

Albania: the Path to Nominal (Economic) Convergence

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Abstract

The European integration process has, for more than two decades, represented an important issue for Albania. This process has been evolving gradually and Albania received the “*candidate country*” status in June 2014. The next step involves the EU membership, subject to the Copenhagen criteria fulfillment: economic, political and *acquis communautaire*. Upon fulfillment and granting the “*member state*” status, the following step would encompass the Economic and Monetary Union (EMU) and introduction of the euro. The latter is related to the Maastricht criteria fulfillment or nominal convergence criteria. Thus, the main objective of this paper is to assess the nominal (economic) convergence of Albania in terms of price stability, exchange rate stability, fiscal criteria and long term interest rate criteria. We will assess how macroeconomic indicators comply with Maastricht criteria requirements as by the end of 2014. Simultaneously, we explore the methodological harmonization degree of the macroeconomic indicators and thus their effective comparability to those of EU. Although Albania is not required to make nominal convergence assessments, this analysis turns to be useful in order to understand the starting position of the Albanian economy, identify areas where progress is still needed and the pursuit of necessary macroeconomic policies aiming to attain a favorable starting position for EMU and ERM II participation. Our main finding is that despite not meeting the Maastricht criteria for 2014, Albania is following the right path toward full effective European integration.

Keywords: *Albania, Maastricht criteria, integration, nominal convergence.*

Introduction

The European integration process represented a strategic objective for Albania since the beginning of the ‘90s. Integration process evolved gradually and on June 27th 2014, Albania received the ‘candidate country’ status. EU membership is subject to the fulfillment of the Copenhagen criteria^{lxvii} as stated by the European Council in 1993: “*Membership requires that the candidate country has achieved stability of institutions guaranteeing democracy, rule of law, human rights and respect for and protection of minorities, the existence of a functioning*

market economy as well as the capacity to cope with competitive pressure and market forces within the Union. Membership presupposes the candidate's ability to take on the obligations of membership including adherence to the aims of political, economic and monetary union."

Once formally member of the European Union, Economic and Monetary Union and the single currency introduction would follow. This second stage is subject to the Maastricht criteria fulfillment (convergence criteria): price stability, exchange rate stability, fiscal criteria and long-term interest rate criteria. It should be noted, however, that a unilateral introduction of the common currency would not suffice: the euro can be introduced only in agreement with EU member countries and only after the EU accession. Such an agreement requires a two-year ERM II successful participation and the convergence criteria fulfillment.

Given the current dynamics and national aspirations, compliance of Albanian macroeconomic indicators with the Maastricht criteria gains significant research importance. Equally important is the matter of comparability: assessing whether these indicators are methodologically harmonized and thus comparable to those of the EU member states. Building on these two main aspects, this research paper will first assess the degree of Maastricht criteria fulfillment and progress conducted in achieving the preconditions for adoption of the euro. Following this, the paper will highlight the areas of intervention necessary on a macroeconomic and methodological level in order to ensure the comparability of domestic indicators with those of the EU.

The study will be structured in four sections. After a short introduction, the second section will explore the Albania milestones in the integration process; in the third section Copenhagen and Maastricht criteria will be explored. In the fourth section we assess compliance to nominal convergence criteria and degree of methodological harmonization. At the end conclusions and recommendation for future research.

Albania: the path toward EU integration

Since the early '90s, Albania moved its first steps towards democracy, rule of law and an open market economy. Albanian transition process from an almost autarchic-communist system to an open-emerging market economy marked important milestones. Following the establishment of the Parliamentary Republic in March 1991, two month later, the European Community established official relations with Albania (see Table 1). In 1992, a Trade and Co-operation Agreement between Albania and the EU was signed and entered in force. Economic co-operation was intensified in 1999 when Albania benefited from the Autonomous Trade Preferences for the EU. Albanian exports obtained duty-free access to the EU markets.

Following the European Council meeting in Thessaloniki on 19-20 June 2003^{lxviii}, Western Balkan countries were identified as potential candidates for EU membership, subject to their progress in delivering necessary reforms: “...we in the European commission will do all we can to help you succeed. But, membership must be earned. It will take the sheer hard work and applied political will of those in power in the region. How far you proceed along the road towards European Integration, and how fast, will be up to you”. An important milestone represented the signature (12 June 2006) and entry into force (April 1st 2009) of the Stabilization and Association Agreement (SAA)^{lxix} between European Communities and their Member States, of the one part, and the Republic of Albania, of the other part. As by the agreement, EU offered the prospect of integration, all the necessary technical assistance and financial support in return to a fully participation and serious engagement in the stabilization process. On 28th of April 2009, Albania formally submitted its application for EU membership. In the November 2010 Opinion, the European Commission assessed that Albania had not achieved the necessary degree of compliance with the membership criteria. In the [Albania Progress Report \(2012\)](#), the EC recommended that Albania be granted the EU candidate status subject to the completion of the key measures identified as: rule of law juridical reform, public administration reform and parliamentary procedures revision. After failing in the first round, the EC recommended Albania to be granted the candidate country status along the identification of the key priorities for opening the accession negotiations ([Albania Progress Report, 2013](#)). Following a positive assessment of the EC regarding implementation and consolidation of the key priorities as summarized in the [Albania Progress Report \(2014\)](#), the European Council granted the candidate country status for Albania on June 27th 2014.

