



Program Information Document (PID)

Concept Stage | Date Prepared/Updated: 11-Jun-2019 | Report No: PIDC26831



BASIC INFORMATION

A. Basic Project Data

Country Albania	Project ID P169524	Project Name Albania Fiscal Sustainability and Growth Development Policy Financing (P169524)	Parent Project ID (if any)
Region EUROPE AND CENTRAL ASIA	Estimated Board Date Mar 26, 2020	Practice Area (Lead) Macroeconomics, Trade and Investment	Financing Instrument Development Policy Financing
Borrower(s) Ministry of Finance and Economy	Implementing Agency Ministry of Finance and Economy		

Proposed Development Objective(s)

This operation supports Albania in (i) strengthening the transparency and sustainability of its public finances and (ii) advancing the re-orientation of the economy for the world of tomorrow.

Financing (in US\$, Millions)

SUMMARY

Total Financing	80.00
------------------------	-------

DETAILS

Total World Bank Group Financing	80.00
World Bank Lending	80.00

Decision

The review did authorize the preparation to continue

B. Introduction and Context

Country Context

1. **Emerging in the early 1990s from a communist regime and international isolation, Albania has become one of the growth success stories of the Western Balkans - although gaps to the aspirational living standards of the European Union (EU) remain large.** Albania is a small economy in the Western Balkans with a population of 2.9 million. With a close to four-fold increase in living standards since 1991, it has been one of the fastest developing economies in the region. Today, Albania is at the cusp of opening formal negotiations for accession to EU membership. Yet, despite this significant



progress, living standards are still more than three times lower than those inside the EU. Poverty remains widespread, with 39.1 percent of the population living on less than USD \$5.50 a day as of latest measurement. The production base is only gradually gaining sophistication, with continued high agricultural employment and rampant informality, and the economy remains relatively closed, particularly considering Albania's proximity to the large and affluent markets of the EU.

2. **A growth slowdown and a sudden deterioration of public finances disrupted progress after 2008. While budget consolidation has since brought deficits under control, Albania continues to face fiscal risks from high public debt and off-budget contingent liabilities.** Macroeconomic weakening and growing fiscal imbalances required Albania to ultimately enter into a three-year IMF program in 2014, and the government has taken important steps to stabilize public finances since then. While fiscal deficits have since been brought under control, this episode saddled Albania with a high stock of public debt at 69.6 percent of GDP as of end-2018 (WB6 average: 50.2), which is particularly concerning given a still chronically weak public revenue base at 27.6 percent of GDP (WB6 average: 35.3) and significant spending needs to close gaps in the social budget and infrastructure. As Albania has increasingly turned to public private partnerships (PPPs) to meet public service needs using private capital, while key state-owned enterprises (SOEs) have continued to underperform financially, off-budget fiscal risks have grown.

3. **Though the economy has regained speed in recent years, Albania needs to further strengthen the quality of growth.** While the banking system's non-performing loans (NPLs) have declined since the crisis, they remain highest in the region at 11.1 percent of the loan portfolio at end-2018 (WB6 average: 7.3), further constraining the ability of an already shallow and undiversified financial sector to provide financing to businesses. While GDP growth has picked up again at 3.8 percent in 2017 and 4.1 percent in 2018, this has been supported by favorable one-off factors that are expected to fade out going forward. Much of the job creation gains recorded in this period have been concentrated in low-sophistication sectors, such as basic textiles manufacturing, administrative support services as well as construction.

4. **Albania's macroeconomic policy framework is sustainable and adequate for this operation.** Growth is projected to remain solid over the medium term, with low inflation and improving fiscal and external balances underpinned by prudent macroeconomic management and structural reforms, some of which are supported by the proposed Development Policy Financing (DPF) and other World Bank operations. Nonetheless, the outlook is vulnerable to external and domestic risks. As a small, open economy, Albania is highly exposed to external shocks, such as slower-than-projected growth in the EU, a possible tightening of financing conditions in international capital markets, and geopolitical risks including prolonged trade disputes between the US and China, potential trade restrictions between the US and the EU, and uncertainty about Brexit can affect Albania's exports and FDI inflows. Economic growth is also dependent on Albania's EU accession prospects, which hinge on the success of ongoing negotiations. On the domestic front, mitigating fiscal risks related to contingent liabilities from PPPs and state-owned enterprises, and improving the efficiency and equity of public spending and revenue mobilization remain priorities to reduce high debt levels, create fiscal buffers to address shocks, and improve the delivery of public services. Finally, sustaining inclusive growth will require addressing structural challenges related to the rule of law, the business environment, energy security, and human capital.

