



REPUBLIC OF ALBANIA  
MINISTRY OF FINANCE

# Public Finance Sector Strategy 2007 to 2013

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## List of abbreviations

CARDS	Community Assistance for Reconstruction, Development and Stabilisation
CEFTA	Common Extended Free Trade Agreement
CFA	Country Fiduciary Assessment
DAC	Development Assistance Committee
DQAF	Data Quality Assessment Framework
GDDS	General Data Dissemination System
GFS	Government Fiscal Statistics
GFSM	Government Fiscal Statistics Manual
HIPC	Heavily Indebted Poor Countries
IFI	International Financial Institutions
IPSAS	International Public Sector Accounting Standards
IPFC	Internal Public Financial Control
OBL	Organic Budget Law
MCC/MCA	Millennium Challenge Corporation/Millennium Challenge Account
IMS	Information Management System
PFM	Public Finance Management
SAA	Stabilization and Association Agreement
FTA	Free Trade Agreement
WTO	World Trade Organization
MTBP	Medium Term Budget Program
GDP	Gross Domestic Product
PEFA	Public Expenditure and Financial Accountability
PEIR	Public Expenditure and Institutional Review
PRGF	Poverty Reduction and Growth Facility
ROSC	Report on the Observance of Standards and Codes
NSDI	National Strategy for Development and Integration
IPS	Integrated Planning System
CTS	Computerized Tax System
VAT	Value Added Tax

## INTRODUCTION

### Purpose

Under Albania's Integrated Planning System, (IPS) the National Strategy for Development and Integration (NSDI) will emerge as a synthesis of a comprehensive set of sector and crosscutting strategies. This paper is the sector strategy covering public finance.

The Ministry of Finance has the lead responsibility for developing a sector strategy covering:

- Macro-economic and fiscal policy, budget management, and financial management and control
- Tax administration (with participation of the General Tax Directorate)
- Customs administration (with participation of the General Customs Directorate)

The public finance sector strategy, like other sector strategies, must reflect:

- The Government Program
- European and Euro-Atlantic integration, namely the implementation of the Stabilization and Association Agreement and the NATO Membership Action Plan
- Public investment
- External assistance

The Ministry of Finance is also charged with participating in the development of cross-cutting strategies for Decentralization, Rural Development, Regulatory Reform, Infrastructure, ICT, Organized Crime, Anti-trafficking and Anti-terrorism.

Besides feeding up into the NSDI, the sector strategy is to link the strategic objectives, which have a seven year perspective, with the three year resourcing plans for departmental programs under the Medium Term Budget Program.

This sector strategy also aims to:

- Promote policy coherence and a common sense of longer term direction within the public finance sector,
- Build better understanding of financial reforms and processes across the public sector
- Make transparent to Parliament, the financial sector, international partners and the public at large, the policies being pursued and the efforts being made by the Government to create professional and credible public finance institutions.

### Scope

This Strategy covers four central government functions: Fiscal Policy, Revenue Administration, the Management of Expenditure and Investment, and Financial Management.

Fiscal Policy includes

- Economic Analysis and Revenue Projection
- Public Expenditure Policy
- Tax Policy
- Customs and Excise Policies
- Debt Policy

- Policies to combat illegal financial transactions

Revenue Administration includes

- Tax administration
- Customs Administration

Management of Expenditure and Investment includes

- Budget Planning and Execution
- Management of Public Capital Investments
- Management of Government's financial interest in other institutions.

Financial Management includes

- Treasury Function
- Public Sector Accounting
- Internal Financial Public Control

## Organization of Sector

The Public Finance Sector Strategy covers three public service organizations for which the Minister of Finance is responsible: the Ministry of Finance, the Directorate General of Taxation, and the Directorate General of Customs.

1) The Ministry of Finance is the Government's chief adviser and the executive body for fiscal policy, and the management of public funds and expenditure. This involves revenue policy, budget policy and execution, debt management, expenditure management and control and the management of public wealth. The Ministry also has a more general role in advising on the whole of government interest in the promotion of efficiency, high performance and good financial governance across the public service, in other levels of government, and in those financial institutions in which government has a stake.

The Ministry of Finance is organized into five General Directorates for:

- Budget (includes Directorates for Budget Policy and Analysis, Budget Management and Execution, and Public Investment and Management)
- Treasury (includes Directorates for Treasury, Accounting, and Public Property Management and regional offices)
- Debt, which includes the directory for financial instruments debt and the directory for foreign projects financed debt
- Macro-Economic and Fiscal Policy (includes directorates for Macro-economic Policy, and for Fiscal Policy). Directorate also responsible for compiling and disseminating Government Finance Statistics (GFS).
- Services (includes Directorates for European Integration, Information Technology, Personnel, and Legal.)
- Audit (includes Directorates for Methodology harmonization and, Audit, Supervision and investigation)

2) The Directorate General of Taxation is Albania's central tax institution. It is responsible for enforcing and managing all national taxes. It has a mission of effective and efficient collection of tax revenues, providing quality services to taxpayers and helping them to deal with all tax obligations. It is composed of the Headquarters, 36 local tax offices, and the Large Taxpayers Unit.

The Headquarters is organized into directorates and units for:

- Internal Audit Directory, Anticorruption Unit, Technical Directory, Legal Unit, Special Projects Unit, Taxpayers Service Unit, Tax Office Operations, Supervision Unit, Tax Audit and Investigation Directory, Tax Police, Human Resources Directory, Administration Directory, Finance Accounting and Statistics, and Information Technology, Appeals Directory.
- Local tax offices.

3) The Directorate General of Customs has a mission of: (i) ensuring safety and security of market and society (consumers' protection, environment protection and national border protection) by applying efficient customs supervision and by developing domestic and international cooperation; (ii) ensuring collection of taxes that are administered by the Customs; (iii) establishing favorable conditions for business development by implementing modern working methods and creating electronic customs environment.

The Directorate General of Customs has three divisions:

- Administrative Division
- Technical Division: (Includes Directorates for Anti-Smuggling, Investigation, Intelligence, Post-Clearance)
- Operational and Investigation Division: (Includes Directorates for Procedures and Debt Collection, Tariff origin and Custom Value, Legal, Statistics, Customs Laboratory)

There are also 3 regional directorates and 17 customs houses.

4) The General Directory of Fight against Money Laundering operates as a separate agency, with organizational and operational independence from the Ministry of Finance, and it reports directly to the Minister of Finance. The strategy for this Directory is to be covered by the Cross-cutting strategies on Organized Crime and Anti-trafficking and Anti-terrorism

## I OVERVIEW

### I.1 International Environment

Over the next seven years the most important international influence on Albania's Public Finance sector is the pursuit of European Integration. Fiscal policy and administration are of central importance in meeting the Acquis requirements, and success in the pursuit of accession will require major changes in the governance, policies and management of the existing public finance institutions.

At this point Albania's public finance organizations fall short of being able to effectively pursue this goal. Furthermore while there will be support for Integration policies from the European Commission, the financial and technical support from the International Financial Institutions and bilateral donors is likely to decline over the 7 year period of the strategy. It is not just a matter of Albania standing on its own feet in finding revenue and finance to replace declining grants and soft loans, but the sector has a pressing need to internalize the capacity to be successful in maintaining such core conditions as macro-economic and fiscal stability-capacities which to date have been propped up by the powerful technical resources of such bodies as the IMF and the World Bank.

### I.2 Domestic Environment

After a period of rapid improvement in macro-economic and fiscal stability and in reducing debt, Albania's Public Finance Sector faces a new set of problems which must be addressed if the country is to achieve its development and integration goals.

The fiscal adjustment from the late 'nineties, which reduced public debt levels from 80% to 55% of GDP, had the unfortunate side-effect of undermining the quality of public expenditure through disproportionate cuts in capital and non-wage recurrent expenditure, and a reduction in the flexibility for reallocation.<sup>1</sup>

The capacity of the government to free up funds for expenditure is constrained by the still high level of debt, and the expensive nature of that debt. 70 percent of Albania's public debt is held in short term domestic instruments, concentrated in the hands of a few domestic institutions. This creates a significant rollover risk and interest costs are relatively high.<sup>2</sup>

To support its development plans government also needs a sustained increase in revenue. This area of the public finance system has proved particularly challenging because Albania's recent history has produced high informality in the economy, a wide cash economy, a culture of low compliance and low trust in public institutions, and some public officials who have proved vulnerable to corruption and coercion. The result is that:

- There are still deficiencies in the transparency and enforcement of tax and customs laws and regulations.
- Revenue administration continues to be managed on tax revenue targets, rather than on performance or standards. This has resulted in recourse to undesirable tax administration practices such as non transparent procedures to determine the amount of

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<sup>1</sup> Non-discretionary spending<sup>6</sup> rising from 57 percent of the budget in 2000 to 63 percent in 2005.

<sup>2</sup> The Government under the IMF supported PRGF/EFF program has recently embarked on the development of a strategy to improve its management of public debt.

advance profit payment by businesses and the delay of vat refunds. The general directories should rather focus on managing compliance.

- The revenue base is narrow and creates incentives for tax avoidance. Business taxes are largely avoided and the decision that local governments should collect the new small business tax, which is the result of the integration of the two existing taxes on small business, carries the risk of further reducing the number of businesses registered to pay VAT. There is massive underreporting of employees for purposes of Personal Income Tax and Social Contribution withholding. Tax policy, including the mix of possible taxes, is not fully developed by international standards and is poorly linked to national strategy. Customs revenue is declining as tariffs are adjusted towards European Union levels.

Economic growth and its sustainability requires not only quantity but also quality and efficiency of investments. But the evidence so far is that the overall quality of public spending remains stubbornly low. Energy, water and telecommunications infrastructure is weak relative to EU standards and this affects the prospects of improving the investment climate. In particular, little has been achieved in building new infrastructure, and the capital investments that have been made are compromised by high costs, poor construction and inadequate provision for and attention to maintenance. It is needed greater attention to efficiency of public investment, reallocation of resources within the education sector to primary and secondary schools, reallocation of budgeted public expenditure in favour of health and education. Better control of total public expenditure, and a stronger and more sustainable revenue stream, should produce better planned and executed public spending.

A major initiative under the Government Programme is regional decentralisation. This includes the devolution of some taxing and spending powers from central to local government. The success of this important development in Albania's governance will depend very largely how well government protects the national fiscal, expenditure and accounting interests under the new arrangements. Without the application of strong national standards in these areas, such as for example, liability for local government debt, there are significant risks to the collective interest.

### 1.3 Public Service Environment

There have been recent decisions to strengthen key processes and to rationalise the responsibilities of the organisations involved in public finance .These have included

- The designation of the Ministry of Finance as the lead department for fiscal policy - creating a clear separation between policy and delivery responsibilities between the Ministry and the two revenue agencies.
- The transfer of central public investment management responsibility from the Ministry of Economy to the Ministry of Finance.
- The transfer of regulatory responsibility for some non-banking financial institutions from the Ministry of Finance to an arms-length authority.
- The transfer of other market regulation functions from the Ministry of Finance to the Ministry of Economy.
- The transfer of responsibility for the national planning process from the Ministry of Finance to the Council of Ministers
- The creation of an independent directorate to deal with financial reporting related to combating money laundering
- The development of the Medium Term Budget Programme and the draft Organic Budget Law, which, when implemented, change the architecture of budgeting, financial

management and accountability across the public sector, and give the Ministry of Finance more tools and responsibility for facilitating the medium term performance of the entire public sector.