Table 1. Timeline of EU - Albania relations

1992	Trade and Co-operation Agreement EU and Albania.
January 1997	The EU Council of Ministers establishes political and economic conditionality for the development of bilateral relations.
January 1999	The EU proposes a new Stabilization and Association Process (SAP) for five countries of South-Eastern Europe, including Albania.
1999	Albania benefits from Autonomous Trade Preferences with the EU.
2000	Extension of duty-free access to EU market for products from Albania.
June 2000	Feira European Council states that all the countries under the SAP are "potential candidates" for EU membership.
November 2000	Zagreb Summit SAP for five countries of South-Eastern Europe, including Albania.
2001	First year of the Community Assistance for Reconstruction, Development and Stabilization (CARDS) programme designed for SAP countries.
2001	The Commission recommends the undertaking of negotiations on SAA with Albania.
October 2002	Negotiating Directives for the negotiation of a SAA with Albania are adopted.
January 2003	Commission President Prodi officially launches the negotiations for SAA

June 2003	At Thessaloniki European Council, SAP is confirmed as the EU policy for the Western Balkans. The EU perspective for these countries is confirmed.
01 June 2004	Council decision on a first European Partnership for Albania.
June 2006	Council decision on a revised European Partnership for Albania.
01 May 2006	Entry into force of the EC-Albania readmission agreement.
June 2006	Signature of SAA at the General Affairs and External Relations Council in Luxembourg.
December 2006	Entry into force of the Interim Agreement.
01 January 2007	Entry into force of the new instrument for Pre-Accession Assistance (IPA).
May 2007	Adoption of the Multi-Annual Indicative Planning Document (MIPD) 2007-2009 for Albania under the IPA.
September 2007	Signature of a visa facilitation agreement between Albania and the EU.
18 October 2007	Albania signs the IPA Framework Agreement.
01 January 2008	The visa facilitation agreement enters into force.
22 January 2008	Albania and the EC sign the Financing Agreement for the instrument for Pre-Accession Assistance (IPA).
18 February 2008	Council decision on a revised European partnership for Albania.
March 2008	Visa liberalization dialogue launched.
June 2008	The European Commission presents a road map identifying specific requirements for visa liberalization with Albania.
1 April 2009	Entry into force of SAA.
28 April 2009	Albania submits its application for EU membership.
16 November 2009	Council approves Albania's application for EU membership and invites the European Commission to submit an opinion.
09 November 2010	The Commission issues its Opinion on Albania's membership request.
15 December 2010	Visa Liberalization with Albania enters into force.
01 February 2011	An action plan addressing the 12 key priorities identified in the EC's Opinion is adopted by Albania.
10 October 2012	EC recommends that Albania be granted EU candidate status.
12 November 2013	EU and Albania hold the first meeting of the High Level Dialogue on Key Priorities
27 June 2014	EU candidate status

Source: http://ec.europa.eu/enlargement/countries/detailed-country-information/albania/index_en.htm

From Copenhagen to Maastricht criteria

In the European integration process there are two important sets of criteria to consider: (i) criteria that a potential new member state must fulfill in order to become a member country of the European Union – Copenhagen criteria fulfillment; and (ii) criteria that the member country must fulfill to obtain full membership in Economic and Monetary Union (EMU) and adopt the single common currency (euro) – Maastricht criteria fulfillment.

III.1 Copenhagen Criteria

After the fall of the Berlin Wall, Central and Eastern European countries showed their interest in joining the European Union. The European Council meeting in Copenhagen in June 1993 made an important decision in regard, concluding that the “...*the associated countries in Central and Eastern Europe that so desire shall become members of the European Union. Accession will take place as soon as an associated country is able to assume the obligations of membership by satisfying the economic and political conditions required*”^{lxx}. The Copenhagen criteria were augmented by the Madrid European Council^{lxxi}, stating that a candidate country must create the conditions for its integration through the adjustments of its administrative structures. According to the Copenhagen criteria, qualification for membership includes:

- *Stability of institutions, guaranteeing democracy, the rule of law, human rights and the respect for and protection of minorities;*
- *Existence of a functioning market economy as well as the capacity to cope with competitive pressures and market forces within the Union;*
- *Ability to take on the obligations of membership (acquis), including adherence to the aims of political, economic and monetary union.*
- *The Union’s capacity to absorb new members, while maintaining the momentum of European integration – principle EU self-imposed.*

The accession for a new member state is not automatic, it is a *step-by-step* process. Any wishing country, shall formally apply to the Council, which, subject to positive recommendation of the Commission and a favorable opinion by an absolute majority of the members of the European Parliament, makes its decision unanimously. Negotiations are not opened automatically, thus the aspirant member state should formally request it. For the Western Balkan countries, the roadmap proposed by the EC and adopted by the Council in 2006, requires the satisfactory performance in meeting all obligations stemming from the countries SAA. Subject to the satisfaction of these obligations, and upon formal request of the aspiring country, accession negotiations are ready to begin.

Table 2. Current status of selected countries.

Candidate countries:	Membership negotiations started?
Albania	
The former Yugoslav Republic of Macedonia	
Montenegro	November 2014
Serbia	
Turkey	June 2010

Source: http://ec.europa.eu/enlargement/countries/check-current-status/index_en.htm

III.2 Maastricht Criteria

The Werner Report^{lxxii} represents the first official step towards the Economic and Monetary Union proposing a three-step strategy within 10 years. This included stabilization and narrowing of the fluctuation margins between currencies of the member states, complete freedom of capital movements, and an irrevocable fixing of the exchange rates between the participating national currencies (Faulend *et al* 2005). In 1979, a European Monetary System was built on the concept of a stable but adjustable exchange rate defined in relation to the newly-created European Currency Unit (ECU). An exchange rate mechanism (ERM) was created which allowed fluctuations around central rates. Formally, the implementation of EMU dates 1988 as stated in the Delors Report^{lxxiii}, requiring for amendments to the Treaty. This led to the Treaty on European Union, formally adopted by the Heads of State and Government at the Maastricht European Council in December 1991. The Treaty of Maastricht provided three stages for EMU:

- Stage 1 (from 1 July 1990 to 31 December 1993) – free movement of capital between member states;
- Stage 2 (from 1 January 1994 to 31 December 1998) – economic policies co-ordination and stronger central bank co-operation;
- Stage 3 (underway since 1 January 1999) – gradual introduction of the euro^{lxxiv} as the single European currency for the member states, and implementation of the common monetary policy by the European Central Bank. Participation in the third stage of EMU and the adoption of Euro as a single currency requires the fulfillment of the convergence criteria as provided in the Art. 140 of the Treaty of Maastricht.

