



REPUBLIC OF ALBANIA

ECONOMIC AND FISCAL PROGRAM

2014 – 2016

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INTRODUCTION

Since 2006, countries which are in the process of negotiating the Stabilization and Association Agreement with the European Union, as well as countries that have concluded this agreement but have not yet received the status of candidate country, are expected to submit an Economic and Fiscal Program (EFP) near the European Commission. Potential candidate countries should progressively develop analytical capabilities needed to participate in the multilateral surveillance procedures of the European Union.

This program aims exactly at preparing institutional and analytical capacity of these countries to participate in oversight procedures of economic and monetary Union. This also serves as a dialogue and cooperation platform with the EU in economic and fiscal policy.

This paper gives clear information of the economic policies and medium term priorities of the country in the context of the structural reforms that are expected to be implemented during 2014-2016, which aimed at ensuring macroeconomic stability and relatively high and stable economic growth, and the establishment of a regulatory framework and the sectoral policies in accordance with the European standards.

The EFP document for 2014-2016 presents the main priorities of the Albanian state institutions in the field of economy. It is based on and in accordance with Law no. 185, no. /12/2013 "For the Budget Year 2014" and with the Macroeconomic and Fiscal Framework 2015-2017¹. This document was prepared by an inter-institutional working group with representatives and experts from a variety of institutions of the Albanian State. The program was approved by the Council of Ministers on 29th of January 2014.

In the first chapter it is described the current situation of the economic developments, the real and monetary sector. In the second chapter it is given the medium term program of the economy divided into three parts, dealing with the forecasts about the real sector, in relation to the level of inflation in relation to the monetary sector and the exchange rate and with that of the external sector. In the third chapter, it is detailed the medium term framework on public finances. This chapter pays specific attention to the revenue and expenditure forecasts for the medium term and to the treatment of the public debt strategy. Chapter 4 presents the most important structural reforms to be undertaken by the Government of Albania in the field of competition, the reforms for attracting foreign investments, and privatization. At the end this program contains a statistical annex over some macroeconomic indicators covering the past three years and the next three years.

¹ Approved by the Council of Ministers dated 29.01.2014

1. OVERALL POLICY FRAMEWORK AND OBJECTIVES

The Economic and Fiscal Program 2014 is based on the Budget Law for 2014², on the Macroeconomic and Fiscal Framework 2015 - 2017³ and on the latest Monetary Policy Report. Economic and Fiscal Program 2014 - 2016 was approved by the Council of Ministers on 29th of January 2014.

The main objective of the economic policies during the medium term horizon is to preserve macroeconomic stability and continuing the structural reforms in order to create the necessary conditions for the economy to operate at its potential growth.

Fiscal policy for the period 2014 - 2016 will be oriented in a trajectory of fiscal consolidation path. It aims firstly placing public finances on a sustainable trajectory, as one of the main pillars of economic growth and sustainable development of the country. For compilation of the fiscal policy in the medium term it has been consulted closely with the International Monetary Fund (IMF) and World Bank (WB). It is also fully in line with European Commission findings and recommendations⁴.

The major medium goal of the fiscal policy is the recovery of the country's economic growth at its potential level and its stability in time.

The main objective of the fiscal policy framework for the medium term ahead, is the level of structural deficit which ensures the sustainability of public debt over the medium and long term in one hand and minimizes the negative short-term effects on growth on the other hand. The main operational quantitative target of fiscal policy within the actual macro-fiscal framework is the overall fiscal deficit, respectively as following for each year:

- *Overall fiscal deficit of 6.7% of GDP in 2014*
- *Overall fiscal deficit of 4.8% of GDP in 2015*
- *Overall fiscal deficit of 3.4% of GDP in 2016*

This quantitative objective of the fiscal policy will be corrected depending on the economic cycle. So the fiscal deficit target will be extended if the economy performs below the current forecast and vice versa.

It should be emphasized that within this deficit levels for the next three years it is included the full payment of all accumulated arrears of the government toward private sector which is a priority and one of the main components of the fiscal policy for the medium term ahead.

The public investments are projected to be kept at a level of at least 5 percent of GDP, which is an optimal level to support a high and stable growth.

The monetary policy objective is to achieve and maintain the price stability. The quantitative target of the monetary policy is to achieve an annual change of Consumer Price Index of 3%, with a tolerance band of +/- 1pp, over the medium term.

The monetary policy will continue to be conducted under a flexible exchange rate regime, where the value of ALL against other foreign currencies is freely determined in the foreign exchange market by its supply and demand.

The drafting of the monetary and fiscal policy is conducted in complete harmony with each other in view of a maximum efficiency of achieving their respective objectives.

² The Budget Law for 2013 was adopted by the Parliament on 2.12.2013, Ref. Nr. 185

³ The Macroeconomic and Fiscal Framework 2015 – 2017 was approved by the Council of Ministers on 29.01.2012

⁴ Albania Progress Report 2013

The implementation of key structural reforms will also be a key lever to exploit the potential of the economy. In this regard, the aim is to improve the legal and regulatory framework of business operation and improve the overall business climate, to increase the competitiveness of domestic products and services, to further improve the financial sector, to reduce the informal economy, to complete the reforms of the public administration, starting the reforms on the pension system and going on with the reforms toward the labor market.

2. ECONOMIC OUTLOOK

2.1. Recent economic developments

The global financial crisis clearly put pressure to the Albanian economy. As a consequence of the global crisis the growth rates were significantly slowed down. Real GDP growth in 2009, were dimidiated from its historical trend, but still remained at positive levels (3.3 percent), these as a result of limited exposure to the international financial markets and because of the expansionary fiscal policies taken immediately after the crisis. Since Albania has a strong economic and trade affair with Italy and Greece, the crisis in these two countries reflected directly a decrease in remittances and in exports, which lead to a considerable slowdown in the economic growth and especially in the budget revenues.

Economic growth continued its moderate growth of 3.8 per cent in 2010 and 3.1 % in 2011. During 2012 and 2013, economic growth has continued to deteriorate even more. Growth rate decreased at the level of 1.3 % in 2012 and continued to slowdown even during 2013. During the first 9 - months of 2013 economic growth estimated by the Institute of Statistics (INSTAT) was 0.4%, being in a worse level compared with the same period of the previous year. Domestic demand continued to stay at the lowest levels and it seems that the chances for an immediate turnover of consumption and private investments still remain very low. The external demand has been the main generator of economic growth these two last years, nevertheless, it still remains affected by the unfavorable development of the euro-zone economy and of a base of non-diversified exporters such as in terms of products, and in terms of the markets.

Real Sector

Economic activity expanded during 2013, but its rhythm of growth continued further to decrease. During the first three quarters of 2013, the cumulative growth rate calculated by INSTAT marked 0.4 per cent, reflecting a big slowdown compared with 1.3 per cent of 2012. Even if it is crucial that economic growth remained within positive performance, its pace is the lowest since 1997.

This growth is mainly generated by the external demand, as a result of increase in exports by 16 per cent and slowdown of imports by 6 per cent. While that domestic demand, even with the entire fiscal stimulus injected during the first half of 2013 (especially during the second quarter), still continue to stay weak. Private investments are estimated to be the weakest component of the domestic demand (which is estimated to have had a negative contribute toward the economic growth), but also the private consumption is still very weak.

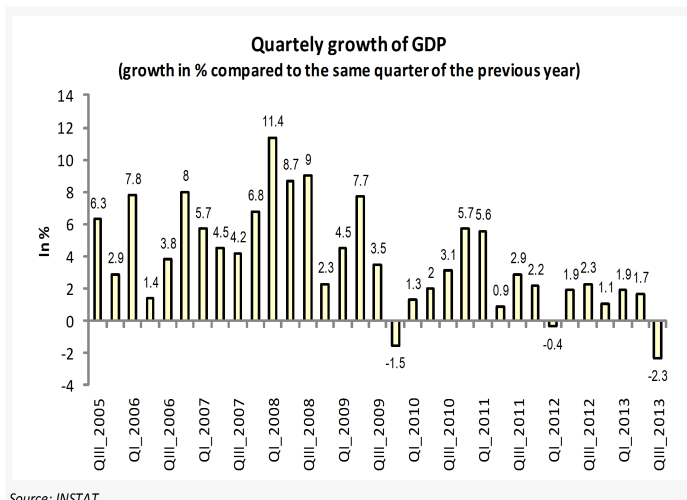
The distribution of the economic growth during the first nine months of 2013 is presented different for the main sectors of the economy. Sectors that are estimated to have increased over this period are construction, which in the second quarter led the economic growth, then follows agriculture and industry.

The manufacturing sector (industry, agriculture and construction) had the leading role in the economic growth of the first half of this year, in contrast to the developments seen in 2012, where GDP growth was led primarily by the dynamics of the service sector. The manufacturing sector is estimated to have contributed with 1 percentage point toward the GDP growth rate, during the first 9 - months of 2013. This contribution reflected mainly the temporary revive of the construction activity during the second quarter, which was supported by the fiscal stimulus injected in this quarter. The biggest contribute in the production of sectors, and also in all the other sectors of the economic activity, was given by the Agriculture sector, which during the first 9 - months of 2013 increased by 2.9 per cent in annual terms, contributing with 0.7 percentage points toward the overall growth rate of this period. Also, even in a small scale the positive growth registered in the industrial activity contributed to the growth with 0.3 percentage points.

GDP growth by economic activity for 9 - months of 2013

	Growth (in % 9M'13/9M'12)	Contribution (in % points 9M'13/9M'12)
Agriculture, hunting and forestry	2.9	0.7
Industry	2.6	0.3
Extracting	18.0	0.4
Manufacturing	-0.9	-0.1
Construction	0.5	0.1
Services	-0.8	-0.5
Trade, Hotels and Restaurants	-2.2	-0.5
Transport	-4.1	-0.2
Post and Communication	0.8	0.0
Other Services	0.6	0.2
GDP Total	0.4	0.4

Source: INSTAT



Source: INSTAT

In contrast, the annual decline of the recorded value added by the service sector was translated into a negative contribution of 0.5 percentage points to the economic growth of the first nine months of 2013. Trade, restaurants and hotel services, and also transportation services were those services which resulted in a decline during the first nine months of the year, with respectively 2.2 and 4.1 per cent in annual terms. Meanwhile, telecommunications

services recorded a marginal increase of the value added by about 0.8 percent compared with the first nine months of 2012 and also the other services increased by 0.6 percent.

From the expenditure point of view, based on the available indirect indicators, it is estimated that growth was almost entirely supported by foreign demand during Q1-2013. During the second and third quarter of 2013 however, foreign demand began to diminish compared to the first quarter. Estimations show that, for the first nine months of 2013, private internal demand contributed negatively to growth, be it through consumption and/or private investments. Especially during Q2-2103, the estimated negative contribution of private domestic demand was partially offset by a public component of aggregate domestic demand. Overall, based on the available indirect

indicators, domestic demand (both private and public) have had an almost negligible contribution to economic growth during the first nine months of the year.

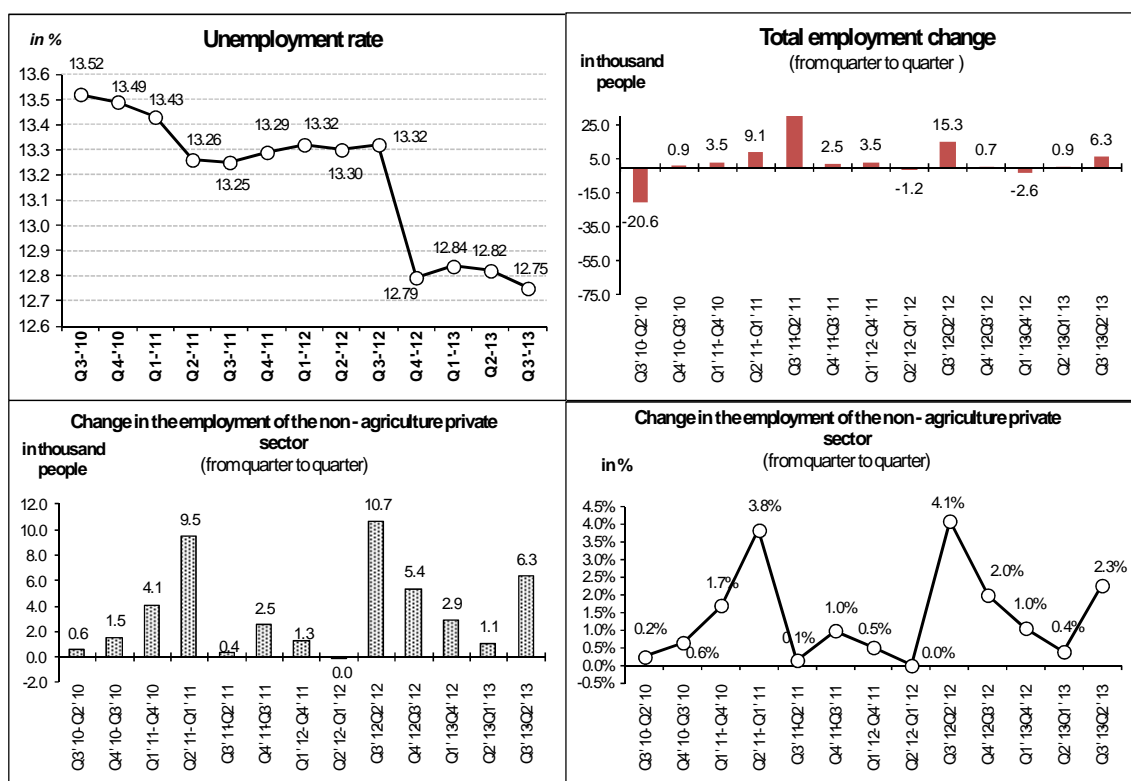
Even during Q4-2013 it is estimated that private internal demand has remained weak, especially private investments. The negative performance of the private domestic demand mainly reflects the high level of uncertainty that continues to affect the decisions of the economic agents. This situation seems to have culminated just prior to the general elections, as reflected by the indices of Consumer and Business Confidence that showed a downturn in Q2-2013 compared to Q1-2013.

This negative performance of private domestic demand also demonstrates the continuation of tight and rigid financing conditions faced by private economic agents. Among the various conditions affecting this situation we can mention a tight credit system for private economic operators for a relatively long period of time, the high rate of interest, the high level of the factors influencing demand for loans, etc. This situation persisted despite a smoothing monetary policy pursued by the central bank, through a series of interest rate decline.

Labor market

Even though in low rates, the continued positive economic growth seems to have partially offset the transmission of the negative impact on the labor market, especially related to employment. Official statistics show that this negative pressure has mostly impacted wages and salaries rather than employment level. This is visible in the fact that employment has slightly increased during 2013 whereas the average real wages have been declining during the same period of time.

Graph: Labor market indicators



Source: INSTAT

During the first, second and third quarter of 2013, employment increased respectively by 0.3%, 0.1% and 0.7% compared to the previous quarters, and 1.3%, 1.5% and 0.6% compared to the same quarters of the previous year. On average, employment growth

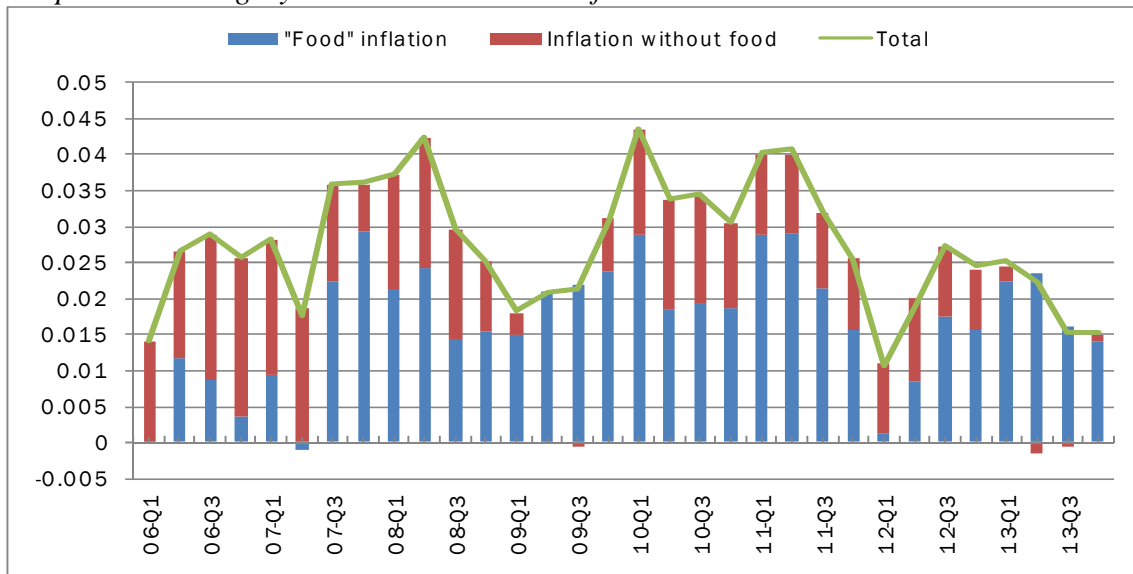
during the first nine months of 2013 was about 1.1 percent in annual terms. This increase was as a result of an increased employment in the private non-agricultural sector, which grew respectively by 7.2%, 7.7% and 5.8% quarterly year by year, while public sector employment continued to shrink by an annual average of 0.4 percent. The employment data in the agriculture sector have remained unchanged. In the third quarter of 2013 the unemployment rate continued to be at 12.8 percent.

Monetary and financial sector

The overall economic and financial environment has been conducive to muted inflationary pressures during the past two years. Weak aggregate demand has led to subdued and below-potential economic growth. The resulting negative output gap has contained growth in unit labor costs and has created a background of low underlying inflationary pressures. Low core inflation figures and declining - but anchored - inflation expectations are testimony to this. Furthermore, imported inflation has slowed down, reflecting both declining inflation in our trade partners and a stable exchange rate.

Annual CPI inflation averaged 2% in 2012, remaining within the target range of the BoA. CPI inflation followed a decelerating trend in 2013, particularly during the third and fourth quarter. The annual inflation rate was 2.5% and 2.2% respectively during the first and the second quarter of 2013; it fell to 1.5% in the third quarter and declined further to 1% in November. The inflation profile during the year was almost entirely determined by the fluctuations of food prices. Beyond the seasonal effects, the decrease in food prices reflected also lower import prices for processed and non-processed food as well as an increase in domestic agricultural product which enters the market at lower prices than their imported counterparts. The prices for other consumer goods items made a low contribution to headline inflation, hence offsetting each other. Particularly, the decline of rent and oil price inflation has contributed to the diminishing of non-food inflation contribution to the headline inflation.

Graph: Food category contribution to total inflation



Source: INSTAT and Bank of Albania

These developments were largely in line with the BoA expectations. However, the magnitude of the decline in inflation was higher, because of lower than expected economic growth and faster than expected deceleration of imported inflation. The weak current and expected inflation developments prompted the BoA to decrease its policy

rate throughout 2013. On the other hand, inflation expectations remain anchored and in line with price stability.

Looking forward, we expect the aforementioned picture to remain broadly unchanged. The expected negative output gap and low monetary expansion will keep the inflation rates low in the period ahead.

In line with developments in the real economy, high risk aversion among commercial banks and low financial intermediation of the financial system, monetary expansion has been moderate in 2013. The broad money aggregate, M3, increased at an average rate of 4% annually, with a decelerating tendency during the second half of the year. In October, M3 growth rate was down to 2.3%. The expansion of broad money has been mainly sustained by the foreign currency component and the government needs for financing, each contributing by 1.9 percentage points to M3 growth in October. The credit portfolio contraction has subtracted 1.1 percentage points to the rate of monetary expansion. On the other hand, the domestic banks' financing of the government deficit and a relatively better performance of credit in the local currency, have sustained an annual expansion rate of M2 at around 6%. Deposit performance shows a decelerating pattern of annual growth. The total stock of deposits at the end of October stands just 1.7% higher compared to the same period a year ago. The slowdown in the growth rate has mainly reflected the reduction of deposits in foreign currency, whose stock has dropped by 3.3% in annual terms. Despite the easing monetary policy and its transmission to the deposit interest rate, the stock of ALL deposits increased by 6.6% annually.

Monetary developments were largely conditioned by a progressive slowdown of credit growth rates. Overall, credit to the economy was reduced by 2.2% in annual terms in October while the credit to GDP ratio declined to around 40.2%. Both credit to households and to businesses, has recorded respectively an annual contraction of -0.2% and -3.8% in October. Credit to households has been performing better, recording positive growth rates throughout most of the period.

The fall in the credit stock does mostly reflect a low demand for financing of the private economic agents, spawned by reduced economic activity and uncertainties for the future developments. However, it does also partly reflect supply side problems, as captured by both bank-lending surveys and the stated bank lending conditions. The extreme risk-averse approach to lending is, at the margin, also responsible for the credit deceleration. Lastly, this year the credit development has reflected also the clean-up of banks' balance sheets from nonperforming loans.

The ALL exchange rate has been largely stable in 2013. From January to November 2013, ALL depreciated on average by 0.15% against the currencies in the NEER⁵ basket. The dynamics of NEER index reflected a depreciation of Lek against Euro that was offset by a significant appreciation against US dollar. In real terms, the domestic currency was largely stable, reflecting no changes compared to the previous year. During 2013, the average level of Euro/ALL and USD/ALL exchange rates were respectively 140.3 and 106. In January-November of this year, the ALL showed a significant appreciation against US dollar (2.2%) and a modest depreciation against euro (0.93%) compared to the same period in 2012. Lower imports in this period, coupled with the continuous recovery of exports seem to have contributed to the stability of ALL against euro.

⁵ NEER - Nominal Effective Exchange Rate, as measured against the currencies of Albania's main trading partners, namely Italy, Greece, Germany, Turkey and China. Higher NEER implies the lek's depreciation.

The correction of the current account deficit continued during 2013, albeit at a slower pace. Inflows in the capital and financial account were largely sufficient to finance this deficit, as a result of high FDIs. During first three quarters of 2013, the current account deficit reached EUR 713.1 million, or about 9.8% of GDP, decreasing slightly from the 10.8% ratio of 2012. The narrowing of the trade deficit was the main determinant behind the current account developments over the first nine months of 2013 and in 2012. In 2013, the contraction of the net factor income deficit, primarily through lower FDI's income outflow, also contributed positively in the narrowing of the current account deficit. On the other hand, the balance of the services account was greatly affected by the incidence of the general elections and of the subsequent interim period prior to the expected government change in the midst of the tourist season. This is believed to have increased uncertainty and to have directly affected inflows into the services account. Due to a progressive fall registered in remittance inflows, the current account transfers surplus contracted and contributed negatively to the overall current account balance. Latest evaluations project a higher current account deficit than previously expected due to downward revised surplus of the current transfers despite a slightly better than expected amelioration of the trade deficit.

Net flows to the capital and financial account resulted in about EUR 626.6 million during the first nine months of 2013, compared to EUR 867.3 million in 2012. As a ratio to GDP they were valued at around 8.6 % over the first three quarters of 2013 and at around 9.2% to GDP in 2012. In 2013, the capital account recoded a lower surplus in annual terms, while conversely, the financial account surplus increased by about 8.1% in annual terms. Privatization receipts, especially over the second quarter of 2013, played an important role in the flow of FDI's during 2013. Net foreign investments were around EUR 690.7 million, up by 25.5% in annual terms. However if one excludes privatizations receipts from the two large public hydropower plants sold to foreign owned companies, FDI growth rates more than halved to 11.7% in annual terms. Net portfolio investments showed a negative balance, mainly by the increase in our assets invested abroad by about EUR 145.9 million. Other investments account recorded a positive EUR 13.0 million in net terms, coming from the considerable increase in assets invested abroad.

