	Description of the measure (4)	Legal/ Administrative instruments (5)	Timetable on progress achieved in the last 12 months (6)	Timetable on upcoming steps (up to three years) (7)				
“Higher skills and better jobs for all women and men” the national objective stated by the “Employment and Skill Strategy 2014- 2020”,	2.3 Improve quality in higher education	2.3.1 Ensuring qualitative Higher Education system.	1: Improvement of legal framework for higher education. 2: Continuously monitoring implementation of their legality and strengthening control regarding procedures for their accreditation.	Preparation of the necessary by laws and regulatory frameworks which will further strengthen and facilitate the links of VET with business sector (Draft joint Decree between MAS and MMSR on establishment of VET Boards (approved) Nr 18, date 31/12/2014	All the teaching and learning materials are published online in the web portal for the VET System providers together with their self- evaluation and their development plans Per year.	The joint efforts between all stakeholders are expected to be further developed	Objectives of SEE 2020 under F dimension of Smart growth. Better and efficient cooperation between VET institutions and business sector is required to integrated the VET graduates to the labour market	Overall and yearly change in government revenue and expenditure (reported in mln. national currency) Contribution of IPA (source and amounts) (10)	Qualitative description of foreseen impacts and their timing (11)	
		2.3.2 Enhancing Competitive scientific research	Within the framework of the reform in scientific research the Agency for Research, Technology and Innovation will be re- structured and set as a dependent institution of the MoES specifically in charge for assisting researchers in EU programme Horizon 2020.							1 million Eur annually participating fee for Horizon 2020 programme from the state budget for the period 2015-2016

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		Main policy objectives and relevance for competitiveness and growth (3)	Description of the measure (4)	Legal/ Administrative instruments (5)	Timetable on progress achieved in the last 12 months (6)	Timetable on upcoming steps (up to three years) (7)				
Encourage competitiveness in all policy areas affecting SME-s (SC TITC 2014 recommendation)	Pillar 3 Better Industrial Structures 3.1 Support business innovation and competitiveness Note: Innovation in this part does not include R&D	Increase innovation possibilities and technological changes for SME-s	3.1.1 Effective implementation of the "Competitiveness Fund 2013-2015" and "Innovation Fund 2015-2017", including but not limited to strengthening of the dialogue with private sector on the usage of the funds, permanent monitoring of the impact, increase awareness through dissemination of best examples/practices.	<u>Existing legal acts:</u> - Government Decree nr.635, date 1.10.2014, (BIDS strategy) - Government Decree nr 419, date 15.05.2013 <u>Upcoming legal acts:</u> 1. New Government Decree on Innovation Fund 2015-2017 2. The renewal of the Competitiveness fund for 2016-2018	1. AIDA received and examined 36 (thirty six) applications for the Competitive-ness Fund, from which, 21 applications are approved and total amount disbursed 23 Million ALL; 2. 33 companies have applied for innovation fund, from which 24 project ideas are approved with disbursed amount of 8,7 Million ALL 3. Awareness comparing in different regions of the country in cooperation with CCI for both funds	During 2015 1. Awareness complain and door to door meetings 2. Evaluation report for the impact of the Fund 2013-2015 Approval of the Gov. Decree for "Innovation Fund 2015-2017" The renewal of the Competitive-ness fund for 2016-2018 During 2016-2017 permanent monitoring and awareness comparing will be executed	1. Dimension K3, K6 of SEE 2020 National Action Plan "Increasing Competitiveness"	1. Availability of financial means from state budget 2. Possibilities to combine public fund with donor financial support 3. Private sector capacities to absorb public funds	Budget forecast, financial 1. Competitiveness Fund 58 Million ALL; 2. Innovation Fund 40 Million ALL;	Diversification of exporting products, technology improvements and increase of production capacities. Increasing export by 9% per year, Increase the number of SMEs by 1.7% yearly and increase of number of new employees by 5% yearly.