Price stability criteria.

The first indent of Article 140 of the Treaty requires “*the achievement of a high degree of price stability; this will be apparent from a rate of inflation which is close to that of, at most, the three best performing^{lxxv} Member States in terms of price stability*”. Article 1 of the Protocol No 13 on the convergence criteria stipulates that “*the criterion on price stability referred to in the first indent of Article 140(1) of the Treaty on the Functioning of the European Union shall mean that a Member State has a price performance that is sustainable and an average rate of inflation, observed over a period of one year before the examination, that does not exceed by more than 1½ percentage points that of, at most, the three best performing Member States in terms of price stability. Inflation shall be measured by means of the consumer price index on a*

comparable basis taking into account differences in national definitions". The average inflation rate is measured by the percentage change in the un-weighted arithmetic average of the last 12 months' indices relative to the un-weighted arithmetic average of the 12 monthly indices of the previous period, rounded to one decimal place. Considering an average value of the three best performing states allows consideration of the effects on inflation rates across member states of common shocks. EC practice suggests that countries which inflation rates are significantly below/over comparable rates in other member states and those strongly affected by exceptional factors will be considered outliers^{lxxvi}.

Public finances criteria: public debt and fiscal balance.

Under EMU, there's no room for intervention in terms of monetary and exchange rate policy to smooth internal or external macroeconomic shocks. Thus, fiscal policy remains the only tool under a country's control to implement and maintain macroeconomic equilibrium. The EU convergence criteria related to the government budgetary position are defined in the second indent of Article 140 of the Treaty, which requires "*the sustainability of the government financial position; this will be apparent from having achieved a government budgetary position without a deficit that is excessive as determined in accordance with Article 126(6)*". Article 2 of the Protocol stipulates that this criterion shall mean that "*at the time of the examination the Member State is not the subject of a Council decision under Article 126(6) of the said Treaty that an excessive deficit exists*". To assess whether a member state has an excessive deficit two criteria for budgetary discipline are considered as set in Article 126:

(a) Whether the ratio of the planned or actual government deficit to GDP exceeds a reference value (specified in the Protocol as 3% of GDP), unless:

- either the ratio has declined substantially and continuously and reached a level that comes close to the reference value; or, alternatively,*
- the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value;*

(b) Whether the ratio of government debt to GDP exceeds a reference value (defined in the Protocol on the excessive deficit procedure as 60% of GDP), unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace.

As shown in Szapáry and Orbán (2004), and Faulend *et al* (2005), a country with 3% to GDP government deficit and 5% to GDP nominal growth rate, in the long run the public debt will stabilize at the level of 60% of GDP. It is interesting to note that at the time the Maastricht criteria were designed, the average public debt to GDP of the member states was approximately

60%, and the potential growth rate was estimated at 5%. Nowadays, the discussion on the public finances criteria is still open since economic conditions have changed over time. In fact, older member states have lower potential economic growth rates, and new member states and future potential member states actually have higher potential economic growth rates. The latter must simultaneously pursue low budget deficits (3% of GDP), raising questions on the long-term 60% of GDP debt sustainability (Szapáry and Orbán, 2004). New member states and future member states with higher economic growth rates, in order to converge to “old member” standards, need to borrow more, and thus these criteria may sound somewhat inflexible.

Exchange rate criterion.

Participation in EMU, like any other monetary union, entails technicalities such as the irrevocable fixing of member countries’ exchange rates and elimination of cross-country exchange rates between member states. Thus, its long-term stability concerns the attained nominal and real convergence level^{lxxvii}, commitment and efforts of member states in adjusting economic policies into harmonization with those of the EU. Although not required, the catching-up process represents an important step towards EMU facilitating the adherence to the Maastricht criteria (De Grauwe and Schnabl, 2004). In order to avoid exchange rate manipulations and unfair competitive positions, nominal exchange rate convergence is required under the Maastricht criteria. The third indent of Article 140 of the Treaty requires “*the observance of the normal fluctuation margins provided for by the exchange-rate mechanism of the European Monetary System, for at least two years, without devaluing against the euro*”. Article 3 of the Protocol on the convergence criteria referred to in Article 140 of the Treaty stipulates: “*The criterion on participation in the exchange-rate mechanism of the European Monetary System referred to in the third indent of Article 140(1) of the said Treaty shall mean that a Member State has respected the normal fluctuation margins provided for by the exchange-rate mechanism of the European Monetary System without severe tensions for at least the last two years before the examination. In particular, the Member State shall not have devalued its currency’s bilateral central rate against the euro on its own initiative for the same period.*” After accession to the EU, membership to the ERM II can take place at any time and is voluntary for member states outside the euro zone. Also, an entering country, the euro area countries, and the ECB must agree on the central rate^{lxxviii} and fluctuating band^{lxxix} around it. The reference value for the ER is not coincident with the conversion rate (the rate at which the national currency will be converted to the euro).

Long-term interest rate criteria.