2.2. Medium-term macroeconomic scenario

The baseline scenario of the macro-economic framework is based on the actual policy mix and assumes the implementation of main planned structural policies for the medium term ahead. It is based on a set of assumption as regard the external environment and it takes into account the rational behavior and interaction between economic actors within the internal and external economic environment considered as the most likely in the upcoming years. An extensive set of macroeconomic statistics and forecasts by different institutions such as, Institute of Statistics of Albania, Bank of Albania, Ministry of Finance of Albania, DG ECFIN-European Commission, International Monetary Fund, Eurostat, European Central Bank, etc., have been used. These statistics are mainly in the form of time series, with annual, quarterly and monthly frequencies. Generally the data taken into consideration for building these framework date back to the year 1996.

Once are follower all the steps of the methodology of forecasting, testing , comparative analysis , static , dynamic , and after are performed some consistency tests ,we obtain a baseline scenario. These baseline scenario aims to display the most likely macro-economic situation for the medium-term 2014 – 2016 and it aims consistency between different economic accounts.

The baseline macro-economic scenario is set up in collaboration with International Monetary Fund.

Real sector

During 2013, the macroeconomic developments have been characterized by very weak growth, low inflation, relatively sound financial fundamentals, an improvement in current account and positive balance of payments, loose fiscal stance and high uncertainties among economic agents. Domestic demand continued to be significantly subdued as a result of uncertainty for the future, households' income position, relative tight lending conditions. Public component of aggregate domestic demand helped to offset somehow low private consumption and investment. The same as in 2012, foreign demand continued to generate almost the growth in 2013. All this resulted in the lowest growth rate in the last five years under the pressures of global crises. The growth is expected at 2.1% for 2014.

Looking ahead, the growth is expected to accelerate somehow in 2014, especially in the second half, due to the fade away of election related uncertainties in 2013 and due to the expected inflows of foreign capital from IFIs channeled toward payment of government arrears to the private sector. Also, even a possible improvement in the eurozone economies it increases the likelihood of a higher growth in 2014 of 2.1%. The output gap is expected to gradually close beginning in 2015 and continuing in the following years. The growth is expected to be more broadly based as economic agents confidence is expected to improve in line with the recovery of the global economic activity and especially of Italy and Greece. Households and businesses will start to benefit from the stimulating monetary conditions, already in place.

The external balance of the economy may continue to improve in the coming years. This along with the consolidation of fiscal stance will sustain the strengthening of the macroeconomic framework. This will lead to lower risk premiums for the economy and contribute to smooth financial intermediation and steady inflow of foreign capital. Also, the correction of imbalances in the external sector indicates the improvement of the gap ratio between savings and investments in the country.

Despite the positive expected growth rates and closing of the output gap, the economy is projected to continue to operate below potential in the short to medium run, implying low inflationary pressures from the demand side.

GDP: Aggregate demand

Final consumption is forecasted to grow in real terms with an annual average rate of 1.5% during the medium-term ahead (2014 – 2016). Specifically, the consumption real growth is forecasted at 0.2% in 2014 contributing by 0.2 p.p. on the economic growth for this year. During 2015 consumption growth is forecasted to accelerate at 1.5%, contributing by around 1.3 p.p. in the overall real economic growth and grows by 2.7% in 2016 or contributing by 2.3 p.p.

Investment (Gross Fixed Capital Formation) during 2014 – 2016 is forecasted to experience an average annual real growth of 3.2%. In 2014 investment are forecasted to grow by -0.4% in real terms contributing by -0.1 p.p. in GDP growth. The contraction is due to the lower level of public investment compared to 2013 of approximately 9.9% lower, while private investment is projected to grow by about 2.3% in real terms. In 2015 total investment are forecasted to increase by 4.3% contributing by only 1.2 p.p. In 2016 investments are forecasted to increase by 5.8% led by private investment with a contribution of 1.6 p.p. in the real economic growth.

Net exports of goods and services are foreseen to continue an improvement of their net balance in the medium-term ahead, it is foreseen that for 2014 the net balance deficit will improve by 12.2% in real terms, contributing by 2.0 p.p in the real GDP growth forecasted to be at about 2.1% in 2014. The balance improvement it is forecasted to go on even in 2015 by 5.8% and by 2.0% in 2016, contributing respectively by 0.8 p.p. and 0.3 p.p. in the economic growth for these two coming years. The improvement in net exports is foreseen to come from a stable increase of exports of goods and services but also from the reduction of imports of goods and its substitution with domestically produced one.

Changes in inventories are assumed with a neutral (zero p.p.) contribution in the aggregate demand and real GDP growth⁶.

GDP: Aggregate supply

According to the optics of aggregate supply, the expected performance of the main economic activities is as follows.

The agricultural production, assuming normal climate conditions, has been projected to grow annually by around 4.4% in average for the upcoming period 2014 – 2016, with an average contribution on GDP growth of 0.9 p.p.

Industrial production, including extracting and manufacturing industry, is forecast to grow in average by 6.1% per year for the medium term ahead, contributing in average by 0.7 p.p. on the forecasted GDP growth.

Table: Main macroeconomic indicators

Indicators	Unit	2008	2009	2010	2011	2012	2013	2014	2015	2016
							Est.	Proj.	Proj.	Proj.
Population	Million	2.9	2.9	2.9	2.8	2.8	2.8	2.8	2.8	2.8
Inflation (end-of year)	%	3.4	2.3	3.6	3.5	2.0	1.9	2.7	2.8	3.0
GDP Deflator	%	4.7	2.0	2.6	1.8	2.1	1.7	2.3	2.5	2.7
Exchange rate (Average)	ALL/USD	83.9	95.0	103.9	100.9	108.2	106.0	106.0	106.0	106.0
Exchange rate (Average)	ALL/Euro	122.8	131.6	137.7	140.5	139.0	140.3	140.0	140.0	140.0
The conversion factor according the Purchasing Power Parity (PPP)	ALL/USD	41.8	41.7	44.5	45.5	45.5	45.5	45.5	45.5	45.5
Real GDP Growth	%	7.5	3.3	3.8	3.1	1.3	0.7	2.1	3.3	4.2
GDP	ALL Billion	1,089.3	1,148.1	1,222.5	1,282.3	1,326.0	1,358.0	1,418.0	1,502.0	1,607.0
GDP	USD Billion	13.0	12.1	11.8	12.7	12.3	12.8	13.4	14.2	15.2
GDP	Euro Billion	8.9	8.7	8.9	9.1	9.5	9.7	10.1	10.7	11.5
GDP per capita	Thousand	372.2	396.1	425.9	451.0	470.9	487.2	508.7	538.8	576.5
GDP per capita	USD	4,436.2	4,170.3	4,097.8	4,470.0	4,353.0	4,596.5	4,798.9	5,083.1	5,438.5
GDP per capita	Euro	3,031.5	3,010.3	3,092.9	3,209.8	3,388.4	3,473.0	3,633.4	3,848.7	4,117.7
GDP per capita	USD-PPP	8,900.7	9,488.4	9,578.6	9,922.3	10,359.9	10,716.9	11,190.5	11,853.4	12,682.0
Unemployment rate (Labor Force Survey since 2012)	%	14.4	16.9	16.2	15.5	14.3
Total Revenues	% of GDP	26.7	26.0	26.6	25.8	24.9	24.0	25.7	26.0	26.5
Total Expenditures	% of GDP	32.3	33.1	29.7	29.3	28.4	30.1	32.2	30.8	29.9
Overall Fiscal Balance	% of GDP	-5.5	-7.0	-3.1	-3.6	-3.5	-6.1	-6.5	-4.8	-3.4
Primary Fiscal Balance	% of GDP	-2.7	-3.9	0.3	-0.4	-0.3	-2.9	-3.2	-1.3	0.2
Current Fiscal Balance	% of GDP	3.1	1.3	2.4	1.9	1.2	-0.5	-1.7	0.3	1.6
Total Net Borrowing	% of GDP	4.9	4.6	3.1	3.9	3.2	5.5	6.4	4.8	3.4
Total Public Dept	% of GDP	54.7	59.5	58.5	60.3	62.5	70.5	72.1	71.7	69.2
<i>General Government Public Dept</i>	% of GDP	51.3	55.5	54.8	56.5	58.4	61.3	65.1	66.3	65.4
<i>Public Dept out of Fiscal Indicators</i>	% of GDP	3.4	4.0	3.7	3.8	4.1	9.2	7.0	5.4	3.8
Current Accounts	% of GDP	-15.6	-15.2	-11.5	-13.0	-10.7	-10.0	-8.3	-7.6	-7.3
Trade Balance (Goods & Services)	% of GDP	-26.6	-24.4	-20.8	-23.1	-18.9	-16.5	-14.1	-12.7	-11.8
Goods	% of GDP	-27.4	-26.4	-23.5	-24.6	-21.0	-17.0	-16.8	-15.2	-14.6
Exports	% of GDP	10.3	8.6	13.2	15.4	16.0	17.8	19.1	20.4	21.9
Imports	% of GDP	-37.7	-35.0	-36.7	-40.0	-36.9	-34.8	-35.9	-35.6	-36.5
Balance of Payments	% of GDP	2.1	-0.3	2.0	-0.3	0.8	0.6	2.2	2.5	2.9

Source: INSTAT, Bank of Albania, Ministry of Finance, IMF, WB

⁶ This assumption is also due to non accurate historical statistics for this component. In the national accounts figures (GDP by expenditures) produced by INSTAT, this item is merged with "statistical discrepancies" and there are not official estimations of pure "changes in inventories".

Construction is expected to continue in 2014 with a decline, although more moderate than the previous years, and is projected to return to positive growth rates for the years 2015 and 2016. In average construction it is forecasted to increase in real terms by 1.5% during 2014 – 2016, contributing positively in the overall economic activity growth by an average of 0.1 p.p. per year.

Services are forecasted to grow in average by 2.7% per year during the medium-term ahead 2014 – 2016, contributing on average by 1.4 p.p. per year on the overall economic growth. The main contribution is expected from Other Services. Trade, Hotels and Restaurants also is expected to have an increasing contribution during the upcoming time horizon.

Based on the above projections of the aggregate demand and supply, the presented baseline scenario projects a real GDP growth of 2.1% in 2014; 3.3% in 2015; and 4.2% in 2016. In the table above are presented the forecasts of the key macroeconomic indicators for the period 2014-2016.

Monetary and exchange rate policy and inflation

Monetary and exchange rate policies during 2013

The BoA has pursued an expansionary stance of monetary policy, in the presence of weak current and expected inflationary pressures. The BoA cut its policy rate four times during 2013 and, by December, brought it to a historically low level of 3%. In order to increase the effectiveness of its monetary policy, the BoA has started to issue forward guidance for its monetary policy. This guidance remains conditional on demand and supply side pressures. However, it has successfully reached its goal of anchoring the long term of the yield-curve and bringing down long-term interest rates. Throughout 2012-2013, BoA has intervened in the money market, injecting liquidity via reverse repo agreements with maturity of 7-days and 1- and 3- months. No changes of monetary policy instruments are noted. Liquidity risk-premium in the market stayed low and short term interbank rates have remained stable.

Even though the Bank of Albania has progressively eased its monetary policy, the credit standards have remained tight while the cost of lending has shown only a slight reduction. The effectiveness of the monetary policy is hampered by the high uncertainties for the future, which have been reflected in low demand for financing and low sensitivity to interest rates. The transmission mechanism continues to be hampered by the deterioration of the credit quality in the banks' balance sheets, resulting in tighter lending standards. At the same time, the continued difficulties of the Eurozone banking system and the tightening of macro prudential policies at EU level, has also affected credit conditions in Albania because of the high concentration of EU banks in our financial system.

In the current juncture, the BoA has thought of subdued demand as the main risk affecting our macroeconomic and financial stability. To this extent, at the end of the first half 2013, the BoA complemented the easing stance of its monetary policy with a relaxation of some macro prudential tools, aimed to support credit growth. These measures: alleviate liquidity requirements for banks, albeit starting from a rather high base; require less capital for new bank lending throughout the year; promote credit restructuring in the economy; incentivizes banks to lend as opposed to investing in foreign financial markets; and, facilitate NPL resolution through a better tax treatment and collateral execution practices. The Bank of Albania will carefully evaluate the stance of macro prudential policies, in order to make it compliant with a stable and long term development of the banking system.

Monetary and exchange rate policies in the medium term

The primary monetary policy objective of the Bank of Albania remains the maintenance of price stability, defined in quantitative terms as the 3.0% annual change of CPI with a tolerance interval of +/- 1.0 pp over the medium term. During 2013 the annual inflation rates is almost 2% (over January -November), remaining close to the lower level of tolerance interval. Based on the latest inflation developments; assumptions for the main inflation determinants; projections for prices' commodities in the international markets; BoA's projections for the continuation of the negative output gap, the annual inflation during 2014 is expected to fluctuate within the range of 0.4% - 3.1%, with 90% probability. The central projection of inflation in the next few quarters remains close to the lower half of the target band of the BoA. The downside risks will be determined by the slowdown inflationary pressures of aggregate demand and weak pressures from imported inflation components. The projections exclude the potential effects of increases in the prices of regulated and excise items of the CPI basket due to the new fiscal package for 2014. Preliminary estimations indicate the overall effect of such measures might have an effect of around 1 percentage point in CPI inflation. However, given the current cyclical position of the Albanian economy, their effects are expected to be temporary.

In the period ahead, the BoA will monitor all incoming information on economic and monetary developments and assess any impact on the medium-term outlook for price stability. The monetary policy stance will continue to be geared towards maintaining the degree of monetary accommodation warranted by the outlook for price stability. In implementing its monetary policy, the Bank of Albania will continue to use the existing market instruments of monetary policy.

The monetary policy framework will continue to operate in tandem with a floating exchange rate. Bank of Albania's interventions in foreign exchange market are minimal and preannounced and do not intend to influence the monetary policy path.

Without jeopardizing its institutional commitment to price stability, the BoA has tried to coordinate its monetary and macro prudential policies with the overall fiscal and economic policy of the country. We believe such coordination is the best way to deliver both faster growth and lower volatility in the economy. The expansionary stance of fiscal policy and the uncertainty surrounding the public debt during 2013 has been a factor in determining the pace of monetary easing in this period. Overall, we believe the BoA commitment to price stability and the flexible exchange rate regime we pursue, provide a credible nominal anchor to the economy. However, the institutional policy-making framework would also benefit from a credible commitment to public debt sustainability.

In its role of the banking system supervisory authority, the BoA aim to promote sound banking practices and competition within the system. The recent emergence of specialized participants in the government bond markets expected will provide benefits in this regard. These more specialized financial intermediaries will push banks to focus their attention on lending. Furthermore, the improvement of the safety nets in the financial system would also encourage banks to take more risks in their lending activity.

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 15.6% in 2008 and 15.3% in 2009. Data of the last three years show there is an improvement of the current account to GDP ratio, reaching 10.7% in 2012, the lowest ratio since 2007.

Going forward, we forecast a contraction of the current account deficit by around 4.3% annually in 2013, guided principally by a large drop in the trade deficit despite lower net current transfers. In 2014, we expect the level of net current transfer to remain largely unchanged and the surplus of net services to experience an accelerated growth. The overall current account deficit is projected to decrease annually. In 2013, the current account deficit is expected to be valued at about 10% to nominal GDP, in 2014 at approximately 8.3% to nominal GDP. Projections for 2015 and 2016 value the current account deficit at respectively 7.6 and 7.3% to GDP as output gap closes with a higher contribution from net exports.

The trade deficit is expected to contract by 17% in 2013 and thereafter expand slightly by 3% in 2014. The exports of goods will remain largely based on natural resources (crude oil) and textile industry (textile and shoes) whereas imports are projected to pick up in 2014 on the back of a slight improvement in domestic demand for foreign goods. New policies focused towards the tourist industry in the country as well as a more stabilized political and economic environment in 2014, are expected to help the pick-up of the net service balance inflows in the subsequent year.

The income account balance is projected to contract sharply in 2013 due to a lower direct investment income outflow. Concomitantly, the net worker compensation is also expected to decrease due to a subdued economic growth in Albania, albeit at a lower rate. In 2014, we expect acceleration in the repatriation of profits from FDIs which nevertheless will be conditional on the reform and application of any new corporate profit tax or mineral resource rent tax proposed. Subject to increased FDIs, we expect the income account balance to deteriorate in 2014.

Current transfers are projected to decline by around 20% in 2013 largely due to a drop in remittances from abroad. The economic contraction and weakened labor markets in the main remittances' originating countries, Italy and Greece, has directly affected financial transfers from Albanian immigrants living abroad. The latter are projected to drop by around 25% in 2013. The declining trend of remittances is projected to continue into 2014 and pick up in 2015 and 2016. Due to the structural factors mentioned above (see 'Services, income and current transfers'), in the longer term, remittances are expected to remain subdued and decline in their importance as a source of foreign finance. Other net factor income outflows are projected to decrease for both 2013 and 2014.

FDIs have performed positively in 2013, primarily due to the privatization of two large public hydro-power plants to foreign owned companies. Going forward, there are some foreseeable developments that are expected to affect the performance of FDIs in Albania.

The signature of the Albanian Government of the Trans-Adriatic Pipeline project that is expected to transport natural gas and oil from Azerbaijan to Western Europe and passes through Southern Albania. Despite the project being on its initial phase, it is expected to greatly increase foreign investment concentrated in construction as well as transport, communication and financial intermediation.

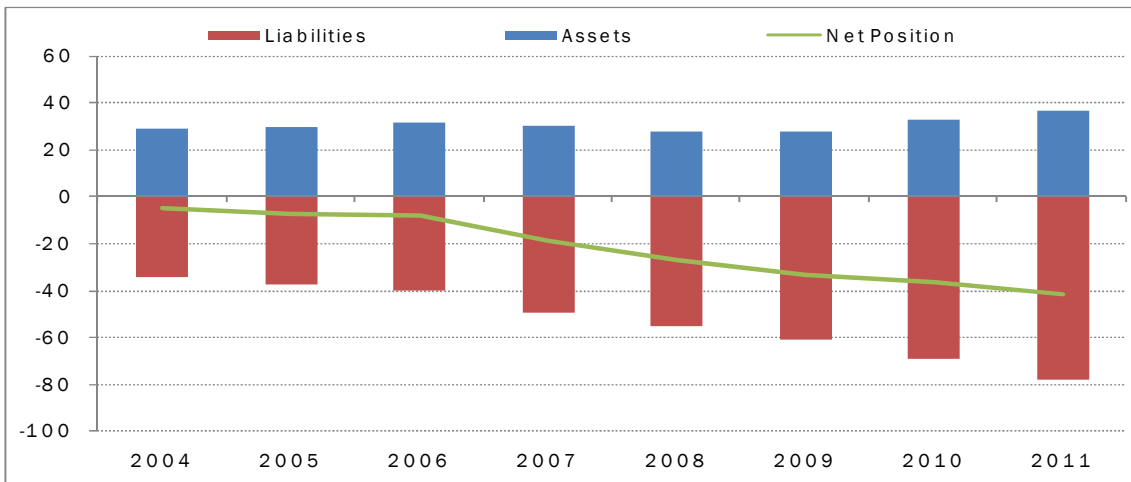
With a major share of the FDI stock gone to privatization operations on existing established companies, there is a large scope for targeted structural policy reforms aimed at attracting green field investment in Albania.

During the first nine months of 2013, net other investment account posted a deficit of EUR 13.0 million, after two years of considerable surplus. The negative balance of this sub-item of the financial account was determined by higher levels of assets invested

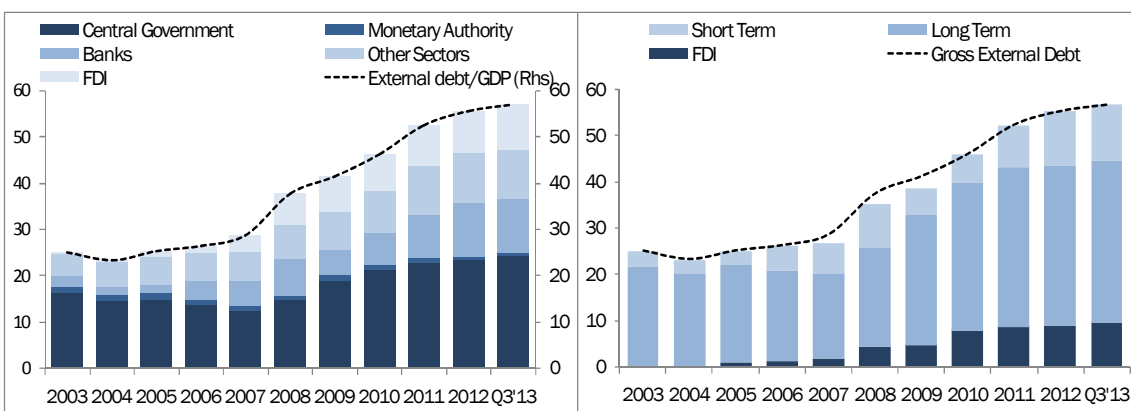
abroad, especially under currency of deposits of home banking system in foreign banking system. Debt-creating financial flows (under private and public) borrowing have followed a downward trend since 2012 and accounted for about EUR 100.6 million over the first nine months of 2013. A proposed increased external borrowing by the central government is expected to accelerate the debt-creating inflows in the subsequent years and is evaluated to further increase the external debt of Albania.

The developments in the net international investment position of Albania continue to be characterized by sluggish growth in the stock of financial assets and an accelerated growth in the stock of financial liabilities. The stock of external financial assets to GDP is valued at 36.5% to GDP, higher by about 3.6% points compared to the previous year. Similarly, the stock of external financial liabilities reached 77.9% to GDP, up by about 8.9% points compared to the previous year. The net international investment position as a ratio to GDP is valued at approximately -41.4% to GDP. Direct investments to Albania and other investments in the form of loans constitute the largest chunk of external liabilities, valued at respectively 42.7 and 37.7% of total external liabilities. On the asset side, reserve assets in foreign exchange (mostly bond and notes) make up nearly 53.7% of the stock of total external assets.

Graph: Net international investment position to GDP



Graph: Gross external debt and sector components to GDP (left) and composition of external debt by maturity (right)



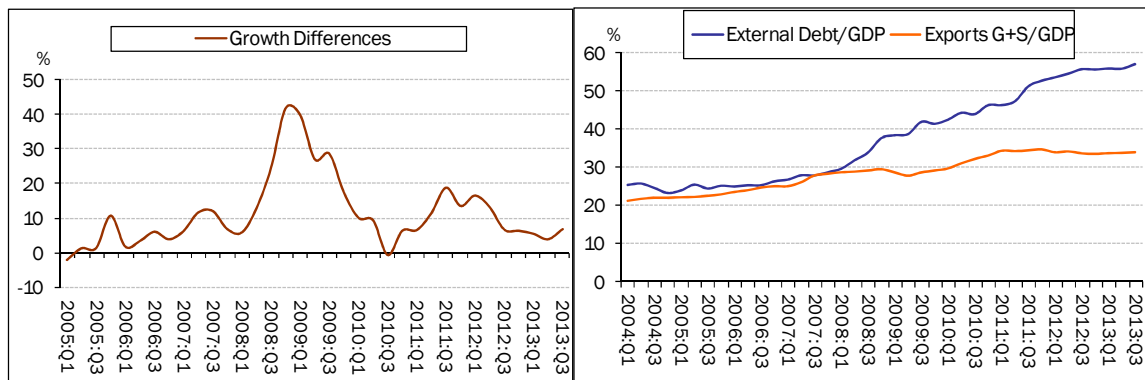
Source: Bank of Albania

The gross external debt of Albania commenced increasing at an accelerated pace during the second half of 2008 and it has maintained a progressive growth path. As of the third quarter of 2013, the gross external debt is valued at around 56.4% to nominal GDP.

Long term debt constitutes around 62% 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 21% of the total composed largely of banks' external borrowing.

Viewing the developments in the gross external debt from a sustainability perspective two primary tenets can be directly observed. The shot up of external borrowing in 2008 has not been associated with a parallel jump of other indicators namely exports and GDP growth. Until 2008, the export of goods and services fully covered the gross external debt of Albania indicating an optimal payment capacity of the economy through external revenues. Subsequently, the long term trend of gross external debt and exports of goods and services to GDP started to diverge continuously, reaching a differential value of around 23% to GDP in 2013. Similarly, evolution of gross external debt was characterized by a high volatility in growth, with peaks in the fourth quarter of 2008 and the third quarter of 2011. Beside these peaks since 2005, the gross external debt has increased at a faster pace compared to nominal GDP.