Recommendation/ country-specific policy guidance (1)	Number and title of the measure and the sector (2)	Description of main measures of direct relevance to support competitiveness and growth, and to address country-specific policy guidance (if applicable)					Link to SEE 2020 targets	Challenges/ Risks	Budgetary implications/ including committed IPA funds	Qualitative elements
		Main policy objectives and relevance for competitiveness and growth (3)	Description of the measure (4)	Legal/ Administrative instruments (5)	Timetable on progress achieved in the last 12 months (6)	Timetable on upcoming steps (up to three years) (7)				
		Increase participation of Albanian companies to COSME	3.1.2 Increase knowledge about community programs	<p><u>Existing legal act:</u> Government Decree 781, dt 19.11.2014</p> <p><u>Upcoming legal acts:</u> Final approval of COSME agreement in Council of Minister</p>	Preparation for signing of COSME	<p>During 2015</p> <p>1. Workshop with stakeholder to present and explain COSME requirements and guidelines</p> <p>2. Awareness comparing to increase knowledge and understanding for COSME</p> <p>During 2016</p> <p>3. Stimulate the setup of new consortium to participate in COSME</p> <p>4. Permanente monitoring of the selected projects during the whole period 2015-2017</p>	1. Dimension K3, K6 of the SEE 2020 National Action Plan "Increasing Competitiveness	1. Lack of knowledge on COSME and its criteria's 2. Lack of capacities in preparing business proposals	Contribution from state budget to COSME with 235 thousand EUR annually (2015-2017);	<p>1. Technology improvements and increase of production capacities.</p> <p>2. At least one winning application for the first year</p>

Recommendation/ country-specific policy guidance (1)	Number and title of the measure and the sector (2)	Description of main measures of direct relevance to support competitiveness and growth, and to address country-specific policy guidance (if applicable)					Link to SEE 2020 targets	Challenges/ Risks	Budgetary implications/ including committed IPA funds	Qualitative elements
		Main policy objectives and relevance for competitiveness and growth (3)	Description of the measure (4)	Legal/ Administrative instruments (5)	Timetable on progress achieved in the last 12 months (6)	Timetable on upcoming steps (up to three years) (7)				
		Increase SMEs capacities for innovation	3.1.3. Introduce Innovation voucher schemes providing grants to outsource technical expertise for innovative SMEs and n	<u>Existing legal acts:</u> Government Decree nr. 635, date 1.10.2014, (BIDS strategy)	Concept assessment to set up the innovation voucher scheme	During 2015: 1. Consultative meetings on the concept and objectives of innovation schemes 2. Approval of the innovation scheme Upcoming legal acts: Approval of the Government Decree for innovation voucher scheme; 3. Implementatio n of the pilot phase During 2016- 2017 permanent monitoring and assessment on effectiveness of the scheme	1. Dimension E 3 of the national Plan SEE 2020: Business Innovation Support	1. Availability of public fund 2. Willingness of donors to contribute to the scheme 3. Availability of TA 4. Administrative capacities to implement the scheme	9 million ALL for 2015- 2017	Strengthen the tripartite cooperation among private sector, academia and Government ; 25 companies are benefiting during the pilot phase