The alignment of long-term interest rates between member countries represents the fourth economic convergence criterion. According to [De Grauwe \(2012\)](#) this criteria aims the prevention of capital gains on bonds issued by countries that paid a high premium due to exchange rate risks. If it is known that the exchange rate will be fixed, investors will sell low premium bonds (lowering their price and increasing interest rates on them) and will buy high premium bonds (increasing their price and decreasing interest paid on them). In countries with initial low interest rates, they will grow and holders of bonds will experience a capital loss; in a country with initial high interest rates, interest rates will fall and bond holders will have a capital gain. To avoid unfair capital gains/losses the fourth indent of Article 140 of the Treaty requires *“the durability of convergence achieved by the Member State with a derogation and of its participation in the exchange-rate mechanism being reflected in the long-term interest-rate levels”*. To monitor the fulfillment of this criterion, article 4 of the Protocol on the convergence criteria referred to in Article 140 of the Treaty stipulates: *“The criterion on the convergence of interest rates referred to in the fourth indent of Article 140 of the said Treaty shall mean that, observed over a period of one year before the examination, a Member State has had an average nominal long-term interest rate that does not exceed by more than two percentage points that of, at most, the three best performing Member States in terms of price stability. Interest rates shall be measured on the basis of long-term (10 years) government bonds or comparable securities, taking into account differences in national definitions”*. If a country does not have long-term government bonds or those present have no benchmark characteristics as required ([ECB, 2003](#); [Convergence Report 2012](#)), it is possible to consider comparable financial instruments, as in the case of Estonia^{lxxx} ([Faulend et al, 2005](#)), Luxembourg^{lxxxii} ([Convergence Report, 2010](#)) and Greece^{lxxxii}.

Macroeconomic Convergence: Where is Albania?

Albania’s convergence to Maastricht criteria will be carried out using the same framework as in EC official convergence reports. The common framework consistently used to examine the state of economic nominal convergence, is based on the Treaty of Maastricht provisions and relative Protocols. Some important principles are followed when applying the convergence criteria^{lxxxiii}: (i) *the individual criteria are applied in a strict manner*; (ii) *the convergence criteria constitute a coherent and integrated package, and they must all be satisfied*; (iii) *the criteria have to be met on the basis of actual data*; (iv) *the application of the convergence*

criteria should be consistent, transparent and simple. When assessing compliance to the convergence criteria, sustainability should be considered over a lasting basis and not at a given point in time. That's why, both a backward and forward looking perspective over a 10 years' period will be considered. This approach would enable understanding on whether current achievements are the outcome of a genuine structural adjustment and not the result of short term maneuvers. The cut-off date for the statistics considered in this study will be the end of June 2015.

...on price stability criterion

As stated on the convergence criteria, the average rate of inflation, observed over a period of one year before the examination should not exceed by more than 1½ percentage points that of, at most, the three best performing Member States in terms of price stability. In absence of a harmonized CPI comparable to that published by Eurostat, CPI released by Instat will be considered.

The Consumer Price Index for Albania was first measured in 1958-1960, when the Statistics Directorate of the Republic of Albania ruled that a general indicator for prices was necessary for the domestic economy. However, the methodology tried to catch seasonal changes on prices for new food and non-food products entering and exiting the markets. Changes in the CPI of those years usually resulted in a decline, and hence the term "inflation" remained outside the economics dictionary of that time. CPI continued to be measured over the next few years and later political constraints imposed the suspension of work measuring the consumer price index in the country for about 33 years^{lxxxiv}. A second attempt to calculate the CPI for Albania took place in December 1991, using December 1990 as a base year. In 1991, the General Directorate of Statistics also calculated the CPI for December 1989 and 1990. From 1992, the CPI has been released monthly. For the first time in 1993, the National Institute of Statistics (Instat) introduced the Households Budget Survey (HBS), and the results were used to update the CPI basket and the weights of each of its entries. December 1993 was used as a base period for the next CPI calculations. The first CPI basket contained 221 articles and all expenses were divided into 8 main groups. In 2000, INSTAT updated the CPI basket and a new CPI index was calculated, using December 2001 as a base period, given the expected changes due to 10 years of economic, political and social transition in Albania. The 2001 basket contained 262 articles and for the first time they were classified into 12 main groups^{lxxxv}, compatible with the COICOP^{lxxxvi} classification, broadly compatible with Eurostat expenditure structure. The last update of the CPI basket was carried out in 2007, based on COICOP classification^{lxxxvii}. The CPI is calculated for 12 categories compatible with those used for the harmonized ICP of EU

countries. HICP is calculated and released by Eurostat and is the one used to assess compliance with the convergence criteria. Given differences in national methodologies applied to CPI calculation at a national level, HICP ensures a better comparability of the data. Currently, Instat is working on building a harmonized index in compliance with Eurostat standards. Actually, there are some important differences in the composition of the consumer basket of CPI and HICP. HICP includes revenues from foreigners' purchases in the country but do not include the imputed rent. CPI includes the imputed rent (weight 10.2%) but does not include the other.

Inflation rate in Albania over July 2014 – June 2015 resulted 1.7%, about 0.7 percentage points below the reference value. At first sight, it would be concluded that Albania fulfills the price stability criteria as specified by the Maastricht Treaty and following protocols. However, we should bear in mind that the convergence of national average prices to EU average prices is a long-term process not only in transition countries but even in established member countries.

Table 3. Price stability criterion assessments

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
HCPI ¹	2.7	2.7	2.9	4.7	3.5	1.2	2.9	3.0	2.3	0.7	0.1
Euroarea ²	2.2	2.3	2.0	2.8	2.3	0.9	2.2	3.4	2.3	0.7	0.0
Inflation Albania ³	2.2	2.3	2.5	3.8	2.3	3.2	3.7	2.1	2.5	1.6	1.7
Reference value ⁴											2.4

Source: Eurostat, Instat.

¹ EU15 - 1995, EU25-2004, EU27-2007, EU28-2013.

² EA11-2000, EA12-2006, EA13-2007, EA15-2008, EA16-2010, EA17-2013, EA18

³ Inflation rate for Albania is calculated as the annual changes of un-weighted average of CPI over the past 12 months to the cut-off date (end of June 2015). Reasoning is the same for all previous periods.