Graph: Annual growth differences between gross external debt and GDP (left) and evolution of gross external debt and exports of goods and services to GDP



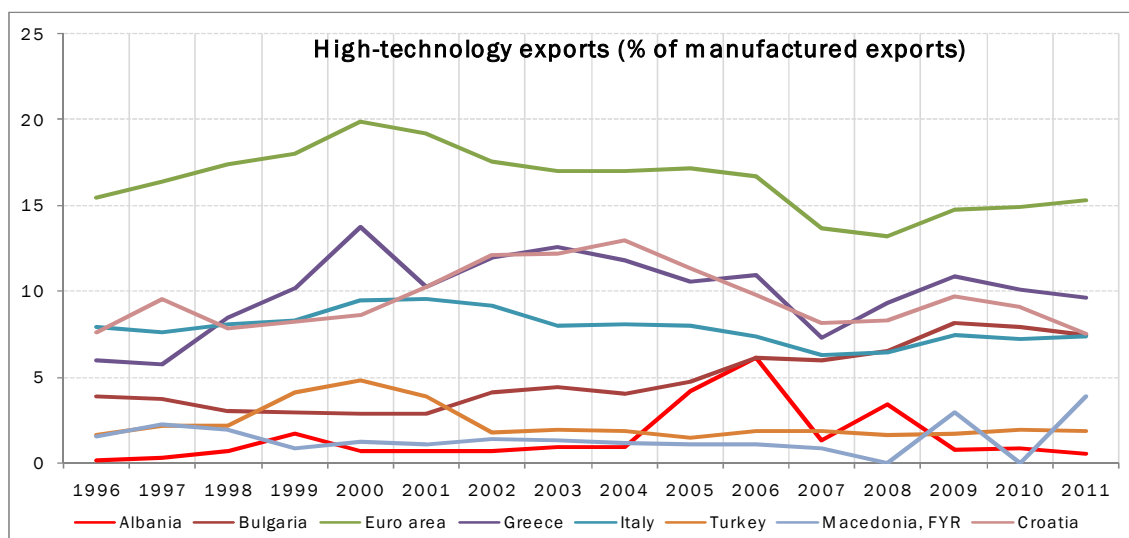
Source: Bank of Albania

The real exchange rate performance has been quite satisfactory in 2013. From January to November, the lek trade-weight-index remained broadly unmoved in nominal terms, whereas its real fluctuations were contained within $\pm 3\%$ annual change. On average, the PPI-deflated index is expected to depreciate by merely 0.2%, while the CPI-deflated REER to appreciate by 0.6% annually. The average price competitiveness is expected to stay put at the current levels in the next couple of years, though there are signs of appreciating in 2015 if adjusted by consumer prices.

With regard to non-price competitiveness, as captured by technological competitiveness (proxy by spending on research and development as percentage of GDP and the ratio of high technologies export as percentage of manufactured export) and the role of FDI, the data show that Albania is still in no advantageous position (Source: WB indicators, 2012).

The data on R&D as percentage of GDP and the ratio of high technologies export (as percentage of manufactured export) reveals that the level of R&D in Albania is lowest (0.2%) compare to other countries in the region and also compared to euro area (around 2%). The same conclusion is drawn from the level of high technologies exports as percentage of manufactured export. As a result, Albania would need further structural changes in the labour market and also on goods market, with respect to both quality and standards, in order to improve its competitiveness and speed up the adjustment development.

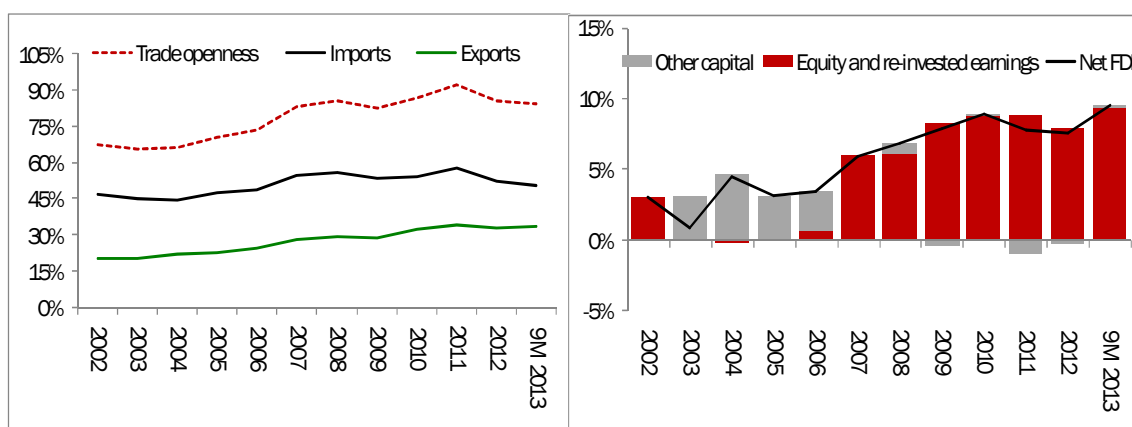
Graph: Non price competitiveness



Source: WB 2013

Trade in goods over the first 10 months of 2013 point to a continuation of the positive growth trend, albeit at a slower pace compared to 2012 and 2011, and to an accelerated decline of goods imports. The harsh macroeconomic environment in our main regional and traditional trading partners instigated a ‘search for new markets’ reflected in changes in the export composition by commodity and by country of destination. In 2013, exports of “Minerals, fuels and electrical energy” were the main determinants of the overall exports positive performance. On the back of increased FDI in the extraction industry, crude oil exports have increased steadily over the considered period. Electrical energy exports also had a positive contribution to total exports but their performance is largely seasonal and deterministic. Re-exported apparel products, embodying a more historically stable private-sector led source of export income, have contributed positively to overall export performance. 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 atypical markets, such as Spain, to the list of exporting partners. Nevertheless, reliance on a concentrated narrow range of exported products has made Albania vulnerable to external shocks.

Graph: Trade openness, export and imports as a percentage to GDP (left) and Net FDI as a percentage to GDP (right)



Source: Bank of Albania, INSTAT

The indicator of trade openness during the period 2002-2013 peaked in 2011 and thereafter decreased slightly due to lower imports. Exports maintained an increasing trend for the whole period. FDI net inflows have increased progressively throughout the whole period despite experiencing slight drops in 2011 and 2012. The majority of the foreign direct investments is in the form of equity & reinvested capital.

Financial sector

Albanian banking sector has maintained its structure⁷ and stability in 2013 despite being confronted with significant challenges related to the weak economic environment and delaying signs of recovery in global markets in recent years which has dampened profitability and increased credit risks. Banking sector solvency positions have improved and remains markedly above the minimum capital requirement – resulting from both rising core Tier 1 capital and reductions in risk-weighted assets. Liquidity risk was moderate because the banking sector continued to post deposit growth, and liquid assets in lek and foreign currency exceeded the minimum threshold required by the regulatory framework.

Regarding market risks, the banking sector appeared to be relatively hedged against direct risk from adverse exchange-rate and interest-rate movements. The banking sector remained indirectly exposed to its clients' sensitivity to adverse exchange-rate and interest-rate movements.

The banking sector remains the main segment of financial intermediation in Albania, accounting for more than 90% of the overall total asset of the financial system. As of end-September 2013, the banking sector assets accounted for 90.8% of GDP.

Analysing Albanian banking sector balance sheet, it is observed that asset size which amounted to ALL 1,188 billion as of end-2012 increased to ALL 1,235 billion in September 2013. The increase in investment in securities dominated the asset performance, whereas lending made downward contribution. In this context, the securities volume of the sector has reached to ALL 288.4 billion showing a 12.4% increase from end of 2012. The main reason behind this considerable increase in securities investment portfolio was the Albanian Government's decision⁸ to concentrate domestic financing at the beginning of the year, in addition to banks tendency toward low-risk investments.

During the same period, the share of loans in total assets has been decreasing relatively while the share of securities has continued increasing. Accordingly, the share of loans in total assets which was 48.3% in 2012 decreased to 45.6% in September 2013. Loans to businesses (68.8% of total loans) being the main driver of lending over the past three years, have contracted by 4% in annual terms, from the 1.5% growth in December 2012. Lending to households increased by 0.8% in annual terms, from the 0.4% growth in December 2012.

The financing sources show that deposits contribute the most to fund generation, accounting for 83% of total liabilities of the banking sector. Banking sector deposits continued to grow albeit at a slower pace than in the previous two years. Dependence of the banking sector to external sources of funding is very limited. Banks instead continue to increase their assets abroad, albeit at lower pace. By contrast, there has been a lower use of credit lines from the parent banks.

⁷ There are 16 banks of which: 2 are Albanian banks and 14 are foreign owned banks. None of the foreign owned banks operate as a branch.

⁸ The first half of 2013, which corresponded to the pre-election period, saw the Albanian Government meeting 90 percent of the annual plan concerning the budget deficit being financed through domestic debt.

When strength indicators of banking system are analyzed, it is seen that capital adequacy ratio of the sector, which has been 17.8% in September 2013, is well above the minimum required level of 12%. The scope of current own funds of Albanian banking sector is mostly comprised of Tier-I capital, providing resilience against shocks.

As credit risk indicator of the sector, ratio of non-performing loans to gross loans increased to 10.5% in 2009 following the emergence of global crisis and expanded further to 24.2% as of September 2013. Credit risk represents the main challenge of the banking system. The slower growth of the economy is the main factor behind the rising of credit risk in banks' balance sheets. Uncertainty about economic development, weak conditions in the labor market, income and remittances volatility and structural issues are some of the factors that have influenced the decline in credit quality, both for households and businesses. Although at different rates, loans quality has deteriorated both for loans in domestic and foreign currency, as well as for loans to businesses and households. The banking sector is more exposed to credit risk for loans in foreign currency and for those granted to business sector. Gross non-performing loans to total loans for both these categories grew at respectively 26.2% and 28.6% in September 2013, from 24.7% and 25.9% in December 2012. Regarding the loan portfolio in foreign currency, around 90% of it is in Euros and the rest in U.S. dollar. Outstanding foreign currency loans, where borrower's income is in domestic currency, accounts for 31.1% of total outstanding loans and 48.8% of outstanding loans in foreign currency in September 2013.

The ratio of the sector's foreign exchange net open position to regulatory capital was 4.3% as of September 2013, which indicates moderate impact from volatility in the exchange rate are far from risky levels. The banking sector exposure to interest rate movements has been limited. The size of exposure, as measured by the gap between interest rate-sensitive assets and liabilities to total assets, is at manageable level. However, the banking sector remains exposed to the impact from its customers sensitiveness to movements in the exchange rate and interest rate. A significant depreciation of the exchange rate or an increase on the interest rate might undermine the solvency of the clients, particularly the ones from the business sector. The main transmission channel of this risk is represented by loans in foreign currency when clients' primary source of repayment is in local currency, and loans granted in variable interest rate.

The ratio of off-balance sheet transactions to assets, which has grown in recent years, has the purpose of hedging of financial risks.

Profit in the system showed positive and encouraging values towards the end of 2012, following this path through the first half of 2013. 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, diminishing profit in the banking system.

RoA and RoE – profitability indicators – were negative in September 2013, to -0.14 and -1.7%, respectively, due to decreased net profit. The system started to show low values for these indicators in May 2013.

The banks' profitability measured as return on equity has worsened during the last year. Nevertheless, the change in RoE 2013, was caused almost exclusively by an decrease in the banking system's profit margin, as changes in risk-weighted assets and leverage level had little impact in the changes from the previous year. The same development is evinced for RoA, being considerably lower towards the level of a year ago.

Table: Banking Sector Overview

	2006	2007	2008	2009	2010	2011	2012	end September 2013
Main Aggregates								
Assets (Billion ALL)	624.28	742.86	834.14	886.31	990.63	1,120.17	1,187.98	1,235.16
Loans (Billion ALL)	197.96	292.46	396.77	449.89	490.87	566.22	577.82	567.61
Deposits (Billion ALL)	525.53	630.11	645.14	694.26	816.73	924.06	991.67	1,026.93
Number of Banks	17	17	16	16	16	16	16	16
Number of Employees (Thousands)	4,189	5,155	6,493	6,404	6,384	6,714	6,836	6,325*
Performance Indicators								
Net Profit (Billion ALL)	7.45	10.57	7.34	3.54	6.72	0.71	3.77	(1.28)
Return on Assets (%)	1.36	1.57	0.91	0.42	0.72	0.07	0.33	(0.14)
Rate of Return for Equity Capital (%)	20.17	20.74	11.35	4.58	7.58	0.76	3.78	(1.67)
Loans / Total Assets (%)	31.71	39.37	47.57	50.76	49.55	50.55	48.64	45.95
Risk Indicators								
Capital Adequacy Ratio (%)	18.07	17.08	17.23	16.17	15.40	15.56	16.17	17.76
FX Position in Balance Sheet (Billion ALL)	2.02	0.78	2.52	3.12	4.53	3.72	1.99	3.33
Net General FX Position (Billion ALL)	2.02	0.78	2.52	3.16	4.53	3.88	4.14	4.94
Non-Performing Loans / Gross Loans (%)	3.05	3.36	6.64	10.48	13.96	18.77	22.49	24.22
Securities Portfolio / Assets (%)	14.73	17.95	19.99	20.05	21.27	21.80	21.61	23.35
Off-Balance Sheet Transactions / T. Assets (%)	42.28	54.84	89.08	94.04	88.74	102.98	107.59	114.64

Source: Bank of Albania *Preliminary figure according to Albanian Association of Banks

Stress test analysis

The stress test exercise assesses the stability of the financial system and the capital adequacy of the banking sector for a period until the end of 2014. This exercise considers the macroeconomic situation on the financial condition of the banking sector, excluding the possibility of raising additional capital during the period under consideration. The analysis is focused mainly on assessing the credit risk and the corresponding impact on the capitalization of banks and contains three scenarios: a baseline scenario and two severe scenarios. The baseline scenario is based on the forecasts of economic and financial indicators according to their historical performance. The severe scenarios assume "stressed" a situation with a low probability of occurrence. They are based on two possible shocks to the Albanian economy:

- no credit growth (0% annual growth), higher interest rates and decline of net interest income by 5% in annual terms (adverse scenario R1)
- no credit growth(0% annual growth), depreciation of the local currency by 20%, higher interest rates and declining net interest income by 10% (adverse scenario R2) .

The results of the exercise indicate that in all scenarios, all the banks remain well-capitalized banks with the exception of the medium size banks where by the end 2014, the capital adequacy ratio falls below the level of 12%. This result is expected given that

the initial level of capital adequacy ratio in September 2013 for medium banks is lower than for other banking groups.

Regarding the major banks, the materialization of R1 scenario has a small negative impact on the capital adequacy rate while the addition of the exchange rate shock would reduce the ratio even further, but it would still remain at levels above 17%.

The materialization of scenarios R1 and R2 has a significant effect in reducing the capital adequacy ratio of the small banks, on average by 8 percentage points in the case of scenario R1 and 9 percentage points in the case scenario R2 as compared with September 2013. Concerning the need for increased regulatory capital for the whole banking sector, in case of adverse scenario R1, the need is estimated at 2.1 billion lek and in case of adverse scenario R2, at ALL 7.03 billion. In January- September 2013 the system has the added capital by ALL 11.5 billion. To assess the exposure of the banking sector towards market risk, we evaluate it in terms of banks investments in sovereign risk and commercial debt portfolio. The market risk scenario assumes a shock in the form of a reductive margin (haircut) to the value of investments in foreign securities market value reported by the banks. The results of the exercise indicate that exposure is sensitive to private commercial debt securities, while exposure to sovereign debt securities is limited.

We also conduct contagion risk scenarios to assess the exposure of the banking sector towards their parents' banks abroad. The results of the stress test suggest that this exposure remains considerable, particularly for some individual banks.

Insurance Sector⁹

The main characteristic of the insurance sector in Albania is its small share of 1.59% of the total asset in the overall financial system as a result of the domination of banking sector (around 92% of total financial system assets'). Actually, 12 insurance companies (of which 9 non-life insurance companies and 3-life insurance companies), 1 reinsurance company and 8 insurance brokers are active on the insurance market. The market continues to be dominated by non-life insurance, which share is about 88.1% of the total premium volume. Life insurance market share is about 11.6% and reinsurance is about 0.3%. Regarding the structure of the premiums, voluntary insurance gross written premiums continue to dominate 54%, followed by mandatory insurance gross written premiums 46%. The insurance premium revenues for the period January-October 2013 were over ALL 6,619 million, or 10.51% less than the same period previous year. During the period, the total paid claims were over ALL 2,323 million or 1.88% more compared with the same period last year.

Market developments on Investment Funds¹⁰.

There are two investment funds operating during the third quarter of 2013. They are "Raiffeisen Prestige" Investment Fund (in domestic currency) and "Raiffeisen Invest Euro" Fund. According to the data analysis for the investment funds developments on 30 September 2013, their net asset value reached ALL 40.85 billion with an increase of 155.2% compared to December 2012. This market is dominated by investment in Government Bonds which represent 74.23% of funds' assets. Actually, Investment Funds assets represent around 3% of GDP and of the total assets of the financial system.

⁹ Based on Albanian Financial Supervisory Authority Publication "Albanian Insurance Market developments for the period January-October 2013"

¹⁰ 30 September 2013, Based on Albanian Financial Supervisory Authority Publication.

Pension funds¹¹

There are three voluntary private pensions' funds operating in the market during the third quarterly of 2013: Raiffeisen Invest, Sigal-Life Uniqa Group Austria and Sicred. Data analysis shows an increase in pension funds' activity by 41.4% as total assets reached ALL 400.95 million. The number of members in the three pension funds increased by 7.8% compared with end of 2012. Pension funds represent a very low share of GDP and of financial system, around 0.03%.

2.3. Alternative scenarios and risks

The negative and positive risks surrounding the baseline macroeconomic and fiscal scenario are estimated to be balanced. 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 the materializing of a set of negative (in case of a "pessimistic" scenario) or positive risks (in case "optimistic" scenario). 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 comprehensive resultant of all these risks, whether negative or positive direction, is quantified and presented in terms of a single variable, real economic growth. Therefore, the alternative scenarios are based on different economic growth assumptions from the baseline for each year 2014 – 2016.

In the "pessimistic" scenario, except for the different assumption on economic growth (lower growth than the baseline in each year), it is also assumed a different tax elasticity for the main revenues items. It is assumed that a lower economic growth leads to a lower tax collection efficiency for some of the major taxes. While in the "optimistic" scenario, the revenue to GDP ratio was assumed at the same level as in the baseline scenario.

Each scenario targets a different level of nominal fiscal deficit. This is in line with the defined trajectory of fiscal policy against potential developments of the economic cycle, closely consulted with the IMF and WB, as explained in the first section of the program. Respectively, 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.

The main items of the expenditures which are planned to absorb most of the change in the case of materialization of each of the alternative scenarios are "capital expenditures with domestic financing", "contingencies for capital expenditures with domestic

¹¹ AFS "Private Voluntary Pension Market Developments, 30 September 2013".

financing", and "contingency for deficit maintaining". The change of deficit financing in each alternative scenario will be completely absorbed by the "budgetary support from the IFIs", which is part of the foreign borrowing.

In the following tables and graphs are given the alternative assumptions incorporated in each of the scenarios, as well as the key fiscal indicators derived from each scenarios.

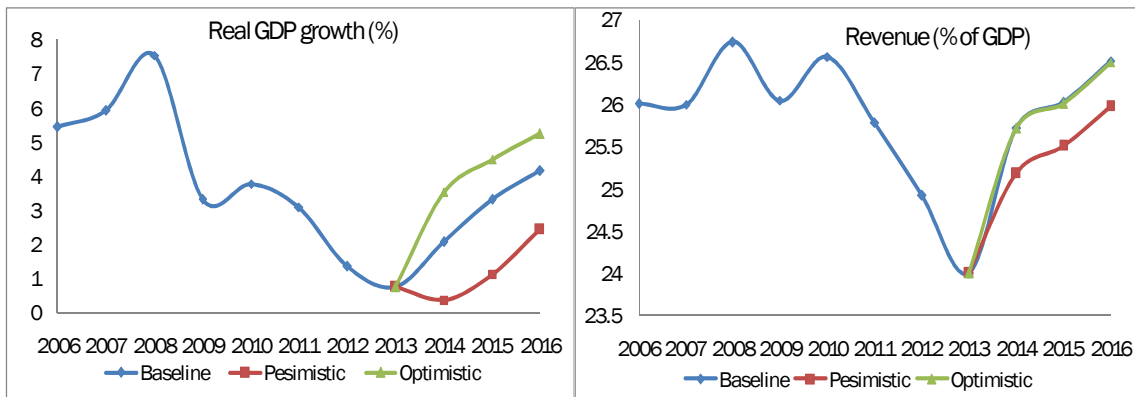
Table: Alternative assumptions in each scenario

	2008	2009	2010	2011	2012	2013	2014	2015	2016
Real GDP growth (%)									
<i>Baseline</i>	7.5	3.3	3.8	3.1	1.3	0.7	2.1	3.3	4.2
<i>Pesimistic</i>							0.4	1.1	2.4
<i>Optimistic</i>							3.5	4.5	5.2
Revenue (% of GDP)									
<i>Baseline</i>	26.7	26.0	26.6	25.8	24.9	24.0	25.7	26.0	26.5
<i>Pesimistic</i>							25.2	25.5	26.0
<i>Optimistic</i>							25.7	26.0	26.5
Overall fiscal deficit (in billion Lek)									
<i>Baseline</i>	-60.3	-80.9	-38.0	-45.8	-45.9	-83.5	-91.7	-72.3	-54.9
<i>Pesimistic</i>							-98.5	-83.4	-70.6
<i>Optimistic</i>							-89.1	-67.3	-47.1

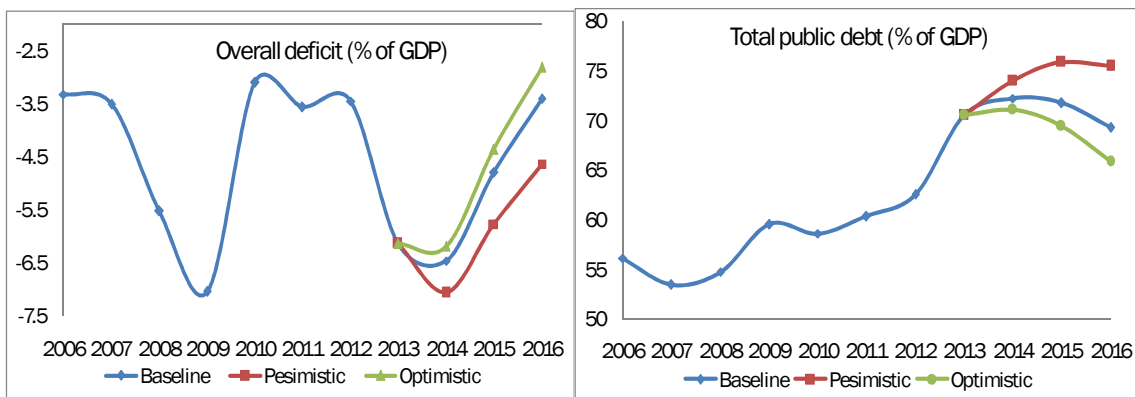
Note: The overall fiscal deficit in nominal terms for each alternative scenario is targeted to be more (less) in the case of the pesimistic (optimistic) scenario than the baseline nominal deficit by 50% of the total revenue difference between the baseline and each respective alternative scenario