This analysis has been reinforced by independent assessments of Albania's public finance sector which have concluded that

- Public financial management is poor in some important respects against international and regional standards<sup>3</sup>
- Public expenditure is of low quality as regards investment in human and physical capital and in the maintenance of infrastructure
- Problems with tax and customs policies and administration impede doing business in Albania more than in similar countries<sup>4</sup>
- Domestic debt stock relatively to GDP remains high and debt servicing is unnecessarily expensive<sup>5</sup>
- The mobilisation of resources from taxation and social insurance is distortional<sup>6</sup> in that it discourages the formalisation of the economy
- The human resource policies in all three of the public finance sector organisations fall short of widely accepted good practice. In particular the extensive use of dismissal and appointment and the limited use of other human resource management tools, will, if persisted in, inhibit the capacity of these organisations to accumulate the institutional knowledge necessary to support the national vision.

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<sup>3</sup> PEFA

<sup>4</sup> BEEPS

<sup>5</sup> PEIR

<sup>6</sup> PEIR

## II VISION AND STRATEGIC PRIORITIES

### II.1 Government Vision

Government has a vision of comprehensive, rapid, sustainable and inclusive growth of 6% p.a., and successful European and Euro-Atlantic integration. This includes<sup>7</sup>:

- Steady growth of expenditures for maintenance and operation of direct public services
- Public revenues increase to 27% of GDP in 2010
- Increasing capital expenditures for priority public investments with the goal of 3.5% of GDP in 2006 and gradually reaching 5% of GDP for capital expenditures financed by domestic sources by 2008
- Reducing public debt costs through deficit reduction as a percentage of GDP
- Gradual stabilization of primary budget balances to ensure the coverage of interest expenses and to increase financing of public investment from steady fiscal revenues, and
- Increasing the level of fiscal decentralization by further decentralization of shared functions.

To help achieve this, the government has committed itself to:

“...profoundly reform the planning of public finances, though the implementation of the Integrated Planning System, which will ensure the harmonization of the development of the annual state budget with the medium-term Budget Planning Framework, with the National Strategy for Economic and Social Development, and with EU Association and Stabilization Process as well as with other policy priorities and strategies.”

### II.2 Vision for the Public Finance Sector

The vision is of Albania having a reputation domestically and internationally of fully professional and strategically oriented public finance sector, implementing credible policies which are backed by high quality institutions:

“A Ministry of Finance which can be relied upon to guard the national treasury, and provide high quality policy advice and public service leadership in the pursuit of national welfare and prosperity in a financially sound manner”; and

“Tax and Customs administrations which execute revenue policies with professionalism, probity and fairness, to a standard which builds trust amongst citizens, and credibility with partner governments and the local and foreign business communities”.

### II.3 Strategic Priorities 2007-2013

Albania’s Public Finance Strategy is to mobilise resources in a manner which better supports Albania’s domestic and international objectives, and to extract better outcomes from public expenditure and investment.

The four pillars of this strategy are to:

- 1) Improve the Quality of Expenditure

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<sup>7</sup> Government Programme, June 2005.

- 2) Broaden the Tax Base and Align Tax Policies with National Priorities
- 3) Modernize management of Public Debt
- 4) Strengthen Performance and Credibility of Customs and Tax Agencies

This Sector Strategy also includes an internally focused strategic plan for building the organisational competence required to achieve the strategic objectives.

### II.3.1 Improve the Quality of Expenditure

Extracting better outcomes from public expenditure requires improvements to be made in six major areas:

- 1) Improving macro-economic and fiscal forecasting. Serious over-estimation (or under-estimation) of budgetary resources, undermines budget predictability for line departments and therefore compromises their capacity to plan and spend in the manner most likely to support national and sector priorities.
- 2) Improving the planning and execution of public investments. Public investments are the most visible evidence of Albania's economic and social progress, yet it is this area that there is the most disappointment in the quality of public spending. In addition to improving the predictability of the budget, there is a need to strengthen the processes for selecting, planning, funding and managing public investments.
- 3) Improving the public expenditure management system. The priority is to deepen the institutionalisation of Medium Term Budget Programme, and the other provisions of the forthcoming Organic Budget Law to better support aggregate fiscal discipline, the efficiency of sector spending, and the allocation and reallocation of resources to areas of national priority. Areas for attention are the budget cycle, the budget preparation and execution process, the harmonisation of fiscally sustainable pay systems, and more generally the enhancement of the organisational competence in the Ministry of Finance and line Ministries, to manage resources strategically
- 4) Strengthening treasury management and control. Low proficiency in cash management, the lack of commitment controls and poor linkage between budgeting and the system of procurement, all undermine the quality of spending.
- 5) Strengthening accounting and the system of internal financial control across the public service. Weaknesses in accounting and control are at the heart of under-performance in public expenditure. The system of public internal financial control (PIFC) is a structured framework, serving as guidance for the development of an appropriate environment for the improvement of the internal audit systems in the public sector in line with international standards and good practice. At the heart of PIFC are such elements as management accountability, decentralization and independence of the internal audit. The whole system aims at increasing transparency, efficiency and effectiveness of public expenditure.
- 6) Strengthen and institutionalize fiscal intergovernmental relations. The system of revenue assignment in Albania has experienced a major overhaul, which started with the introduction of new local tax, charges, and fee legislation in December 2002, with further progress in the transfer of functions to local government in several sectors, such as health, education, water supply companies, etc. The existing local government expenditure consists of conditional transfer, block/unconditional transfers and tax and non-tax own revenue. Trend clearly shows a gradual shift in the direction and structure of public expenditure from conditional transfers to unconditional (independent) transfers. Policies will aim at institutionalizing the roles and cooperation between ministry of finance and local government in the framework of budget policies,

increasing transparency and objectivity in the local budgeting process, correct implementation of OBL, monitoring fiscal position of local governments.

### II.3.2 Broaden Tax Base and Align Tax Policies with National Priorities

The goal is Tax policy in Albania which strikes and maintains the right balance between providing the necessary revenue for public expenditures, while not stifling the investment climate. The tax burden should not distort the investment decisions, of domestic and foreign investors.

The strengthening of taxation policies will be effected through:

- 1) Spreading the tax burden more equitably. This will involve policy and administrative measures to achieve a better level of compliance and increase the incentive for formalised employment, by refining current policies and execution so the tax burden is spread more equitably in the community.
- 2) Developing a mix of taxes which better support policies for equity, and economic and business development. Once there is a more robust administrative capacity in place, and compliance is at an acceptable level, other tax policies and tax related measures will be developed to more effectively serve the government's economic and social strategies.
- 3) Progressively aligning policies on indirect and direct taxes towards European norms

### II.3.3 Modernize Public Debt management

This component of the strategy is to manage government borrowing to meet essential financing needs of the government, but in a manner which reduces the costs and risks of public debt in the medium and long term. Key components of the strategy are to

- 1) Increase maturity period of domestic borrowing and the relative importance in the stock of debt of long term maturity debt. This will involve strengthening of the competitiveness in the domestic market for treasury bonds; financial instruments diversification (towards long maturity), and of investors; issuance of five year maturity government bonds in 2006.
- 2) Establish a better balance between domestic and foreign debt, with an increased reliance on foreign debt over domestic debt. This will involve completing the procedures for Albania to have an international credit rating, and developing appropriate policies to cover exchange rate risks.
- 3) Improve the ratio of domestic stock of debt to GDP.
- 4) Establish an Integrated Debt Management System; strengthen professional and IT capacity of the Debt Directory to carry out risk analysis and debt sustainability.

### II.3.4 Strengthen performance and credibility of customs and tax agencies

Revenue administration currently lacks prioritization and focuses too much on short-term revenue targets. This approach undermines more strategic objectives, such as encouraging self-compliance, fight against evasion, establishing a good investment climate, protection of markets from trafficking and smuggling, etc. Achievement of strategic objectives is impeded by limited information on taxpayers' responsibilities and a non-uniform and non transparent application of existing regulations by employees of both administrations. Progress on this front is not only essential to increase yields and achieve greater equity

and compliance through a widening of the tax net, but is a key institutional reform needed to encourage new investment. The strategy aims at reforming the two administrations towards modernization, efficient operating, flexibility to internal and external incentives, oriented to self-assessment and voluntary compliance.

The key components of this pillar of the Strategy are to:

- 1) Address major sources of tax evasion and reduce the tax gap. Tax administration has a major role in reducing fiscal evasion and broadening the tax base, by proper enforcement of laws and regulations and by increasing compliance. Custom administration ensures proper tax collection through controls on movements of goods and correct implementation of tax legislation.
- 2) Upgrade the quality of service for taxpayers, in particular to establish favorable conditions for business development. Effective taxpayer services play an important role in improving the public image and developing a reputation for integrity and effectiveness. In the tax administration, this will include simplifying tax procedures, improving the consistency of tax laws and instructions and making them more widely available to taxpayers in a user-friendly way. In the customs administration attention should be on implementing modern working methods and creating an electronic customs environment
- 3) Market and society protection. Customs administration is becoming one of the most important institutions in protection of market and society by establishing favorable conditions for development of international trade. SAA agreement with EU opened new possibilities for the Albanian Customs to carry out this role by ensuring a political and legal basis (EU policy on fight against terrorism, resolutions of the World Customs Organization on safety and simplification of international trade chain, etc.) and more expeditiously exchange information with customs of other countries.
- 4) Strengthen performance, management control and audit in the General Directorates for Taxation and Customs to improve capacities for strategic management, address inconsistent application of procedures, ensure proper and uniform enforcement of FTAs, and reduce corruption. This should include risk- based oriented internal audit, independent investigations of wrong-doing, complaints procedures, and the simplification and clarification of rules and procedures to eliminate unnecessary discretion
- 5) Accelerate progress with tax and customs administration reform to meet EU requirements.
- 6) Implement the Government policy of creating a National Revenue Agency. The NRA is a long term Government objective, which consists in the unification of all bodies that collect and administer central government revenues, with the purpose to provide an integrated revenue service, oriented to high quality service and cooperation with taxpayers.

### III POLICIES

This chapter shows the key policies to achieve the sector strategy over the next seven years. For the outer years, only the most critical policies are listed. This is a rolling strategic management process and more detailed policy for the outer years will be developed as the time gets closer.

#### III.1 Improve the Quality of Expenditure

Extracting better outcomes from public expenditure requires improvements to be made in six major areas:

##### III.1.1 Improving macro-economic and fiscal forecasting.

*Strengthening forecasting and estimation capacities in the Ministry of Finance, for both macroeconomic and fiscal indicators*

*Adopt Consistency Framework.* To reach agreement to work jointly with the Bank of Albania on the same consistency framework (macroeconomic model) to ensure fiscal policy is developed in line with monetary policy.

##### III.1.2 Improve planning and execution of public investments.

*Implement Action Plan for Improving Public Investment Management* covering; Institutional arrangements, procedures, information systems, and human resources and capacities

*Strengthen the processes for selecting, planning, funding and managing public investments*

- Rationalize the portfolio of domestically financed projects
- Integrate investment planning with MTPB. Ensure public investment planning and management is fully integrated within the MTBP procedures for program expenditure and investment planning.
- Standardize Appraisal. Develop and implement procedures for identifying, appraising and approving projects for both domestically and externally financed projects and link these to the MTBP process.
- Cost Benefit Analysis for major investments. Make cost-benefit and/or cost-effectiveness analysis an appraisal requirement for large investments.
- Adopt a full cost multi-year funding approval for all public investment projects.
- Maintenance provision. Give priority to the more adequate funding of the maintenance of infrastructure networks.

