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**Statement by Mr. Hilbers and Mr. Cools on Andorra
Executive Board Meeting
June 7, 2021**

On January 3, 2020, the Principality of Andorra applied for Fund membership. Ten and a half months later, on October 16, 2020 Andorra became the 190th member of the Fund. Five months after that, Andorra had its first Article IV mission. The Andorran authorities want to express their gratitude to Mission Chief Ms. Srobona Mitra and her team, as well as all involved departments, for having steered the authorities through this momentous period with highly valuable policy advice. They agree with the trust of the staff report and its Selected Issues Paper. They want to thank staff for having taken the time to meet with a wide range of public and private stakeholders to gain an in-depth understanding of the Principality. Finally, after many virtual meetings, the authorities are eager to meet the IMF team in person.

Membership to the Fund is a step in a deeper process of engagement with the world, which gained speed since Andorra's constitutional referendum in 1993, the year in which Andorra also joined the United Nations and the Council of Europe. This year was followed by a process of regional integration with the European Union, through a Monetary Agreement involving Andorra's two neighbors, Spain and France, with whose economies the Andorran economy is deeply integrated. Under this agreement, Andorra is committed to transpose and implement EU financial law. An important next step in Andorra's regional integration is the ongoing negotiation of an Association Agreement with the EU, which will make Andorra effectively a part of the EU internal market and help diversify the Andorran economy. This integration into the broader world also extends to tax issues. Ten years ago, Andorra introduced corporate income tax, followed by personal income tax in 2015. Since then, Andorra has among others ratified OECD standards on exchange of information and is negotiating double tax treaties.

A Commitment to Transparency

The accession to the Fund is the logical next step. As staff writes, it is inspired by the authorities' desire to increase transparency about the Andorran economy. Transparency will help Andorra secure favorable market access. In April this year, Andorra had an oversubscribed 10-year bond issuance of EUR 500 million. This issuance was historic in many ways. It was not only Andorra's first international

issuance, it was also its first green and sustainable bond. While this issuance has led to a temporary increase in Andorra's public debt, it will also considerably lengthen the maturity profile.

Thanks to the Fund's technical assistance, Andorra has been able to publish balance of payment statistics on May 7, 2021, for the first time in its history. These BoP statistics reveal a sizeable current account surplus. Together with a prudent rules-based fiscal policy and the absence of exchange rate risk, Andorra's solid competitiveness position is one of the key strengths of the Andorran economy. More transparency about the economic fundamentals can only be beneficial, for Andorra and the outside world. The authorities are therefore developing IIP statistics and look forward to receiving Fund TA to help close the remaining statistical gaps.

Outlook – COVID-19

IMF accession and the first Article IV mission took place against the background of the COVID-19 crisis. Universal testing strategy and expanded hospital capacity have kept the number of fatalities low and allowed the authorities to target containment strategies as much as possible. Nonetheless, the 12% fall in GDP in 2020 has been momentous, given the inevitable travel restrictions and the fall in tourism revenues.

Andorra's solid fiscal starting position has facilitated the support of households and businesses through the crisis. This support included measures of temporary unemployment, loan guarantees and rent subsidies. Firms' strong levels of capitalization going into the crisis have also helped them to weather the crisis. The authorities agree with staff's advice to withdraw these measures gradually. Much will depend on how the summer tourism season will turn out. In light of the improving Covid situation in Europe, the authorities are hopeful about the coming summer. The authorities expect to have 60% of the population vaccinated by the beginning of the summer.

Harnessing Stability

To cement economic and financial stability, the authorities are committed to 1) further improve financial sector oversight, 2) reform the pension system, and 3) build international reserves.