Relationship to CPF

5. **The reforms supported by this program are well-aligned with the World Bank Country Partnership Framework (CPF) and the WBG's twin goals of reducing poverty and boosting prosperity.** The CPF for 2015-19 supports Albania's aspirations to achieve equitable growth and integration into the European Union. Its three key focus areas are (i) restoring macroeconomic balances, (ii) creating conditions of accelerated private sector growth and (iii) strengthening public sector management and service delivery. Pillar 1 of this operation supports focus areas 1 and 3. Pillar 2 of this operation supports



focus area 2. Moreover, the prior actions of this DPF are expected to contribute directly and indirectly to poverty reduction and shared prosperity by generating resources and creating the conditions for future favorable economic growth. The reforms are aligned with the WBG's priorities in the Climate Change Action Plan 2016-20 to support transformational policies and institutions as well as to scale up climate action. The design of this operation complements the WBG's portfolio of other current lending projects and technical assistance services for Albania, including a 2018-19 initiative of the World Bank to identify jobs and growth priorities for Albania, a range of parallel TA projects accompany implementation of the prior actions, a parallel World Bank Gender DPF that strengthens access to economic opportunities for women. Moreover, the operation is informed by lessons learned from recent and ongoing operations, including two Public Finance DPFs (2014 and 2015), a Financial Sector DPF (2017) and a Competitiveness DPF (2017) in Albania.

C. Proposed Development Objective(s)

This operation supports Albania in (i) strengthening the transparency and sustainability of its public finances and (ii) advancing the re-orientation of the economy for the world of tomorrow.

Key Results

6. **Actions supported by this operations are expected** to (i) reinforce Albania's revenue raising capacity, by strengthening the quality of tax policy, strengthening tax compliance, and ensuring timely, transparent and predictable payment of value-added tax (VAT) refunds by the government; (ii) strengthen management of off-budget fiscal risks, including those related to PPPs and municipal water companies; (iii) strengthen the mobilization of private capital through a bolstered NPL resolution framework, a modern payment services law and a new legal framework for investment funds; (iv) strengthen investment opportunities for Albania along key growth paths by broadening access to high speed internet in rural areas; (v) strengthen the sustainability of growth and protects key economic sectors that rely on the richness of Albania's natural assets, by protecting Albania's forests.

D. Concept Description

7. **The design of this stand-alone operation reflects a systematic prioritization exercise and builds on two pillars. The first pillar of this operation supports Albania in adopting key reforms strengthening the transparency and sustainability of its public finances.** This pillar aims to mitigate fiscal risks and to prevent further growth setbacks. First, to build fiscal space and bring down government debt, this pillar reinforces Albania's revenue raising capacity. The operation supports institutionalization of regularly published reviews on the costs and benefits of tax incentives, hence strengthening the quality of tax policy. A reorganization of the tax administration enhances Albania's capacity to enforce tax collection, particularly among high-value taxpayers, thereby strengthening tax compliance. Ensuring timely, transparent and predictable payment of value-added tax (VAT) refunds by the government aims to make the tax system more business-friendly and encourage participation in the tax system. Second, this pillar aims to strengthen management of off-budget fiscal risks. A strengthened selection and monitoring framework for PPPs aims to ensure that the projects deliver value-for-money and that risks for the budget are contained. A reformed framework for performance-based transfers to municipal water companies aims to enhance incentives at key SOEs to tackle financial underperformance and to more efficiently manage their water resources.