⁴ For the period July 2014 - June 2015 the three best performing countries resulted to be Estonia +1.09%, Austria +0.97% and Lithuania +0.79. The simple average of the three best performing members was 0.95%. Reference value is calculated as the sum of the average of the three best performing countries plus 1.5 percentage points.

The first decade of post – communist era was characterized by strong structural imbalances causing high fluctuations in the consumer prices inflation rate (alongside other macroeconomic indicators). Average inflation rate stabilized around 3% over 2001 – 2014, on the back of a successful disinflationary process (Muço, Sanfey and Taci 2003). However, annual inflation dynamics have been subject to high sensitivity of the domestic economy to shocks in prices in foreign markets, changes in administered prices and volatility in food prices (representing about 39% of the basket) and other country specific factors. Average annual inflation rate jumped from 3.1% in 2001 to 5.2% in 2002 due to electricity energy crisis, political uncertainty following June 2001 elections, higher administered prices of energy and water, turmoil in Macedonia, introduction in circulation of the euro. From 2003, the annual inflation rate

stabilized within the Bank of Albania tolerance band, sometimes slightly overshooting or undershooting the point target of 3%^{lxxxviii}. In a context of structural reforms ongoing, high informal economy (Boka and Torluccio, 2013a), privatizations ongoing, external shocks from international trade channels, inflation was assessed as low, stable and within the objective tolerance band of BoA. Financial markets turmoil in 2008, coupled with the sovereign debt crisis in some EU countries – Albania main trading partners – intensified uncertainties in the real sector of the economy. Absence of changes in the administered prices and higher prices the previous year, determined a lower average inflation rate of 2.3% in 2009. Monetary policy conducted by BoA^{lxxxix} was forward-looking and timely decisions were very important in order to attain and maintain price stability in this period. Alongside the Bank of Albania decisions, depreciation of the national currency, rising prices of commodities and administered ones materialized in an annual inflation rate of 3.6% and 3.5% in 2010 and 2011 respectively. The downward trend in international prices, relative stability of the exchange rate towards main currencies, weak internal and external demand exerted low inflation pressures on the demand and supply side. Average inflation rate fell from 2% in 2012, to 1.9% in 2013 and 1.6% in 2014. Developments in annual inflation rates over the first six months of 2015 reflect the downward inflationary pressures from international markets and weak internal demand.

It seems that the current price stability level pursued is safe from threats. Albania is a small opened economy to international developments, and it is almost impossible to account for all the external shocks that may occur and could affect the domestic inflation rate. Another very important point is that the price stability criterion represents a moving target; the reference value is not fixed (Boka and Torluccio, 2013b). Therefore, attaining and maintaining price stability requires strong efforts and commitment of the central bank.

International institutions forecasts^{xc} project inflation rate to remain below the Bank of Albania target until the end of 2015 and pick up the next year. Inflation is expected to be 1.8% during 2015 and to pick up to 2.5% over 2016. According to BoA's forecasts average inflation rate for 2015 is expected to be 1.8% due to persistence of the negative output gap till the end of the year. Bank of Albania expects average inflation rate to hit the targeted objective of 3% in 2017. Higher inflationary pressures are expected to be triggered by a stronger internal demand in the next two years. Capacity utilization rate is expected to grow enabling for a higher expected GDP growth rate and monetary policy to remain on the easing side. External demand is expected to remain weak, since the slowdown in the second biggest economy (China). Recent developments in China are triggering low prices in international markets exposing the world to a potential disinflationary wave.

...on fiscal criteria

The sustainability of the governmental financial position requires the ratio of government deficit to GDP below the reference value of 3% and the ratio of public debt to GDP not to exceed the reference value of 60%.

In Albania, the compilation methodology underlying the data for the consolidated budget is broadly consistent with the analytical framework set out in the IMF's "Manual on Government Finance Statistics, 1986 (GFSM)"^{xci}. Presentation and classification are not in the GFSM format. Future plans concern the adoption of the methodology of the IMF's "Government Finance Statistics Manual, 2001" (GFSM 2001). To assess fiscal criteria convergence, consolidated budget statistics should be compiled in accordance with Eurostat ESA 95 methodology. EU 28 member states have almost completed the harmonization of their methodologies to ESA 95 and data are reported according to ESA 95. The classification debt data in Albania mostly comply with the international standards indicated in the IMF's "Public sector debt statistics-Guide for compilers and users 2011". From the methodological point of view, the data on the public debt cover the internationally recognized definitions of central, local and general government. The general government in Albania consists of two levels, central and local government. According to the Organic Budget Law^{xcii}, government guarantees are included. These are not in line with GFS 2001 and ESA 95 methodology. Despite all methodological differences in compiling and reporting consolidated fiscal indicators, Albania does not fulfill the fiscal deficit to GDP ratio criteria of 3%.

Table 4. Fiscal criteria assessments

	GDP (ALL mill)	Fiscal Balance (ALL mill)	Fiscal Balance /GDP (%)	Reference Value UE (%)	Public Debt (ALL mill)	Public debt less guaranties (ALL mill)	Public debt/GDP (%)	Public debt less guaranties/GDP (%)	Reference value UE (%)
2001	583369	-40409.9	-6.9	3	339640	341521	58.2	58.5	60
2002	622711	-37921.5	-6.1		391314	391309	62.8	62.8	
2003	694097	-33928.3	-4.9		408290	408300	58.8	58.8	
2004	751022	-38083.3	-5.1		423965	423909	56.5	56.4	
2005	814797	-28176.7	-3.5		468087	467838	57.4	57.4	
2006	882209	-29371.7	-3.3		494584	495463	56.1	56.2	
2007	967670	-34118.6	-3.5		516923	489521	53.4	50.6	
2008	1089293	-60254.2	-5.5		595882	559335	54.7	51.3	
2009	1143936	-80882.7	-7.1		682546	636772	59.7	55.7	
2010	1239645	-38031.0	-3.1		715521	670096	57.7	54.1	
2011	1300624	-45877.0	-3.5		772735	724419	59.4	55.7	
2012	1335488	-45857.0	-3.4		828268	774815	62.0	58.0	
2013	1364782	-70413.0	-5.2		956583	905259	70.1	66.3	
2014	1413932	-70634.0	-5.0		1015502	960961	71.8	68.0	
2015*	1441644	-58228.0	-4.0		1040693	975160	72.2	67.6	
2016*	1525360	-41974.0	-2.8		1086957	1017134	71.3	66.7	
2017*	1626287	-31859.0	-2.0		1124933	1078993	69.2	66.3	

