



The World Bank

Albania Fiscal Sustainability and Growth Development Policy Financing (P169524)

Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 18-Aug-2020 | Report No: PIDA28423



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 29-Oct-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)

The project development objective is to support Albania in (i) strengthening the transparency and sustainability of its public finances, (ii) enhancing finance for recovery and growth and (iii) supporting key sectoral opportunities for sustainable growth.

Financing (in US\$, Millions)

SUMMARY

Total Financing	80.00
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DETAILS

Total World Bank Group Financing	80.00
World Bank Lending	80.00

Decision

The review did authorize the team to appraise and negotiate

B. Introduction and Context

Country Context

1. The Fiscal Sustainability and Growth Development Policy Financing (DPF) operation for Albania is part of broader World Bank Group (WBG) support to manage the impacts of the earthquake and COVID-19 crises. In line with



the World Bank's COVID-19 Crisis Response approach paper, this operation focuses on critical structural reforms supporting restructuring and a resilient recovery. This complements immediate crisis relief efforts assisted through other operations. The project development objective of this operation is to support Albania in (i) strengthening the transparency and sustainability of its public finances, (ii) enhancing finance for recovery and growth and (iii) supporting key sectoral opportunities for sustainable growth. This is a stand-alone IBRD loan in the amount of US\$ 80 million.

2. **Two recent devastating shocks in quick succession - a highly destructive earthquake in late 2019 followed by the global COVID-19 pandemic in early 2020 – have reinforced the need to strengthen the foundations of Albania's growth model as the basis for a vigorous and sustainable economic recovery.** In November 2019, Albania was struck by a 6.3-magnitude earthquake, killing 51 and displacing 17,000 people. Damages to physical assets and losses were equivalent to an estimated 7.5 percent of GDP. As Albanians started the reconstruction process, supported by a significant financial assistance package from the international community, a second crisis hit. In March 2020, Albania was forced to take unprecedented public health measures to slow the spread of the global COVID-19 pandemic, a highly contagious virus that can cause respiratory illness in people. By August 18, 2020, Albania reported 7,499 confirmed cases and 230 confirmed deaths – with an uptick in cases since public health measures were partially relaxed at the start of the summer. The freeze of large parts of the economy due to the pandemic has plunged Albania into recession, leading to a downward revision of the World Bank's GDP forecast for Albania by more than 11 percentage points for 2020. The World Bank estimates that, even with current policy support measures, Albania's poverty rate will increase by between 2 to 5 percentage points - up from an already high 36.0 percent of the population living on less than US\$ 5.50 per capita per a day (2011 PPP) estimated for 2019. As a result of the crisis, public finances have come under stress. Strengthening policies and institutions for fiscal sustainability and economic development is key to ensuring that Albania can rebound vigorously and rebuild better, as public health restrictions on economic life are gradually lifted.

3. **During these challenging times, this operation serves as an anchor to support Albania in maintaining a line of sight on critical structural reforms to support economic restructuring and a resilient recovery.** During a time in which the earthquake and COVID-19 naturally shift attention to short-term crisis-fighting emergency measures, this operation supports Albania to not lose sight of the reforms needed for ensuring sustainable business growth and job creation and strengthening policies, institutions and investments for rebuilding better.

4. **At the same time, this operation provides important financing support to Albania in a time of stress and is part of a larger coordinated assistance package by the international community.** The twin shocks have severely disrupted the Albanian economy, undermining revenues in a time in which government spending is needed to protect lives and livelihoods. A parallel World Bank Emergency COVID-19 Response project finances immediate relief and assists Albania's direct public health response to the pandemic, alongside other development partners. This Fiscal Sustainability and Growth DPF is part of a larger coordinated effort by the international community to provide general budget support, alongside other partners such as the EU, IMF and the French development agency (AFD). Beyond its direct financing contribution, this operation also aims to help Albania crowd in and leverage private sector financing by providing an anchor for critical structural reforms and acting as a signal of Albania's continued commitment to fiscal sustainability and growth.