Source: Ministry of Finance

Graph: The assumptions of economic growth and income elasticity in each scenario



Graph: The main fiscal indicators derived by each scenario



Source: Ministry of Finance

Table: Main fiscal indicators in each scenario

	2008	2009	2010	2011	2012	2013	2014	2015	2016
Total Revenue (in billion Lek)									
<i>Baseline</i>	291.2	299.0	324.7	330.5	330.4	325.9	364.7	390.8	426.1
<i>Pesimistic</i>							351.1	368.6	394.7
<i>Optimistic</i>							369.8	400.9	441.6
Total expenditures (in billion Lek)									
<i>Baseline from which:</i>	351.5	379.9	362.8	376.3	376.2	409.4	456.4	463.1	481.0
Current expenditures	250.3	283.9	300.9	305.6	312.6	329.3	349.6	364.6	381.6
Capital expenditures <i>from which:</i>	93.8	95.9	67.5	70.7	61.7	77.3	67.3	76.9	80.9
Domestic financing	50.0	75.6	46.6	41.1	27.4	36.6	27.9	22.3	22.4
Contingency for domestic CapEx	0.0	0.0	0.0	0.0	0.0	0.0	0.0	11.3	20.5
Foreign financing	43.6	20.3	20.9	28.0	34.3	39.9	38.6	42.3	37.0
Contingency for deficit protection	0.0	0.0	0.0	0.0	0.0	0.8	3.0	0.0	0.0
<i>Pesimistic from which:</i>							449.6	452.0	465.3
Current expenditures							349.5	364.2	380.9
Capital expenditures <i>from which:</i>							63.6	66.2	65.9
Domestic financing							24.2	22.3	22.4
Contingency for domestic CapEx							0.0	0.6	5.5
Foreign financing							38.6	42.3	37.0
Contingency for deficit protection							0.0	0.0	0.0
<i>Optimistic from which:</i>							459.0	468.1	488.7
Current expenditures							349.8	364.9	382.0
Capital expenditures <i>from which:</i>							69.7	81.6	88.2
Domestic financing							30.3	27.0	29.7
Contingency for domestic CapEx							0.0	11.3	20.5
Foreign financing							38.6	42.3	37.0
Contingency for deficit protection							3.0	0.0	0.0
Overall deficit (% of GDP)									
<i>Baseline</i>	-5.5	-7.0	-3.1	-3.6	-3.5	-6.1	-6.5	-4.8	-3.4
<i>Pesimistic</i>							-7.1	-5.8	-4.6
<i>Optimistic</i>							-6.2	-4.4	-2.8
Financing of overall deficit (in billion Lek)									
<i>Baseline from which:</i>	60.3	80.9	38.0	45.8	45.9	86.5	91.7	72.3	54.9
Domestic financing	24.4	70.7	13.2	26.1	26.5	68.3	46.2	31.4	15.4
Foreign financing <i>from which:</i>	35.8	10.2	24.9	19.8	19.4	18.2	45.5	40.9	39.5
Budgetary support from IFIs	0.0	0.0	0.0	0.0	0.0	0.0	35.0	31.1	35.7
Other foreign financing	35.8	10.2	24.9	19.8	19.4	18.2	10.5	9.8	3.8
<i>Pesimistic from which:</i>							98.5	83.4	70.6
Domestic financing							46.2	31.4	15.4
Foreign financing <i>from which:</i>							52.3	52.1	55.2
Budgetary support from IFIs							41.8	42.2	51.4
Other foreign financing							10.5	9.8	3.8
<i>Optimistic from which:</i>							89.1	67.3	47.1
Domestic financing							46.2	31.4	15.4
Foreign financing <i>from which:</i>							42.9	35.9	31.8
Budgetary support from IFIs							32.4	26.1	27.9
Other foreign financing							10.5	9.8	3.8
Total public debt (% of GDP)									
<i>Baseline</i>	54.7	59.5	58.5	60.3	62.5	70.5	72.1	71.7	69.2
<i>Pesimistic</i>							73.9	75.8	75.4
<i>Optimistic</i>							70.9	69.4	65.8
GDP (in billion Lek)									
<i>Baseline</i>	1,089.3	1,148.1	1,222.5	1,282.3	1,326.0	1,358.0	1,418.0	1,502.0	1,607.0
<i>Pesimistic</i>							1,394.1	1,445.1	1,519.9
<i>Optimistic</i>							1,438.3	1,541.3	1,666.7

Source: Ministry of Finance

3. GENERAL GOVERNMENT BALANCE AND DEBT

3.1. Policy strategy and medium-term objectives

Fiscal policy for the period 2014 - 2016 will be oriented in a trajectory of fiscal consolidation path. It aims firstly placing public finances on a sustainable trajectory, as one of the main pillars of economic growth and sustainable development of the country. For compilation of the fiscal policy in the medium term it has been consulted closely

with the International Monetary Fund (IMF) and World Bank (WB). It is also fully in line with European Commission findings and recommendations¹².

The major medium goal of the fiscal policy is the recovery of the country's economic growth at its potential level and its stability in time.

The main objective of the fiscal policy framework for the medium term ahead, is the level of structural deficit which ensures the sustainability of public debt over the medium and long term in one hand and minimizes the negative short-term effects on growth. The main operational quantitative target of fiscal policy within the actual macro-fiscal framework is the overall fiscal deficit, respectively as following for each year:

- *Overall fiscal deficit of 6.7% of GDP in 2014*
- *Overall fiscal deficit of 4.8% of GDP in 2015*
- *Overall fiscal deficit of 3.4% of GDP in 2016*

This quantitative objective of the fiscal policy will be corrected depending on the economic cycle. So the fiscal deficit target will be extended if the economy performs below the current forecast and vice versa.

It should be emphasized that within this deficit levels for the next three years it is included the full payment of all accumulated arrears of the government toward private sector which is a priority and one of the main components of the fiscal policy for the medium term ahead.

The public investments are projected to be kept at a level of at least 5 percent of GDP, which is an optimal level to support a high and stable growth.

3.2. Budget implementation in 2013

Revenue analyses for 2013

Revenues of consolidated budget for 11-month period of 2013 amounted to 292.2 billion, 0.2 per cent more than forecast and -3.1 per cent for the period less than a year ago.

- Income from taxes and customs were 202.6 billion, or about 2.3 billion more from the forecast period, and -4.5 per cent less compared with 11-months of the previous year, equivalent to 9.5 billion in absolute value;
- Local government revenues totaled 10 billion from 9.2 billion projected for this period and the annual decline of -0.1 per cent;
- Income from special funds totaled 54.9 billion, in line with forecast and 4.2 per cent annual growth,
- Income resulting benefits for the period from 4.3 billion to -10.4 per cent annual decline,
- Non-tax revenues for this period were approximately 20.2 billion with forecasting significant decline of about -7.4 per cent and -7.2 per cent annual decline.

Value Added Tax: The Value Added Tax is one of the most problematic items for this period, with a decrease in collected revenues by -7.3 per cent on an annual basis, reaching the level of 99.3 billion ALL, which is almost the same level of the year 2009.

¹² Albania Progress Report 2013

The revenue collected from imports was at 77.9 billion as VAT, less compared with 78.9 billion that it was forecasted at the beginning of the year.

For this period, revenues from VAT to customs comprise about 78.5 per cent of the total revenue from VAT. Compared with the same period of last year, it results 6.4 billion or -7.5 percent less. Revenues from VAT at customs are influenced by the performance of imports for the period. From the data of the Directorate General of Customs results that for 11-months period are imported 6.4 percent less in value than the same period a year ago: meanwhile by the total imports, imports were 7.6 per cent levied less than a year ago (as in money value).

Revenues collected on domestic supplies are 21.5 billion as VAT for the period January - November, with an annual decline of -6.3 per cent. Refund of VAT for 11-months period from the tax administration reached 7.2 billion with an annual growth of 11.1 per cent. Within the structure of tax revenue collected by the tax administration, is clearly noted the specific weight difference of the total VAT from 23.9% to 27.1 per cent in the 11-months of 2013.

Excise: Excise revenues for January - November amounted to 33.2 billion, compared with the same period of 2012 revenues from this tax have a very slight difference at the level of 0.1 per cent. Excise is entirely administrated and collected by the Customs Administration.

The following table shows the annual imports by major commodity group and the comparison with the 11-months period of a year ago, which shows a decline in imports of major commodities, except oil which presented a slight increase compared with the same period of a year ago, by around 2 per cent.

Regarding excise revenue by major commodity group, noted in this period: significant decline in revenues from the excise tax on cigarettes coffee and beer, which has affected the overall performance of this tax for this period. We have a slight grow of fuel revenues by 0.1%. We note that there are no changes in the levels of excise duties on key products such as; (liquor, cigarettes and fuel), during 2012-2013.

Table: Imports of main excise goods

Item	Fuel (ton)	Beer (000 liters)	Cigarette (ton)	Cafe(ton)
11 month 2012	391,878	28,109	3,305	6,674
11 months 2013	400,439	25,231	3,129	6,283
Percentage (%)	2 %	-10%	-5%	-6%

Source: GDC

Regarding to other excise goods we mention the excise change for the roasted coffee, at the end of 2012, from 140 to 60 and exemption of excise duties for immature coffee. Administratively, the new law on excise was effective on 1 October, changing so the structure of the administration and collection of taxes and new rules for the production and distribution of fiscal stamps.

Personal Income Tax: Revenue from personal income tax reached 26 billion for the period January - November, or 4.1 per cent more than the same period of a year ago. For a clearer illustration of the progress of this tax, in the table below are reflected the main sources of income to individual income (in millions) for the nine month period.

Total income from taxes on wages are roughly on par with a year ago, but within that income, wages from in the public sector resulted into an increase by 4 per cent, while those from the private sector declined by 9.7 per cent on an annual basis. Revenue performance by this group (especially private sector) has been led by the repeal of the

reference wage and the increase of the exemption threshold from 10,000 PIT 30,000 starting from June 2013.

The positive effect on income from PIT on an annual basis was provided mainly by: income from dividends (which has been growing significantly for January - November 2013, compared with the same period a year ago), interest income and proceeds from the sale of immovable property (recall that in 2012 there were almost no revenue from this item due to the revaluation process of individuals of real estate).

Table: PIT Revenues by Source

Item	11 M 2012 (mln)	11 M 2013 (mln)	Në %
Personal income Tax	24993	26008	+4.1
Public Sector Wages	8150	8480	+4.0
Private Sector Wages	8463	7644	-9.7
Interest Revenues	3250	3471	+6.8
Income from Dividends	1345	2154	+60.1
Income from Real Estate	277	514	+136.8
Personal Income Tax Small Business	135	172	+27.4
Others	3373	3573	+5.9

Source: GDT

Small business entities that have an annual turnover of ALL have paid 2-8 million personal incomes amounting to 172 million for the 11-month period January-November 2013 from 135 million last year with almost +27 per cent more.

Taxes on Income from Business: Revenue from income tax for 11 months in 2013 amounted to about 13.6 billion from 15.2 billion collected a year ago, with a -10.7 per cent decline, and -1.3% less than forecast period January - November 2013.

Revenue from local taxes on small businesses reached 1.9 billion, with an annual decline of -6.8 percent.

Property Tax: These include taxes on buildings and agricultural land. For 11 months property taxes reached 2.3 billion, or -4.5 per cent lower than a year ago.

National Tax: Income from fees and other national total for the period were 25.5 billion with an annual decline of -2.5 percent. Regarding the main taxes of this group we note: mineral endowment in total revenue increased 20 per cent on an annual basis (increased rents accruing to Customs by 36% and decrease the rent that we collect taxes by about 44 per cent), from carbon taxes are collected -18.8 per cent less revenue than a year ago, the revenue collected by the means used to transport declined by about -18.8 per cent, reflecting a halving of the tax in May 2013, the turnover tax on petrol and diesel are up for the 11-month around 5.3 billion from 3.8 billion the previous year, with 40 per cent growth annually. We notice a significant declines and revenue from Casinos and Gambling, with 17.5 per cent decrease compared with the first 11 months of the previous year.

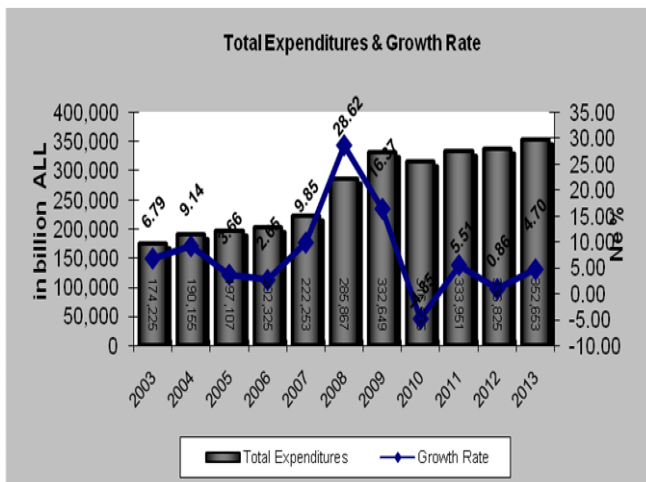
Custom duties: Income from customs duties for the period January - November are about 5 billion, 2.1 per cent more than forecast, compared with the same period of 2012, revenues from this tax are reduced by 478 million, or -8.6 per cent. Data from the Directorate General of Customs, Customs average tax for this period was 1.38 per cent from 1.4 per cent that it was the same period a year ago.

Other Revenues from Local Government: The revenue collected from local taxes for the period January - November reached 10 billion from the planned amount of 9.2 billion, while compared to 11-months of 2012 revenues decreased by -12 million (about -0.1 per cent less). Other local taxes (without small business tax and property taxes which

are mentioned above) have collected about 5.9 billion from the forecast of 5.1 billion compared with the same period last year these taxes have increased by 4.2 per cent.

Revenues from Special Funds: Income from special funds for the period January - November 2013 amounted to 54.9 billion, an increase of 4.2 per cent compared with the same period a year ago and in line with the forecast for the period. This income group accounts for about 20.5 per cent of total tax revenue for this period. From special funds total, around 53.3 billion are social and health security contributions and around 1.6 billion for compensation of owners. Social insurance has collected 46.7 billion, 3.3 per cent annual growth; health insurance collected 6.7 billion, 5.1 per cent more than 11 months of a year ago.

Analysis of budget expenditures 2013 (January - November)



According to preliminary data from Ministry of Finance Treasury, *total budget expenditures*, at the end of November 2013, amounted to about ALL 352.6 billion from ALL 364.2 billion target set for this period or nearly 96.8 per cent of the period's forecast, with a shortfall of around ALL 11.6 billion. Compared with the 2013 annual plan, these expenditures were realized around 87 per cent, while compared to the same period of 2012, budget expenditures are

about ALL 15.8 billion higher or about 4.7 per cent more.

Current expenditures by the end of November 2013, reached the level ALL 295.5 billion. Compared with the annual plan these expenses were realized at about 90 per cent, while compared to the same period of 2012, these expenses result in approximately ALL 13.8 billion higher, or about 4.9 per cent more.

Within current expenditures, *personnel expenses*, which represent about 22.0 per cent of total current expenditures realized during the period January - November 2013, were realized almost at the level of the period's forecast. These expenses, against the annual plan at the end of November, were realized at about 92.7 per cent, while in comparison with the same period of 2012, personnel expenses are about ALL 1.8 billion higher or about 2.9 per cent more. Wages are about 1.7 per cent over the period's planned level, while social insurance contributions are almost at the planned level, being respectively wages expenditures at about 101.7 per cent and social insurance expenditures at about 98.9 per cent.

Interest Payments, which represent about 13.3 per cent of total current expenditures realized during the period January - November 2013, resulted in a saving of around ALL 0.9 billion, from which ALL 0.5 billion in the domestic interests and about ALL 0.4 billion in foreign interests. Against the annual plan, interests are carried out at about 87.7 per cent, meanwhile compared to 2012 they are about ALL 1.2 billion higher, or 3.1 per cent more.

Operating and Maintenance Expenditure during the period January - November 2013 amounted to approximately ALL 28.8 billion, or ALL 0.5 billion lower than the

projected level. It should be taken into account even the expenditures from the reserve fund of the Council of Ministers and from the contingency fund.

Expenditures on subsidies at the end of November 2013 were around ALL 1.4 billion or about ALL 82 million less than forecast.

Expenditures for Special Funds during January - November 2013 resulted at around ALL 1.1 billion less or 0.9 percent below the period's forecasted level. Compared to the annual plan, special funds expenditure are realized at level 89.7 per cent, from which, social insurance expenditures are realized at around 91.8 percent of the annual plan, health insurance expenditures at around 87.9 per cent, while expenditures for owners' compensation at around 83.2 per cent. Compared to the 2012, social insurance expenditures are about ALL 5.2 billion higher or about 6.5 per cent more, health insurance expenditures are about ALL 1.2 billion higher or about 4.7 per cent more, while expenditures for owners' compensation are around ALL 381 million more.

Local government expenditures represent about 8.8 per cent of current expenditures. For the period January-November 2013 they reached the level ALL 26.1 billion, almost at the planned level for this period. Compared to the annual plan, these expenditures were about 91.2 per cent of it, while compared with 2012 these expenditures are about ALL 1.4 billion higher or about 5.8 per cent more.

Unemployment expenditures are realized at around 90.5 per cent of the period's forecast or about 78.9 per cent of the annual forecast. At the same time, this level is about ALL 176 million less than 2012's same period or about 19.3 per cent lower.

Economic Assistance during the period January-November 2013 resulted at around ALL 200 million more or about 1.2 per cent over the period's forecast (or about 97.8 per cent of the annual plan). Compared to the 2012's same period, this item is almost ALL 1.3 billion higher or 8.5 per cent more.

Capital expenditures by the end of November 2013 were executed at 76.9 per cent of the annual plan. The domestically financed investments are realized at 89.9 per cent, while foreign financed investments are realized at 65.6 per cent of the annual plan. Compared to the 2012's same period, domestic investments are about ALL 7 billion higher or about 29.1 per cent more while foreign investments are about ALL 3 billion lower or 10.3 per cent less. Consequently, total investments the end of November 2013 were about 7.5 per cent more or ALL 4 billion higher than the 2012's same period. The structure of capital expenditures realized during the period January-November 2013 is about 54.1 per cent domestically financed and about 45.8 per cent foreign financed.

3.3. Medium-term budgetary outlook

Income and Tax Policy

Projected revenues in the Consolidated Budget

Forecast of revenues of the consolidated budget approved for 2014, is based on the expected trends in macroeconomic aggregates of Albanian economy, the expected revenues surplus from improvements in administration and the effects of the fiscal package for 2014, as analyzed below.

Total revenues for 2014 are forecasted at the level of 364.7 billion ALL, an increase of 11.9 percent compared to the revised budget revenue for 2013 (last December revision), reaching 25.7 per cent of GDP, of which:

- Income tax and customs are projected to be 260.5 billion, showing an increase of 16.2 percent compared with the budget of 2013, or about 18.4 percent of GDP.
- Revenues from special funds, including social security contributions and health and income in the amount of compensation provided to ex-owners amount to 63.8 billion, with an increase of 6.5 percent compared with the revised budget for 2013, or about 4.5 percent GDP.
- Forecast for local government revenues for 2014 is 10.7 billion, an increase of 8.6 percent compared to the revised budget for 2013, or 0.8 percent of GDP.
- Non-tax revenues are expected to amount 21.1 billion, or 1.5% of GDP.
- Income from aid provided about 8.5 billion, or 0.6 percent of GDP.

According to the different items, projections for 2014 are as follows :

VAT Revenues: Total income from VAT is forecasted at 118.4 billion, growing 8.5 percent compared to the revised budget for 2013, or about 8.3 percent expressed as a ratio to GDP. Forecast for VAT is based on the expectations on economic activity for specific sectors of the economy, the predictions on the nominal level of imports, the historical trend of the coefficient of elasticity of these revenues to the nominal level of imports of goods, as well as expectations regarding administrative improvements in the collection of this tax. Effects on the expected VAT revenues of tax policies are analyzed in detail below.

Profit Tax Revenues: Total income for profit tax are projected at 23 billion for 2014, from 15 billion ALL of the revised 2013 figure. In relation to GDP, revenues from profit tax amount to about 1.6 percent. Forecast for this item is based on the forecast of the taxable base trends, primarily related to the performance of economic activity, as well as the expected improvements in the administrative side. Effect of tax rate change (as analyzed below) is about 7 billion ALL for 2014.

Excise Revenues: The revenues collected from excise duty projected for 2014, amount to about 48.4 billion, with annual growth of 29.5 per cent compared to the revised budget for 2013, or at 3.4 percent of GDP. The bulk of the revenue growth comes from the increased level of taxation for some of the main excise goods in the Republic of Albania, such as cigarettes, tobacco, spirits and beer.

Personal Income Tax: Revenues from personal income tax are projected at a level of 28.5 billion, or 0.3 percent more than the value of the revised budget for 2013. In relation to GDP, expected revenues amount to about 2.0 percent. Collection of this tax will be affected mainly by the reform of the wage taxation, with the application of the progressive taxation, as explained below. Effect of PIT income tax reform is estimated at 1.5 billion less in annual terms for 2014.

National Tax Revenues and Others: National tax revenues for 2014 are projected to be about 36.4 billion, growing 26.9 percent year on year, compared to the revised budget for 2013 (or 2.6 percent of GDP). Forecasts for revenues from this group of taxes are based on the economic activity growth projections, on expected performance of exports, which directly affect revenues from royalties, on the historical trend of growth and expectations for improvement on the administrative side. The bulk of the increase in revenues is due to higher taxation on petrol and diesel (circulation tax), estimated at about 5.5 billion surplus for the year 2014.

Custom Duties Revenues: For 2014, expectations for customs duties revenues amount to 5.9 billion, year on year increase of 5.7 percent compared with the revised 2013 budget. Much of the negative effects of tariff reduction, due to the implementation of

the preferential tariff reductions from free trade agreements with countries in the region (CEFTA), with Turkey and the European Union countries are already exhausted, so that the performance of custom duties revenues for the coming year is mainly related to the performance of taxed imports.

Income From Special Funds: Revenues levied from special funds for 2014 are expected at about 63.8 billion, an increase of 6.5 percent compared with the figure of the revised budget for 2013. Of these, income from social security contributions and health for 2014 are projected at 62.5 billion or about 7 percent more than the revised budget for 2013, while about 1.6 billion ALL are expected to be collected from payments during legalization procedures of property, to be used for the compensation of ex-owners. Projected revenues from social and health contributions for 2014 are based on projections on economic growth, employment trends, wage level, the ongoing efforts for the reduction of informality in the labor market and the expected impact of removing the “ceiling” for the calculation of contributions health on gross wages.

Local Government Revenues: Local government revenues for 2014 are expected to reach 10.7 billion ALL, increasing around 8.6 percent over the revised budget for 2013, reaching 0.8 percent of GDP. Forecast for this group of taxes is based on the forecast for nominal GDP growth, and the improvements on the administrative side, primarily on property taxes. New tax measures which affect local taxation, in force for 2014, are expected to have a net budgetary effect of 300 million ALL.

Non-tax Revenues: Projections of non-tax revenue for 2014 are 21.1 billion ALL or 12.3 percent less than the revised budget for 2013. The determining item here is the decrease in the level of profit that will be transferred by the Bank of Albania to the state budget, which historically has been at about 5 billion and for 2014 is projected at 1.5 billion.

Income from Grants: The grants forecast for 2014 is 8.5 billion, based on information about projects that are expected to be funded by donors in 2014.

Expected revenues for the three years 2015-2017 are based on the approved budget for 2014, 2015-2017 macro-fiscal framework and the standard methodology applied for these projections, based upon these four main indicators:

- Impact of macroeconomic aggregates
- Tax policy
- Administrative improvements in the collection of the tax and customs revenues;
- Specific items of income, their typical behavior and their correlation with economic variables.

Based on the approved budget for 2014, as well as macroeconomic and fiscal framework adopted for the period 2015-2017, total income in the consolidated budget for three years from 2015 to 2017 are respectively projected at levels 390.8 billion for 2015; 426 billion for 2016 and 467.1 billion in 2017, with annual growth of respectively 7.2%, 9% and 9.6%, while the income share of GDP will be respectively 26% in 2015, 26.5% in 2016 and level of 27.1% of GDP in 2017.