##### III.1.3 Improve public expenditure management system

*Institutionalise MTPB.* Formulation and approval of the new organic budget law, which will improve approximation of budgeting standards with those of the EU and IMF fiscal transparency. Deepen the institutionalisation of Medium Term Budget Programme, with all ministries complying with basic MTBP procedure by the end of 2007, and pursue a process of instruction, guidance, support and training to raise planning, budgeting, costing and accounting capacities in Ministry and in line Ministries

*Strengthen the focus on the outer year MTBP resource ceilings; so that they can provide a realistic and credible basis for medium-term budget planning at sector and agency level*

*Strengthen the linkage between the Annual Budget, the MTPB and the National Plan for Development and Integration.*

*Further develop the program-based budget classification in order to strengthen explicit linkage between the sectoral policies and the budget, in parallel with strengthened capacities*

*Implement the Organic Budget Law once it has been passed.*

*Implement full value multi-year procurement particularly for capital investment projects*

*Improve regulation of virements. Develop clear and transparent procedures for virement and or revision of annual budgets, to provide budget users with appropriate flexibility, but maintain the integrity of the budget process.*

*Strengthen external accountability ability by more meaningful and strategic engagement of Parliament on PFM issues*

- Adapt budget cycle to allow additional time for discussion of the Budget in Parliament
- Engage the Parliamentary Commission for Economic and Financial Issues, and the External Auditor on the changing nature of financial reporting under the OBL and the MTBP.

### III.1.4 Strengthen Treasury management and control

Policies related to the treasury functions management, in general are:

*Complete update of Treasury regulations*

*Complete design and implement computerised Treasury Management System. The implementation will extend to all of Albania and will include tax and customs systems, as well as other budgetary institutions.*

*Formulation and issuance of the manual for computerised Treasury Management System, with the cooperation of UNDP and ORACLE project.*

*Shift focus towards managing and controlling commitments as well as cash and payments*

*Develop cash forecasting*

In respect of each of the specific functions of the Treasury system, the following policies will be pursued:

Improve Budget Execution through:

- On-line communication between treasury directory and district treasury offices to reduce operational costs of information and documentation flows.
- Capacity building, to improve budget allocation process and changes through the year.
- Ensure on time information about commitments and expenditure of the spending agencies, to improve planning of outflows, daily and monthly, of the government deposit. On line communication with the four major spending ministries.
- Centralize public payment transactions and all public cash inflows through the Single Treasury Account in the central bank.
- Discontinue practice of mandatory closing out of the treasury single account at the end of the fiscal year.

- Label cash payments to public institutions under a category defined by the agency collecting the payment.
- Improve the planning of deposit inflows through on-line information from tax and customs administration concerning planned revenues.
- Include foreign financing in the single treasury account. For that, improvement of source data coverage for external donor financed projects is needed and, an active management of liquidities in the single account and that of special accounts in the bank of Albania will start.

#### Management of Government Liquidities and Financial Assets

*Manage equity participation in national and international financial institutions*

### III.1.5 Strengthen accounting, internal audit and public internal financial control for all of the public service.

Policies in the public accounting component aim at improving public expenditures and properties management, increase fiscal transparency through ex ante control procedures and public accounting and reporting procedures, through the following:

*Complete the formulation of OBL and de-centralization regulations*. Cooperate with other directories and bodies in the formulation of instructions to implement the new organic budget law, the decentralization process and budget release operations

*Prepare and implement Accounting Standards and Reporting Forms* for budget execution, to be used by the Treasury structures and spending units;

*Accelerate work aimed at formally adopting the GFSM 2001-based reporting format*, including for high-frequency data (monthly cash flow and quarterly government operations data) as well as quarterly non financial public sector debt.

In the context of the development and implementation of the new Oracle-based IT infrastructure, construct and document as soon as feasible, a national chart of accounts for all general government sub sectors aligned with *GFSM 2001* classifications.

*Implement treasury computerized system in the whole territory of Albania*, and expand it to customs, tax and the other budgetary institutions.

*Formulate the new law on public accounting*, with the public accounting standards based on International public accounting standards (IPSAS)

Policies related to public internal financial control (PIFC) will support the strategic goal of improving the quality of expenditure, by providing a complete legislative and procedural framework for Internal Financial Control in the public system, in the framework of public finance reforming process.

*Development of the policy paper for PIFC* and of the key elements of this system: management accountability, decentralization and independence of the internal audit.

*Formulation of policies, programmes and strategies for internal audit in the public sector.*

*Ensure a high quality internal audit process in the public sector*, transparent and accountable.

*Formulation of appropriate and updated procedures, methodologies and instructions, to support the every day activity of internal auditors.* These will reflect the international standards and EU recommendations.

*Strengthen institutional capacities and human resources,* by providing training activities for staff of all levels, and by restructuring and reorganizing the Audit Directory.

### III.1.6 Strengthen and institutionalize Fiscal Intergovernmental Relations

*Increase transparency and objectivity in the horizontal allocation among sub national governments.* Local budgeting has mainly been ad hoc. Mechanism for conditional and unconditional grants has non-transparent features in that it is unpredictable, depending basically on the bargaining (bureaucratic and political) powers between local authorities and line ministries. Thus, horizontal equalization will improve, in order to reflect demographic and economic development dynamics of the different regions and their inequalities. In the area of conditional grants, the process of competitive allocation of investment grants, started in 2006, will expand. A complete and adequate legal and regulatory framework for local budget process will be developed, as part of the new Organic Budget Law. This framework will provide the vehicle for the institutionalization of the respective roles of Ministry of Finance and local government and their process of annual consultation on proposed fiscal decentralization reforms, overall fiscal policy and management and monitoring of local budget process in the context of MTBP.

*Improve and clarify legal and regulatory framework for local budget process.* The main areas of intervention concerning MOF are: (i) treasury procedures, mainly related to differences between amounts estimated of conditional transfers and actual transfers; (ii) timeliness and clarity of instructions and details for local budget process; (iii) budget execution rules, related to the existence of a single Treasury account for all resources of local governments and therefore the potential for the displacement of resources in the event of liquidity crises; (iv) the system of financial accounting and reporting and the related difficulties to track expenditures and ensure that local budgets are delivered as approved.

*Improve local tax legislation framework,* by considering the possibility to review the indicative tax rates of the property and local small business taxes and to adopt a provision allowing local governments to adjust them for inflation.

*Implement a fiscally sound framework for local borrowing.* Local governments are still not authorized to borrow, but there are ongoing, current efforts to draft a local borrowing law. Government will ensure a policy framework that states clear rules about: (i) involvement of national government in local borrowing, emphasizing the need for management of aggregate public debt, especially in view of the Maastricht criteria, which consider all public debt as one, including local public debt (so that national government keeps tabs of the nature and extent of financial obligations of local governments); (ii) ensure prudent local borrowing, which is related to risk management policies for public finances in general; (iii) the system of debt guarantees offered by the local government; (iv) volume limitations on local debt in general, closely linked to the management of overall public finances and aggregate public debt; (v) monitoring and control mechanisms; (vi) resolution of cases of financial distress and local governments insolvency following local borrowing, to avoid that Ministry of Finance becomes entangled in local debt obligations.

Draft Public Finance Sector Strategy 2007 to 2013

Improve the Quality of Expenditure	Macro-economic and fiscal forecasting	Planning and execution of public investments	Public expenditure management system.	Treasury management and control	Accounting, internal audit and control	Strengthen intergovernmental fiscal relations
2007-9	Develop Consistency framework Establish co-operative mechanism with Bank of Albania.	Implement Action Plan for Improving Public Investment Management Rationalise domestically funded investment Standardize Appraisal Improve Maintenance provision.	Commence implementation of OBL Review and revise procurement procedures Institutionalise MTPB. Strengthen linkage with Annual Budget, MTPB and NSDI	Complete update of Treasury regulations Design Treasury Management System Implement new treasury computerized system in all Albanian territory. Design Commitments management system Agreement on donor funds going through Treasury Single Account On-line communication between treasury directory and district treasury offices. Ensure on time information about commitments and expenditure On line communication with the four major spending ministries. Centralize all public payment transactions through the Single Treasury Account. Develop cash forecasting	Complete the formulation of OBL and de-centralization regulations Accounting Standards and Reporting Forms for budget execution Harmonisation of financial records and accounting standards New law on public accounting, based on IAS New legal framework for public internal financial control Manual of procedures for Financial Control and Management Train MoF and other ministries in accounting, financial control and internal audit.	Increase transparency and objectivity in allocation among SNGs. Improve and clarify legal and regulatory framework for local budget process Improve local tax legislation framework Implement a fiscally sound framework for local borrowing
2010-11	Consistency framework fully operational for Ministry of Finance and Bank of Albania	Implement Action Plan for Improving Public Investment Management Integrate investment planning with MTPB Cost Benefit Analysis for major investments	Institutionalise MTPB. Strengthen outer year MTBP resource ceilings Strengthen external accountability	Implement Treasury Management System Implement Commitments management system External Funds all channelled through Treasury Single Account On-line communication with all budgetary institutions Adopt formally GFSM 2001 based accounting forms.	Fully implement harmonisation of financial records, accounting and internal control Train MoF and other ministries in accounting, financial control and internal audit National chart of accounts based on GFSM 2001.	Implement a fiscally sound framework for local borrowing
2012-13		Complete Action Plan for Improving Public Investment Management Adopt a full cost multi-year funding approval for all investment projects	Implement full value multi-year procurement Strengthen external accountability	Treasury management system operates for all Albania and for Tax Customs and budget institutions	Expand activity of internal control on EU funds Monitor standards	Local budget process is distinct, transparent and credible.

## III.2 Broaden Tax Base and Align Tax Policies with National Priorities

The strengthening of taxation policies will be effected through:

### III.2.1 Broaden tax base and spread the tax burden more equitably.

Broadening the tax base is more about tax administration than legislative interventions. But policies will be developed to increase tax compliance and contribute to a more compliant wider environment. The key policies are:

*Adopt a flat tax system*, with lower rates. This means uniform (instead of progressive) taxation of personal incomes, applying a rate of 10%, the same for profit taxation. This would make tax administration easier, reduce distortions and promote formalization in the economy. Starting from 1994, 11 European countries have adopted the flat tax system, while other three countries are expected to do so in 2008. (Albania for the profit tax, Czech Republic and Bulgaria). Research in the field has not yet reached a widely accepted conclusion about the effects of the introduction of a flat tax system. Nevertheless, experience in some of those countries has shown that a flat tax system serves as an incentive for a number of institutions, individuals and companies to come out from the grey part of the economy. This would increase revenues. Research has also shown that the success of a flat tax lies on the tax rate: the lower the rate, the more efficient the tax.

*Manage the compliance gap*: identify and address the major sources of tax evasion and reduce the size of the tax gap. Studies have shown that major sources of revenue under-performance are Personal Income Tax, Social Contributions, and excises. Another important source of evasion is underreporting of real turnover in order to avoid VAT registration. Legislative changes concerning these taxes will be put in place.