2018*	1740809	-20856.0	-1.2		1145788	1069848	65.8	61.5	
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Source: Ministry of Finance, Instat.

*Data for 2015-2018 are projections of the Ministry of Finance available at:

http://www.financa.gov.al/files/userfiles/Programimi_EkonomikoFiskal/Programi_Ekonomik_e_Fiskal/NERPNational_Economic_Reform_Program/Albania_NERP_2015.pdf

Fiscal data show a progressive reduction of budget deficit till 2006, mainly on the back of a better performance in the revenue side. The expansionary fiscal policy followed over 2008 - 2009 was reflected in higher public expenditures and consequently a higher budget deficit, (about -7.1% of GDP in 2009). Higher public investments (especially Durrës Kukës highway) determined a wider deficit over this period. Fiscal policy over 2010 was oriented towards fiscal consolidation through lower expenditure and higher revenues.

With regard to the convergence criteria, Albania set close to the reference value only in 2010 when fiscal deficit recorded 3.1% of GDP. From 2010, fiscal deficit widened progressively accounting for about 5.0% of GDP in 2014. Despite aiming to assure public finances sustainability, during 2011 it was necessary to pursue a prudent fiscal policy (which could be considered slightly stimulating).

Fiscal policy is expected to be strictly oriented towards consolidation in the medium term^{xciii}. The baseline fiscal scenario targets a fiscal deficit at the level of 4.0% of GDP in 2015, down by the level of 5.0% in 2014. Fiscal consolidation is expected to continue in the 2016 and 2017 targeting a fiscal deficit of respectively 2.8% and 2.0% of nominal GDP^{xciv}.

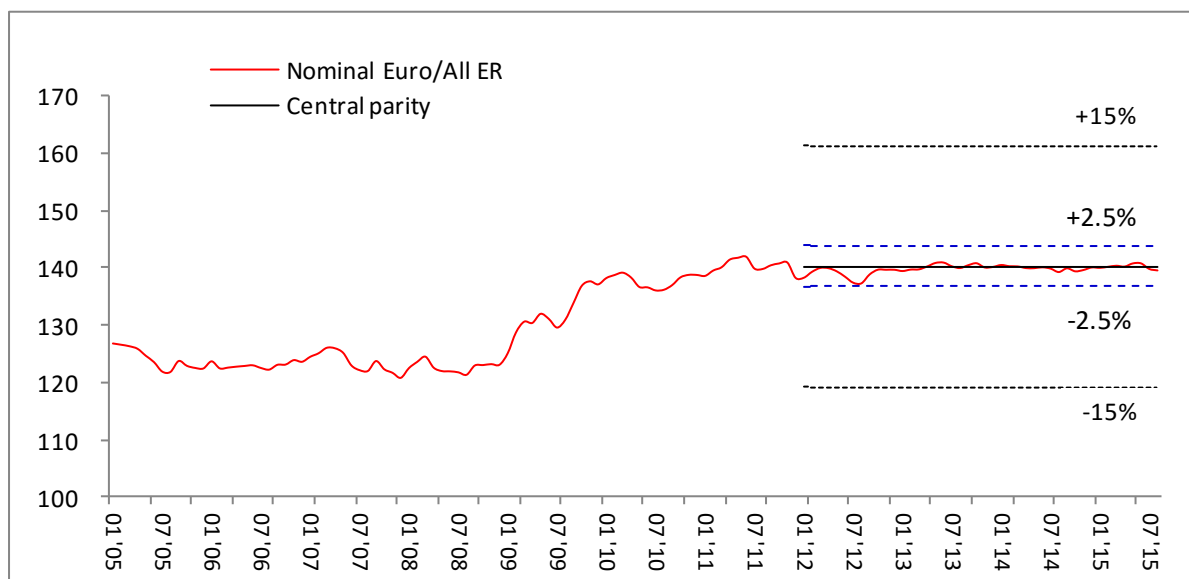
Public debt data show a progressive reduction till 2008. Despite picking up in the following years, public debt figures stood below the EU reference value of 60%. Public debt registered its lowest level in 2007, accounting for about 53.4% of GDP. In 2008, mainly due to capital expenditure financing needs, public debt stock increased, reaching 54.7% of GDP in 2008 and 59.7% of GDP in 2009. Given the 2008 financial crises and the debt crisis in Greece, and as part of the National Strategy for Development and Integration, a more prudent and better administration of the public debt strategy was adopted^{xcv}. This strategy comprised two main elements: domestic debt maturity extension and, from the technical point of view, the improvement of the securities market infrastructure (Bank of Albania, 2008). From 2012, public debt to GDP ratio increased steadily, reaching the highest level of 71.8% in 2014. The increasing trend of public debt to GDP ratio is expected to continue all over 2015. Public debt less guarantees, during 2008-2012, stood below the 60% threshold. Since 2013 public debt less guarantees to GDP ratio followed an upward trajectory, lying above the threshold level indicated by the EU convergence criteria.