The trend of revenue from taxes and customs as the main item of income of the state budget for the period 2015-2017 is projected to have an annual growth of 9.4% in 2015, 9.2% in 2016 and an increase of 10% in 2017 versus a year ago. In relation to GDP, they are expected to be at the level of 19%, 19.4% and 19.8% of GDP for the three years from 2015 to 2017.

The trend of revenue from Value Added Tax for the period 2015-2017 in value are projected respectively in levels 129 billion for 2015, 141 billion for 2016 and 155.4 billion in 2017 with an annual growth of 9% in 2015, 9.3% in 2016 and an increase of 10.1% in 2017 versus a year ago. Among other things, for 2015, are included in the assessment of the expected effects of the ongoing policy of repealing the exemption from this tax that clash with Community legislation. In relation to GDP, they are expected to be at the level of 8.6%, 8.8% and 9% of GDP for the three years from 2015 to 2017.

The trend of revenue from Income Tax for the period 2015-2017 in value are projected respectively 24.7 billion for 2015, 26.9 billion for 2016 and 28.7 billion in 2017 with an annual growth of 7.5% in 2015, 8.7% in 2016 and a 6.8% increase in 2017 compared to a year ago. In relation to GDP, they are expected to be at the level of 1.6%, 1.7% and 1.7% of GDP for the three years from 2015 to 2017.

Excise revenues performance for the period 2015-2017 are projected at 53.2 billion for 2015, 59.5 billion for 2016 and 68 billion in 2017 with an annual growth of 10% in 2015, 11.9 % in 2016 and an increase of 14.4% in 2017 versus a year ago. In assessing revenues for this period, the effects of increased excise adopted on tobacco products for three years in question were taken in consideration. In relation to GDP, they are expected to be at the level of 3.5%, 3.7% and 3.9% of GDP for the three years from 2015 to 2017.

The collected revenues from personal income tax for the period 2015-2017 are projected at 32 billion for 2015, 35 billion for 2016 and 38.3 billion in 2017 with an annual growth of 12.2% in 2015, 9.3% in 2016 and an increase of 9.6% in 2017 versus a year ago. In relation to GDP, they are expected to be at the level of 2.1%, 2.2% and 2.2% of GDP for the three years from 2015 to 2017.

Revenues of National Taxes for the period 2015-2017 are projected to 39.5 billion for 2015, 41.6 billion for 2016 and 44 billion in 2017 with an annual growth of 8.7% in 2015; 5.2% in 2016 and an increase of 6% in 2017 compared to the previous year. In relation to GDP, they are expected to be at the level of 2.6%, 2.6% and 2.6% of GDP for the three years from 2015 to 2017.

Revenues from Customs duties for the period 2015-2017 are projected respectively at levels of 6.4 billion for 2015; 7 billion for 2016 and 7.6 billion in 2017 with an annual growth of 8.7% in 2015; 9% in 2016 and an increase of 9.3% in 2017 versus a year ago. In relation to GDP, they are expected to be at the level of 0.4% of GDP for the three years from 2015 to 2017.

Revenues of local government units for the period from 2015-2017 are projected respectively 11.5 billion for 2015, 12.6 billion for 2016 and 13.8 billion in 2017 with an annual growth of 7.9% in 2015; 9.2% in 2016 and an increase of 9.5% in 2017 versus a year ago. In relation to GDP, they are expected to be at the level of 0.8% of GDP for the three years from 2015 to 2017.

Revenues from Special Funds for the period 2015-2017 are projected respectively at 65.7 billion for 2015, 72.2 billion in 2016 and 79.5 billion in 2017 with an annual growth of 2.9% in 2015; 9.8% in 2016 and an increase of 10.1% in 2017 versus a year ago. In relation to GDP, they are expected to be at the level of 4.4%, 4.5% and 4.6% of GDP for the three years from 2015 to 2017.

Non-tax revenues for the period 2015-2017 in value are projected respectively at 21.2 billion for 2015, 22.7 billion for 2016 and 24 billion in 2017 with an annual growth of 0.2% in 2015, 7.1% in 2016 and an increase of 5.7% in 2017 versus a year ago. In

relation to GDP, they are expected to be at the level of 1.4% of GDP for the three years from 2015 to 2017.

The new Fiscal Package

The set of measures in the Fiscal Package 2014 brought significant changes to the tax system, applied both on indirect and direct taxation. The net impact of these changes is estimated to be around 21 billion ALL revenues surplus in the Budget of 2014.

Value Added Tax: Pharmaceuticals and health services will be exempted from VAT, with effect from April 1st 2014, from the current reduced rate of 10%. In a broader framework of policies supporting the health sector, this change aims to reduce the cost to users of the health service system and pharmaceuticals. Exemption policies for health services is in accordance with the EC Directive, 2006/112 / EC of the Council, dated 28 November 2006 on the common system of value added tax, Section 132 DE 2006/112 CE.

Hydrocarbons: All exemptions from VAT on imports of goods for the stages of development, as well as domestic supplies to contractors and subcontractors related to the development stage of Hydrocarbons sites have been repealed. This has served as a fiscal incentive in favor of the research and development in the sector, until now. However, the exemption does not comply with the EU directive for hydrocarbons and has created over time abusive situations aiming to fiscal evasion and tax base erosion.

VAT Refund: Changes were made to the current procedures of re-payment of outstanding credit refundable VAT to taxpayers, from tax administration to the treasury, as well as the deadlines for control and approval of credit, to 60 days. This changes aim at:

- Elimination of tax administration discretion in granting VAT refunds;
- Ensuring the implementation of the main principle of re payment of VAT refundable "first in, first out";
- Reducing corruption cases to meet the requirements for reimbursement.

The extension of time for the tax administration for control and approval of the claims to 60 days is deemed necessary as the number of VAT taxpayers has increased (following the decrease of the threshold from 8 million per year to 5 million ALL per year in 2010), thereby increasing the number of applications for refundable VAT.

Excise: Tobacco products. Cigarette excise tax has increased, according to a defined schedule over the years, as follows:

4500 ALL/1000 pieces, from 1 Jan 2014;

5500 ALL/1000 pieces, from 1 Jan 2015;

5500 ALL/1000 pieces, from 1 Jan 2016;

6000 ALL/1000 pieces, from 1 Jan 2017.

According to the EU directive, the minimum level of cigarette excise tax should be 57% of the retail price. The level of excise duty in Albania, before this change, has been at 34% of retail price.

The progressive increase over the years addresses a persistent request of economic operators in the sector to have a legal timetable of increases in the cigarette excise tax, to help them in their business planning cycle. In the table below are presented excise

levels as percentage of the price for the next four years. This change is in line with the *Acquis*.

Also excise taxes on tobacco with curly has increased to ALL 3,000 per kg from 1,500 ALL/kg, with further annual growth of 700 ALL for the following three years.

Table: Excise rate

Year	Excise rate as % to the price of cigarettes
2014	36.10%
2015	38.30%
2016	40.60%
2017	42.10%

Source: Ministry of Finance

The reason behind this measure is the growing trend of this product consumption, imported as well as domestically produced. Now, trading of curly tobacco is done through excise stamps which make it more controllable. On the other hand, the very high margin between excise on cigarette product and excise on curly tobacco was not justified.

Alcoholic beverages: Increase if excise duties on alcoholic beverages (not beer) in 5200 ALL/HL for sparkling wine, champagne and fermented beverages and carbonated (E300) and alcohol intermediate (I000) from the current 2600 ALL/HL. Levels of excise of these categories were low and inconsistent to the level of excise other alcoholic beverages.

Beer: By the end of 2013, taxation of beer in Albania had a structure based on 4-levels (production levels) and four different rates of taxation.

The new excise taxation of beer has changed as follows:

- From local and foreign producers with quantities less than 200,000 HL per year, 360 ALL / HL / alcohol degrees;
- From local and foreign producers with quantities greater than 200,000 HL per year, 710 ALL / HL / degrees alcohol.

The restructuring of excise duty on beer is consistent with Article 4 of the Directive (Excise) of the European Council, based on two basic criteria:

- Applying a single threshold for output for the reduced taxation (200,000 hl per year);
- The level of excise duty to be expressed according to the directive, /HL/degrees alcohol.
- Reduced tariff (360 ALL / HL / alcohol degrees) not to be less than half of the standard tariff.

New Excise Products: new products are added to the list of excise products, grease with 40 ALL / kg and "energy drink" with 50 ALL / liter.

Repeal of some exceptions. From 1 April 2014 the exemption from excise duty of imported fuel for own needs of hydrocarbon companies is removed. The rationale of the measure is part of the entire package of removals of tax reliefs that this sector enjoys. According to the data from tax and customs administrations, these fiscal incentives have been used with discretion by the companies' hydrocarbon fuel, being imported duty-free and sold in the market. Removing this exemption is in line with the *Acquis*.

Personal Income tax: From 1 January 2014, tax on wages is progressive, with these tax rates:

Table : Progressive rates of PIT

<u>Taxable Income</u> <u>(ALL/Month)</u>		<u>Percentage</u>
<u>From</u>	<u>To (including)</u>	
0	30.000	zero percent
30.001	130.000	+ 13 per cent of the amount over 30.000 lekë
130.001	More	13.000 ALL + 23 per cent of the amount over 130.000 lekë

Source: Ministry of Finance

Taxation of wages has gone through important changes, replacing flat taxation progressive taxation. The formula approved takes into account the government programme, according to which 95% of the employees in the country will be taxed less. Progressive taxation consisting of:

- Unchanged taxation system for wages to 30 000 per month, which remain exempted from personal income tax.
- Wages of 30 000 / month serves as the first threshold of progressive tax;
- Second threshold formula consists of monthly wages of 130 000. Employees in Albania who declare over 130 thousand ALL/month, comprise about 3% of total employees.

Income Tax: From 1 January 2014, income tax is 15 %. Income tax rate increased 15 % from 10 % that was previously. This change is consistent with the formula of progressive taxation in Albania and the logic according to which “who earns more, pays more taxes”. Increasing the rate to 15 % is consistent with the effective tax rate of the progressive personal taxation. These tax measures will be accompanied by administrative measures in order to improve the administration of corporate entities, to minimize tax evasion. In a short time, the Large Taxpayers audits will be carried on by special audit company. This measure aims, among other things, to eliminate the practice being used in Albania for several years according to which Albanian businesses operate with two sets of financial statements, one for the state to pay taxes and a profit for their own commercial real.

Simplified tax on profits of small businesses: The small business tax has been removed (as well personal tax of small businesses). These two taxes, which small business paid respectively to local governments and the central tax administration, are replaced with a single tax - simplified profit tax of 7.5%, while for subjects with turnover from 0 up to 2 million per year, there is a fixed fee of 25,000 ALL per year.

Currently, activities in Albania operate as small business entities about 60 thousand taxpayers. Fiscally, previous tax payments to the municipalities and then its lending in central tax administration, in view of the personal income tax, resulting in an increase of abusing and under reporting, making income tax personal small business a tax not solid fiscal system. For this reason, simplified income tax small business at the rate of 7.5% of taxable profit (the difference between revenue and expenses recognized fiscally) will consolidate this tax by excluding the tax credit to small business and provides tax incentives this category. By the administration, this tax will be local tax, but shall be convened by the central tax administration on behalf of the local administration.

Budget Expenditure Planning for 2014

According to the Annual Budget Law No.185/2013 dated 28.12.2013, total expenses for 2014 are set out at the level of ALL 456.4 billion or 32.7 percent of GDP, registering an increase of about 12.6 percent compared to the 2013 Normative Act. More specifically:

Personnel Expenditures: Personnel expenditures for 2014 are based in a policy of increasing efficiency and effectiveness in the use of human resources. They are forecasted at a level of ALL 74 billion or 5.3 percent of GDP. More specifically:

- The foreseen fund for Salaries and Social Insurance Contributions of about 86.288 public employees, amounts at ALL 71.7 billion. This fund takes into consideration the actual cost of the public employees, as well as the annual calculation of the increase implemented in August 2013. Moreover, the planned figure includes also some specific sector policies, such as:
 - The increase of salaries in the judicial system, starting from January 2014, with an overall financial effect of about ALL 200 million;
 - The expanding of judicial system's administration, with the establishment of the new Administrative Court, with an financial effect of about ALL 60 million for an added staff of 40 employees;
- The 2014 Annual Budget does not foresee a separate fund for the overall salaries' increase in the public sector. However, it is included a Contingency Fund of about ALL 1 billion, only to assure the wages increase for the State Police as a support towards a highly priority sector in the current situation, where public order and security are the core elements, as well as a serious precondition of the economic growth.
- The Bonus Fund for salaries is foreseen at level ALL 1.2 billion, and its use consists usually in cases of fatalities, illness, etc.

The abovementioned expenditures do not include the recent reduction of the public administration employees' number, as long as this is an ongoing process. As a result, the savings obtained by the end of this process shall be *partially* used to cover the budgetary effect of the shorten employees. Thus, the real effect from a budgetary point of view shall be visible only starting from the 2015 annual budget.

Interest Expenditures: The estimation for interest expenditures has been based on the domestic and foreign borrowing afflux, as well as on the interest rate's forecasted level. As a result, expenditure for this item is foreseen at level 3.3 percent of GDP, from 3.2 percent of GDP it registered in the 2013 Normative Act.

Operational and Maintenance Expenditures: Operational and maintenance expenses for 2014 are foreseen at the level of ALL 35.3 billion or 2.5 percent of GDP, from ALL 32.2 billion it was in 2013 Normative Act. They will continue to be oriented towards the increase of expenses for the functioning and maintenance in priority sectors such as infrastructure, education, health and agriculture, by applying a differentiated rate of increase for these sectors.

Subsidies: The subsidy expenditures rely on the existing policy of subsidies and on the policies for their gradual reduction. Based on the recommendations for a gradual overtime reduction of subsidies, all the institutions have been required to undertake reforms to the effect of a better management of the respective sectors and improvement of their financial performance. In 2014 these expenditures are foreseen to keep the level of 0.1 percent of GDP.

Local Budget Expenditures: Local Budget Expenditures in 2014 are foreseen at the level of ALL 33.1 billion or 2.4 percent of GDP, increasing by almost ALL 4.6 billion compared to 2013 Normative Act.

Expenditures for Social Assistance and Disability Benefits: Expenditures for Social Assistance and Disability for 2014 are foreseen at level ALL 19 billion or 1.4 percent of GDP, same as in the 2013 Normative. In this forecast is taken into consideration the policy of the differentiated increase of the components of these expenditures. The size of the increase shall go towards the disability allowances, as a consequence of its indexing, increasing of the number of beneficiaries and improvement of procedures of obtaining such a status. From the other hand, the Economic Assistance, as a result of the legal and administrative improvements shall decrease (in relative terms). Meanwhile, the Ex-prisoner's Compensation is foreseen at level ALL 1.8 billion, which will partially cover the payments for the second tranche of their compensation, taking place since 2013. Especially for the year 2014 has been foreseen the fund of Compensation for Food, Energy, etc, at about ALL 1.1 billion, as a financial compensation for the poor and vulnerable categories, alleviating the effect of the VAT burden.

Reserve and Contingency Fund: For 2014, the item "Reserve Fund + Contingency" is foreseen at level ALL 4.5 billion. It is constituted by the Reserve Fund of CoM of about ALL 1.5 billion and by the Contingency for Financing the Deficit at the level of ALL 3 billion.

Capital Expenditures: Capital Expenditures for 2014 are foreseen at level of ALL 67.3 billion or 4.8 percent of GDP. More specifically, domestically financed investments will register ALL 28.7 billion, which will be used basically to cover the expenses of VAT and Local Cost for foreign investments, as well as part of the ongoing domestic projects. In this context, in accordance with the Government Program, we will also prioritize those projects defined as strategic for the country's and the region's economic and social development, orienting them towards such sectors as: education, health, agriculture, infrastructure and rural development. Meanwhile, the foreign financed investments are foreseen at level ALL 38.6 billion or 2.8 percent of GDP.

Payment of arrears: Being evaluated that, one of the major weaknesses of the public finances management system is the generation of payment arrears, the Ministry of Finance has pursued an intensive process of their tracking down, estimating and auditing. As a result, currently we have at our disposal a complete and detailed report from the international Auditing Company "Deloitte", concerning all the payment arrears of the state budget toward domestic and foreign private businesses for offered public works and services, which amounts at about ALL 24.6 billion. According to the above mentioned report, state budget owes around 65 percent of this amount or nearly ALL 16 billion to infrastructure projects, around 17 percent to pharmaceutical companies and medical equipment and 8.4 percent to schools infrastructure. Meanwhile, the Tax Administration has completed the identification and estimation of about ALL 22.8 billion, regarding arrears linked to the VAT reimbursement and profit tax. Part of the above mentioned arrears, for a total amount of about ALL 35 billion, are already part of the 2014 State Budget, identifying also their source of financing. The remained amount shall be disbursed through the next 2-3 years, as foreseen in the Draft-Strategy for the Arrears' Prevention and Payment, which will be approved by the end of January 2014.

Budget Deficit estimation: Taking into consideration the above section, the budget deficit for 2014 will be at level 6.6 percent of GDP, equally balanced between its domestic and foreign financing, respectively at level 3.3 percent of GDP.

3.4. Debt levels and developments

At the end of December 2013, the Central Government Debt is estimated to be 883.849 million ALL or 65.08% of GDP. If we consider arrears, which have been estimated at around 72.6 billion ALL; the public debt stock will stand at the level of 70.43% of GDP for end of 2013.

Table: Public debt stock evaluations for 2013

*in million ALL	2008	2009	2010	2011	2012	2013
Debt Stock + Arrears	595,883	682,546	715,371	772,517	827,981	956,449
Debt Stock	595,883	682,546	715,371	772,517	827,981	883,849
Domestic Debt Stock	400,456	415,028	407,372	438,582	470,358	520,786
External Debt Stock	195,427	267,518	307,999	333,935	357,622	363,063
Arrears	0	0	0	0	0	72,600
GDP	1,089,293	1,148,082	1,222,462	1,282,255	1,326,000	1,358,000
Debt Stock+Arrears/GDP	54.70%	59.45%	58.52%	60.25%	62.44%	70.43%
Debt Stock /GDP	54.70%	59.45%	58.52%	60.25%	62.44%	65.08%
Domestic Debt Stock/GDP	36.76%	36.15%	33.32%	34.20%	35.47%	38.35%
External Debt Stock/GDP	17.94%	23.30%	25.19%	26.04%	26.97%	26.74%

Source: Ministry of Finance

Borrowing analysis

Domestic borrowing for 2013 was achieved at the level of 46.2 billion ALL and noted that this founding was entirely conducted with long term instruments.

This founding has enabled significant improvement in the domestic debt indicators and also in the maturity profile. The indicator of the number of days to maturity is estimated to be 560 days compared to the 386 days that were at the end of the previous year, thus making possible the reduction of the refinancing risk.

For 2013, is worth to be mentioned the diversification done on the instruments and on the founding sources. For the first time, it has been successful the issuing of the 10 year bond (8.2 billion ALL) and of the 2 year Euro bond.

2013 was favorable year in terms of debt holder diversification, where it is to be observed the decrease in the specific weight of Raiffeisen Bank at the level of 22.5% compared with the level 29.4% of the previous. Meanwhile, the specific weights of the other banks have been increasing at the level of 40% compared to the level of 37.45% of the previous year, and for the non banks financial institutions they have gone at the level of 12.6% compared to 6% of the previous year.

During the second half of the year 2013, the interest rates for the governmental securities have been significantly reduced as result of the excess of liquidity in the banking sector and due to the reduction of the base interest rate by the central Bank of Albania.

As result, the cost of debt was reduced and the level of the weighted average yield for domestic debt portfolio reached the level of 6.72% at the end of 2013 by being reduced 110 basis points compared to the previous year.

In the end of December 2013 the foreign stock of debt is estimated to be (preliminary evaluation) about 2,589 million Euro from which 224 million Euro is guaranteed debt. Meanwhile, the evaluation for the contracted debt but not yet disbursed is 725.5 million

Euro and it is expected to be disbursed according to the agreements with the creditors in the coming years.

As in the previous years, the external debt portfolio continues to maintain the trend of its composition with the three main currencies (EURO, USD, YEN), where the main weight in the portfolio is kept by the Euro currency.

Public debt service

Table: Public debt service

In million ALL	2008	2009	2010	2011	2012	2013
Total Debt Service (I+II)	35,555	42,061	48,116	48,734	52,166	56,109
I. Interests	31,307	36,301	41,604	41,121	41,497	43,335
Domestic	28,386	31,408	35,583	34,253	34,005	35,890
External	2,921	4,893	6,021	6,868	7,492	7,445
II. Repayments	4,248	5,760	6,512	7,613	10,669	12,774
GDP	1,089,293	1,148,082	1,222,462	1,282,255	1,326,000	1,358,000
Interests/GDP	2.87%	3.16%	3.40%	3.21%	3.13%	3.19%
Interests of Domestic Debt/GDP	2.61%	2.74%	2.91%	2.67%	2.56%	2.64%
Interests of External Debt/GDP	0.27%	0.43%	0.49%	0.54%	0.57%	0.55%
Repayments/GDP	0.39%	0.50%	0.53%	0.59%	0.80%	0.94%

Source: Ministry of Finance

During the last year, domestic debt service has increased by 8 basis points compared with 2012. This is caused by the increasing budget deficit, despite the low interest rates in the market. Meanwhile, the external debt service growth is associated with the borrowing conditions of the funds in concessional terms.

Debt prospects in the medium-term period (2014-2016)

The debt portfolio analysis indicates that this portfolio bears a high risk. This is because the short-term domestic borrowing continues to keep a significant portion of the portfolio, which requires refinancing in a relatively short time period. On the other hand, borrowing in foreign currency which has grown lately, is characterized by the exchange rate risk.

External debt repayments will increase significantly in 2014 and then will continue with an upward trend from 1.4 % -1.6 % of GDP, requiring the use of a large part of the budget balance. In that way, risk assessments show the importance of the debt reduction, otherwise the negative financial effects will be large and cause higher payments of debt service. In 2015, the Eurobond matures and the repayments reach the level of 4.5 % of GDP. Debt management strategy evaluates the possibility of reissuing this instrument and to enter in the international markets in order to provide the necessary funding and get advantages from the opportunities that these markets offer.

Beside the positive developments in the domestic market of the segment of government securities, we should take into account the awareness of the banks toward the long-term investments exposure and their risk assessment policies from the parent banks.

Meanwhile, the investment funds are still undeveloped and their sustainability is related to the institutional and structural developments in the overall economy.

From this point of view, deficit financing with long-term instruments is a challenge that will continue throughout 2014 and for this reason in addition to the base strategy it is also prepared a backup strategy that takes into account the use of short-term instruments and their effect and impact on the debt portfolio and its management.

In a broader perspective, the implications are on the increase of interest rates for the required financial instruments and this will require urgent measures to provide the needs of refinancing.

The Baseline strategy

The base strategy of the debt management is based on the assessment done to the expected costs and to the risk characteristics of their borrowing.

In the domestic market this strategy aims to provide new borrowing through long-term instruments, while refinancing the current debt through existing debt instruments.

Foreign borrowing is based on the expected funding of projects and completed with the provision of the external financing in accordance with the agreements of the IMF and the World Bank as regard of the repayment of arrears.

Based on this strategy, with long-term financing instruments, at the end of 2014 the stock of domestic debt is projected to be around 546.7 billion and the ratio between short-term and long-term instruments is expected to be 44.8 % with 52.2 % in favor of the long-term instruments. Following the same financing strategy, in the years 2015-2016 is expected an increase in the gap between instruments at 41.5 % - 58.5 % in favor of long-term instruments.

Based on the maturity profile of 2014, the instruments that mature within one year are expected to stand at the level of 56.47% compared with 62.85% that was in 2013.

Average days to maturity are expected to stand between the interval of 620 - 670 days at the end of 2014, and are expected to decline to 570 - 620 days at the end of 2016.

The Backup strategy

In the conditions of an absence of liquidity in the market and in the case of facing difficulties to issue long-term instruments, the new borrowing strategy will rely on short and long-term instruments in the ratio 50% to 50%, thus making the debt indicators to deteriorate significantly compared with the base strategy.