First, Andorra is committed to continue strengthening its financial sector oversight. MCM's Technical Assistance in that respect is much appreciated. Since the conclusion of the Article IV mission, the Andorra Financial Authority (AFA) has undertaken four relevant initiatives:

1. **Lending related to Covid:** AFA is currently conducting a banking-sector wide inspection in order to validate that (i) processes to extend Covid soft loans have been correctly implemented, and (ii) that Covid related lending, as well as moratoria are correctly reflected in banks' balance sheets. AFA teams are carrying out onsite inspections to that effect.
2. **Related party financing:** AFA has undertaken two measures to mitigate risks linked to related party financing:

- a. Pilar II, issued in April, a few weeks after the Article IV Mission, includes a specific mention to related party financing for banking entities with a related party lending level above market standards.
 - b. AFA has indicated to these banks that it expects them to comply with a 15% related-party-financing-to-own-funds limit.
3. **Cross-border funds:** AFA and Andorra's Financial Intelligence Unit, UIFAND, have developed a Technical Communique requiring all banking entities to report detailed cross-border transfer information on a regular basis.
 4. **Liquidity:** AFA has set up a specific Liquidity Coverage Ratio (LCR) dashboard that will be reported to the Banking Supervision Team and will be reviewed each month by AFA's General Management.

Andorra is firmly resolved to meet the highest international standards to fight money laundering and terrorism financing. The authorities are determined to further improve their anti-money laundering framework and its implementation. Since the 2016 Moneyval Assessment, the authorities have updated their national Risk Assessment and have scaled up on-site inspections. Additionally, they have further enhanced and developed cooperation networks at international level to improve the prevention of criminal use of the banking system for money laundering. Transposition of the 5th EU Anti-money laundering Directive is entering its final phase. The authorities are also committed to further strengthen their national anticorruption framework and are currently considering the ratification of the UN Convention against Corruption.

Second, the authorities remain committed to prudent fiscal policies. To control medium-term fiscal risks, the authorities plan to reform the pension system. Short- and medium-term risk arising from high roll-over needs have been substantially addressed with the recent 10-year bond issuance. The authorities take good note of staff's assessment that public debt remains sustainable even under a higher public investment scenario, and that under that scenario the public debt limit of 40% of GDP will be reached in 2025, only one year later than in the baseline scenario. In this vein the authorities are currently working together with international financial institutions on a number of targeted initiatives to develop key projects, including digitalization and sustainable infrastructure, that would further enhance Andorra's connectivity with the countries within its immediate vicinity. The authorities take good note of staff's assessment that it is possible to both frontload investment as well as to build the required level of international reserves by 2026, while remaining committed to fiscal prudence.

The authorities strongly agree that front-loaded investments should focus on the transition towards a green, digital and sustainable economy. The authorities do caution nonetheless that in a small country like Andorra, multiplier effects might be more subdued than expected. They take note of staff's concern about the 0.4% reduction in public investment in 2020, but also argue that the public investment level in 2019 was unusually high. In addition, while unemployment has increased in 2020, it still remains low at 3.0%. Finally, Andorra's two SOEs have an investment capability as high as the central government.

Third, the authorities agree with staff's recommendation to build international reserves of 12% of GDP by 2026. They concur with staff's methodology, taking into account euroization and the absence of a lender of last resort. The authorities also consider the timing to be feasible, and will

reflect on the various options to reach the reserves target. The expected SDR allocation will be a helpful first step.

Structural Challenges

As the recovery is taking roots, the authorities are committed to address Andorra's structural challenges. Diversifying the economy is high on the government's agenda. A key step will be the finalization of the Association Agreement with the EU which will provide greater market access (in and out). Andorra's strategy to diversify the tourism industry as well as the roll-out of its Horizon 2023 digitalization Strategy are key priorities for the Government. Finally, on climate, the authorities are very much aware of the impact climate change can have on Andorra's mountain ecosystems. They are a strong supporter of the Paris Climate Accord and are committed to becoming carbon neutral by 2050. The authorities are currently preparing a carbon tax proposal, the proceeds of which will serve to upgrade public transport and retrofit buildings, among others.