

Strengthening the Sustainability of Albania's Growth Model

Albania Country Economic Memorandum

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Memorandum

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ACRONYMS AND ABBREVIATIONS

AGFIS	Albanian Government Financial Information System
AIDA	Albanian Investment Development Agency
ALMP	Active labor market program
BAS	Business advisory services
CBAM	Carbon Border Adjustment Mechanism
CEM	Country Economic Memorandum
COVID-19	Coronavirus disease 2019
ECEC	Early childhood education and care
EGD	European Green Deal
EU	European Union
FDI	Foreign direct investment
GDP	Gross domestic product
GDT	General Directorate of Taxation
GHG	Greenhouse gas
GRID	Green, resilient, and inclusive development
HCI	Human Capital Index
ICT	Information and communication technologies
MNE	Multinational enterprise
MoESY	Ministry of Education, Sports and Youth
MoFE	Ministry of Finance and Economy
MSME	Micro, small, and medium-sized enterprise
NE	Ndihma Ekonomike
NDC	Nationally Determined Contribution
NPL	Non-performing loan
OOP	Out of pocket
PISA	Programme for International Student Assessment
PIT	Personal income tax
SEE	South East Europe
SME	Small and medium-sized enterprise
SSC	Social security contribution
STEE7	Seven small transition economies of Europe
STEP	Skills Towards Employment and Productivity
TFA	Trade Facilitation Agreement
TFP	Total factor productivity
UIL	Unified investment law
VAT	Value-added tax
VET	Vocational education and training
WB6	Western Balkans 6
WDI	World Development Indicators

Executive Summary

ES1. Albania is gradually emerging from the unprecedented economic disruptions caused by the coronavirus disease 2019 (COVID-19) pandemic. Albania was still dealing with the aftermath of the devastating November 2019 earthquake when it was forced – along with much of the rest of the world – to introduce lockdown and social distancing measures to contain the spread of COVID-19 in the spring of 2020. The resulting economic dislocations led Albania's gross domestic product (GDP) to contract by an estimated 4 percent in 2020. In 2021, the gradual rollout of vaccines is nurturing prospects for a normalization of economic life – although the exact timing of the end of the health crisis remains highly uncertain. The World Bank's baseline macroeconomic forecast expects a recovery of the Albanian economy in 2021, with GDP growth at 7.2 percent.

ES2. As the pandemic is overcome, it is crucial to shift attention back to Albania's long-term objective of building a stronger underlying economic growth model. In a crisis, it is natural to focus on short-term emergency measures to save people's lives and livelihoods. However, as Albania gradually emerges from the pandemic, it is important to look forward and refocus attention on the long-term structural economic reform agenda. Even before the current health crisis, Albania's living standards – as measured by GDP per capita – were already more than 3 times lower than the EU average (Figure 1). Given these prospects, tens of thousands of Albanians each year decide to emigrate in the hope of starting a better life abroad. Yet, improving the country's living standards is possible. If Albania implements a concerted reform package to match high-performing peers in the Western Balkans, the World Bank projects that the country could catch up to European Union (EU) standards within 30 years (Figure 2).

Figure 1. Living standards are lower in Albania than in regional peers ...