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Stimulate access to finance (EC Progress Report 2014)	3.2 Improve access to finance	Increase financing possibilities and lowering cost for credit	3.2.1 Oversee the implementation of the program of integrated assistance for the Albanian SMEs and support the participation of SME-s to the program	<u>Existing legal acts:</u> 1. Approval of the financial agreement Programmed that entered into force on 12 July 2014; <u>Upcoming legal acts:</u> No specific legal acts planned at this stage	1. Approval of the financing program 2. Awareness comparing on criteria, guidelines and requirements of the program, in particular for credit lines and guarantee fund	1. Permanent monitoring of the effectiveness of the program and assess the impact for SMEs	Dimension K3 and K6 of SEE 2020 National Action Plan: "Increasing Competitiveness"	1. Low absorption of funds from private sector 2. Lack of capacities to prepare projects proposals	1. No financial implications for the state budget 2. The fund provided by Italian Government (15 Million EUR from which: 11 million EUR credit line, 2,5 Million EUR guarantee fund, and 1,5 Million EUR TA)	Increased production capacities of SMEs; around 25 winning projects per year.
		Support women entrepreneurs and start-ups to ease market entry and growth	3.2.2 Provision of financial support to women entrepreneurs and start-ups, subsidizing interest loans for women and providing grants for start- ups	<u>Existing legal acts:</u> 1. Government decree nr.592, date 10.09 2014 for the establishment of Women entrepreneurs hip fund"; 2. Government decree no.593, dt10.09.2014 for the establishment of Start-up fund; <u>Upcoming legal acts:</u> No new legal acts planned	1. Approval of women entrepreneurship fund and start-up fund; 2. Approval of the regulation for the functioning of the Fund; 3. Awareness campaign for both funds in different regions of the country.	During 2015 1. Effective implementation of the funds 2. Permanent monitoring of the effectiveness of implementation during the whole period.	Dimension K3 and K6 of SEE 2020 National Action Plan: "Increasing Competitiveness"	1. Low absorption of funds from women entrepreneurs and star-ups. 2. Lack of capacities to prepare projects proposals.	Women entrepreneurship fund - 24 Million ALL 2015-2017; 2. The Start-up fund -23 Million ALL 2015-2017	Increased possibilities for women and start- ups to ease access to credits; Around 400 women entrepreneurs will benefit for the whole period of the fund; Increase the number of enterprises led by women from 28% in 2013 to 32% in 2017.

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		Streamlined and improved procedures for bankruptcy	3.2.3 Improve bankruptcy procedures	<u>Existing legal acts:</u> 1. Law No 8901, 23.05.02 "On bankruptcy and implementing regulations <u>Upcoming legal acts:</u> 2. Amendment to the Law No 8901, 23.05.02 "On bankruptcy" and respective implementing regulations	1. 109 application for bankruptcy evaluated during 2014. 2. Consultation and roundtable discussions on the implementation of the existing law. 3. Initial draft of the amendment is in place.	1. Adoption of the legal changes and the implementing regulations	n.a	1. Delay in approval process 2. Lack of knowledge from the private sector 3. lack of Administrative capacities of bankruptcy administrators	1. No financial implications for the state budget 2.The fund for TA provided by IFC	1. Reorganization of the companies 2. The maximization value of the assets for full distribution to creditors 3. Reduction of the duration of the bankruptcy procedure 4. Reduction of the administrative costs 5. Discovery of the abusive and fraudulent actions fraud in bankruptcy procedure

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Albania 2014 Progress report	3.3 Foster the competitiveness of the tourism sector	(i) Establishing a database of updated information for touristic enterprises and to collect information from them.	establishing the integrated database for touristic enterprises, structures and touristic sites in 3 regions in Albania	During 2015 it is expected to be approved the legal framework of tourism	Will be implemented for the first time during 2015	Ongoing during 2015		change in funding of tourism sector	7 million ALL	- Incentives to the formalization of the tourism sector - Improvement of the regulation and supervision of touristic activities
		(ii) Building tourist destination with a consolidated touristic product	Creating three products of nature tourism, three products of cultural tourism with services and attractive activities of cultural tourism and two products of coastal tourism.	During 2015 it is expected to be approved the Strategy of Tourism Development 2014-2020 and action plan	Will be implemented for the first time during 2015	Ongoing during 2015		1. Increase by 5-8% the number of visitors for 2015 compared to 2014. 2. Increase by 4-5% the duration of staying for the foreign visitors 3. Increase the contribution to the PBB by 5% annually. 4. Creation of 3 thousand jobs in the tourism industry/ change in funding of tourism sector		- Improvement of the quality of services - Improvement in consumer protection - Development of new touristic destinations and products - Development of new market niches - Improvements in coordination, implementation and planning of projects in the sector - Sustainability of tourism development