- Introduce Personal Income Tax Returns. Personal Income Tax returns are deemed crucial to discouraging personal income tax (PIT) evasion. This is because in the current situation of under-reporting and cash payment of salaries, compliance controls for personal income withholding tax are difficult and unlikely to yield additional revenue. Introducing PIT returns will also help to collect some of the taxes which are not currently being collected despite law provisions, such as taxes on rental revenue and social insurance contributions.
- Simplify and reduce tax rates. In the short and medium term, tax policy reforms aimed at simplifying and reducing tax rates will be introduced at a measured pace, to ensure that revenue gains are sustainable. Introduction of the flat tax at a low rate will simplify the tax scheme and reduce the tax burden for businesses, which will have the effect of reducing the incentive to underreport and register as small business. Emphasis will be on further reducing the tax wedge on labour, mainly through cuts in social security taxes, while taking care of the sustainability of the pension system. This policy aims at a progressive increase of the declared number of employees. Reductions in the VAT rate will be considered in the long term.

*Amendments in tax legislation and regulations*. Albanian tax laws (especially law on tax procedures and corporate taxation) contain many contradictory provisions, overlapping clauses, discrepancies between legal clauses and numerous gaps that need to be addressed. This induces tax authorities to exercise wide discretion in interpreting the law, giving rise to corruption. Therefore a review process is under way, for all legal and regulatory tax acts.

*Address the issue of administrative overlapping for collection of small business tax*, transferred recently to the local governments administration, especially in the areas of businesses registration and under reporting for VAT registration purposes.

### III.2.2 Develop a mix of taxes which better support policies for equity, and economic\_and business development.

*Meet Trade Policy Obligations.* Ensure commitments to WTO and Free Trade Agreements are reflected correctly in the fiscal package each year. These commitments are:

- Sign Free Trade Agreement, CEFTA, Amended and Extended, for the creation of a Regional Free Trade Area between Albania, Bulgaria, Croatia, Macedonia, Moldavia, Romania, Serbia, Montenegro, and Kosovo.
- Negotiate and sign, within five years from ratification of FTA with the EU, the Free Trade Agreement with Turkey.
- Ensure timely implementation of scheduled commitments following from WTO membership.
- Implement free trade agreement with the EU.

*Support the climate for investment* by taking steps to:

- Assess impact of removing non-tariff and tariff barriers to improve the business environment;
- Introduction of the flat tax. This policy measure is expected to have positive effects on the competitiveness of the Albanian economy, through improvement of the investment climate. Though there is not a direct relation between flat tax and macroeconomic improvements of an economy, research over several countries economies have shown a positive trend of economic growth, after the introduction of the flat tax (i.e. the case of Slovakia).
- *Optimize the tax mix .to reduce burden on businesses.* Taking into account the whole range of taxes paid by businesses, their tax burden is above the statutory profit tax rate (50% as compared to the tax rate of 20%). Some redundant taxes will be abolished.

### III.2.3 Progressively Align tax policy with the *Acquis Communautaire*

*Align legislation on indirect taxes to the EU legislation,* following EU recommendations. In Annex 1 of the National Implementation Plan of the Stabilization and Association Agreement there is a list of legal measures to adopt in order to align Albanian tax legislation with the EU norms. Some of these are: excise rates and procedures harmonization with EU (December 2010); expand integral revenue declaration system for personal income tax (December 2008); full application of integral revenue declaration system for personal income (December 2010).

*Gradually reduce and eliminate tariff trade barriers* with EU countries.

Broaden Tax Base and Align Tax Policies with National Priorities	Broaden tax base and spread tax burden more equitably	Tax mix supports policies for equity, and economic and business development.	Align policies on indirect taxes and direct taxes (where possible) with European norms
2007-9	Manage the compliance gap. Address overlapping administrative issues between central and local tax administration.	Meet Trade Policy Obligations: CEFTA FTA with Turkey WTO commitments schedule Support climate for investment: <ul style="list-style-type: none"> <li>Assess impact of removing non-tariff and tariff barriers</li> <li>Create non distortional investment tax incentives</li> <li>Optimise the tax mix to reduce burden on businesses</li> </ul>	Align legislation on indirect taxes to the EU legislation Gradually reduce and eliminate tariff trade barriers with EU countries
2010-11	Manage the compliance gap.	Meet Trade Policy Obligations <ul style="list-style-type: none"> <li>WTO commitments schedule</li> </ul> Create non distortional investment tax incentives.	Gradually reduce and eliminate tariff trade barriers with EU countries
2012-13	Adopt a flat tax system	Meet Trade Policy Obligations	

### III.3 Modernize public debt management

This component of the strategy is to manage government borrowing to meet essential financing needs but in a manner which reduces the costs and risks of public debt in the medium and long term. Key components of the strategy are

#### III.3.1 Increase maturity period of domestic borrowing and diversify domestic investors base

Policies are to:

*Develop the domestic market for government bonds.* Take steps to further develop the domestic government's security market, such as: opening up the Treasury bond auctions to a wider market; and, developing an effective and liquid secondary market for government bonds, to ensure that individuals and institutional investors participate in financing government debt.

*Diversify financing instruments.* Recent introduction of a three year Treasury note into the market and the issuance of five year maturity government bonds, with the aim of lengthening debt maturity are important steps to achieve this goal.

*Strengthen strategic debt management.* Implement the National Medium Term Strategy for Debt, approved by the government by end of 2006 and the related strategic action plan.

### III.3.2 Establish a better balance between domestic and foreign debt,

Policies will be focused on reducing domestic debt<sup>8</sup> and increasing foreign debt. The recent decline, due to declining deficits, is expected to continue in the near term, but policies will support decline in the longer term through:

*Reducing reliance on domestic resources to fund deficit*, because of the high interest costs of the domestic stock of debt.

*Use additional tax administration gains* to retire domestic debt.

*Increase access to foreign official financing*, which Albania already receives, given its long term nature.

*Obtain gradual access to long term external commercial financing sources* in the longer term, in order to reduce overdependence on official and bilateral creditors and enhance external financing flexibility. This is conditional to improving macroeconomic performance, building a sound track record of payment (including the clearance of existing arrears), and improving credit rating.

### III.3.3 Improve domestic debt stock ratio to GDP

*Use privatization revenues* to reduce debt stocks.

*Make reduction of debt stock an integral part of the Medium Term Debt Strategy.*

### III.3.4 Set up Integrated Debt Management System

*Enact a new public debt law*

*Establish a General Debt Management Directorate.* Raise capacities for debt risk and stability analysis, which to date have been propped up by technical assistance of such bodies as the IMF and the World Bank.

*Gradually change Treasury bill issuance*, to better reflect government cash flow patterns.

*Provide a level playing field* for nonresident investors.

*Modernize custody and depository systems.*

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<sup>8</sup> Empirical estimates indicate that a 1 percentage point of GDP increase in domestic financing reduced GDP per capita growth rate by one third of a percentage point (Baldacci, 2003). Studies also showed that fiscal adjustments based on reducing domestic financing have about one and a half times the effect on growth as adjustments based on reducing both domestic and foreign financing (Gupta, 2002).

Modernize debt management	Increase maturity period of domestic borrowing and diversify investors' base	Establish better balance between domestic and foreign debt	Reduce ratio of stock of domestic debt to GDP	Set up Integrated Debt Management System
2007-9	Diversify financing instruments Strengthen strategic debt management	Reduce reliance on domestic resources to fund deficit Increase access to foreign official financing Use gains from tax administration to reduce domestic debt stock Ensure credit rating for albania	Use privatization revenues to reduce domestic debt stock. Make reduction of debt stock an integral part of the medium term debt strategy.	Develop a new public debt law; Establish a General Debt Management Directorate Gradually change treasury bill issuance to better reflect government cash flow patterns; Provide level playing field for nonresident investors, Modernize custody and depository systems.
2010-11	Develop the domestic market for government bonds Strengthen strategic debt management	Reduce reliance on domestic resources to fund deficit Increase access to foreign official financing	Use privatization revenues to reduce debt stocks.	Implement Public Debt Law Treasury bill issuance reflects government cash flow patterns; Level playing field for non-resident investors, Custody and depository systems modernized
2012-13	Strong Domestic Market for government bonds created	Albania has international credit rating and access to long term external commercial financing sources		

### III.4 Strengthen Performance and Credibility of Customs and Tax Agencies

The policies for this pillar of the Strategy are to:

#### III.4.1 Address the major sources of tax evasion and reduce the tax gap

##### Tax administration:

*Strengthen management of compliance.* Tax Directory will focus on management of compliance rather than attaining revenue targets. This will require: closely monitoring of non compliance rates concerning registration, filing, and payment obligations, underreporting and other means of evasion.

- Improve compliance with Personal Income Tax and withholding of social contributions. In the short and medium term, polices will focus on simplifying filing procedures for PIT a social contributions withholding, intensifying control of filings and payment obligations and based and joint audit for the two taxes, in order to exploit economies of scale and increase revenue effectiveness by combining the functions. In the longer term, PIT Returns will be introduced, accompanied by a comprehensive compliance improvement program, based on effective tax return filings and payments control, an effective audit function and proper enforcement of PIT arrears. The choice of making the introduction of PIT Returns a long term policy relates to difficulties and serious administrative constraints for GDT to properly administer PIT Return requirements.

- Improve VAT administration and compliance (2007-2009), by: strengthening VAT compliance control programs and addressing under-reporting; addressing the VAT refund process which has crucial implications for taxpayer compliance. The GDT strategic plan and the Directory's management of performance will have a clear objective of full compliance with the VAT refund obligations and identifying and implementing working methods to ensure timely VAT refunds.
- Simplify registration and tax payment procedures to reduce costs of compliance and increase number of registered businesses. Introduction of the one-stop-shop system for business registration, in September 2007, will make it easier to start a business in Albania. Concerning the simplification of tax procedures, we consider internet based payments as a possibility for the near future, initially for large taxpayers. This requires monitoring of developments regarding business use of internet, weighing costs and risks against benefits.

#### Customs administration

*Improve and develop means for accumulation, analysis, exchange and exploitation of customs information, for use in preventing violations of customs legislation, and discovering offenders*

*Develop data exchange and increase cooperation between the Albanian Customs and; the business sector, other institutions of the Republic of Albania, other law enforcement institutions; and with the Customs authorities of other countries, EU institutions and international organizations in the fields of implementation of customs legislation, prevention of violations, control and investigation*

*Improve tax accounting, and collection, to more efficiently prevent infringements of tax related legislation*

#### III.4.2 Upgrade quality of service for tax payers.

##### Tax administration

The key policies are:

*Strengthen Tax Payer Services* by Increasing personnel numbers and management support for this function;

*Improve Accessibility of Taxpayer Services* in terms of timelines, accuracy, convenient location and response time, and limproving the clarity, transparency and consistency of tax laws and regulations.

*Promote Culture of Better Service to Taxpayers* is a longer term objective to be pursued throughout the GDT as means of increasing compliance and tax revenues by

- developing clear and specific objectives for taxpayer services and defining indicators to measure performance against the established objectives
- developing and delivering awareness and education programs for taxpayers

*Strengthen administrative appeals system for taxpayers' protection:* one instance of complaint is set up within the tax administration; the other is a Tax Tribunal as a final step of administrative complaint to be set up in the short term.