In the medium term, the consolidation path is expected to bring down public debt to GDP ratio. Public debt is expected to mark 72.2% of GDP at the end of 2015, 71.3% in 2016 and 69.2% at the end of 2017. Debt contraction is expected to be achieved despite significant energy related guaranties taken into account in the medium term.

...exchange rate stability criterion

The exchange rate stability criterion requires a successful participation in the ERM II, a multilateral agreement, for at least two years after the EU accession of the country (stability of the exchange rate against Euro and no unilateral devaluation). Thus, assessment for exchange rate stability criteria might be carried out only when Albania will participate in ERM II. For the purposes of this study, we can only analyze ER fluctuations against Euro since its introduction. Of course, whether the exchange rate shows relative stability or not, we cannot conclude that Albania formally fulfills or not the exchange rate criteria. An analytical assessment in relation to the exchange rate stability criteria requires the determination of a (hypothetical) central parity of ALL/Euro exchange rate. If we suppose that Albania would have participated in ERMII in July 2013, the central parity might be assumed as equal the average exchange rate over the 12 month period comprised from July 2012 to June 2013. Under this assumption we can make assessments on the stability of the ALL/Euro exchange rate over the last two years.

Chart 1. Nominal ER Eur/All



Source: Bank of Albania

The Bank of Albania (BoA) formulates and implements the monetary policy under a free-floating exchange rate regime^{xcvi}. The value of the national currency Lek (ALL) against foreign currencies is freely determined in the foreign exchange market by the interaction of supply and demand. Nevertheless, the Bank of Albania reserves the right to intervene in the foreign exchange market in presence of severe shocks aiming to safeguard stability and development of the domestic financial markets.

At the beginning of 1999, the Eur/ALL exchange rate was set at 162.2 Lek per Euro (simple average for January 1999). After appreciating till 2001 (+11.8%), the national currency depreciated over 2002-2003 on the back of both appreciation of Euro against USD in international markets and confidence crisis in national currency during the first months of 2003^{xcvii}. From 2004 to 2008 a progressive appreciation of the national currency may be noticed, reflecting domestic macroeconomic stability, high inflow of remittances and foreign direct investments. The peak was reached in the aftermath of the global financial crisis of 2008 (122.8 Lek per Euro). Since then, Eur/ALL followed a depreciating trajectory over the next couple of years. From 2012, apart from seasonal factors, Lek/Eur exchange rate fluctuated between narrow limits of 139 – 140 on average, showing a relative stability.

...long-term interest rates convergence criteria

Long term interest rates indicate markets agent's inflation expectations and financial markets integration level. Low interest rates, suggesting for low inflation expectations and low risk premium, signal for potential stable and sustainable future economic growth. Long term interest rates convergence criteria assessment requires using long term government bonds (with 10 years residual maturity) issued in national currency. As by the first half of 2015, the instruments issued by the Albanian government^{xcviii}, include treasury bills (3, 6 and 12 months' maturity); bonds (2, 3, 5, 7 and 10 years' maturity). From the methodological point of view, none of the instruments issued by the Albanian government is comparable those required to assess for nominal convergence of interest rates. Skipping the methodological aspects, as by the sample approach, 10 year bonds might be used to some extent. The 10-year maturity bonds were firstly issued in October 2013 and have regular quarterly frequency. Although not meeting the requirements of the Treaty and the availability of a short time series we try to make some compliance assessments using it as a benchmark interest rate^{xcix}.

Table 5. Long term interest rate assessments

Best performing countries in terms of price stability	Interest rate for EMU convergence criteria (%)	10Y Bonds (%)	5Y Bonds (%)	12Y T-Bills (%)
Bulgaria	2.9			
Lithuania	2.4			
Austria*	0.9			
Average	2.0			
Reference rate	4.0			
Albania		9.2	6.6	3.4

Source: Bank of Albania

*Best performing countries in terms of price stability as by June 2015 are Austria, Lithuania, and Estonia. Since there are no data on interest rates for Estonia we consider the fourth best performing country in terms of price stability, Bulgaria.

The Albanian government demand for financial resources is oriented to domestic markets, issuing treasury bills (1Y TBills) as the main instrument. Recently, bonds with longer maturities were issued but, none of them meet the Treaty requirements and neither exist other comparable instruments to be considered. Thus, if we account for 10Y bonds, interest rates are significantly above the reference rate. The same stands for 5Y bonds.

Conclusions

The main objective of this paper was to present Albania's current stage of compliance to Maastricht (nominal) convergence criteria. All the indicators considered are not methodologically harmonized with those of EU member countries, and thus are not fully comparable with them. CPI is the only one methodologically comparable to Eurostat HICP.

Bearing in mind the methodological differences we conclude that: (i) Albania fulfills the price stability criteria at the cut-off date. Furthermore, monetary authority in Albania is strictly committed to attaining and maintaining price stability. Experience has shown that BoA has been relatively successful in achieving its primary objective; (ii) Albania does not fulfill the fiscal criteria on fiscal deficit and public debt at the cut-off date. Also, there's a weak methodological alignment to the international standards for fiscal accounts; (iii) Eur/ALL has been relatively stable but not assessment can be done prior fixing a central rate; (iv) long term interest rate criteria assessment could not be carried out as required since no benchmark data could be found.

Given the above considerations, strong efforts should be directed towards methodological harmonization with those used by Eurostat and further research conducted on Albania real convergence.

^{lxvii}European Council in Copenhagen, 21-22 June 1993, Conclusions of the Presidency

http://aei.pitt.edu/1443/1/Copenhagen_june_1993.pdf

^{lxviii} Available at: http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/76279.pdf

^{lxix} Available at: http://ec.europa.eu/enlargement/pdf/albania/st08164.06_en.pdf

^{lxx} Available at: http://europa.eu/legislation_summaries/enlargement/ongoing_enlargement/114536_en.htm

^{lxxi} Available at: http://www.europarl.europa.eu/summits/mad1_en.htm

^{lxxii} The Werner Report (1970) took for granted fixed exchange rates to the US dollar. After the US dollar effectively floated, efforts to tie communities' currencies more closely resulted in the "snake in the tunnel" mechanism for managing fluctuations of member currencies (the snake) inside narrow limits against the US dollar (the tunnel).