5. **Albania's macroeconomic policy framework is adequate for this operation.** Despite the high uncertainty surrounding all macroeconomic forecasts during the ongoing COVID-19 crisis, growth is projected to rebound 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 DPF and other World Bank operations. Nonetheless, the outlook is highly vulnerable to external and domestic risks. The performance of the economy will depend crucially on the evolution of the pandemic, the speed and extent to which public health restrictions are lifted as well as



the speed and extent to which households and businesses will normalize their behavior. As a small, open economy, Albania is highly exposed to external shocks, such as slower growth in the EU or further tightening of financing conditions in international capital markets. Economic growth is also dependent on progress of Albania's EU accession process, which is a key anchor for the country's structural reform agenda and macroeconomic framework. 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

6. **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 2015-20 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. Pillars 2 and 3 of this operation support focus area 2. 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.

C. Proposed Development Objective(s)

7. The project development objective of this operation is to support Albania in (i) strengthening the transparency and sustainability of its public finances, (ii) enhancing finance for recovery and growth and (iii) supporting key sectoral opportunities for sustainable growth.

Key Results

8. Actions supported by this operations are expected to (i) reinforce Albania's revenue raising capacity, by enhancing the quality of tax policy and strengthening tax compliance, and by strengthening the management of off-budget fiscal risks related to PPPs; (ii) support the mobilization of private capital through a bolstered NPL resolution framework and a new legal framework for both capital markets and investment funds, as well as enhance the use of non-cash payments through a modern payment services law; (iii) strengthen key sectoral opportunities for sustainable growth, by expanding broadband penetration in the country and by promoting sustainable management of Albania's forestry resources.

D. Project Description

9. **The design of this stand-alone operation reflects a systematic prioritization exercise and builds on three pillars. As a pre-condition for a resilient recovery, the first pillar of this operation supports Albania in adopting key reforms strengthening the transparency and sustainability of its public finances.** Even before the current crisis, Albania had a high stock of public debt at 67.8 percent of GDP as of end-2019 (compared to a WB6 average¹ of 50.8 percent), particularly

¹ The WB6 refers to the six countries of the Western Balkans region: Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia and Serbia. Regional statistics are computed as simple averages.



concerning given a still chronically weak public revenue base at 27.8 percent of GDP (compared to a WB6 average of 35.7 percent). The current crisis is projected to further increase government debt to above 80 percent of GDP. In this context, first, this pillar reinforces Albania's revenue raising capacity to build fiscal space and bring down government debt. This pillar supports publication of Albania's first full tax expenditure review and institutionalization of regular publications going forward. Fiscal transparency can play an important role in disciplining policy and ensuring that budgetary resources are deployed more effectively, which is particularly valuable in the current crisis context of unprecedented fiscal measures to support the economy. Furthermore, to raise revenues, this operation supports a reorganization of the tax administration to enhance Albania's capacity to enforce tax collection, particularly among high-value taxpayers. Second, this pillar aims to bolster management of off-budget fiscal risks. In recent years, as Albania has increasingly responded to budgetary pressures by turning to public private partnerships (PPPs) to meet public service needs using private capital, off-budget fiscal risks have grown. The current crisis has increased budgetary pressures even further. This operation therefore supports a strengthened selection and monitoring framework for PPPs aimed at ensuring that projects deliver better value-for-money and that risks for the budget are more contained. This action includes the publication of Albania's first PPP monitoring report as well as the institutionalization of regular publications going forward – bringing greater transparency to a part of the Albanian economy that has been notorious for opacity and political controversy.

10. The second pillar of this operation assists Albania in enhancing finance for recovery and growth. To fund the investments needed to upgrade Albania's growth model, this pillar strengthens the mobilization of private capital while contributing to sustainable business growth and job creation. First, this pillar bolsters Albania's non-performing loans (NPL) resolution framework. Although the banking system's NPLs had declined since the Global Financial crisis of 2008-09, they were still the highest in the region at 8.4 percent of the loan portfolio at end-2019 (compared to a WB6 average of 5.3 percent). The current crisis will further increase financial distress among borrowers. In this context, this pillar supports the adoption of an NPL out-of-court resolution framework that will support firm restructuring and NPL resolution. Second, this pillar supports the adoption of a critical package of financial sector laws aligning Albania's legislation with the EU acquis and international standards. 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 capital markets and investment funds can catalyze a more vibrant and diverse non-bank financial system, providing a wider set of investment opportunities for the Albanian economy. This pillar provides critical support for this substantive legal package, enabling enactment of the laws despite a complex adoption process and the twin shocks facing the country.