##### Customs administration:

*Establish favorable conditions for business development*

*Provide reliable and useful information to the public on its activities, as well as legislative and procedural framework.*

*Implement provisions of EU customs legislation providing simplifications applicable to business entities*

*Pursue measures related to implementation of the e-customs initiative, aimed at simplifying submission of customs declarations, computerizing customs procedures, providing easy access to information, providing customs services based on a “single window” approach, and expanding the public information system on customs activities.*

### III.4.3 Protection of market and society

Policies to be pursued by customs administration will be:

*Implement measures related to safeguarding security of international trade and prevention of terrorist acts and organized crime:*

*Implement a computerized management system for risks related to goods, customs procedures and persons, and to integrate it into EU risk management process*

*Become a coordinating institution, responsible for control of goods being transported through the external borders of Albania in the integrated state border protection system of the Republic of Albania. Control of movement of goods will be insured by implementing modern measures and methodologies, as used in other EU Member States, for customs examination of goods and the vehicles transporting the goods.*

*Ensure appropriate provision of the Albanian customs institutions with up-to-date means of control and inspection equipment and to ensure effective use of such means.*

### III.4.4 Strengthen performance, management control and audit.

#### Tax administration

Policies are to address inconsistent application of procedures, absence of risk management approach, ineffectiveness of audit, insufficient number of well trained officials:

*Improve capacities for strategic management, to ensure that GDT assesses and reacts to internal and external developments, identifies the main risks to revenues, set performance measures and manages activities according to priorities set in the strategic plans. This will avoid the current practice of implementing measures which are not based on analysis and strategic issues to be addressed.*

*Upgrade staff knowledge of procedures.* Ensure that officials understand and properly perform day to day tasks, according to the functional structure and the procedural manuals.

*Improve taxpayer audit system and procedures:* introduce and manage a risk based audit selection system supported by a risk assessment software that will provide for taxpayers to be selected on the basis of objective criteria while the design of audits will shift from a comprehensive to a more narrow or single-issue focus; discontinue the practice of prescribing mandatory audits so that such audits may be left to the discretion of the tax department; develop training programs to support introduction of modern audit techniques.

*Review efficiency/effectiveness of resource use in tax administration.* Some areas of intervention are:

- Review the role of the tax police; integrate tax police staff into the structural functions of tax administration, such as audit, enforcement, investigation, in order to increase allocation of skilled human resources to more productive activities, to help increase compliance levels revenue collection.

- Set up a system of bigger local tax branches (14 to 15 of them), incorporating the numerous actual small and inefficient small local branches (there are 37 tax branches in Albania), which in turn will serve as Service Offices for taxpayers.
- Refocus resources towards larger taxpayers; Improve the LTO structure and set up measures to strengthen large taxpayer compliance control.

*Strengthen operation of Anticorruption Unit*, within the tax administration; review Ethical Code of Conduct; increase professional standards.

*Enforce internal audit procedures*, independent investigations of wrong-doing, complaints procedures, and the simplification and clarification of rules and procedures to eliminate unnecessary discretion

*Strengthen human resources management*; apply transparent rules of hiring, promotion and dismissal, according to Public Service basic rules and law on Tax Procedures; gradual shift to civil servants regime; intensify staff training, particularly in audit techniques, and achieve full compliance with existing legislation and regulation regarding human resource issues and procedures.

*Complete computerization of offices*; include in ITS (Integrated Tax System) all kind of taxes<sup>9</sup>; *on line* communication with local tax branches.

#### Customs administration

Policies are aimed at organizational improvements, human resources development and information technology investment.

*Modernize management of the Albanian Customs* by taking up best practices of foreign customs, improving internal control system and establishing up-to-date methods of quality management

Apply a consistent policy on the *centralization and decentralization of the distribution of functions and control tasks* among customs offices

*Correct and standartized management of customs values determination*, in all customs territory of Albania.

*Improve administrative capacities of the Albanian Customs by:* apply transparent rules of hiring, promotion and dismissal, according to Public Service basic rules and law on Tax Procedures; gradual shift to civil servants regime; establish conditions for attracting, educating and retaining specialists of high qualification, establish gradual career seeking, and enhancing the motivation of officers, to improve their qualifications.

*Implement systematic corruption prevention:* improve the investigation and disclosure of acts of corruption; *develop standards* of behavior to minimize corruption; correct enforcement of law on Conflict of Interests, through standard implementation of rules on identification, registration, resolution and punishment of conflictual cases.

*Concentrate activities of the Albanian Customs in modern and well equipped customs points*

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<sup>9</sup> ITS is financed by the European Union.

### III.4.5 Accelerate progress with tax and customs administration reform to meet EU requirements

#### Tax Administration

*Strengthen anti corruption structures* within the fiscal revenue service to fight against tax evasion, fraud and corruption: carry out confidential questionnaire-based surveys on corruption in the General Directorate of Customs and the LTO

*Adopt Code of Conduct for Business Taxation* for the new fiscal measures;

*Complete computerization of tax office*; progress towards the creation of centralized system to link into a single network all elements of fiscal revenue services; implementation of the electronic filing; infrastructure improvements (2007-2009)

*Increase transparency and information exchange with the EU countries*

#### Customs Administration

*Approximation of customs standards with EU:*

- Increase service quality and speed of customs procedures;
- Increase computerization of customs procedures, vertically and horizontally; extend the ASYCUDA computerization system to all remaining customs offices and
- Implement risk analysis procedures for custom branches with high and medium flows of goods; improve the effective use of the risk selection module
- Implement ASYCUDA-WORLD system to simplify customs declaration submission and easy information access.

*Train staff* in implementation of laws and procedures approximated with EU legislation;

*Strengthen administrative cooperation* with countries signatories of MSA and EU countries.

*Combat fiscal evasion, corruption and smuggling* by:

- Strengthen administrative and human capacities;
- Increase cooperation and information exchange with EU bodies and for preventing fiscal evasion and smuggling practices;
- Making customs procedures more transparent.

*Approximate customs legislation with the Acquis*, according to Annex 1 of the national plan for the implementation of SAA.

### III.4.6 Implement the government policy of creating a National Revenue Agency

Policies envisaged both for tax and customs administration

*Unify tax and customs administration.*

This is a major machinery of government initiative that will be carefully planned and phased to ensure that expertise and experience is preserved and developed, that services are maintained and improved in the interim, and that the problems of management and internal control in the current agencies are dealt with and are not transmitted to the new agency. The steps will be

- Design NRA. Government assigns responsibility for the development of proposals for the governance structure and resourcing of the new agency

- Decisions and resourcing of NRA. Government decides on the governance and structure, resourcing and appropriate legislative and budgetary provision is made
- Transition Planning. Person or body responsible proposes, and when approved, implements a transition plan to create the agency while minimizing disruption to revenue services and continuing pursue the short and medium policy and administrative improvements identified in the Public Finance Sector Strategy.
- Transition Implementation

*National Revenue Agency is established*

Tax administration

Strengthen performance and credibility of tax administration	Address the major sources of tax evasion and reduce the tax gap	Upgrade quality of service for tax payers	Strengthen performance, management control and audit	Accelerate progress with tax reforms to meet EU requirements	National Revenue Agency
2007-9	<p>Strengthen management of compliance:</p> <ul style="list-style-type: none"> <li>• Improve compliance with PIT and withholding of social contributions</li> <li>• Simplify registration and tax payment procedures</li> <li>• Improve VAT administration and compliance</li> <li>• Internet based payments of tax obligations for large taxpayers.</li> </ul>	<p>Strengthen Tax Payer Services</p> <p>Strengthen administrative appeals system for taxpayers' protection</p> <p>Improve Accessibility of Taxpayer Services</p> <p>Develop and deliver educative/informative programmes</p>	<p>Improve capacities for strategic management</p> <p>Upgrade staff knowledge of procedures</p> <p>Improve taxpayer audit system and procedures</p> <p>Review efficiency/effectiveness of resource use</p> <p>Strengthen operation of Anticorruption Unit</p> <p>Enforce internal audit procedures</p> <p>Strengthen human resources management</p> <p>Complete offices computerization</p>	<p>Adopt Code of Conduct for Business Taxation</p> <p>Increase transparency and information exchange with EU countries</p> <p>Correct implementation of laws and regulations</p>	<p>NRA approved</p> <p>Interim plan approved</p>
2010-11	<p>Strengthen management of compliance</p> <p>Internet based payments of tax obligations</p>	<p>Promote Culture of Better Service</p> <p>Develop and deliver educative/informative programmes</p>	<p>Improve capacities for strategic management</p> <p>Strengthen human resources management</p> <p>Strengthen operation of Anticorruption Unit</p> <p>Improve taxpayer audit system and procedures</p>	<p>Increase transparency and information exchange with EU countries</p>	<p>Interim plan implemented</p> <p>NRA formally established</p>
2012-13		<p>Promote Culture of Better Service to Taxpayers</p> <p>Develop clear and specific objectives for taxpayer services; define indicators to measure performance</p>	<p>Improve capacities for strategic management</p> <p>Strengthen human resources management</p>	<p>Strengthen transparency and information exchange with EU countries</p> <p>Intensify fight against corruption.</p>	<p>Interim period ceases and NRA fully operational</p>

Customs Administration

Strengthen performance and credibility of tax administration	Address the major sources of tax evasion and reduce the tax gap	Upgrade quality of service for tax payers	Protection of market and persons	Strengthen performance, management control and audit	Accelerate progress with customs reforms to meet EU requirements	National Revenue Agency (Tax and Customs)
2007-9	<p>Improve accumulation, analysis and exploitation of customs information</p> <p>Improve tax accounting, and collection</p> <p>Develop data exchange</p>	<p>Establish favorable conditions for business development</p> <p>Provide high quality information about customs activity and legislation.</p> <p>Provide simplifications applicable to business</p>	<p>Implement a computerized management system for risks</p> <p>Become a coordinating institution</p> <p>Ensure provision with up-to-date means of control and inspection equipment</p> <p>Implement measures related to safeguarding security of international trade</p>	<p>Modernize management of the Albanian Customs</p> <p>Implement concepts of centralization and decentralization of functions and control tasks</p> <p>Improve administrative capacities of the Albanian Customs</p> <p>Implement systematic prevention of corruption</p> <p>Concentrate activities modern and well equipped customs point</p>	<p>Increase service quality and procedures' speed;</p> <p>Increase computerization;</p> <p>Implement risk analysis procedures;</p> <p>Train staff for new standards;</p> <p>Combat fiscal evasion, corruption and smuggling</p> <p>Increase cooperation with EU bodies</p>	<p>NRA approved</p> <p>Interim plan approved</p>
2010-11		<p>Pursue measures related to implementation of the e-customs initiative</p>		<p>Modernize management of the Albanian Customs</p> <p>Conceptualize centralization and decentralization of distribution of functions and control tasks</p> <p>Implement systematic prevention of corruption</p>	<p>Increase service quality and computerization.</p> <p>Implement risk analysis procedures;</p> <p>Combat fiscal evasion, corruption and smuggling</p> <p>Strengthen administrative and human capacities;</p> <p>Increase cooperation with EU bodies</p>	<p>Interim plan implemented</p> <p>NRA formally established</p>
2012-13		<p>Implement e-Customs initiative.</p>		<p>Modernize management of the Albanian Customs</p> <p>Implement centralization and decentralization of distribution of functions and control tasks</p>	<p>Approximation of customs standards:</p> <p>Combat fiscal evasion, corruption and smuggling</p>	<p>Interim period ceases and NRA fully operational</p>

## IV RESOURCE IMPLICATIONS

This chapter presents the key resource issues related to the achievement of the strategy's goals. It provides an overview of the resource allocations across policy areas according to the 2008-2010 MTBP and identifies the resources that are currently flowing into the sector through externally-funded projects. An estimation of internal resources for the period 2011-2013 is also provided in this section. It then singles out those areas where the implementation of the strategy will require new investment and new organisational competencies.