^{lxxiii} Available at: http://ec.europa.eu/economy_finance/euro/emu/road/delors_report_en.htm

^{lxxiv} The 1995 Madrid European Council agreed on the name for the new currency – the euro – and set out the scenario for the transition to the single currency that would start on 1 January 1999.

^{lxxv} Countries experiencing deflation are not considered as failing to meet the price stability criterion (Lithuania ECB Convergence Report, 2004). Also, best performer will be considering even a state with a negative inflation rate.

^{lxxvi} Lithuania in Convergence Report (2004); Ireland was in Convergence Report (2010); Greece, Bulgaria and Cyprus in Convergence Report (2014).

^{lxxvii} Nominal convergence refers to Maastricht criteria fulfillment, and real convergence (or catching-up process) refers to the attainment of other member states' average income per capita, implementation of necessary structural reforms and the creation of the institutional structures close to those of EU. Nominal convergence represents a precondition for the adoption of the euro, while real convergence does not.

^{lxxviii} Used as reference value to observe exchange rate fluctuations.

^{lxxix} The standard fluctuating band is +/-15%. Countries may agree for narrower fluctuation band (+/-2.5%) and subject to multilateral agreement.

^{lxxx} Indicator for long-term interest rates is considered bank's interest rate applied to long-term loans (in national currency) to households and businesses (non-financial corporation's) over 5 years' maturity.

^{lxxxi} Indicator based on a basket of securities (issued by a bank with solid rating) with common residual maturity of 10 years.

^{lxxxii} Interest rates on 5-year bonds.

^{lxxxiii} Convergence Report 2014, 2012 <https://www.ecb.europa.eu/pub/convergence/html/index.en.html>

^{lxxxiv} Since almost impossible to find documentation related to the CPI methodology and its calculation in 1958-1960, the source of information for this section is Mrs. Liri (Xhepa) Josa, the first female statistician in Albania, who carried out this project.

^{lxxxv} Alcohol and tobacco; clothing; housing; household equipment; health; transport; communication; recreation and culture; education; hotels and restaurants; miscellaneous articles.

^{lxxxvi} COICOP stands for Classification of Individual Consumption by Purposes.

^{lxxxvii} A new basket for CPI purposes is expected to be introduced soon.

^{lxxxviii} From the beginning of 2006, the Bank of Albania adopted a point objective of 3% for the annual inflation rate instead of the previous interval tolerance band of 2% – 4%. For more information see Monetary Policy Document 2009-2011.

^{lxxxix} The Bank of Albania "*is granted the exclusive right to independently implement the monetary policy (Art. 161, Constitution of the Republic of Albania)*", it has as its main task "*to independently formulate, adopt and implement the monetary policy of the Republic of Albania, consistent with its main objective (Art. 3, paragraph 4a, Law No.8269, dated 23 December 1997, "On the Bank of Albania")*", and the primary objective of the Bank of Albania is to "*achieve and maintain the price stability (Art. 3, paragraph 1, Law No.8269, dated 23 December 1997, "On the Bank of Albania")*".

^{xc} Eastern Europe Consensus Forecasts, August 17, 2015

^{xci} Source: www.dsbb.imf.org/Pages/GDDS/DQAFViewPage.aspx?ctycode=ALB&catcode=CGO00&Type=CF

^{xcii} Units of the central government are: President, the Parliament, the Council of Ministers, 14 ministries, 8 non-ministerial departments, and various central institutions; Social Security Institute; Health Care Insurance Institute. The local governments cover 36 districts and 43 municipalities (including Tirana, which is both a district and municipality). There are no extra-budgetary operations at either central or local government level. Source: <http://www.dsbb.imf.org/Pages/GDDS/DQAFViewPage.aspx?ctycode=ALB&catcode=CGO00&Type=CF>

^{xciii} Law No. 8379, dated 29.07.1998 on the "Preparation and execution of the state budget of the Republic of Albania".

^{xciiii} Albanian National Economic Reform Programme (NERP), 2015. Ministry of Economic Development, Trade and Entrepreneurship.

^{xcv} Macroeconomic and Fiscal Programme – revised for 2016-2018, CMD No 6395, date 31.07.2015, available at: http://www.financa.gov.al/files/userfiles/Programimi_EkonomikoFiskal/Kuadri_Makroekonomik_dhe_Fiskal/K

[uadri+Makroekonomik+e+Fiskal+per+Periudhen+2016-018+i+Rishikuar+%28VKM+Nr+695+dt+31+07+2015%29.pdf](#)

^{xcv} Annual Report (2008), Bank of Albania.

^{xcvi} Monetary Policy Document for 2012 -2014, Bank of Albania.

^{xcvii} The adoption of the law on deposit and the beginning of the privatization process of the largest saving bank in Albania caused a sort of confidence crisis. The Bank of Albania intervened in the foreign exchange market to smooth fluctuations and speculations on the exchange rate.

^{xcviii} Source: Ministry of Finance, Albania.

^{xcix} Protocol No 13 on the convergence criteria suggests that in the case no comparable benchmark is found for long term interest rate assessments, alternative comparable instruments might be used. That's the case of Estonia where the long-term interest rate on loans has been used as a benchmark rate (Faulend et al, 2005). In the case of Albania neither alternative instruments are suitable. The greatest proportion of long-term loans is mainly in foreign currency, often indexed to Euribor, as a result of the considerable rate of euroisation of the economy. It is doubtful whether these interest rates on long-term loans can be used as a suitable reference value.