8. **The second pillar of this operation assists Albania in making policy changes supporting the re-orientation of the economy for the world of tomorrow.** The aim is to enable the creation of more and better jobs, by strengthening the sustainability of Albania's growth model. First, to enable entrepreneurs to fund their business plans, this pillar strengthens



the mobilization of private capital. A bolstered NPL resolution framework will support banks in unwinding their legacy NPLs, while encouraging issuance of new loans. A modern payment services law will facilitate transactions and encourage more Albanians to participate in the formal financial system, providing an entry point for access to other financial services including lending. A new legal framework for investment funds can catalyze a more vibrant and diverse non-bank financial system, providing a wider set of investment opportunities for the Albanian economy. Second, this pillar strengthens investment opportunities for Albania along key growth paths. By broadening access to high speed internet in rural areas, more entrepreneurs will connect to the internet and to digital business opportunities. By protecting Albania's forests, this pillar strengthens the sustainability of growth and protects key economic sectors that rely on the richness of Albania's natural assets, including the already rapidly growing tourism industry.

9. **The reforms under the pillars of this operation are aligned with the government's NSDI 2015-20 focus on growth through fiscal sustainability and competitiveness, respectively.** By fighting water wastage, the operation also supports the NSDI 2015-20 focus on sustainable growth through effective use of resources. By protecting Albania's forestry resources, the project helps Albania in addressing its NSDI 2015-20 focus on sustainable growth through effective use of resources. By supporting Albania's large and often disadvantaged rural communities by (i) improving connectivity to broadband internet and (ii) protecting the forests on which many depend for their livelihoods, the operation also supports the NSDI 2015-20 focus on investing in people and social cohesion. Policies supported by this operation are implemented in close coordination with Albania's partners. In several cases, partners are providing the technical assistance that supports the Government in delivering on the prior actions for this operation.

E. Poverty and Social Impacts and Environmental Aspects

Poverty and Social Impacts

10. **By strengthening both the sustainability and quality of Albania's growth model, this operation is expected to have a poverty-reducing impact in the long-run.** Actions under pillar 1 strengthen public revenues and tackle off-budget fiscal risks, reducing the probability of a future macro-fiscal crisis. As low-skilled jobs and the poorest are particularly vulnerable to crises, such preventive measures help avoid growth reversals and protect social gains. Strengthening the performance of municipal water companies may have both small positive and negative impacts on the poor. On the one hand, better services particularly benefit the poor who cannot afford their own pumps and tanks. On the other hand, improving efficiency at the utilities could lead to job cuts and tightened enforcement of water bill payments (including for poor households). Since the operation includes measures to strengthen budget revenues, the poor face the prospect of higher taxes. However, the operation is designed to minimize this effect. Tax compliance is strengthened by focusing the resources of the tax administration on raising revenues from large taxpayers. To the extent that the tax expenditure reviews supported by this operation lead to a roll-back of tax incentives, this will largely hurt the better off that are often more able to take advantage of tax loopholes.

11. **Actions under pillar 2 aim to create an environment in which Albanian firms can thrive, creating more and better job opportunities, including for the poor.** More formalized jobs give the disadvantaged access to legal labor market protections and additional social welfare services. By supporting the use of financial transaction services, this DPF bolsters financial inclusion, and would be particularly beneficial to women, rural households and the bottom 40 percent of the population who are most susceptible to be financially excluded. By enhancing broadband internet access in rural areas and by preserving Albania's forests, this operation will support disadvantaged rural communities. It bridges gaps between rural and urban areas and protects assets that serve rural communities.

Environmental Impacts



12. **This operation is expected to help Albania avoid wastage and enhance the sustainability of its natural assets.** By institutionalizing performance-based transfer schemes for the municipal water companies, this operation strengthens incentives to reduce water wastage. Leveraging the existing electricity cable transmission network to provide broadband internet to households will promote digitalization, while protecting the environment by avoiding additional civil works. Finally, the forestry law supported by this operation strengthens the borrower’s capacity to manage its forestry resources more sustainably.

CONTACT POINT

World Bank

Christoph T F Ungerer, Hilda Shijaku, Johanna Jaeger
Economist

Borrower/Client/Recipient

Ministry of Finance and Economy

Implementing Agencies

Ministry of Finance and Economy
Erjon Luci
Deputy Minister
Erjon.Luci@financa.gov.al

FOR MORE INFORMATION CONTACT

The World Bank
1818 H Street, NW
Washington, D.C. 20433
Telephone: (202) 473-1000
Web: <http://www.worldbank.org/projects>

APPROVAL

Task Team Leader(s):

Christoph T F Ungerer, Hilda Shijaku, Johanna Jaeger



Approved By

Country Director:	Linda Van Gelder	30-Jun-2019
-------------------	------------------	-------------