Given the indicative resource projection for the Ministry of Finance, it is assumed that any additional costs will be funded in either of three ways: new resources (either domestic or foreign); reallocation of existing resources from areas of low strategic value to areas of high strategic value; and improved management. The assessment is not complete and calls for: better information and analysis on current costs than has so far been available; the outcome of the NSDI priority setting process to which this sector strategy is an input; the nature and timing of the decision on a National Revenue Agency; and agreement with development partners on their support for the strategy.

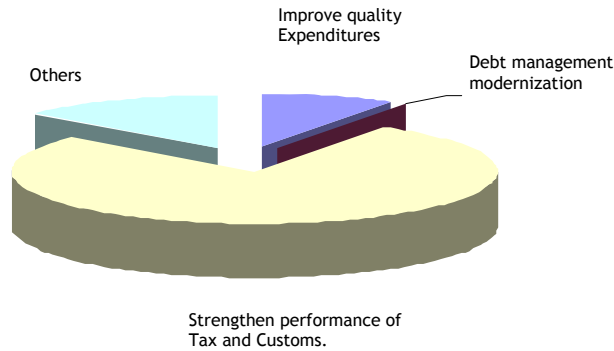
### IV.1 Current allocations

#### IV.1.1 Budget

The following table presents the resources (in million Lek) allocated to each of the budget programmes according to the 2008-2010 MTPB to the Ministry of Finance, the General Directorate for Taxation, and the General Directorate for Customs. Estimation for the outer years is based on the assumptions that the ratio of resources for public finance sector to total budget remains the same and economic growth for these years of 5% p.a. The first column maps indicatively the four pillars of the sector strategy to the budget programmes. Some budget programmes are not exclusively related to a specific pillar, such as the planning, management and administration budget programme.

Pillar	Budget programme	2007	2008	2009	2010	2011	2012	2013
Improve quality of expenditure	Public expenditures management (1)	261	341	360	385	408	433	459
Modernize debt management	Internal audit of public finance (2)	49	54	57	65	69	73	77
4. Strengthen performance and credibility of customs and tax agencies	Tax revenues management (5)	1598	1690	1726	1834	1926	2022	2123
	General Directorate of Customs (6)	1205	1272	1300	1382	1991	2022	2123
Others	Planning, management and administration (3)	209	229	237	255	268	281	295
	Payment execution (4)	250	220	220	220	200	180	168
	Fight against illegal transactions	42	44	45	47	49	51	53
	Public Sector, total	3,664	4,887	3,945	4,188	4,910	5,060	5,321

Definitions: 1. Revenue forecasting, annual budget preparation and execution, public debt management, treasury. 2. Policy and methodology for public financial internal control. 3. Administration of the ministry structure. 4. Payments execution due by the government for citizens who have appealed against court decisions dhe payments due to political staff (and not only) as a benefit over the salary. 5-6. collection of tax revenues.



The following table indicates the distribution of available resources by types of expenditure (salaries, other recurrent, and capital) for each budget programme for 2007. No major changes have been scheduled for years 2008 and 2009.

Budget programme	Salaries (%)	Other recurrent (%)	Capital (%)
Planning, management and administration	35.5	48	17
Macroeconomic and fiscal forecasting	100	0	0
Payment execution	0	100	0
Budget planning	100	0	0
Budget execution	79	21	6
Debt management	100	0	0
Internal audit and financial control	49	51	0
Fight against illegal transactions	66.7	28.5	4.8
Ministry of Finance, total	40.8	54.6	4.6
Tax administration	70.1	20.3	9.6
Customs administration	75.1	18.6	6.3

#### IV.1.2 External resources

The following table lists the main foreign assistance projects in the public finance sector<sup>10</sup>.

<sup>10</sup> The list of projects was assembled by the Donor Technical Secretariat in June 2006. The table omits smaller technical assistance projects from which the Ministry of Finance and its dependent institutions are benefiting (e.g. from OECD SIGMA) because information about them was not readily available.

Donor	Project	Pillar/Policy area	€ million	Duration
<b>Grants</b>				
Netherlands, Sweden, UK	Strengthening public expenditure management	Improve quality of expenditure Budget policy	5.9	2006-2008
EU-Albania, CAFAO	Support to the general directorate of customs (tax and customs)	Implementation of the customs strategic plan for 2007-2013	3.0	Applied in Dec. 2006
CARDS (Albania-Greece)	New border transit point in Qafe Bote, Konispol (tax and customs)	Enhance commercial cooperation with Greece	2.3	Applied in Oct. 2006
CARDS 2004-PAMECA	New border transit point between Albania and Montenegro in Muriqan (tax and customs)	Strengthen cooperation between the two countries	1.6	agreement to be signed.
CARDS 2004 (Albania-Germany)	Twinning project between Albanian directory for the prevention of money laundering and the German federal police office. Technical and material assistance	Enhance cooperation between the two countries in issues such as the prevention of money laundering and financing of terrorism	1.7	2007-2009
Italian Government	Mezzogiorno-Balkan area (tax and customs)	Improve customs procedures along national border part of VIII Corridor	0.3	Negotiations
USA-USAID	Threshold programme: improving the MCA eligibility requirements	Tax system administration	5.44	2006-2008
UNCTAD	Development of the customs computerized system, based on ASYCUDA (tax and customs)	Continuation of the technical assistance for ASYCUDA, support and training activities for European standards and best practice customs procedures		Negotiations
EU-Albania, CAFAO	(tax and customs)	Tax system administration		2005-2008
SIDA-Swedish Government	(tax and customs)	Tax system administration		2007
CARDS 2005	Improve infrastructure for local offices, Ministry of Finance	Improve public expenditure/budget execution	1.0	2006-2007
<b>Loans</b>				
World Bank	Public administration reform	1. Improve quality of expenditure Budget policy; treasury management	4.500 [\$5.7]	2000-2006

A rough calculation suggests that the Ministry of Finance and the two general directorates receive approximately €8 million worth of support from external resources on an annual basis (or almost 30% of the resources that they receive through the government budget).

## IV.2 Future demands

The previous section has outlined the resource allocation decisions in the medium and long term. This section examines individual policies under the four pillars and in particular proposed investments that will call for additional financial resources. It assesses the

alternative sources of funding for these policies. It also addresses demands for additional human resources. As mentioned earlier, improved management practices are expected to be the main source of funding internal capacity building programmes. However, the scope for reallocating existing resources to areas of high strategic value is also explored.

#### IV.2.1 Investment

A number of policies included in Chapter 3, particularly but not exclusively in the tax and customs administrations, involve investments in technology which may be costly and which are unlikely to be funded by national sources. The table below summarises these investment plans and identifies an indicative cost<sup>11</sup>.

Policy area	Policy	Cost
<b>1. Improve quality of expenditure</b>		
Macro-economic and fiscal forecasting		
Planning and execution of public investments		
Public expenditure management system	Design and implement the computerized treasury management system On-line communication between: <ul style="list-style-type: none"> <li>Ministry of Finance and district treasury office</li> <li>Ministry of Finance and four major ministries</li> </ul>	
Treasury management and control		
Accounting, internal audit and control		
<b>2. Broaden tax base and align tax policies with national priorities</b>		
Spread the tax burden more equitably		
Develop mix of taxes to support policies for equity, economic and business development		
Progressively align policies on indirect taxes towards European norms		
<b>3. Reduce the costs and risks of public debt</b>		
Increase maturity period of domestic borrowing; diversify domestic investors base	Develop the domestic market for government bonds	
Establish better balance between domestic and foreign debt		
Reduce domestic debt ratio to GDP		
Set up integrated debt management system	Set up Debt Management General Directory Modernize custody and depository systems	
<b>4. Strengthen performance and credibility of customs and tax agencies</b>		
Address the major sources of tax evasion and reduce the tax gap		
Upgrade quality of service for tax payers	Undertake an intensive educational campaign on taxpayer rights and responsibilities Construction of a new customs facility in Fier	\$400,000
Protect market and society		
Strengthen performance, management control and audit	Set up an Integrated Tax System: <ul style="list-style-type: none"> <li>Develop a reliable IT network between the GDT and the 15 district tax offices throughout</li> <li>Install a comprehensive MIS (management information system) system</li> </ul>	\$ 235,000 \$ 300,000 \$ 600,000 <sup>12</sup>

<sup>11</sup> Parts of the table which are more visible refer to consistent investments in terms of financial resources.

<sup>12</sup> Only for Tirana tax branch.

	<ul style="list-style-type: none"> <li>Improve Physical Facilities</li> </ul>	\$ 300,000
	Strengthen anti corruption unit within GTD	\$ 300,000
	Set up the Tax Tribunal	
Accelerate progress with tax and customs administration reform to meet EU requirements	Increase computerization of customs procedures; expand ASYCUDA system in all customs points.	
Create a National Revenue Agency	Establish National Revenue Agency	

The big potential expenditure is the creation of the National Revenue Authority. This strategy doesn't provide any cost assessment and financing sources in this regard because of lack of information.

#### IV.2.2 Human Resources Management and Development

In order to achieve the public finance strategic goals, particular emphasis will be placed on improving organisational competence within the Ministry of Finance, the General Directorate of Taxation and the General Directorate of Customs. These deep-seated organisational and capacity changes require the active and sustained attention of both political and administrative leaders and cannot be achieved simply by applying more funds and hiring more people. Achieving organisational competence means the creation of appropriate skills, processes, management environment, institutional knowledge, values, and reputation:

- The Ministry of Finance has to create a strong knowledge-based culture with highly committed and professional staff that - by sound analysis, well-balanced policy advice and good example - provides leadership for the successful development of Albania's public sector.
- For the General Directorate of Taxation the challenge is an organisation that has the respect of citizens and which provides tax collection with the credibility necessary to deter tax evasion and increase voluntary compliance.
- The General Directorate of Customs has similar challenges but the added responsibility of being a shop window for Albania in its relations with foreign visitors and traders, and of demonstrating to the rest of Europe that Albania can fully participate in a common European border regime.

Various ongoing initiatives aim to improve capacity for particular functions and processes. However, the relative priority of these initiatives had not been assessed within the Ministry to ensure that they are successfully institutionalised. The strategy places these initiatives in the context of the entire public finance sector and aims to strengthen their management and sequencing.

The table below summarises the main human resource-intensive activities that will be directed not only to the Ministry of Finance and the two general directorates but also to line ministries and service beneficiaries.

Policy area	Training and management implications of policies
<b>1. Improve quality of expenditure</b>	
Macro-economic and fiscal forecasting	Train Macroeconomic and Fiscal Policy Department staff in the macroeconomic framework and fiscal forecasting
Planning and execution of public investments	Train line ministries in public investment procedures Train Public Investment Department staff in new procedures and in cost-benefit analysis
Public expenditure management system	Train line ministries in medium-term budget procedures

Treasury management and control	Establish stronger management framework to oversee the public expenditure management processes Train Treasury Department staff in cash forecasting Train line ministries and subordinate units in the treasury computerised system
Accounting, internal audit and control	Train Audit Department staff in harmonised methodology Train line ministries to harmonise financial records and accounting and internal control standards
<b>2. Broaden tax base and align tax policies with national priorities</b>	
Spread the tax burden more equitably	Train fiscal policies staff to increase capacities in policy proposals and formulation (as well as revenue forecasting).
Develop mix of taxes to support policies for equity, economic and business development	
Progressively align policies on indirect taxes towards European norms	Train fiscal policies staff for indirect taxes legislation harmonization with EU.
<b>3. Reduce the costs and risks of public debt</b>	
Increase maturity period of domestic borrowing; diversify domestic investors base	
Establish better balance between domestic and foreign debt	
Reduce domestic debt ratio to GDP	
Set up integrated debt management system	Set up of the general directory of debt management; increase staff capacities (including debt stability analysis)
<b>4. Strengthen performance and credibility of customs and tax agencies</b>	
Address major sources of tax evasion and reduce tax gap	Strengthen management of compliance with personal income tax
Upgrade quality of service for tax payers	Develop and deliver awareness and education programmes for taxpayers; train staff for delivering high quality services.
Protect market and society	
Strengthen performance, management control and audit	Upgrade staff knowledge of procedures Train auditors for new risk analysis procedures. Reallocate staff from small business to large taxpayers Reallocate staff from small local branches, after their closure and transformation in service offices. Rationalise use of resources in the Tax Police; reallocate staff within Tax Police structures.
Accelerate progress with tax and customs administration reform to meet EU requirements	Strengthen anti corruption structures Train staff at the General Department of Taxation and the General Department of customs in new standards and Acquis provisions Strengthen administrative and human capacities at customs to combat fiscal evasion, corruption and smuggling

The Ministry of Finance will prepare an action plan on training to ensure that the above activities are scheduled appropriately not only across years but also within each year.