The ratio between short and long-term instruments at the end of 2014 is estimated to be 49% to 51% and to remain at the same levels for the years 2015 to 2016, by having significant differences with the base strategy where the improvements of this ratio are evident in favor of the long-term instruments by 8%.

Deficit financing based on this strategy will have negative impact on the average lifetime of the portfolios, because the average days to maturity are estimated at 540 to 590 days for 2014 and during the following years will go down to the level of 500 days, thereby increasing the exposure towards refinancing risk, towards interest rate risk and deteriorating the repayment profile.

Debt service is estimated to be increased due to the concentration in short instruments and because of the pressure created in the market in the condition refinancing large amounts of these instruments.

Another potential risk over public debt for the coming years is the exchange rate risk to which and external debt in particular is exposed as result of its low diversification as regard to the currency composition structure.

A possible fluctuation in the exchange rate EUR/ALL should have an impact on the level of the debt.

According to the baseline scenario we assume that the exchange rate EUR/ALL will be as the average rate of the last year plus four standard deviations for 2014 (142.16) and plus five standard deviations (142.64) for 2015 and for the following years.

Based on the above assumptions, we say that the stock of debt to GDP ratio under the influence of the effect of exchange rate will increase up to 27 basis points for 2014 (3.8 billion) and up to 35 basis points for the coming years (5.6 billion ALL).

Objectives of the strategy

- To provide new borrowing for the domestic financing through the use of long term instruments.
- Increase the average lifetime of the portfolio in the level of 620-670 days.
- Provide external financing through the implementation of the development projects related to the creditors and completed by the IMF and World Bank for the financing of the repayments of arrears.

Budgetary implications of "major structural reforms"

- Starting from September 2013, Ministry of Finance and the Department of Public Administration, based on the Council of Ministers Decision no.474 dated 16.06.2011 "On the standards and procedures that should be followed during drafting and approval of organizational structures of public administration institutions", were engaged with the review of all the organizational structures of the line ministries and budgetary institutions. The aim of this reform was to make the public administration more efficient and effective by redesigning each element of the organizational hierarchy and thus eliminating posts and functions that result redundant. Regarding the results of this reform, please refer to the above Section 3.3.
- The Social Assistance Scheme (as mentioned in the section 3.3, above) shall be subject of legal and administrative reforms, which aim to reduce the level of targeting errors; strengthening the mechanisms of fund allocations and beneficiaries' targeting; adding incentives for investment in human capital through offering additional social payment on registration and attendance for families who have school-age children; starting the process for creating an unified registry of beneficiaries of social assistance programs, and changing the indexing formulas for disability payments program. In addition, the Law no.10399 dated 17.3.2011 "On some amendments and additions to Law no.9355 dated 10.3.2005 "On social assistance and social services (amended)", provided the application of a new evaluation form that guarantees the inclusion in the scheme of every family that lives in poverty. This new scheme, tested in 2012, started with the full digitalization and creation of the National Electronic Register of Beneficiaries. It is foreseen that in the medium term, the gains in terms of better targeting would result in wider coverage of this scheme and larger size of benefits for the beneficiaries. The same applies for the Disability Benefit Scheme, which will also be subject of legal and administrative reforms, in order to better target the eligible categories and adequately finance their livelihoods.
- Starting from 2010, to the effect of encouraging the local and regional development, the national budget policies have been harmonized with the local budget policies. It is widely understood that the economic development of the communes, municipalities and regions is not a local-isolated problem, but it is closely related to the country-wide economic development. In the light of this philosophy, it became a necessity to integrate the sector policies of central government at a regional level.

For this purpose, the budget policies are oriented toward the policy of “Regional Development”, being so a pre-exercise for the regions in order to enhance their ability to apply for European Union’s structural and investment financing. This fund is part of the 2014 budget. Through sharing criteria, Regional Development Fund will promote the reform of the new territorial division.

3.5. Sustainability of public finances

Pension system indicators

Regarding the financial sustainability of the pension system and its impact on household budgets, it is important to review the development of some analytical financial indicators over the past years, such as the coverage rate, the replacement rate, etc.

Pension benefits have increased rapidly thanks to government policies for the recovery of the corrosive inflation effects, improvement of the lives of the retirees, and poverty reduction. Pension policies have always aimed higher increases of low pensions as well as equalization of rural pensions with urban ones, for those farmers who have contributed to the social insurance scheme from 1994 onwards.

Alongside with the annual pension indexation, the Government has implemented a revenue growth policy for the retirees with minimum incomes by providing compensations funded by the state budget.

The coverage rate, which expresses the ratio of the number of contributors to the labor force, has been in decline over the period 2012 - 2014. This indicator reveals the existing evasion in the social insurance scheme, which is still a serious problem. The dependency rate, which expresses the ratio of beneficiaries to contributors to the social security scheme, was 1.2 in 2012. Although it has occasionally improved, the social insurance system is still at a critical level.

The replacement rate (which expresses the ratio between the pension and salary) of urban pensions, in 2012, reached 36.5 %, while the replacement rate of rural pensions went to 41.6 %. Calculating this ratio to pensioner’s incomes, the replacement rate for urban and rural pensions is respectively 40.7 % and 45 %.

Although a number of indicators seem to be well improved and even though the reform of gradual increase of the retirement age has ended, there is still a high deficit of 1.52 % of the GDP in the pension branch, whose tendency is to further worsen.

Incomes from contributions: One of the SII priorities has been the improvement of contributions collection and the increase of contributors’ number of the social insurance scheme. Total incomes in 2014 have been estimated (for the compulsory social insurance and supplementary insurance) ALL 3,326,500 million.

Projected incomes from self-employed contributors in agriculture for 2014 are ALL 2,786,000 million.

Some negative phenomena have been identified in the rural social insurance scheme in 2013, which led to non accomplishment of the planned incomes from contributions:

- Young people in rural areas are less interested to insure themselves.
- All those who have completed 35 years of insurance are not continuing with participation.

Projected incomes from voluntarily contributors in 2014 are ALL 410,500 million. During 2013, for the purpose of encouraging voluntary insurance, constant publicity has

been done both inside and outside the country, especially for the emigrants in Italy. In this context, cooperation with some Italian homologous, such as "INAS CISL", "ACAI", "ACLI", "ENAS- UGL", has continued in terms of attracting Albanian emigrants to the voluntary insurance scheme and confirmation of their previous insurance periods.

Health insurance system

The government's new approach to the health system model as a human and comprehensive one, undoubtedly requires a new approach concerning the funding of this system, implementation of new economic and financial policies in order to guarantee the financial stability and meet the government's major goals to expand and improve the health services.

Expenditures for health insurance scheme constitute about 2.4 % of GDP for the year 2014. In order to ensure financial sustainability of the scheme, one of the priorities is to provide incomes coming from contributions and the state budget.

Revenues from health insurance contributions were 0.54% of GDP in 2013, while a rate of 0.62 % of GDP is projected for 2014. This growth will be due to the enforcement of the new Law on Health Care Compulsory Insurance Fund (FSDKSH), which calculates the amount of contributions on gross salary. This will establish a progressive system in contributions payments. Removal of the ceiling in health insurance contributions will have more impacts on employees with higher salaries. This tax is set in accordance with the implementation of solidarity principle in order to improve health service. 73,000 self-employed in Albania will pay less health contributions starting from April 2014. They will pay health contributions at a rate of 3.4 % of the double minimum wage, from 7% of the minimum wage they actually pay. Concerning the employees, the ceiling of health contributions calculation by five times the minimum wage, will be removed. Employees will pay 1.7 % of nominal wage. The state budget benefits All 900 million as the result of this change, while the reduction of 10% VAT for drugs in 2014, will bring an effect of All 1 million.

Incomes from contributions for 2014 are foreseen 8,619,000 thousand ALL with an increase of 16.3 % compared to 2012. 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 8,625,000 thousand ALL or 8 % less compared with figures programmed for 2012.

In providing the sustainable incomes of the health insurance scheme, it is important the payment of contributions, tax evasion avoidance and reduction of unemployment in the country. Also avoidance of out of pocket payments by formalizing them in the form of copayment for health services, will be another source of getting more revenues for the Fund.

3.6. Quality of public finances and institutional features

Enhancing and institutionalizing the inter-governmental fiscal relations

Fiscal decentralization reform has had positive effects on the growth of local revenues in general, as well as increased income from taxes and fees versus unconditional transfers to state budget. The decentralization reform in general and that of fiscal decentralization in particular, has significantly changed the structure of revenue sources to local governments. In 2002, that represents the last year of the old scheme of financing local government, this structure was 76 to 24 percent in favor of resources coming from the state budget. After this year, with the introduction of a fiscal package

to increase the fiscal autonomy of local government, this structure has undergone major changes. Revenues to finance local government to exercise its functions were provided over 50 percent from local taxes and fees. Even the 2014 budget aims to maintain this trend, in favor of increasing tax revenues and fees. Financial autonomy of local governments has increased significantly from year to year, considering that in 1996 the local government had the right to decide for only 1 percent of their budget, while in 2014 this autonomy will be over 75 percent.

In 2014, the small business tax will be removed from local taxes, but its effects on the local budget will be offset through the simplified income tax, small business and unconditional transfers. In the context of decentralization and strengthening of local financial autonomy, the tax level of buildings for business activity is increased. In 2014, this measure will increase the local revenues by ALL 1.1 billion, more than in 2013.

From the experience so far, we can say that the amount of total transfer generally has followed the growth of the overall budget. In 2014, there is a qualitative step forward regarding the size of the unconditional transfers granted by the central government, unlike many countries in the region and beyond that have cut funding for local government, under the impact of the economic crisis. The size determination of the unconditional transfer relies on: the functions transferred to local governments, the respective funds for them, as well as and the volume of local taxes and fees. Government's target for 2014 is to continue the consolidation and increase of local revenues to guarantee the sustainability of the decentralization reform and the acceleration of the decentralization reform process in key areas.

An important process is the reform of new territorial division as well as the improved performance in local asset management, as an important tool to increase revenue and increased investment for local infrastructure. Transfer of assets owned by the local government, offers great opportunities to increase revenues, through their use by the local government, or by third parties, as well as through increased collateral to obtain credit for public investment financing. The growth performance of joint stock management and water supply and sanitation (under the local government units), will be influenced through the use of financial mechanisms for the distribution of subsidies.

Fiscal decentralization reform will focus on the clarification of fiscal relations between central and local government. This will be accomplished by establishing the law on local finance, which will: set the procedures for the implementation of the local budget, financing scheme of unconditional transfers to local governments, enable increasing transparency and accountability. During the year 2014 the government, will continue close cooperation with donors to assist local government in terms of fiscal decentralization and modernization of local finances.

Local funding: Based on Law No. 9869 dated 04.02.2008 "On local government borrowing", local government units have begun to apply and receive loans. By this law, the government is responsible for:

- coordination of national and local debt policy (in such a way that the central government to maintain control of nature and expanding local fiscal obligations);
- providing a local prudential borrowing (in terms of risk management in the context of public finance);
- the system of guarantees for local borrowing;
- monitoring and control mechanisms.

In order to consolidate the national finances during 2014 and onwards, the government's efforts will focus on identifying the problems concerning the need for a regulatory framework for local finances. This regulatory framework will aim to define: the procedure for designing and implementing the financing scheme of unconditional transfer for the local budget, accounting issues, internal and external audit, transparency, assisting local units that want to borrow etc. This process will be subject to discussions with various interest groups.

Developments in the field of financial harmonization

Activities during the year 2013

- Compiling by laws for completing the legal framework for FMC, as for example:
 - Order No. 5759 of the Minister of Finance, dated 10/04/2013, "On Approving the Methodology on Performance Monitoring of Public Entities"
 - Order No.33 of the Minister of Finance, dated 11/07/2013, "On Standard Audit Trails about Low and High Value Procurement";
 - Instruction of the Minister of Finance dated 24 December 2014 "On the closure of the annual accounts of 2013 budget".
- The Central Harmonization Unit for Financial Management and Control (CHU/FMC) within the Ministry of Finance, is focused in the implementation of Pilot Project "Support to the Ministry of Finance of Albania regarding Improved Financial Management and Control of Public Funds", at the Ministry of Public Works and Transport and Albanian Road Authority..
- Was prepared and presented to the Council of Ministers and the Supreme Audit Institution within May 2013 "The Annual Report on Functioning of Internal Public Financial Control System in the General Government Entities for the period January - December 2012".
- The appointment of Authorizing and executing officers in the public entities, according to FMC Law requirements (Law 10296, dated 08/07/2010), has been carefully monitored continuously by the CHU/FMC.
- Within the implementation of the requirements of the law no. 10296, dated 08.07.2010, "On Financial Management and Control" and other acts issued for its implementation, CHU/FMC organized information and training seminars for other officials and managers of local government units.

Objectives for the following period (year 2014) will consist on:

- Beginning of the 2 years Twinning Project on "Implementation of a modern Financial Management and Control System and Public Financial Inspection in Albania".
- Review of the legal framework of public finance.
- Ongoing awareness workshops.
- Monitoring the assignment of Executive Officers at the time to come (Finance Managers).
- Training and seminars for managers, finance managers and specialists of risk management and audit trail in collaboration with Public Administration School.

Developments in Treasury management

Future Treasury expectations are:

- Strengthening the cash forecasting and liquidity management process.
- To improve the overall availability, quality, integrity and reliability of information pertaining revenue receivable and accounts payable, required to produce cash forecasts and trend analysis that are an integral part of a modern cash forecasting process.
- To improve the overall transparency, relevance, quality and timeliness of the consolidated budget execution by capturing transactions at the source.
- Foster a higher degree of adherence to sound internal controls over public revenues and expenditures across the spectrum of line ministries, spending units, municipalities, communes and other local public administrative bodies (budgetary institutions).
- Consolidation of all revenue receipts in the Central Bank. Strengthening public expenditure management, including control of multi-year management contracts in the coming years into the Government Financial Information System.
- Taking measures in order to prevent arrears creation during the budget execution process.

Advantages from a PFM perspective:

- Opportunity to strengthen business and procedural flows.
- Strengthening PFM integration.
- Further optimization of the process of revenue collection and administration by the Government of Albania.
- Greater commitment of human resources to strengthen oversight of budget execution.
- Redefining the role of Treasury, from bookkeeper to overseer of the consolidated budget execution process.
- Strong interaction with other key GoA's initiatives, example PIFC.
- More tools on performance evaluation regarding the budget execution process.

Institutional developments and structural reforms in Albanian Customs Administration

- A Memorandum of Understanding in the field of mutual assistance on customs matters is signed between General Directorate of Albanian Customs and General Directorate of customs and Indirect Taxes of France.
- Information is exchanged with neighboring countries through Systematic Electronic Exchange System Data (SEED), Phase II.

During the first quarter of 2013 have been signed a series of 1 inter-institutional agreements:

- Cooperation Memorandum No 390 Prot., dated 10.01.2013 "On authorization for issuing the international customs document ATA Carnet and on implementation of the Convention on Temporary Admission signed in Istanbul on 26 June 1990" between the Union of Chambers of Commerce and Industry of Albania and General Directorate of Customs.

- Memorandum of Understanding No 1150/2 Prot., dated 4.02.2013 “On information exchange” between the Albanian Agency of Investment Development and General Directorate of Customs.
- With UNDOC assistance, in cooperation with the Police, it was established joint team/office for the control of containers at Durres Port, for which it was organized an inauguration ceremony in February 2013.
- A project funded by IAEA (International Atomic Energy Agency) is in development phase, with the objective to build a national scheme of reaction against the detection of radioactive materials at BCPs and to buy fixed and portable detection equipments. In this project Customs cooperates with the Office of Radiation Protection, the Center of Applied Nuclear Physics, Border Police, etc.
- In order to strengthen the cooperation with the General Directorate of Patents and Trademarks, it is organized a joint seminar on cooperation of Law Enforcement Institutions (Tirana 11-12 March 2013).
- It is implemented the Module of Electronic Payments in the ASYCUDA World System.
- Albanian Customs Administration is part of the inter-institutional group in the framework of CBRN initiative, Centres of excellence, in order to reduce risks and threats related to the equipments and chemical materials, biological, radiological and nuclear substances. The involvement of Customs in CBRN initiative, financed by EU and applied by UNICRI AND JRC, is related to the strategic objectives of National Plan for the Implementation of the Stabilization and Association (NPISA) for the Albanian Custom, concerning the improvement of its role in safety and security and deepening of institutional cooperation for this purpose. In this context, there is a commitment, an exchange of information and a closely cooperation with other institutions such as the Ministry of Defense, Ministry of Interior, Ministry of Agriculture, Ministry of Environment, Ministry of Economic Development, Trade and Venture, Ministry of Health, National Nuclear Agency, etc.

Twinning Project “Support for the Albanian Customs Administration (AL2011/IB/FI/01)

- The Twinning Project “Support for the Albanian Customs Administration (AL2011/IB/FI/01) aims to support Albanian Customs according to the EU acquis, specifically:
 - To improve the performance of ACA by increasing its capacities for Risk Analysis and Management in close cooperation with the Directory of Risk Analysis and Monitoring;
 - To improve the capacities of efficient application of post-clearance controls in close cooperation with the Directorate of Post-Clearance;
 - To develop the capacities of efficient application of IPR in close cooperation with the Directorate of Intellectual Property Rights;
 - To fully align the Customs Laboratory with the best EU practices and standards in close cooperation with the Directory of Customs Laboratory.
 - The expected results to be achieved are by the implementation of the best management and operational modules of the above mentioned Customs sectors according to EU blueprints and WCO security standards; increasing of the human capacities; continuous exchanging of information and knowledge in all the sectors including the Customs Laboratory in order to improve the operational

- standards and implementation of policies that aim to achieve a higher quality of services and Customs procedures.
- In order to facilitate the Trade/Transit Albania-Kosovo, it is under negotiations the draft-agreement “On cooperation and mutual assistance of joint Customs procedures at the ports of Republic of Albania”.
 - During September - November 2013 the Customs Administration has cooperated with the State Police based on existing legal documents and administrative joint acts. The Inter-Institutional Working Group on drafting the Strategy and Action Plan of IBM 2014 - 2020 initiated the work and the first meeting was held on 14.11.2013.

4. STRUCTURAL REFORM OBJECTIVES

4.1. Obstacles to growth and the structural reform agenda

- The current position of the public finances is an obstacle to achieve potential and stable economic growth in time. On one hand, the high level of public debt undermine the trust of economic agents for economic stability , and in the other hand the immediate need to engage in fiscal consolidation exerts pressure on short-term growth of the economy which is already extremely weak.
- The high level of bad loans accumulated in the banking systems portfolios, which at a considerable extent is due to the accumulated stock of government arrears to the private sector, continues to be one of the biggest obstacles stalemate in terms of capital financial intermediation efficiency and effectiveness between different economic agents. As a result, the lending to the economy already holds the economy contracted significantly below its potential.
- The need to consolidate public finances and at the same time fast payment of the accumulated arrears of the government to the private sector will be one of the priorities of the Albanian government during the next three years. The materialization of this priority will be assisted by a stabilization program with the International Monetary Fund.
- The labor market in Albania is deeply damaged by a high level of informality in all sectors, especially in agriculture, construction and services. This problem will be addressed through measures taken to reduce the informal economy as increased inspections by the State Labour Inspectorate (SLI), the increased controls of Tax Investigation Task Force and the increased use of fiscal devices.
- Frequent changes in the legal framework and fiscal packages bring uncertainty and hesitation to business investment. One of the issues raised by transport associations was the ban for a long time in Customs. For this reason will be adopted the European directive "On cross - border mergers".
- An acute problem for the small and medium enterprises has been the lack of credit due to a hesitation of the banking sector. This limitation slows new investments and often the ordinary activities of enterprises too. We aims to fully utilize SME financing scheme with the Italian government. The European Fund for Southeast Europe (EFSE) will be one of the creditors of small enterprises in the financial sector. The fund of "creative economy" will be available to the craft sector.
- Other problems stem from a multiyear story arbitrariness of tax administration and a low formalization. The lack of coordination of public administration in relation to the business, not using a central server, forces a business to meet three times the same

documentation for taxes, SSI and directories subordinate ministries, costs which can be eliminated through further better coordination and a more effective information system.

- Justice system is perceived as slow and corrupt. Manifestly illegal decisions were often given for example when the law gave to the borrower the permission not to repay the debt. In addition to other effects, this element also encourages the growth of non-performing loans. Opening the Administrative Court represents a positive step towards accelerating proceedings. Laws on ownership rights are in conflict and proof of ownership documents are not always taken into account by the authorities when they are fully valid.
- Higher education in Albania is not adequately linked with the businesses, their products. Their human resources are not always prepared for the tasks required.
- The road infrastructure in Albania although improved in recent years still is not in line with international standard. A significant part of the national road axes, which have begun the construction a long time ago, are still unfinished. The overlong of works has caused the degradation of investments and has brought costs to the economy.

4.2. Key areas of structural reform

4.2.1 Product and capital markets

Policies for Private Sector Development: The main objective of the government policy for developing the private sector has consisted in the entire reforming of the legal and regulatory framework in the field of business, aiming priorly the improvement of business environment, the reduction of the administrative barriers, as well as implementing a Small Business Act (SBA). The main policies envisaged for the development of the private sector are as follows:

- Implementation of Strategy for Business Innovation and Technology.
- Reduction of the cost and time for registering a new business.
- Simplification of licensing procedures.

Improving business financing schemes: To improve the financing environment in the field of SME development policies, a number of measures are taken toward credit guarantee schemes.

- Credit scheme for SMEs by the Italian – Albanian Program. Since the official launching in January 2009 the credit line for SMEs has been very successful.
- European Fund for Southeast Europe (EFSE) is one of the largest creditors of micro and small enterprises in the financial sector.
- Capacity growth entrepreneurship in the craft sector through the implementation of "Creative Economy Fund (Craft)".
- The Council of Ministers Decision no. 667, date 20.09.2011, approved the creation of the Innovation Fund for the period 2011 – 2014, with a value of 40 million ALL for a 3 year period.
- Increasing the competitiveness of SMEs through the implementation of the Fund Competition Program.

- Competitiveness and Innovation Program (CIP) for SME: Participation of Albania in the Competitiveness and Innovation Program – CIP for the period 2007-2013 is approved with the decision of European parliament No 1639/2006/EC.
- Activities for the community project CIP-EIP: Albania participates in the program on the Ambassadors of European Women Network, and European Network of Mentors for Women Entrepreneurs, European week of SMEs.

Informal economy: There is a progress in the measures taken to reduce the informal economy. Three main directions as regards reducing informality are:

- Increasing the controls from the State Labor Inspectorate (SLI)
- Increasing the controls from the Task Force Unit in the Tax Investigation Department
- Increasing the use of fiscal equipment from taxpayers.

Main directions for private sector development 2014 – 2016: The approval of the Business and Investments Strategy for the period 2014 – 2020.

- Adaptation of Directive 2005/56/EC "On cross-border mergers."
- Adoption of Directive 2011/7/EC "On fighting of the late payment in commercial transactions".
- Strengthening and expanding the role of women in entrepreneurship.
- Supporting the growth of social business and corporate social responsibility.
- Support for creative industries.
- Improve SME lending - the expansion of credit guarantee schemes.
- Implementation of 3-year Italian program to support SMEs through the soft line credit and credit guarantee fund.
- Implementation of financial programs of the Competitiveness Fund and Credit Guarantee Fund for Export (FK and FGKE's).
- Implementation of the innovation fund and creative economy fund.
- Strengthening the dialogue with business.
- Supporting business associations and companies operating under the exporting sector and product.
- Implementation of the Innovation Strategy, Technology Business and Action Plan 2011-2016.

The privatization plan for the period 2014 to 2016: *Privatization in non-strategic sectors:* For 2014 it is planned the privatization of all state assets and shares of companies in non-strategic sectors. The total value of these assets and the state share is estimated at a value of 5 million Euros. Ministry of Economy, Trade and Entrepreneurship is reviewing all documentation for inclusion of all enterprises in the process of privatization or liquidation.