11. The third pillar of this operation supports key sectoral opportunities for sustainable growth. The aim is to enable the creation of more and better jobs, by strengthening the vitality and sustainability of Albania's growth model. First, by broadening access to high-speed internet in rural areas, this operation supports investments to rebuild better by connecting more Albanians with the opportunities of the digital economy. Second, by strengthening sustainable management of Albania's forest resources, this pillar protects key economic sectors that rely on the richness of Albania's natural landscape assets and services, including the tourism sector – which uses Albania's natural beauty as core selling point – as well as Albania's large agricultural sector – which relies on landscape services to address the complex nexus of rural livelihoods, land degradation, climate change, environmental security and economic growth. All too often, pre-crisis, growth came at the expense of depleting Albania's natural ecosystem and at the expense of sustainable development. This operations aims to support reorientation of the economy towards green business growth and job creation.

12. 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. Reforms under Pillar 1 are aligned with the government's NSDI 2015-



20 focus on growth through fiscal sustainability. Both raising revenues and tackling off-budget fiscal risks are key foundations for fiscal sustainability. To the extent that the prior actions free fiscal space that can be devoted to Albania's social budget, including the education and health sectors, the pillar also creates the foundations for tackling the NSDI 2014-20 focus on investing in people and social cohesion. Reforms supported under Pillar 2 and 3 are aligned with the government's NSDI 2015-20 focus on growth through competitiveness. By strengthening the resilience of the financial sector and facilitating the clean-up of the NPLs that are encumbering bank balance sheets, the operation supports the NSDI pillar on macro-economic and fiscal stability. By protecting Albania's forestry resources, the project helps Albania in addressing its NSDI 2015-20 focus on sustainable use of resources.

E. Implementation

Institutional and Implementation Arrangements

13. **Albania's Ministry of Finance and Economy (MoFE) is responsible for the implementation of this operation.** The proposed operation leverages the authority of the MoFE to coordinate and monitor the implementation of the supported reforms and their integration with the on-going government fiscal reform and growth agenda. The World Bank will work closely with the MoFE and other key stakeholders to monitor and assess reform progress and impacts during the course of the proposed operation. Monitoring and evaluation will be supported by the MoFE, the Bank of Albania, the Ministry of Infrastructure and Energy as well as the Ministry of Tourism and Environment through legislative and economic analysis provided by these authorities and verified in official disclosures, directives, and regulations. Data are provided by the respective agencies and tracked according to the results indicators agreed under this operation's policy and results matrix.

F. Poverty and Social Impacts, and Environmental, Forests, and Other Natural Resource Aspects

Poverty and Social Impacts

14. **By strengthening both the sustainability and quality of Albania's growth model, the reform program supported by this operation is expected to have a poverty-reducing impact in the long run.** The World Bank estimates that – even with current support measures - Albania's poverty rate will increase by between 2 to 5 percentage points due to the COVID-19 pandemic. Poverty reduction through this DPF is therefore particularly important. 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. Actions under pillar 2 and 3 aim to create an environment in which Albanian firms can thrive, enhancing finance and key sectors for growth, 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.

15. **The reforms of the retail payments system and those supported under Pillar 3 of this operation are expected to benefit more disadvantaged groups, including in rural areas, the bottom 40 income earners, and women.** With adoption of the new payments law, non-bank financial institutions will be allowed to offer payment services and maintain transactional accounts enabling access to a wider range of electronic payment services benefiting disproportionately underserved segments of the population, including women. Closing the gender gap in financial inclusion can act as an enabler of countries' development, economic growth, inequality reduction, business evolution, and social inclusion. According to the World Bank Global Findex Database, the gender gap in Albania is estimated at 4 percentage points. The



gap is even larger for the bottom 40 income earners and rural population where only an average of 23 and 31 percent respectively had an account at a formal financial institution and 13.1 and 21.5 percent respectively made or received digital payments. Similarly, enhancing broadband internet access in rural areas and a legal framework for the sustainable use of Albania's forests support the economic advancement of disadvantaged rural communities. First, the digitalization prior action bridges the connectivity gap between rural and urban areas and enhances access to broadband internet for rural Albanians, enabling them to connect with the global digital community and to explore new online business opportunities. Women can gain in particular from access to flexible online work arrangements, enabling them to combine traditional family responsibilities with income-generating opportunities on the internet. Second, forests are a crucial source of income for the rural poor, sustaining employment in recreational industries, foraging (including berries, medicinal plants) and woodworking. The Law on Forestry strengthens the sustainable management of this vital natural asset, by clearly designating rural communities living in rural areas in the vicinity of forests as key stakeholders and providing them with explicit user rights, while establishing clear roles and responsibilities for municipal governments and village community structures regarding the sustainable use and preservation of the forests. Empowering local communities within a solid legal framework should increase the sustainability of traditional activities related to the forest and contribute to their preservation, while providing critical sources of income for deprived rural communities.