No analysis of the possibilities for reallocation has yet been done. This will be a priority for the senior management of Ministry of Finance once they have improved the information base for resource allocation by means first of a better MTPB program and

costing structure. Within the area of public investment management, one strategic decision with possible reallocation implications is whether Ministry of Finance continues to provide regional services once fiscal decentralization is better developed.

An indication of potential staffing needs is provided by comparing the current staffing norms of Ministry of Finance departments in Albania and Slovenia.

General Department	Department	Albania	Slovenia
Macroeconomic and fiscal policy		14	38
	Macroeconomic policy	7	4
	Fiscal policy	7	34
Budget		31	74 <sup>13</sup>
	Budget policy and analysis	8	
	Budget management and execution	13	
	Public investment management	8	
Treasury		32	184 <sup>14</sup>
	Treasury	7	18
	Debt management	8	14
	Accounting	8	122
	Public property management	7	30
Audit			
	Internal audit	9	
	Methodology and statistics	10	
	Supervision and investigation	14	38

### IV.3 Managing the strategy

In order to utilise human and financial resources with sufficient intelligence and coherence to achieve the strategic goals the following strategy management arrangements are envisaged:

- There will be a process of strategic management across the public finance sector: the Strategy, Budget and Integration Working Group at the Ministry of Finance will monitor this strategy and will deal with issues such as the establishment of priorities for external funding, and the delineation of policy and operational responsibilities.
- The Ministry of Finance and the two general directorates will strengthen their processes for resource management: the senior officers of each organisation will give more time attention and structure to the corporate resource management process. Each of the three organisations will translate the strategy through the MTBP process into operational plans which set priorities and allocate resources, and will actively oversee recruitment, and career development in the areas of strategic importance. A performance management and control system will delegate components of the strategy and operational plan to individual managers and hold them accountable for responsibilities. The budget programme and output structure will be further developed

<sup>13</sup> Including a department for EU funds management.

<sup>14</sup> The figure covers treasury directory, public property management directory, and public accounting directory.

so that they provide more usable information about strategic priorities, policies and the full cost of pursuing them.

## V ACCOUNTABILITY, MONITORING AND EVALUATION

This chapter covers the indicators relevant to outcomes of the Public Finance Strategy, the means by which they are monitored, and the arrangements through which the Government will be held to account for its performance in this sector. It also covers consultation process and transparency. This will help increasing accountability of the three organizations, by involving internal and external stakeholders and public in general.

### V.1 International Standards and Monitoring processes

For “Public Financial Management” as widely conceived, and so covering most of the functions of the Ministry of Finance and the Directorate General of Taxation, the Government of Albania has already committed itself to important international standards and monitoring processes. These are:

#### V.1.1 PEFA (*Public Expenditure and Financial Accountability*) indicators for Public Financial Management

The Government of Albania is a party to the Public Financial Management (PFM) Performance Measurement Framework (PEFA) which is an integrated monitoring framework that allows measurement of country PFM performance over time. It has been developed through concerted international effort by PEFA partners in collaboration with the OECD/DAC Joint Venture on PFM. PEFA is a multi-agency partnership program sponsored by the World Bank, the International Monetary Fund, the European Commission, The UK’s Department for International Development, the French Ministry of Foreign Affairs, the Royal Norwegian Ministry of Foreign Affairs, the Swiss State Secretariat for Economic Affairs, and the SPA Strategic Partnership for Africa.

The framework incorporates a set of high level indicators which draw on HIPC expenditure tracking benchmarks, the IMF Fiscal Transparency Code and other international standards, and a PFM Performance Report that provides information on PFM performance as measured by the indicators.

The PEFA identifies the critical dimensions of performance of an open and orderly PFM system for all countries. These are:

- 1) Credibility of the budget - The budget is realistic and is implemented as intended.
- 2) Comprehensiveness and transparency - The budget and fiscal risk oversight are comprehensive and fiscal and budget information is accessible to the public.
- 3) Policy-based budgeting - The budget is prepared with due regard to government policy.
- 4) Predictability and control in budget execution - The budget is implemented in an orderly and predictable manner and there are arrangements for the exercise of control and stewardship in the use of public funds.
- 5) Accounting, recording and reporting - Adequate records and information are produced, maintained and disseminated to meet decision-making control, management and reporting purposes.

Last PEFA report for Albania refers to June 2005-July 2006 and this assessment is prepared as a part of Country Fiduciary Assessment Update (CFA) and Public Expenditure and Institutional Review (PEIR).

This indicator and measurement system is directly relevant to three of the four pillars of the Strategy, and it will therefore serve as a very important input to Government's monitoring of it. This Strategy does not set performance targets based on the PEFA, but it could well do so in the future. The PEFA report provides an international bench-mark for progress against these indicators in the form of comparison of Albania's rating against regional countries.

### V.1.2 Report on Observance of Standards and Codes (ROSC)

A second important international public finance monitoring system in which Albania has chosen to be involved are the IMF Reports on the Observance of Standards and Codes (ROSC).

One area of ROSC monitoring refers to macroeconomic statistics. The last March 2006 ROSC data module provides an assessment of Albania's macroeconomic statistics against the recommendations of the General Data Dissemination System (GDDS), complemented by an assessment of data quality based on the IMF's Data Quality Assessment Framework (DQAF July 2003). The DQAF lays out internationally accepted practices in statistics, ranging from good governance in data producing agencies to practices specific to datasets. To this regard the Ministry of Finance is responsible for compiling and disseminating data for central government and operations (e.g. accounting and reporting procedures) and central government external debt- both areas of importance in the measuring and monitoring of this Public Finance Sector Strategy.

Assessment of data quality is based on six dimensions: Prerequisites of quality; Assurances of integrity; Methodological soundness; Accuracy and reliability; Serviceability; Accessibility. Periodicity and timeliness exceed the GDDS recommendations.

A second form of ROSC monitoring is their report on Fiscal Transparency, last undertaken in 2003. In this case the standard applied is the IMF Code of Good Practices in Fiscal Transparency. The main areas covered which are relevant to this Strategy are the transparency of:

- Tax legislation and procedures: including *inter alia*: laws and regulation; audit and control; forecasts of revenue; instructions and dissemination to, and accessibility for taxpayers; appeals procedures; and the publication of tax analysis and of the cost of tax concessions in terms of revenue foregone
- Budget preparation and quality including *inter alia*: the documentation and classifications of the budget; budget cycle; involvement of parliament; transparency to public; treatment and extent of virements; treatment of foreign grants and loans; relationship between annual budget and MTPB; budget analysis; evaluation of investment proposals; and reporting on local government:

### V.1.3 Commitments for EU integration, Standards and Monitoring processes

The Stabilization and Association Agreement includes practical commitments covering the full scope of the public finance sector including Tax and Customs. These commitments constitute a regionally calibrated standard against which progress can be measured and monitored by the Government of Albania, and with periodic independent review by the European Commission. The National Plan for Implementation of SAA does not set specific indicators for progress towards commitments but it only contains commitments and the relative schedule. For this plan purposes, Ministry of Finance as well as General Directory of Taxation and Customs, report on a monthly basis on progress towards objectives set in the plan. The European Commission, on the basis of this reports as well as other information, delivers a progress report on reforms in Albania, with focus at the

components of the Stabilization and Association Process (political and economic conditions, implementation of the SAA commitments).

#### V.1.4 Other Measurement, Monitoring and Evaluative Activities

In addition to the formal internationally referenced standard setting and monitoring processes described above, there are a range of regular and ad hoc evaluations by international financial institutions and bilateral development partners which can support the government in measuring and monitoring specific public finance areas.

In the framework of Millennium Challenge Corporation (MCC) - Threshold Program for Improving the MCA Eligibility requirements for 2005-2006, there are important indicators for reforms in the tax administration aiming at reducing corruption and increasing transparency. The most important are the tax policy indicator and the tax buoyancy.

Of particular importance are the World Bank's Public Expenditure and Institutional Review (PEIR), which has just been completed for Albania; the letters of agreement between the Government and the International Monetary Fund in connection with IMF financing; credit agreements with the World Bank and related documents (e.g. Development Policy Loan and others).

Also important are the Action Plans which the Government has adopted on Investment Management, Debt Management and Macro-economic and Fiscal Forecasting which have been decided by the Government. These constitute standards against which progress can be measured.

### V.2 Monitoring public finance strategy

This first Sector Strategy, will itself provide a basis for future measurement and monitoring. The challenge in measuring progress against the sector strategy to "*...mobilise resources in a manner which better supports Albania's domestic and international objectives, and to extract better outcomes from public expenditure and investment*", is rather to set targets and time frames for progress towards the standards. This plan does not attempt to do this but doing so will be a priority for the next sector strategy.

Following is an overview of indicators for measuring and monitoring of the four pillars of the strategy Albania's Public Finance Strategy.

#### V.2.1 Improving quality of expenditures

In the following table, we call PEFA indicators those related to the PEFA report of July 2005-august 2006 for Albania; ROSC indicators those related to the IMF Report on the Observance of Standards and Codes of July 2003 on Fiscal Transparency; DQAF indicators those related to IMF ROSC report of March 2006 on macroeconomic statistics.