Privatization in strategic sectors: The privatization of the remaining package of Albtelecom sha: The sale of State-owned package is planned for 2014. The remaining 16.7683661 per cent of the stock is estimated at a value of 2,500 million ALL or 18 million EUR.

- The privatization of the left amount package of ARMO Sh.a: sale of state package is planned to be implemented during 2015. In ARMO sh.a. state owns about 14.9 per cent of the shares with a value estimated at around 22 million EUR.
- The privatization of the remainder in OSSH Sh.a: OSSH Sh.a. was privatized in 2009. Around 76% of the shares were sold and now the state currently owns 24% of the company stock. The remaining shares of 24%, which are estimated at around 32 million Euros is planned to be sold during 2016.
- The privatization of Albpetrol sh.a. During the period 2015 - 2016 it is planned to sale 100 per cent of the state-owned package from the state. The registered capital of the company named Albpetrol is estimated around 95 million EUR.

State aid in the enterprise sector: The total amount of state aid granted in Albania for the period 2007 - 2012 is 83.523.75 million ALL (631 million €). State aid for 2012, including all sectors, reaches the value 21.480.77 million ALL (154.49 million €), representing 1.6 per cent of GDP in Albania, compared with 1.26 per cent in 2011, registering an increase of 27 per cent. The increase in the value of total aid in 2012, compared to 2011, amounting to 4,935.5 million ALL has come as a result of a significant increase in aid for research & development and energy. Meanwhile, less assistance is provided to public utilities, public transportation, employment, training and mines.

The priorities 2014 – 2016 on state aid will be:

- Implementation of state aid legislation.
- Ensure the independence and strengthening of the administrative capacity of the State Aid Commission and the Division of State Aid Control.
- Increasing awareness of aid providers for the procedure of notification for state aid.
- Ensuring transparency in the use of public funds through control schemes and individual aid from the CSA and reflected in the annual reports of state aid approved by the Council of Ministers.
- Review of state aid legislation.

Reforms in the energy sector

Liberalisation of the energy market, entry of private operators: The new law on the electrical energy sector is expected to be adopted during 2014. Upon adoption of this law, it will be opened the road towards further liberalisation of electricity market, with the aim to achieve a complete market opening within the 1st of January 2014, in compliance with the objectives of the Energy Community Treaty.

In line with the anticipated scenario of adoption of the new law on the electrical energy sector, it is foreseen even the preparation of the new design of the Electricity Market, which will be in compliance with the guidelines to be provided by the new law on the Electrical Energy Sector.

In the context of liberalisation of the energy production market and entry of private operators into the production market, during 2013 there have been concluded 47 new contracts for construction of 112 HPPs with a total value amounting to EUR 454.1 million. So far, there have been concluded 168 concession contracts for the construction of 441 hydro-power plants, with a total installed power of 2.012MW, and an overall investment value amounting to approximately EUR 2615 billion. 74 hydro-power plants are productive. During 2014, around 17 hydro-power plants are expected to enter into production. As soon as these objects become productive, it is foreseen to be guaranteed

of electricity supply of the domestic market and sale to the regional market of a quantity of the produced energy.

In the context of the market opening, considerable investment is made to increase capacity of transmission and interconnection networks. During 2013, it was signed the agreement for construction of the Albania-Kosovo interconnection line and it was signed the financing agreement with KfW.

At the same time, during 2014, efforts will be made to sign the agreement for construction of the interconnection line with FYROM and identifying the source of financing. 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. Here it is worth mentioning the project of the south ring, 220 kv Tirana2-Rrashbull line and Elbasan-Fier line.

Challenges, priorities of 2014-2016: Energy market liberalisation, considerable investment in the development of infrastructure of electrical energy transmission and interconnection systems and also uninterrupted supply of consumers with electricity, are some of the main achievements in this sector. The legal amendments done in the previous years, have been fully in line with the European Union rules, thus opening the way to competition in the domestic electricity market and eliminating the monopoly situation of this market. The direct result of policies has been the uninterrupted supply of consumers with electricity. During 2009-2013, the only cases of power cut have occurred because of network fault, non-payment of the bills by the consumers, or remounts notified in advance.

The main challenges during 2014-2016 period and following this are linked to the improvement of the structure of supply with primary energy sources, building of the generation capacity of the country, reduction of network loss, further building of energy exchange capacities with the countries of the region, connection of Albania with the international gas network, full liberalisation of electricity market etc. The priorities of the 2014-2016 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). With the construction of these HPPs, Albania meets the demands of the domestic market and it may become a net exporter of electricity. 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.

Connection of Albania with the regional network of natural gas: until 2015, the aim is to cover 15% of the total energy consumption through the natural gas consumption. The Albanian government is intensively working to implement TAP and IAP project. In concrete terms, on the 5th of April 2013, two agreements linked to TAP project were signed: “Agreement with the Host Government, between the Republic of Albania, acting through the Council of Ministers and Trans Adriatic Pipeline AG, concerning the Trans Adriatic Pipeline Project (TAP project)”, a.k.a HGA, and “Agreement between the Republic of Albania represented by the Council of Ministers and Trans Adriatic

Pipeline AG, concerning the Trans Adriatic Pipeline Project (TAP project)". These agreements were ratified by the Parliament of Albania on 15th April 2013 (law no 116/2013 of 15 April 2013). TAP project is funded by several shareholders which starting from 30 July 2013 are: BP (20%), SOCAR (20%), Statoil (20%), Fluxys (16%), Total (10%), EON (9%) and Axpo (5%). Similarly, the National Council of Territory (NCT) adopted decision no 2 of 20 December 2012 "On considering the Trans Adriatic Pipeline Project (TAP) as an issue of national relevance in territory planning", the National Sector Plan by decision no 1 of 4 July 2013 of the NCT and it is underway the procedure for approval of the Complex Development Permit.

The project is expected to start in 2015, with a construction duration of 4-5 years. According to the preliminary assessment, the project is expected to have a contribution of approximately EUR 420 million in GDP for the 2015-2019 period. During construction, 4200 jobs are foreseen to be opened (along with the additional impact on economy, there are foreseen 10-12000 jobs). The net contribution to the state budget during operation is foreseen to be around EUR 40-50 million/year. The measures already taken and future measures are linked to the follow-up of legal and administrative practices for the implementation of the project.

As regards the IAP project, it is in the final phase in which the parties (Government of Albania, Montenegro, Bosnia-Herzegovina and Croatia) will have to express themselves on the feasibility of the project. Work is being done for the environmental impact study and market design to be followed in the process of implementation of this project. The project will be connected with TAP project in Fier and it will move up north towards Croatia.

Development of the internal electrical energy transmission and interconnection network: the investment scheme has been designed to afford the increasing demand of consumers for electricity, initially to import and afterwards to export excess energy. The priorities during 2014-2016 are the construction of interconnection line with Kosovo, over which the financial resources have already been provided, and the completion of the feasibility study and source mobilisation for the interconnection project with FYROM. In the transmission system there have been identified some 20 projects, 7 of which are considered primary ones. Their feasibility study is being carried out and they are expected to start within the programme period.

Energy efficiency. Among the range of measures guaranteeing supply and market functioning, it has to be underlined the measure for promotion of generation of the electricity from renewable sources (solar panels, wind turbines etc), increase of energy efficiency (9% until 2018) through implementation of the National Action Plan for Energy Efficiency, adoption of the legal framework for energy efficiency and Code of Buildings, provision of support financing instruments for energy efficiency, including adjustment of electricity bills, aiming at covering the production and service costs, but protecting the categories in need from the price increase effect.

The respective costs of the measures foreseen for supporting energy sector are foreseen in detail in the 2014-2016 mid-term expenditure framework. Meanwhile, the projects implemented in the area of energy production, including distribution, are implemented by the private sector and eventually they do not present relevant costs for the state budget.

Development of mining industry. The priority during 2014-2016 period, referring to the indications of the strategy for mining development will be improvement of productivity and competition, internationalisation of mining products for rational use of financial, human and natural resources; exports increase; increase of the level of concentration of

mining subjects working for construction material; extension of the range of minerals which are used to ensure considerable revenues from the mining sector.

Reforms on financial system

In the activity of financial system, direct and indirect credit risk represent major risks, particularly to the banking sector. Loans quality deterioration during 2012 was accompanied by a considerable slowdown in lending pace. As both tendencies have a strengthening effect on each other, the Bank of Albania undertook some measures to encourage banks to lend and engage in earlier loan restructuring (in force from May 2013).

More specifically, in order to boost lending, the regulatory amendments provide for:

- reduction of capital requirements for the annual growth of lending to the economy if it ranges between 4-10%.
- the increase in capital requirements for the additional banking sector investments with non-resident financial institutions.
- overall decrease by 5 percentage points of the regulatory requirement for the minimum liquidity ratio in total, in lek and foreign currency, compared to the existing level, by banks' risk profile. However, the prudential approach toward Greek banks, already in place, was maintained.

To attenuate the restructuring and the non-performing loans increase, the regulatory amendments provide for:

- loan restructuring since the stage it is categorized as standard but the borrower begins to manifest the first problems in paying the credit. The new terms and conditions following the loan modification process seek to preserve borrower's solvency and loan quality. This loan will continue to be classified as performing (in the first two classes) but will require higher provisioning of 10%.
- decreasing from nine months (or until the borrower has paid 3 loan instalments) to six months, the period which the restructured loans may return to performing ones.

The change in capital requirements for the annual growth of credit and banking sector investments with non-resident financial institutions is counter cyclical and transitory, and will be effective for 2013-14. Unless otherwise decided by the Bank of Albania, these amendments will be repealed upon the termination of the effect period, and banks will ensure compliance with the current regulatory framework requirements by June 2015. This mechanism is considered important to preserve banks' cautious lending and well-capitalized activity.

The stock growth of non-performing loans provides the needs for a write-off process of loss loans. However, the write-off has been modest due to unclear definition of bad debt by tax law, which has caused some of those written-off amounts not to be deducted from expenses for fiscal purpose. Bank of Albania has proposed some changes to the respective by-laws, for a proper definition of bad debt, which proposal, after negotiations, was taken into consideration by the Minister of Finance and the change took place on May 24th 2013.

In addition, several efforts in cooperation with FinSAC, a World Bank project, have taken place to establish a NPL resolution framework.

The Bank of Albania (BoA) continued to consolidate its work by revising the regulatory and supervisory framework in compliance with the Basel Committee standards, aiming its further alignment also with the EU acquis. During the reporting period a number of

new regulations on banking supervision have been amended and been approved by the Supervisory Council (SC) of the BoA:

- Regulation¹³ “On the granting of license to non-bank financial subjects”.
- Regulation¹⁴ “On risk management in the activity of non-bank financial institutions”.
- Regulation¹⁵ “On electronic payment instruments”.

The whole revision of the three abovementioned regulations, with regard to the E-money institutions and E-money activity, has been done in compliance with the EU Directive 2009/110/EC “On the taking up, pursuit and prudential supervision of the business of electronic money institutions” amending Directives 2005/60/EC and 2006/48/EC and repealing Directive 2000/46/EC.

- Guideline¹⁶ “On managing interest rate risk in the banking book”, that aims to partially approximate the European Parliament and Council Directive 2006/48/EC relating to the taking up and pursuit of the business of credit institutions and European Parliament and Council Directive 2006/49/EC on the capital adequacy of investment firms and credit institutions.
- Regulation¹⁷ “On Capital Adequacy”, which further approximate the regulatory framework with the European Directive 2006/48/EC “Relating to the taking up and pursuit of the business of credit institutions” and 2006/49/EC, “On the capital adequacy of investment firms and credit institutions” and Basel II Accord.

Details on Basel II implementation project: Adoption of the Basel II Framework is the key priority within the strategy for financial sector monitoring strengthening.

As far as Pillar 1 is concerned, the new capital requirements are currently drawn up and COREP tables are ready for discussion and use. The final version of the COREP has been presented to the banking industry during September 2013, followed by a discussion with the ad-hoc group of the Albanian Association of Banks (AAB), in the last quarter of 2013. With the new Pillar 1 requirements and the COREP in place, a “parallel run”¹⁸ will be required by banks, starting at the second quarter 2014 and lasting until the end of 2014. This will also serve as a time for clarification and resolution of any potential problem or concern that might be encountered during this phase.

Meanwhile, the work for implementation of Pillar 2 has already started and is expected to last throughout the entire 2014 and 2015.

With regard to market discipline and Pillar 3 requirements in general, Bank of Albania is planning on reviewing and updating its current regulation no.60, dated 29.08.2008 “For the minimum requirements on disclosing information from banks and foreign bank branches¹⁹”, starting at the second quarter of 2014. These changes will be pursued by a

¹³ Approved by decision no. 1, dated 17.01.2013 of Supervisory Council of Bank of Albania.

¹⁴ Approved by decision no. 2, dated 17.01.2013 of Supervisory Council of Bank of Albania.

¹⁵ Approved by decision no. 3, dated 17.01.2013 of Supervisory Council of Bank of Albania.

¹⁶ Approved by decision no.33, dated 30.04.2013 of Supervisory Council of Bank of Albania.

¹⁷ Approved by decision no. 48, dated 31.07.2013 of Supervisory Council of Bank of Albania.

¹⁸ The reporting of two sets of data, generated, based, on current and new regulatory requirements, respectively.

¹⁹ The regulation “On minimum requirements of disclosing information from banks and foreign bank branches” (approved by decision no.60, dated 29.08.08 of the Supervisory Council of the Bank of Albania sets out the minimum requirements, the methods and timelines associated with the information that needs to be published in the periodical reports of banks and foreign bank branches. According to this Regulation, banks should publish periodical reports which contain information in accordance with the main six categories defined by the Basel Committee and EU directive 2006/48/EC (Chapter 5, Annex XII) i.e financial performance and their activities, risk profile, practices and strategies in risk management, CAR ratio, quality of loan portfolio, accounting policies, etc..

reporting testing period by banks for the last two quarters of 2014 (changes are foreseen to be enter into force in 2015).

Regulation in process: Regulation no.31, dated 30.04.2008 “On the risk management from large exposures of banks” is currently under review and will be thoroughly replaced by a new regulation - the draft has been completed and sent out for consultation with the industry and is expected to be approved, by the BoA Supervisory Counsel, at the beginning of 2014. The new proposed rules intend fair alignment with the rules and concepts of the new BoA 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).

- Guideline no. 57, dated 05.05.1999 “On regulatory capital” will be reviewed and updated in accordance with Basel II and Basel III rules on supervisory capital. The new draft is expected to be completed and approved in June 2014.
- In addition, following FSAP recommendations, Bank of Albania, is planning during 2014, on reviewing and updating its current regulations:
 - No.01, dated 17.01.2013 “On Licensing and activity of non-bank financial institutions” in the context of facilitating the licensing criteria for Assets Management Organizations (buy-sell Loans). It is expected to be completed in March 2014.
 - No.14, dated 11.03.2009 “On granting the license and the exercise of banking activity of banks and branches of foreign banks in the Republic of Albania” (criteria for qualifying holding above 33% and 50%). It is expected to be completed in December 2014.

Improved coordination regarding financial stability: In addition to improvements in the regulatory structure of the financial market, the organization of the financial stability framework has been developed further. Safeguarding financial stability is a shared responsibility between the Bank of Albania (BOA), the Ministry of Finance (MOF), The Financial Supervision Authority and the Deposit Insurance Agency (DIA). In order to strengthen coordination of matters pertaining to financial stability, the above mentioned institutions have signed an agreement to coordinate their actions under a special committee on financial stability – Financial Stability Advisory Group (January 2012). All of these authorities have different roles in the work with financial stability. The committee meets at least four times a year to consult and exchange information on assessments of risks that could threaten the financial system as a whole, and to discuss appropriate preventive measures. A press release is published afterwards in the bank of Albania website.

4.2.2. Labor market

Public employment policies will continue to include measures to promote employment (active policy) and providing income support (passive policies). Active policies to labor market include employment services, programs of creating new jobs and vocational training programs.

Employment promotion programs implemented in 2013 will be present in Albania in the coming years as well. In the 2013 Budget the amount aimed to employment promotion

was 90 million ALL and the projected programs were implemented, in total 6 of them with 72 projects with 844 unemployed jobseekers involved.

Vocational Training. The annual target for 2013, in terms of the number of trainees in the Regional Public Vocational Training was 8500 persons. For the period January - November 2013 were registered a total of 8,255 persons and 7,935 of them have been certified, of which 3,343 are women. From the total of graduates where employed 380 persons after completing a course. Also, during this period was conducted a training of 1,561 prisoners.

Passive Policies Unemployment benefits program is among the first programs applied in the employment offices. This program is part of labor market policies, which provides income support to unemployed at the time they register as such. Its main objectives are:

- To compensate income for the unemployed.
- To provide active support to the beneficiaries of the unemployment, in order to return to work.

Labor Inspectorate. During 2013, work has started for completing the legal framework of health and safety, as in the framework of the implementation of Law 10238 " Safety and Health at Work" and specifically article 42, paragraph 3, where each institution responsible for security issues and health at work, shall issue appropriate regulations, according to the field of activity, approved by Council of Ministers. The package will be completed in 2014.

Steps for 2014 - 2016 labor markets: With the input and assistance from IPA 2010 Project "Human Resource Development", work is still being done to develop strategies in the fields of employment and training. Both drafts are designed specifically for crosscutting strategy for employment strategy and vocational training and lifelong learning strategy.

In this context, within the contribution of the above project, is already working to develop a common strategic document for employment and vocational education. This strategy will define concrete measures to guide development of the education system, vocational training, and employment. Also in the strategy will be provided concrete measures for inclusion of vulnerable groups to answer a particular low level of women's employment through vocational training, employment promotion programs and high unemployment of youth. This strategy is forecasted to be completed in March 2014.

The vision of the National Employment and Skills Strategy 2014 – 2020 - inspired by the overarching goal of Europe 2020 to deliver smart, sustainable and inclusive growth – is to have by 2020 a competitive economy that is grounded on "Higher skills and better jobs for all women and men". The overall goal of the Strategy is to promote quality jobs and skills opportunities for Albanian women and men throughout the lifecycle. This will be achieved through coherent and concerted policy actions that simultaneously address labor demand, labor supply and social inclusion gaps. The Employment and Skills Strategy centers on four strategic priorities, as follows:

- Getting people into jobs through appropriate employment measures.
- Offer quality education and vocational training for young people and adult. This will be achieved by:
- Promote inclusion of disadvantaged people. This will be achieved by:
- Strengthen the governance of labor market and qualification systems.

Also by the support of the project IPA 2010 is being developed a pilot model of Tirana office of employment with the new employment services. This is done to increase the efficiency of employment services in the labor market.

Funds for employment promotion programs for 2014 have been tripled. In this framework is being revised the legal basis of these programs to make them more efficient and transparent. New programs related to the employment of people with disabilities, apprentice etc, will be implemented further on.

Social Insurance Scheme: In the context of preparations for the European Social Fund, consultations have began on the drafting of a national fund for employment and has been established a working group of experts from Ministry of Social Welfare and Youth and Ministry of Education and Sports with the support of IPA 2010.

Social insurance scheme is facing several problems like:

- Pension compression causing average pensions to be very close to the minimum pensions.
- High replacement rate for minimum pensions and very low for average and maximum pensions.
- High level of subsidy from the state budget to support farmer's scheme.
- In general, the lower measures of the pensions and ongoing growth of budget transfers to cover the growing costs of the pension's scheme.

The government is committed to start preparing a pension's scheme reform, to improve the ability of self-financing scheme and the development of incentives for a wider participation of contributors.

After having addressed the pension system issues for quite a long time in collaboration with political stakeholders, the World Bank, the IMF and groups of interest, work is being done to prepare a draft on the pension's system reform in the coming months. The Reformation of the pension's system comes as a necessity for the future social and economic developments and the integration process of Albania in the European Union. The key financial objectives are:

- To consolidate the social insurance scheme sustainability;
- To substantially improve benefits administration;
- To improve the funds management quality;
- Payments administration;
- To identify and take measures to minimize risks and strengthen control upon the use of funds.

It is scheduled that during 2014a technical working group will be organized and that all stakeholders will participate for the preparation of a long-term pension strategy and preparation for all the necessary laws.

Meanwhile it is forecasted that the pensions will increase only as the level of inflation, while the system parameters must be improved within the objective of a better connection to measure the contribution with benefits, improving the coefficient of dependence and coefficient of replacement and improvement of financial situation scheme.

4.2.3. Administrative reform

Functional and structural reform on public administration

During 2013, the main objectives of the functional and structural reform were:

- Adaptation of the organizational structure of public administration institutions, with the mission, functions, competences and activities they should perform.
- Work initiation on drafting the bylaws pursuant to Law no. 90/2012, "On the organization and functioning of state administration", as well as on the functional analysis of the state administration institutions.

Regarding the above framework, during 2013 were carried out the following activities :

- In order to realize one of the main objectives of the new government, an efficient and transparent governance, immediately after coming on duty , the government started the work on drafting and approving the organizational structures of 16 ministries.

During this process the work focused on:

- Analysis of the functions of each existing (previous) ministry. Elimination of redundant layers in the management process ;
- Strengthening of priority areas.

Besides the above, during the drafting process of the organizational structures of the new ministries, were also introduced several innovations in order to ensure a stable governance with progressive opportunities, and concretely:

- The dimension of European integration and the capacity of each ministry in this regard was strengthened and, above all, the Ministry of Integration, was strengthened through a 20% increase in staff;
- The strategic planning/management was determined as a core function of each ministry, including also the result-oriented financing approach.
- It was created an Anticorruption National Network, by appointing an Anti-corruption Coordinator at the deputy minister level for each ministry. This network is run by the National Anticorruption Coordinator, the State Minister for Local Affairs.
- The concept of ‘delivery units’ was adapted from Great Britain, by establishing a delivery unit network to ensure constant focus on performance management and results. A ‘delivery unit’ is established in each ministry and led by a Deputy Minister. All the civil servants of these units will be supported and trained by the delivery unit of the Prime Minister’s office.

The “Chief Information Officer” network was created in each ministry, in order to design strategic plans in terms of technology. This network is led by the National Coordinator, State Minister for Public Administration and Innovation. As a result:

- With the adoption of the structures of 16 new ministries the total number of employees was reduced by 15%

The biggest cuts were made in the larger existing ministries with an average of about 30% (Ministry of Finance, Ministry of Interior Affairs, Ministry of Foreign Affairs, Ministry of Defense);

- Through reallocation, the number of employees focused on priority areas was increased by 14 % (as a result of the establishment of new ministries or of increasing the staff of the Ministry of European Integration)

Pursuant to law no. 90/2012, “On the organization and functioning of state administration”, during October and November 2012, the Council of Ministers approved relevant decisions, determining the fields of activity under the responsibility of each State Minister and line ministries..

Additionally, in view of the structural reform and with the aim of increasing effectiveness, stability of public institutions, reducing service costs and increasing public confidence, an “Inter-ministerial Committee for the State Structural Reform” has been established under the Prime Minister’s order, no. 167, date 8.10.2013.. This committee is chaired by the Prime Minister and consists of State Ministers and Deputy Ministers covering the respective fields.

The Inter-ministerial Committee is responsible for the following:

- review/ assess the current institutional and administrative state structure, from a constitutional, legal and factual point of view;
- receive and evaluate ideas and suggestions from subjects related to, or interested on the reform;
- identify needs and propose appropriate reforming amendments;
- prepare recommendatory reports for the Council of Ministers on the undertaken initiatives.

So far, the Inter-ministerial Committee has prepared a material regarding the principles to be followed and the standards required for creating the structures of subordinate institutions, as follows:

- Where possible, eliminate overlaps between subordinate institutions
- Where necessary, clarify the dependency of the institution from the Ministry
- Consider the geographical structure of each subordinate institution (national or regional)
- Propose improvements on efficiency and eliminate unnecessary management and/or support services
- Strengthen the priorities of subordinate institutions
- Implement several innovations in each subordinate institution (such as the functioning of strategic planning / an advisor on technologies)
- Implementation of several innovations
- Propose new institutions in accordance with the set priorities
- Ensure that each subordinate institution fulfils its purpose. (Some institutions may be merged/shutdown - legal changes may be necessary to enable it).