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IPARD II Programme 2014- 2020	3.4.Boost competitiveness in agriculture: (IPARD measure) Investments in physical assets concerning processing and marketing of agricultural and fishery products	Enhancing farm viability and competitiveness of agriculture and primary food- processing, while progressively aligning with the Union standards	The objective is to develop viable, high quality food production by developing a competitive and innovative agro-food sector able to sustain the competitive pressure in the domestic and EU markets, and meeting EU standards and market requirements.	Article 2(1) of IPA Regulation (EU) No 236/2014 of the European Parliament and of the Council of 11 March 2014 laying down common rules and procedures for the implementation of the Union's instruments for financing external action; Article 27(1)(c) of the Sectoral Agreement; Annex 4 of the Sectoral Agreement	From IPARD – like support (IPA 2011) for the period January - December 2014 has been made 81 applications from which 34 in the first call, 19 applications in the second call and 28 applications in the third call. The applicable fund for this measure for the three calls was 13.8 M Euro.	For the period 2015-2017 are foreseen to be supported: 95 projects, with a total value of 35.5 M Euro, 95 enterprises performing modernization projects and 95 enterprises progressively upgrading towards EU standards. Is foreseen to be increased the number jobs up to 300.	Part of the Dimension E 3: Business Innovation Support	Bottle neck in ensuring the construction permits Increase knowledge of technical expert to prepare successful applications	Indicative budget of EU and Albanian contribution: -Yearly EU contribution: 5.3 M Euro -Yearly Albanian contribution: 1.3 M Euro	By increasing the production capacities through achievement of EU standard.

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Improve business environment (EC Progress Report 2014)	Pillar 4 Good Business Environment 4.1 Reduce regulatory burden to business	Improve the quality of services and reduce administrative cost for businesses	4.1.1 Merge NRC and NLC to allow single window service for registration and licensing and provision of full e- registration	<u>Existing legal acts:</u> Government Decree nr.635, date 1.10.2014; Government Decree no. 591, dt. 10.09.2014; Law no. 9723, dt 3.05.2007 "On National registration Center" and implementing regulations Law no. 10081, dt 23.22.2009, "On licensing, permits and authorizations in the Republic of Albania" and implementing regulations. <u>Upcoming legal acts:</u> New law on the merger of NRC and NLC and implementing regulations	1. Assessment on the potentials for merging NRC and NLC 2. The model for the new institution designed and approved 3. Action Plan on next steps prepared 4. IT investment at NRC to allow e-registration 5. Awareness comparing with regard to the new institution	During 2015: 1. Approval of the legal changes 2. Prepare the interface for e- registration through a web based application 2015-2016 3. Physical investment for the new institution 2017 4. Assessment on the impact to SMEs	Dimension C1 of the SEE National Action Plan: "Integration to the global markets"	1. Compatibility of both survives (institutional culture, etc.) 2. Not committed fund for physical investment (approx. 70 million ALL)	Approx. 70 million ALL, not committed for 2015 TA for legal drafting provided by GIZ	1. Reduction by 30% of visits in NRC headquarter and 10% in then regional windows 2. Online provision of different documents for businesses, upon request, to 50% of applicants in 2015 and 100% in following years; 3. Online filing of the financial reports 4. Reduce registration from 24 hours to 8 hours within 2015

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		Simplify authorization procedures and reduce cost for businesses	4.1.2 Renewing of the authorization scheme with the objective of removal of unnecessary authorizations and inclusion of the remaining to the NLC system.	<u>Existing legal acts:</u> Government Decree nr.635, date 1.10.2014; Law no. NR.10081, date 23.22.2009, "On licensing, permits and authorizations in the Republic of Albania" and implementing regulations, Order of Minister MEDTE no 461, of 2014 on the set up of the WG for riveting the authorizations scheme <u>Upcoming legal acts:</u> The legal changes are dependent to the legal review of authorization in force	1. Set up of the WG 2. Preliminary inventory of authorization prepared	During 2015 1. Finalize the inventory of all authorizations in force, 2. Screen the necessity for all authorization and propose removal where possible; 3. Introduce the inclusion of the authorization into NLC system amending Government Decree No 538, date 26.05.2009 During 2016- 2017 Other sectorial legislative changes as provided in the screening exercise.	Dimension C1 of the SEE National Action Plan: "Integration to the global markets"	Institutional resistance to change Delays in legal drafting Limited administrative capacities for the reform	No financial implications for the state budget 2.The fund provided by GIZ	Objective is to remove up to 10 authorizations and streamline other 20