16. The prior actions and the broader reform program aim to minimize the risk of a higher tax burden for the poor. Since the program includes measures to strengthen budget revenues, taxpayers in lower income brackets could face the prospect of higher taxes. However, the reforms aiming at increasing tax compliance are designed to focus the efforts of the tax administration on raising revenues from large taxpayers. Further, to the extent that the tax expenditure reviews included in the program lead to a roll-back of tax incentives, this is expected to primarily close tax loopholes exploited by the better off.²

Environmental, Forests, and Other Natural Resource Aspects

17. This operation is expected to help Albania enhance the sustainability of its natural assets. The prior action on the forestry law yields climate co-benefits. The prior action creates a legal framework for the management of Albania's forestry resources through the adoption of the Forestry Law. The Forestry Law delineates the rights and responsibilities of the national government, local governments and local communities. It also creates the National Forest Agency that will coordinate technical knowledge, data management and monitoring of forest resources. Clarifying responsibilities, improving coordination and building institutions is particularly pressing after the administrative reform of 2016 which transferred to new municipalities 80 percent of forest and pasture lands, but lacked mechanisms to coordinate actions between stakeholders. The prior action therefore puts in place the legal and institutional foundations for strengthening the sustainability of Albania's forestry resources. Forests contribute to the overall economy through the generation of essential services that sustain key sectors like agricultural and tourism in rural and urban areas by protecting watersheds, providing habitat for biodiversity, and reducing the risk of natural disasters. Forests also provide for both mitigation and adaptation to climate change through various channels, including increased employment opportunities in afforestation and reforestation, reduced cost and increased availability of renewable fuels, increased diversification of food sources and livelihoods through improved access to forest fund lands for non-timber forest products and reduced air pollution due to improved fire control measures.

² If the budget revenue gains are channeled towards strengthening Albania's social budget, including tackling under-spending on education, the poor may also benefit through this indirect channel.



18. **Other prior actions are finance- and infrastructure related and are likely to also have either a positive or no significant impact on the environment.** The PPP monitoring instruction supported for this operation for instance, explicitly recommends that PPP monitoring for waste incinerator projects include tracking of project impact on pollution and the environment. Leveraging the existing electricity cable transmission network to provide broadband internet to households will promote digitalization, without requiring significant new civil works - hence protecting both limited public funds and the environment.

G. Risks and Mitigation

19. **The overall risk for this operation is assessed to be substantial.** The risks related to the political situation and governance, the macroeconomic context, technical design of the program and institutional capacity are all rated as substantial. The remaining risks are rated as moderate or low. Political tensions between the Government and the opposition remain elevated. In 2019, a series of street protests shook the country. Opposition lawmakers gave up their seats in Parliament and boycotted the local elections. While tensions have somewhat moderated in 2020, the renewal of political disruptions remains a risk – and this could impact reform implementation. National elections are scheduled for 2021. Equally, the twin shocks that have hit Albania – the November 2019 earthquake and the 2020 COVID-19 pandemic – have triggered a sharp decline in economic activity. Public finances are under stress. As the fight against the virus is still ongoing, the full cost of the crisis remains difficult to assess. If the macro-economic framework deteriorates even more sharply than anticipated, this could undermine the effectiveness of the structural reforms supported by this program. At the same time, the technical design of this operation is ambitious, and the implementation capacity of the Government is limited. The Government's immediate priority is to deal with the aftermath of the earthquake and COVID-19, further constraining the Government's capacity to implement structural reforms. Physical distancing measures during the COVID-19 crisis mean that many government staff work from home, which may slow down progress with reform implementation. Despite the circumstances, the Government has demonstrated commitment to the reform agenda. To mitigate risks, the operation has put emphasis on closely aligning with technical assistance and other financing operations by the WBG and other international partners.

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APPROVAL

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Approved By

Country Director:	Linda Van Gelder	15-May-2020
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