For the implementation of the recommendations of the Inter-Ministerial Committee for the State Structural Reform and for the fulfillment of obligations arising from the Law 90/2012, during 2014 it will be proceeded with the drafting of the relevant legislation in this regard.

The Inter-Sector Strategy of Public Administration Reform 2014 – 2020

The first draft of the Inter-Sector Strategy of Public Administration Reform 2014 – 2020, was drafted and consulted starting from October 2012 until May 2013, under the national Strategy for Development and Integration. These consultations were held with the advisory group, representatives of line ministries and independent institutions, with

the aim of discussing and giving their contributions to this document. The long-term objectives of the draft strategy aim:

(i) strengthening of Public Administration capacities to develop effective and coherent policies to achieve public goals; (ii) more effective management systems; (iii) improved organizational structures oriented toward service culture; (iv) fully responsible and transparent use of resources.

The medium-term objectives of the draft-strategy include:

- Implementation of an efficient and effective management system of human resources in public administration, as well as monitoring this management system;
- Performance improvement and capacity development of public administration, including the promotion of continuous learning programs and the provision of short-term and long-term trainings;
- Improving the services offered to the public, through strengthening existing structures and building new structures;
- Increasing the reliability of public officials, by delegating the decision-making closer to the position in charge for exercising the function;
- Making informed decisions about human resource policies and salaries in public administration, through the use of Human Resource Management Information System (HRMIS).

Concrete implementation of the Strategy will be carried out through a phased approach. Two separate action plans will take place in the successive stages:

- The Action Plan 2014 - 2016 (medium-term objectives) will focus on (i) the implementation of civil service legislation; (ii) institutional structural reform; (iii) the completion of the human resources database, as well as (iv) improvement and harmonization of the civil service system with European standards.
- The Action Plan 2017 -2020 (long term objectives) will be prepared in the second half of 2016. Advancing the country's development process towards European integration requires increasingly higher standards of the public administration in order to meet the European Administrative Space criteria and implement the European legislation. This action plan will be based on an assessment of the implementation of the objectives of the previous period and reassessment of priorities and will include new activities in key areas of administrative reform, including improvements in the areas where progress has not been sufficient.

Civil service reform

The human resources management reform aiming at creating a professional, merit-based, depoliticized public administration that is able to face challenges, remains a key priority of the Albanian government. An important step in this direction was the adoption of Law no. 152/2013, "On the Civil Servant", which relies on several key pillars:

Creates the Top Level Management Corps of the Civil Service. This corps will have a special legal regime of, employment and management related instruments. *Establishes group recruitment.* Candidates for "entry level" positions in the civil service will be selected through an annual national concurs aiming at creating one or more groups with candidates, who meet the general recruitment conditions and the specific ones to be appointed to positions with similar requirements and responsibilities in a ministry or other institution.

Career development and promotion. The career development instruments will be the horizontal promotion (within the category) and vertical promotion (to the immediate higher category). The horizontal promotion/lateral transfer will be based on a position-based internal competition procedure aimed at selecting the best available candidate from within the civil service. The vertical promotion will be based on an open competition organized for one or more specific positions and this competition will be based on a preferential bonus system for existing civil servants.

Mobility. The law provides for rotation and transfer as instruments of mobility and career development.

Considering that this law was conceived as a framework law that defines principles and determines general management standards and relevant responsibilities, in order to be applicable it shall be accompanied with the relevant bylaws planned for adoption.

Considering the implementation of a new civil servant law as one of its priorities, the government has taken the necessary steps to draft all the bylaws. In this way, the new civil service law will be implemented in respect to the principles and standards adopted in it.

In this process, the Government (the State Minister for Innovation and Public Administration and the Department of Public Administration), is being supported, a support that will continue over the next year, by SIGMA (an institution which has consistently assisted the Albanian government in the public administration reform area).

Currently, the 10 draft-bylaws required for the implementation of the new civil service law have been drafted and are under consultation phase.

Further, during January 2014, these draft-bylaws will be sent for revision and adoption to the Council of Ministers, and then it will be proceeded with the training of all officials directly involved in the implementation of this legislation, as well as with its implementation.

4.2.4. Additional reform areas

Reforms on the tourism sector, territory development and social housing

Review of Legislation for Planning and Development of Territory: Review of territory planning legislation lies in the government's program for urban, rural and regional development.

The need for review of this legislation is related to the fact that planning legislation, adopted in 2009 and entered into force in 2011, has undergone a series of changes, often drastic, that have damaged the structure, consistency and its principal concepts.

To correct these problems of the law and regulations will be undertaken an open and transparent process, where the parties/stakeholders will discuss the problems and difficulties encountered during the implementation of planning legislation and will propose its improvements. This is thought to be carried out during 2014.

Institutional and legal reform in the field of tourism: In order to ensure the proper instruments to orient Albanian tourism toward a competitive and sustainable development, creation of a legal and adjusted space as well as the presence of potential investors, is necessary to review the legal and institutional framework in the field of tourism. Chaotic development of the tourism industry, often with deficient rules and without control of institutions, has created problems that are added to the immaturity and initial phase of this industry.

Legal changes will address:

- categorization of tourist market players for the entirety of the products
- classification of accommodation facilities and services according to international standards , inspection systems and administrative controls
- establishment of collection and statistical evaluation system
- elimination of barriers to business and investments promotion
- legal definition and development of priority tourism areas and the cooperation between public and private sectors will be supported legally

This is foreseen to be conducted during 2014.

Restructuring of facilitate lending program: Reforms in the social housing sector will also include restructuring of the facilitate lending program. In this program is aimed to interrupt the component that supports political officials and carry control over the manner of benefits; expand partnership by including the builders, in order to reduce costs; support the families and individuals that buy a house for the first time. This is foreseen to be conducted during 2014.

Reforms on health services

Currently, funding of health services are fragmented by several sources. This problem in the financing of health services has established loose connections between financing and activities carried out by health services and its performance, particularly hospital services. The problem of fragmented funding is one of the problems that has caused significant lacks of medicines and medical materials in hospitals.

The transformation of the current system will be gradual, by shifting from the current mix contributory system to the general taxation, which is applied in many developed countries in Europe and beyond. Sustained growth of budget revenues due to new policies will bring more funding for health services.

The new law provides strengthening of the Fund's role. The main principle on which the health insurance scheme is built is the principle of solidarity. The scheme aims to cover all population in order to benefit from health care services, financed by both public and private sectors.

Reforms in the area of reimbursement of medicines:

- In 2014, based on the fiscal package expected to be approved by parliament, the 10% of VAT on drugs shall be removed bringing an effect of All 1 million. This will result in a reduction by 10 % of the price of medicines in the country and necessarily a 10% reduction in the price of medicines in the Reimbursement List.
- The drugs included in the list will be selected according to certain priorities:
- There will be negotiations with companies for prices.
- There will be an increase of generic drugs in the list of reimbursable drugs both in primary health care and hospital services.

Reforms on justice

Improvement of the activity of Bankruptcy Supervision Agency by amending the Law No. 8901 dated 23. 05. 2002 "On bankruptcy", amendments of DCM No. 197 dated 13. 04. 2007 "On conditions and criteria for determining the amount of compensation and reimbursement of expenses of bankruptcy administrators, finalization of the bylaws

drafts, preliminary training and organization of exam on the procedures of licensing of 10 administrators”.

Reforms on agriculture sector

Albania continues to support agricultural restructuring through improvements in business environment, infrastructure development and investments support.. In 2013, Albania’s government allocated 7.6 million Euros to support the investment in agriculture through national schemes.

The sustained government support to this sector has had a positive impact in increasing the competitiveness of agricultural activities.

Growth in the agricultural sector is mainly a result of increased productivity.

5. SUMMARY DATA

Table 1a: Macroeconomic prospects

Percentages unless otherwise indicated	ESA Code	Year 2012	Year 2012	Year 2013	Year 2014	Year 2015	Year 2016
		Level (bn EUR)	Rate of change				
1. Real GDP at market prices	B1*g	8.968	1.3	0.7	2.1	3.3	4.2
2. Current GDP at market prices	B1*g	9.125	3.4	2.4	4.4	5.9	7.0
Components of real GDP							
3. Private consumption expenditure	P3	7.371	-1.2	-0.1	-0.3	1.9	3.0
4. Government consumption expenditure	P3	0.810	-1.8	-0.8	4.4	-1.5	0.2
5. Gross fixed capital formation	P51	2.936	-4.1	-4.5	-0.4	4.3	5.8
6. Changes in inventories and net acquisition of valuables (% of GDP)	P52+P53	-0.073	0.0	0.0	0.0	0.0	0.0
7. Exports of goods and services	P6	3.106	-1.7	2.2	12.7	7.7	9.5
8. Imports of goods and services	P7	5.182	-7.6	-2.9	4.5	4.0	6.7
Contribution to real GDP growth							
9. Final domestic demand		11.1	-2.5	-1.5	0.1	2.5	3.9
10. Change in inventories and net acquisition of valuables	P52+P53	-0.1	0.0	0.0	0.0	0.0	0.0
11. External balance of goods/services	B11	-2.1	3.8	2.2	2.0	0.8	0.3

Table 1b: Price developments

Percentage changes, annual averages	ESA Code	Year 2012	Year 2013	Year 2014	Year 2015	Year 2016
1. GDP deflator		2.1	1.7	2.3	2.5	2.7
2. Private consumption deflator		2.4	1.7	2.9	3.2	3.3
3. HICP		n.a.	n.a.	n.a.	n.a.	n.a.
4. National CPI change		-1.4	-0.1	0.7	0.1	0.2
5. Public consumption deflator		2.5	2.5	2.4	2.5	2.6
6. Investment deflator		0.7	1.2	0.2	0.3	0.4
7. Export price deflator (goods & services)		1.5	1.5	1.5	1.5	1.5
8. Import price deflator (goods & services)		1.5	1.5	1.5	1.5	1.5

Table 1c: Labour markets developments

	ESA Code	Year 2012	Year 2012	Year 2013	Year 2014	Year 2015	Year 2016
		Level	Level/Rate of change				
1. Population (thousands)			2815.7	2787.6	2787.6	2787.6	2787.6
2. Population (growth rate in %)			-0.96	-1.00	0.00	0.00	0.00
3. Working-age population (persons)[1]			2235.1	2270.5	2306.5	2343.0	2380.1
4. Participation rate			47.8	47.0	46.1	45.3	44.5
5. Employment, persons [2]			928.0	927.9	927.9	927.9	927.8
6. Employment, hours worked[3]			n.a.	n.a.	n.a.	n.a.	n.a.
7. Employment (growth rate in %)			0.0	0.0	0.0	0.0	0.0
8. Public sector employment (persons)			164.4	162.9	146.7	143.7	140.8
9. Public sector employment (growth in %)			-0.4	-0.9	-10.0	-2.0	-2.0
10. Unemployment rate [4]			14.4	16.9	16.2	15.5	14.3
11. Labour productivity, persons[5]		1400.2	1.3	0.7	2.1	3.3	4.2
12. Labour productivity, hours worked[6]			n.a.	n.a.	n.a.	n.a.	n.a.
13. Compensation of employees	D1	n.a.					

Table 1d: Sectoral balances

Percentages of GDP	ESA code	Year 2012	Year 2013	Year 2014	Year 2015	Year 2016
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	-13.0	-10.7	-10.0	-8.3	-7.6
<i>of which:</i>						
- Balance of goods and services		-23.1	-18.9	-16.5	-14.1	-12.7
- Balance of primary incomes and transfers		9.2	7.4	6.1	5.1	4.6
- Capital account		0.9	0.9	0.4	0.7	0.6
2. Net lending/borrowing of the private sector	B.9/ EDP B.9	-9.5	-4.6	-3.6	-3.5	-4.1
3. Net lending/borrowing of general government		-3.5	-6.1	-6.5	-4.8	-3.4
4. Statistical discrepancy		0.0	0	0	0	0

Table 1e: GDP, investment and gross value added

	ESA Code	Year 2012	Year 2013	Year 2014	Year 2015	Year 2016
GDP and investment						
GDP level at current market prices (in domestic currency)	B1g	1326.0	1358.0	1418.0	1502.0	1607.0
Investment ratio (% of GDP)		30.3	28.6	27.4	27.0	26.8
Growth of Gross Value Added, percentage changes at constant prices						
1. Agriculture		7.2	3.3	3.6	4.9	4.8
2. Industry (excluding construction)		-0.8	3.1	6.2	5.6	6.6
3. Construction		-17.9	-0.3	-1.5	1.3	4.8
4. Services		3.8	-0.1	1.6	2.8	3.6

Table 1f: External sector developments

Billion Euro unless otherwise indicated		Year 2012	Year 2013	Year 2014	Year 2015	Year 2016
1. Current account balance (% of GDP)	% of GDP	-10.7	-10.0	-8.2	-7.5	-7.3
2. Export of goods	million EUR	1525.6	1721.7	1935.4	2188.9	2517.3
3. Import of goods	million EUR	3524.8	3365.7	3632.5	3819.4	4189.7
4. Trade balance	million EUR	-1999.2	-1643.9	-1697.0	-1630.3	-1672.3
5. Export of services	million EUR	1655.1	1547.3	1812.3	1906.5	2036.0
6. Import of services	million EUR	1459.9	1503.9	1544.4	1643.1	1723.6
7. Service balance	million EUR	195.2	43.4	267.9	263.3	312.3
8. Net interest payments from abroad	million EUR	-178.4	-126.4	-162.9	-199.5	-241.3
9. Other net factor income from abroad	million EUR	89.5	61.6	67.0	66.8	68.5
10. Current transfers	million EUR	871.7	694.7	687.0	689.4	698.1
11. <i>Of which</i> from EU	million EUR	n.a	n.a	n.a	n.a	n.a
12. Current account balance	million EUR	-1021.2	-970.4	-837.9	-810.2	-834.6
13. Capital and financial account	million EUR	867.3	802.8	834.3	849.7	937.3
14. Foreign direct investment	million EUR	727.2	850.4	806.4	883.004	1002.8
15. Foreign reserves	million EUR	1972.4	2014.9	2,240.9	2,510.0	2,842.2
16. Foreign debt	million EUR	5284.0	5472.6			
17. <i>Of which</i> : public	million EUR	2223.6	2327.5			
18. <i>O/w</i> : foreign currency denominated	million EUR	5284.0	5472.6			
19. <i>O/w</i> : repayments due	million EUR	n.a	n.a	n.a	n.a	n.a
20. Exchange rate vis-à-vis EUR (end-year)	NCU/EUR	139.7	139.8	139.7	139.7	139.7
21. Exchange rate vis-à-vis EUR (annual average)	NCU/EUR	138.9	140.2	140.0	140.0	140.0
22. Net foreign saving	% of GDP	77.0	71.5	59.1	53.9	51.9
23. Domestic private saving	% of GDP	164.0	170.9	165.5	163.1	158.8
24. Domestic private investment	% of GDP	2037.5	1794.7	1724.7	1758.7	1824.5
25. Domestic public saving	% of GDP	30.2	-7.8	24.8	48.7	77.6
26. Domestic public investment	% of GDP	31.0	39.0	34.5	36.6	36.3

Table 1g: Sustainability indicators

	Dimension	Year 2009	Year 2010	Year 2011	Year 2012	Year 2013
1. Current Account Balance	% of GDP	-13937.7	-10520.1	-12990.2	-10703.3	-10024.2
2. Net International Investment Position	% of GDP	-30074.3	-33137.4	-41476.7	0.0	0.0
3. Export market shares	%, yoy	0.0	25.0	10.0	0.0	9.1
4. Real Effective Exchange Rate [1]	%, yoy	5.4	5.4	3.6	-2.8	-0.5
5. Nominal Unit Labour Costs	%, yoy	n.a.	n.a.	n.a.	n.a.	n.a.
6. Private sector credit flow	% of GDP	3.4	3.3	3.5	0.5	-0.9
7. Private sector debt	% of GDP	32.3	34.9	36.9	35.3	32.1
8. General Government Debt	% of GDP	98.5	104.8	98.7	101.0	100.7

Table 2: General government budgetary prospects

	ESA code	Year 2012	Year 2012	Year 2013	Year 2014	Year 2015	Year 2016
		Level (bn NCU)	% of GDP				
Net lending (B9) by sub-sectors							
1. General government	S13	-45.857	-3.5	-6.1	-6.5	-4.8	-3.4
2. Central government	S1311	45.857	3.5	6.1	6.5	4.8	3.4
3. State government	S1312	45.857	3.5	6.1	6.5	4.8	3.4
4. Local government	S1313	0.000	0.0	0.0	0.0	0.0	0.0
5. Social security funds	S1314	62.565	4.7	5.0	5.1	5.2	4.9
General government (S13)							
6. Total revenue	TR	330.384	24.9	24.0	25.7	26.0	26.5
7. Total expenditure[1]	TE	376.241	28.4	30.1	32.2	30.8	29.9
8. Net borrowing/lending	EDP.B9	-45.857	-3.5	-6.1	-6.5	-4.8	-3.4
9. Interest expenditure	EDP.D41 incl. FISIM	41.498	3.1	3.2	3.3	3.5	3.6
10. Primary balance[2]		-4.359	-0.3	-2.9	-3.2	-1.3	0.2
11. One-off and other temporary measures [3]		-1.500	-0.1	0.0	0.0	0.0	0.0
Components of revenues							
12. Total taxes (12 = 12a+12b+12c)		209.9	15.8	14.8	16.2	16.8	17.2
12a. Taxes on production and imports	D2	161.2	12.2	11.3	12.3	12.6	13.0
12b. Current taxes on income and wealth	D5	31.9	2.4	2.4	2.4	2.5	2.5
12c. Capital taxes	D91	16.8	1.3	1.1	1.6	1.6	1.7
13. Social contributions	D61	56.1	4.2	4.3	4.4	4.3	4.4
14. Property income	D4	0.4	0.0	0.1	0.0	0.0	0.0
15. Other (15 = 16-(12+13+14)) [4]		63.8	4.8	4.8	5.0	4.9	4.8
16 = 6. Total revenue	TR	330.3	24.9	24.0	25.7	26.0	26.5
p.m.: Tax burden (D2+D5+D61+D91-D995) [5]		266.1	20.1	19.1	20.6	21.1	21.6
Selected components of expenditures							
16. Collective consumption	P32	119.9	9.0	9.0	9.2	8.8	8.4
17. Total social transfers	D62 + D63	140.9	10.6	11.2	11.2	11.1	10.9
17a. Social transfers in kind	P31 = D63	0.0	0.0	0.0	0.0	0.0	0.0
17b. Social transfers other than in kind	D62	140.9	10.6	11.2	11.2	11.1	10.9
18 = 9. Interest expenditure (incl. FISIM)	EDP.D41 + FISIM	41.4	3.1	3.2	3.3	3.5	3.6
19. Subsidies	D3	1.8	0.1	0.1	0.1	0.1	0.1
20. Gross fixed capital formation	P51	68.3	5.2	6.4	5.5	5.8	5.7
21. Other (21 = 22-(16+17+18+19+20)) [6]		3.6	0.3	0.3	2.8	1.5	1.2
22. Total expenditures	TE [1]	376.2	28.4	30.1	32.2	30.8	29.9
p.m. compensation of employees	D1	79.8	6.0	6.0	6.0	5.7	5.4

Table 3: General government expenditure by function

% of GDP	COFOG Code	Year 2012	Year 2013	Year 2014	Year 2015	Year 2016
1. General public services	1	5.7	1.8	1.9		
2. Defense	2	0.9	0.9	0.9		
3. Public order and safety	3	1.6	1.5	1.6		
4. Economic affairs	4	3.3	3.5	2.6		
5. Environmental protection	5	0.0	0.1	0.1		
6. Housing and community amenities	6	1.7	1.6	1.5		
7. Health	7	2.8	2.6	2.7		
8. Recreation, culture and religion	8	0.4	0.1	0.2		
9. Education	9	3.3	2.8	2.8		
10. Social protection	10	8.6	8.7	9.0		
11. Total expenditure (item 7 = 23 in Table 2)	TE	28.4	30.1	32.2	30.8	29.9

Table 4: General government debt developments

% of GDP	ESA code	Year	Year	Year	Year	Year
		2012	2013	2014	2015	2016
1. Gross debt [1]		62.5	70.5	72.1	71.7	69.2
2. Change in gross debt ratio		2.2	8.0	1.7	-0.4	-2.5
Contributions to change in gross debt						
3. Primary balance [2]		-0.3	-2.9	-3.2	-1.3	0.2
4. Interest expenditure [3]	EDP D.41	3.1	3.2	3.3	3.5	3.6
5. Stock-flow adjustment		-1.3	1.8	-4.8	-5.3	-5.9
<i>of which:</i>						
- Differences between cash and accruals [4]		0.0	0.0	0.0	0.0	0.0
- Net accumulation of financial assets [5]		0.0	0.0	0.0	0.0	0.0
<i>of which:</i>						
- Privatisation proceeds		0.0	0.0	0.0	0.0	0.0
- Valuation effects and other [6]		0.0	0.0	0.0	0.0	0.0
p.m. implicit interest rate on debt [7]		5.4	5.3	4.8	5.2	5.4
Other relevant variables						
6. Liquid financial assets [8]		0.0	0.0	0.0	0.0	0.0
7. Net financial debt (7 = 1 - 6)		62.5	70.5	72.1	71.7	69.2

Table 4a: Contingent liabilities

% of GDP		Year 2013	Year 2014
Public guarantees	% of GDP	3.8	4.2
<i>Of which: linked to the financial sector</i>	% of GDP	0	0

Table 5: Divergence from previous program

	Year 2012	Year 2013	Year 2014	Year 2015	Year 2016
1. GDP growth (% , yoy)					
Previous update	1.5	3.1	3.9	4.1	
Latest update	1.3	0.7	2.1	3.3	4.2
Difference (percentage points)	-0.2	-2.4	-1.8	-0.8	4.2
2. General government net lending (% of GDP)					
Previous update	-3.7	-3.5	-2.4	-2.2	
Latest update	-3.5	-6.1	-6.5	-4.8	-3.4
Difference	0.2	-2.6	-4.1	-2.6	-3.4
3. General government gross debt (% of GDP)					
Previous update	61.9	63.8	63.8	63.4	
Latest update	62.5	70.5	72.1	71.7	69.2
Difference	0.6	6.7	8.3	8.3	69.2

Table 6: Basic assumptions on the external economic environment underlying the EFP framework²⁰

	Dimension	Year	Year	Year	Year	Year
		2012	2013	2014	2015	2016
Short-term interest rate [1]	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 rate	Annual average	1.3	1.3	1.3	1.3	1.3
Nominal effective exchange rate	Annual average	113.3	113.7	113.8	113.9	114.1
Exchange rate vis-à-vis the EUR (NC/EUR)	Annual average	139.0	140.3	140.0	140.0	140.0
Global GDP growth, excluding EU	Annual average	4	3.5	4.1	4.4	4.5
EU GDP growth	Annual average	-0.4	0	1.4	1.9	2.1
Growth of relevant foreign markets	Annual average	-0.7	-0.5	1.1	1.7	2
World import volumes, excluding EU	Annual average	3.2	4.1	5.9	6.3	6.9
Oil prices (Brent, USD/barrel)	Annual average	111.8	108.8	105.8	99.7	101

²⁰ This table should preferably be included in the program itself; if not, these assumptions should be transmitted to the Council and the Commission together with the program.

Table 7: Matrix of policy commitments

Description of policy	Year	Year	Year	Year
	2013	2014	2015	2016
<i>1. Policy measure</i>				
A. Implementation profile*				
B. Net direct budgetary impact (if any)				
B.1 Direct impact on budgetary revenue				
B.2 Direct impact on budgetary expenditure				
<i>2. Policy measure</i>				
A. Implementation profile*				
a. Implementation profile*				
(...)				
<i>Total net budgetary impact</i>				
Total impact on budgetary revenue				
Total impact on budgetary expenditure				

* indicate start and, if needed, end with an "X" mark