	Indicator	Current performance	Source	Future source	Value 2006	Value 2003
PEFA-1	Aggregate Expenditure Outturn compared to original approved budget	Aggregate deviation has declined since 2002 from 7.3% to 1.27%.	PEFA	PEFA	B	

PEFA-2	Composition of expenditure out-turn compared to original approved budget	The variance in expenditure composition by administrative basis exceeded the overall deviation in primary expenditure by more than 10 percentage points in two out of the three last fiscal years.	PEFA	PEFA	D	
PEFA-3	Aggregate revenue out-turn compared to original approved budget	Actual domestic revenue collection was below 94% of budgeted domestic revenue collection only in one of the last 3 fiscal years.	PEFA	PEFA	B	
PEFA-4	Stock and monitoring of expenditure payment arrears	Little payment arrears exist in salaries and social insurance. But no monitoring is in place for contract-related arrears due to lack of commitment control.	PEFA	PEFA	D	
PEFA-5	Classification of the budget	Functional classification is in conformity with COFOG standard and sub-functional levels. Yet, recording transactions with new classification system is yet to be tested.	PEFA	PEFA	A	
PEFA-6	Comprehensiveness of information included in the budget documents	The 2005 budget documentation satisfies 3 of the requirements for information from the 9 listed by PEFA	PEFA	PEFA	C	
PEFA-7	Extent of unreported government operations	While extra budgetary funds are appropriately accounted for, donor-financed projects are very poorly recorded, resulting in data inconsistency and poor planning	PEFA	PEFA	D+	
PEFA-8	Transparency of intergovernmental fiscal relations	SN governments suffered from delayed information of transfers and unclear allocation mechanism on conditional grants. On the other hand, SN governments are obliged to provide actual spending reports in a timely and consistent manner.	PEFA	PEFA	C+	
PEFA-9	Oversight of aggregate fiscal risk from other entities of the public sector	Public Enterprises and Autonomous Gov. Agencies' financial statements are not properly monitored, thus, poses potential contingent liability to government.	PEFA	PEFA	C+	
PEFA-10	Public access to key fiscal information	The government makes available to the public information on 4 of the 6 listed types in the PEFA report	PEFA	PEFA	B	
PEFA-11	Orderliness and participation in the annual budget process	Albania has a fixed budget calendar, which engages political and other stakeholders throughout the process. Parliament also approves budget before the start of fiscal year	PEFA	PEFA	A	

PEFA-12	Multiyear perspective in fiscal planning, expenditure policy and budgeting	Government decided preparation of MTBP in 2001 and there has been progress since then. Nevertheless, linkage between MTBP ceiling and actual resource allocation is still very weak and sector strategies still lack costing information for investment and forward estimate for recurrent costs	PEFA	PEFA	C	
PEFA-16	Predictability in the availability of funds for expenditure commitments.	Significant in-year budget adjustments are frequent and carried out with some transparency. Two month allotment to line ministries serves as a guideline for available funds. However, as evidenced by the large number of virements, allotted amounts are not sufficiently realistic nor allotted period is long enough to provide predictability to line ministries	PEFA	PEFA	C+	
PEFA-17	Recording and management of cash balances, debt and guarantees	The quality of recording and reporting of debt and guarantees appear to be high and Government cash balances are consolidated on a regular basis.	PEFA	PEFA	B	
PEFA-18	Effectiveness of payroll controls	The fact that payroll and personnel records are not integrated and often not computerized undermines the credibility of the systems	PEFA	PEFA	B+	
PEFA-20	Effectiveness of internal controls for non salary expenditure	There are no commitment controls and whereas compliance with rules appears to be fairly high, spending ceilings do not effectively limit spending to cash availability. Existing rules and procedures in some cases lead to inefficiencies in the use of funds	PEFA	PEFA	B	
PEFA-21	Effectiveness of internal audit	A modern internal audit system is being developed but is still to demonstrate its impact on the effectiveness of Government operations	PEFA	PEFA	C+	
PEFA-22	Timeliness and regularity of accounts reconciliations	Bank reconciliations for the TSA including the payment system administered by the commercial banks and BOA take place monthly and typically within four weeks of end of period. The information available was insufficient to assess frequency of suspense account clearances	PEFA	PEFA	B provizor	
PEFA-23	Availability of information on resources received by service delivery units	Information on cash resources received by primarily schools and health institutions is not captured by the Treasury and no information on in-kind resources is provided to any central government institutions	PEFA	PEFA	D	

PEFA-24	Quality and timeliness of in year budget reports	In-year budget execution reports from budget entities are normally timely and accurate but do not provide information on commitments	PEFA	PEFA	C+	
PEFA-25	Quality and timeliness of annual financial statements	The Government's annual financial statements are comprehensive and timely and follow national accounting standards	PEFA	PEFA	B+	
ROSC 2	Public availability of information	2.1 Defense expenditures in budget documents.  2.2 Information on contingent liabilities  2.3 Tax expenditures presentation in parliament and publication.	ROSC	ROSC		Defense expenditures comprehensively recorded, subject to the same accounting and auditing rules as other spending.  Only limited information in budget documents.  Full assessment of the costs of explicit and implicit tax concessions and exemptions is not available to parliament and the public.
ROSC 3	Open budget preparation, execution and reporting	3.1 Disclosure of projections on macroeconomic indicators and revenues through budget documents.  3.2 Estimates of new policy initiatives and ongoing operations in budget documents.  3.3 Report of progress of major policies against objectives.	ROSC	ROSC		Not sufficiently detailed and without adequate explanations.  Costs of new recurrent activities not distinguished from ongoing operations. Investment projects and relative details not reflected in budget documents individually.  No progress report against policy objectives presented to parliament is provided in the explanatory section.
DQAF 0	Prerequisites of quality	0.2 Resources	ROSC	ROSC		LNO: Existing staff resources are inadequate for current GFS compilation demands and do not allow capacity for additional development work

DQAF 2	Methodological soundness	2.1 Concepts and definitions.	ROSC	ROSC		LO: A formal migration path from the current presentation to the <i>GFSM 2001</i> framework has not been articulated. Fiscal accounts are largely based on <i>GFSM 1986</i> , although divergences exist in the presentation of data.
DQAF 3	Accuracy and reliability	3.1 Source data	ROSC	ROSC		LO: The weakness in source data is in the availability of data on certain external donor financed (grants) projects that do not pass through the treasury system.

Definitions. LO (practice largely observed): some departures, but these are not seen as sufficient to raise doubts about the authorities' ability to observe the DQAF practices; LNO (practice largely not observed): significant departures and the authorities will need to take significant action to achieve observance

Most of the first pillar of the strategy, improvement of expenditure quality, is covered by PEFA indicators. These include also the majority of ROSC indicators and recommendations for fiscal transparency, as expressed in the report of July 2003.

### V.2.2 Broaden tax base and align tax policies to national priorities

The SAA commitments provide the standards and the system of monitoring for the latter policy area. For the others a priority is to establish the information base which will allow better analysis of existing patterns, and the development of a comprehensive and transparent tax policy strategy.

	Indicator	Current performance	Source	Future source	Value
MCC	Tax policy indicator		MCA		End of program value
ROSC 1	Clarity of roles and responsibility	1.1 Legislative and regulatory framework for economic activity  1.2 Clarity and enforcement of tax legislation	ROSC	ROSC	Enforcement of law requires improvement, through strengthening of institutional capacity and reducing corruption and tax evasion. Tax legislation and regulations are mostly clear, but some are not properly defined. Legislative provisions are not always observed.

### V.2.3 Modernize public debt management

The core information needed for monitoring these areas is the levels of: Central government debt, Domestic debt (by debt holder and instrument), and External debt (by currency, maturity, debt holder and instrument).

	Indicator	Breakdown	Source	Future source	Value 2006	Target for 2009
	Debt to GDP; domestic debt to GDP; external debt to GDP (in %)		MoF	MoF	55.7; 38.6; 17.1	52.7; 35.7; 17.0
	Domestic debt to total debt (external debt to total debt) (in %)		MoF	MoF	67.9 (32.1)	55-58 (45-42)
	Long maturity to stock of domestic debt (in %)		MoF	MoF	22	44.55
	Cost of debt service to GDP (in %)		MoF	MoF	3.01	2.97
	Average Maturity		MoF	MoF	235 days	365 days
PEFA-6	Comprehensiveness of information included in budget documents	Deficit financing, describing anticipated composition Debt stock, including details at least for the beginning of the current year.	PEFA	PEFA	Composition of deficit financing is only divided into foreign and domestic financing. (Satisfied) No information provided. (Unsatisfied)	
PEFA-12	Multiyear perspective in fiscal planning, expenditure policy and budgeting.	Scope and frequency of debt sustainability analysis	PEFA	PEFA	C	
PEFA-17	Recording and management of cash balances, debt and guarantees.	Quality of debt data recording and reporting Systems for contracting loans and issuance of guarantees	PEFA	PEFA	B B	

Evaluations will have to relate to progress in reducing domestic debt to GDP, diversification, and internationalization, and the degree to which this does indeed reduce the servicing cost. The proximate measure will be the degree to which the Ministry of Finance adheres to the forthcoming Integrated Debt Management System. This will have to be supported by an outcome evaluation once the new approach has been implemented.

#### V.2.4 Strengthen performance and credibility of tax and customs administration

PEFA indicators and those related to the SAA commitments are very important in this area.

	Indicator	Current performance	Source	Future source	Value 2006	Target
PEFA-13	Transparency of taxpayer obligations and liabilities	N/A	PEFA	PEFA	N/A	
PEFA-14	Effectiveness of measures for taxpayer registration and tax assessment	N/A	PEFA	PEFA	N/A	
PEFA-15	Effectiveness in collection of tax payments	N/A	PEFA	PEFA	N/A	
ROSC 3	Adequate legal protection of tax and customs administrations from political interference.		ROSC	ROSC	The formal protection is undermined from improperly defined tax provisions.	
MCC	Tax policy index		MCA		-0,89	-6,53
MCC	"Tax buoyancy" = $\% \Delta T / \% \Delta GDP$	VAT Profit tax Personal tax	MCA		1,65 0,97 0,44	> 1,65 > 1,00 > 1,00
Others	Tax gap=1-total revenues collected/potential revenues		Tax/Customs	Revenue Agency		
Others	No of tax declarations filed/no of registered taxpayers		Tax/Customs	Revenue Agency		
Others	Amount of taxes paid voluntarily/amount of taxes payable on the basis of tax declarations.		Tax/Customs	Revenue Agency		
Others	No of cases of tax evasion, customs fraud and smuggling successfully prosecuted each year.		Tax/Customs	Revenue Agency		
Others	Additional taxes assessed after investigation and audit/tax liability declared		Tax/Customs	Revenue Agency		
Others	Average no of days taken to identify and notify stop filers, non filers and non payment or underpayment of declared tax liabilities.		Tax/Customs	Revenue Agency		
Others	Administrative costs/Total revenues collected		Tax/Customs	Revenue Agency		
Others	No of taxpayers/No of employees		Tax/Customs	Revenue Agency		
Others	Direct and indirect costs incurred by taxpayers		Tax/Customs	Revenue Agency		

Definitions: N/A not applicable

It is a priority of this Strategy to ensure that reliable data is available in these areas - beginning with the data required for the completion of the revenue section of PEFA. Moreover, general directories of taxation and customs do not use reliable indicators to measure performance, with the exception of collected revenues against target set by the Government. Therefore, there is urgent need for these agencies and the government to define appropriate indicators to measure performance in the area of revenue collection.

The Integrated Tax System, to be introduced with technical assistance from EU, will have MIS (Management Information System) functions imbedded in it, in the framework of MCA threshold program. MIS is designed to include setting targets for all work areas, performance indicators, performance measures and reporting tools

Related to Others group of indicators, these are potential indicators which will be considered for use in the future by the revenues agencies to measure efficiency and

effectiveness of revenues management (the list is not exhaustive of the possible indicators, but just a presentation of potential ones). Their adoption time depends on availability and management of data and staff capacities for measurement and monitoring tasks.

### **V.3 Accountability**

Government's commitment to such processes as PEFA, PEIR and ROSC, and the transparency of those documents, is important part of being transparent and accountable. Public Finance accountability will also be reinforced by the provisions of the forthcoming Organic Budget Law, and the strengthening of accounting and reporting standards.

It is expected too that this Sector Strategy, will itself serve to strengthen accountability. In its final form it will have had input from the Council of Ministers, the Ministry of the Economy, the Bank of Albania, the Albanian Statistics agency , the International Financial Institutions, and the bilateral development partners involved in public finance. It is also intended that the finalized plan will be given wide currency, including on the websites of the organizations involved.