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		Streamline procedures in all areas affecting business activity	4.1.3 Permanent monitoring and evaluation of the action plan 2014-2016 to ease doing business	<u>Existing legal acts:</u> Government Decree nr.635, date 1.10.2014; Government Decree no. 591, date 10.09.201 4; Order of the Prime Minister no. 30, date 30.1.2014 <u>Upcoming legal acts:</u> Not applicable	1. Thorough analyses with respect to current situation in doing business indicators 2. Set up of the inter- institutional WG 3. Adoption of the National Action Plan for ease of Doing Business	During 2015 1. Legal amendments compliant with the government Decree 591, date 10.09.2014 will be prepared 2. Monitor implementation not the Action plan and prepare the report for PM 3. Propose changes to the action plan, if needed 4. Consultation with private sector on the reform agenda and necessary changes 5. Inform international partners on reform progress Steps for 2016- 2017 are dependent to evaluation carried out the first half of 2015	Dimension C1 of the SEE National Action Plan: "Integration to the global markets"	1. Timely drafting and approval of the legal acts 2. Keep reform momentum 3. Availability of TA	Administrative cost of the staff	Expected results: 5 procedures and only 60 days for the getting the construction permit; e-filing not more than 10 times per year and simultaneous tax e- filing and e- payment; only 3 procedures and 45 days in getting a new point of electricity connection; one stop shop property registration service, within maximum 4 days.

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	Pillar 5 Trade integration 5.1 Boost trade integration	Facilitate import and export procedures and reduce administrative cost for business	5.1.1 Reduce administrative costs and the elimination of non-tariff trade barriers: i) reduce documents accompanying exports and imports ii) improve procedures for export and import (iii) introduce risk management for agriculture products.	<u>Existing legal acts:</u> Government Decree nr.635, dt 1.10.2014 Government Decree no. 591, dt 10.09.2014 "Action Plan for Doing Business 2014-2016" <u>Upcoming:</u> 1. Amend the order of the Minister of Agriculture no. 72, dt.15.03.2011 to remove the obligation to obtain a certificate of origin 2. Legal changes to eliminate 100% physical controls for agriculture products coming from OECD countries 3. Legal changes to unify language requirement for certificates accompanying the products in import-export	1. Analyses on number of documents and procedures on import-export carried out. 2. Recommendations are prepared and approved	During 2015 1. The legal drafting will finalize and monitoring of the implementation will be permanently undertaken 2. Establishment of Single Window in customs will start in 2015. The objective is to be finalized within 2017 During 2016-2017 Risk management will be introduced for agriculture products	Dimension A3 of the National Action Plan: "Reduction of administrative cost and removal of NTBs"	1. Cooperation between customs and other border agencies. 2. Administrative capacities of border agencies 3. Availability of TA	IFC budget 90 million ALL till 2017 State budget 9 million ALL till 2007, not committed yet Budget committed for Single Window for 2015, 42 million ALL	1. Reducing trade barriers by reducing number of documents in import and export up to 5 2. Streamlining the procedures in the border. 3. Increase exports of goods by 9% yearly and 19% as share of export per GDP in 2017 from 16% in 2013

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		Open market for services to increase potentials for trade	5.1.2. Liberalization of service trade with the countries of the region and Turkey	Government Decree nr.635, date 1.10.2014; Free trade agreement with CEFTA and Turkey.	1. Establishment of Negotiating Group for CEFTA 2. Negotiations with CEFTA have officially started and preliminary offers are prepared.	The time table will vary upon the developments in the negotiations with CEFTA. The objective is to conclude negotiation by 2016. During 2015 official launching of negotiations During 2016 negotiations with Turkey will be finalized and finalization of internal legal procedures within 2017	Dimension A1 of the National Action Plan: "Further liberalization of trade in services"	1. The mutual understanding and will to have a greater level of liberalization within CEFTA 2. Political constraint for signing within CEFTA	Administrative cost of the staff	Liberalization of service trade and increase of export of services with CEFTA countries and Turkey

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		Reduce cost for business in bilateral trade with Kosovo	5.1.3 Reduce obstacles in trade logistics and harmonization of procedures in bilateral trade with Kosovo.	<u>Existing legal acts:</u> Agreement between Albania and Kosovo to promote trade facilitation; Joint Action Plan to facilitate trade between Albanian and Kosovo is prepared <u>Upcoming legal acts:</u> No specific legal acts planned at this stage	1. The Action plan covering TBT, SPS and administrative barriers is in place 2. Three joint working groups in the area of TBT, SPS and administrative barriers are established.	During 2015, Preparation of the agreement for recognition of conformity assessment procedures with Kosovo; Identification of products with mutual interest	Dimension A3 of the National Action Plan: "Reduction of administrative cost and removal of NTBs"	Administrative capacities for implementation Cooperation between customs and other border agencies between two countries;	Administrative cost of the staff	Reducing trade barriers in bilateral trade with Kosovo Increased cooperation among border agencies Increased trade volume by 10%, yearly
		Branding Albania as an investment destination	5.1.4 Promote "Made in Albania" products	<u>Existing legal acts:</u> Government Decree nr.635, date 1.10.2014; Government Decree nr 419, date 15.05.2013, amended <u>Upcoming legal acts:</u> The renewal of the Competitiveness fund for 2016-2018	36 (thirty six) applications received and examined for the Competitiveness Fund, from which, 21 applications are approved and total amount disbursed 23 Million ALL;	During 2015 1. The renewal of the Competitiveness fund for 2016- 2018 2. Awareness comparing throughout the country 3. Final monitoring report for the period 2013-2015 During 2015- 2017 Participation in trade fair, exhibitions and other export promotional activities	Dimension K6 of the National Action Plan : "Increasing Competitiveness"	1. Insufficient state budget 2. Size of the exporting companies in Albania and their respective capacities	Estimated amount of Competitiveness Fund 2016-2018, 60 million ALL	Increase exports of goods by 9% yearly and 19% as share of export per GDP in 2017 from 16% in 2013

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	5.2. Strengthen FDI policy and promotion	Promote green field investment in sector with strategic interest; economic zones (industrial parks)	5.2.1 Stimulate new investment in strategic sectors through implementation of a special law for strategic investment and a new law on PPP; improve CRM through AIDA.	<u>Existing legal acts</u> Government Decree nr.635, dt.1.10.2014; Law no 7764, dt. 2.11.1993 "On Foreign Investment" Law no. 125/2013 "On concessions and private public partnership" and Law no 88/2014 "For some amendments in the law 125/2013" Law no. 9789 dt.19.07.2007 "On the establishment and functioning of economic zones"	1. Identification of strategic sectors is finalized 2. Draft law on strategic investment is prepared 3. Draft law on PPP prepared 4. Set up of the WG for amendment to the law on economic zones 5. Establishment of the database of foreign investors	During 2015 1. Approval of the new law on strategic investment 2. Approval of the new law on PPP 3. Awareness comparing on benefits deriving from the new laws. 4. Approval of the amendment to the law on economic zones 5. Transformation of AIDA as a One Stop Shop for CRM During 2016-2017 Effective implementation of the new laws Assess the impact on FDI increase	Dimension C 1 of the National Action Plan: "Integration to the global markets"	1. Increased competitiveness from other countries of the region. 2. Slowdown of FDI during the last year; 3. Potential delays in the approval process 4. Administrative capacities to monitor the implementation of the laws.	Administrative cost of the staff	Increase of FDI inflows by 5% per year Increase of FDI as share of GDP from 8.3% in 2013 to 9% in 2017
		Branding Albania as an investment destination	5.2.2 Promote Albania in international event with the aim to attract FDI	Not applicable	During 2014 Participation in 12 promotional activities	2015-2016 Participation in 8 promotional activities	Dimension C 1 of the National Action Plan: "Integration to the global markets"	Improved image of Albania Increased interest to invest in Albania	State budget contribution at 133 million ALL	n.a