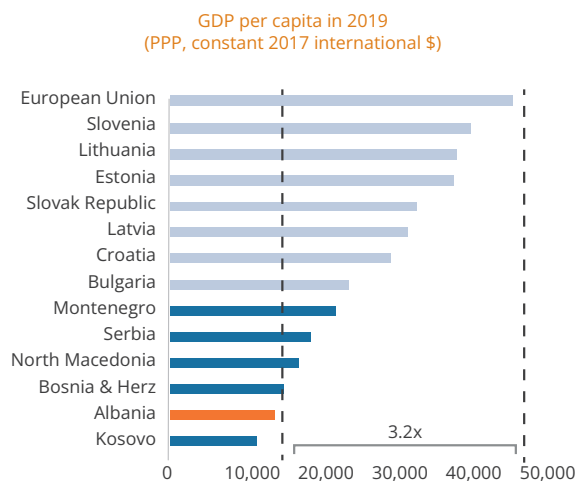
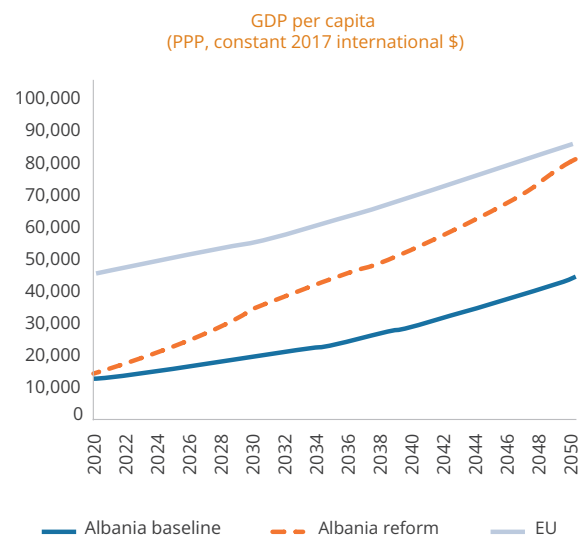


Figure 2. but concerted reform efforts could narrow the gap to peers.

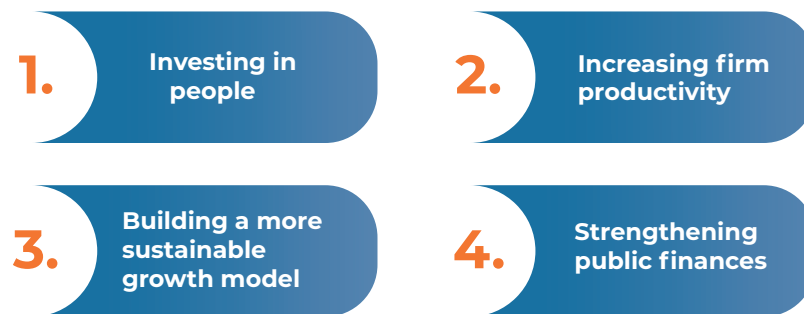


Source: World Development Indicators.

Note: Baseline projections assume that 2015–19 average growth rates are maintained during the entire projection period; the reform scenario assumes Albania implements concerted reforms in key areas to match high-performing peers in the Western Balkans. Methodological details can be found in Box 1 of Chapter 1 of the CEM.

ES3. This Country Economic Memorandum (CEM) highlights 4 key priorities to help Albania identify the next steps in its structural reform agenda. Albania needs to refocus attention on the pre-crisis reform agenda and accelerate long-term economic growth, including by spurring productivity growth, building human capital, and supporting investment. On the labor supply side, this means investing in people and supporting workers' transition to better employment (Priority 1), while on the labor demand side, this means accelerating firm productivity growth and creating better job opportunities (Priority 2). But Albania should also use the current crisis to set its aspirations higher. Beyond achieving higher economic growth, policymakers need to strengthen the quality of the country's socioeconomic development model. Through more green, resilient, and inclusive development (GRID), Albania could ensure the sustainability of economic growth (Priority 3). Foundationally, this CEM highlights the need for Albania to create fiscal space to support its growth priorities (Priority 4). The COVID-19 crisis has driven public debt to new heights, and upgrading Albania's growth model—including by implementing many of the reforms proposed in this CEM – would require further public spending. This makes it a priority to improve public financial management and create additional fiscal space (Figure 3).

Figure 3. Four Reform Priorities for a Stronger Albanian Growth Model



Source: World Bank

ES4. Priority 1: Investing in people and facilitating the transition of workers to better employment opportunities. The expected continued structural transformation both within sectors (i.e., toward more high-productivity jobs that require advanced skills) and across sectors (i.e., from agriculture to manufacturing and services) means that the labor market will drastically change for many Albanians. Addressing the country's skills gap is a huge challenge. For example, for Albania's share of employment in high-skilled occupations to reach the average of the Western Balkans, 111,000 workers (9 percent of the workforce) would need to transfer from low- and medium-skilled jobs to high-skilled jobs. To facilitate this transition and ensure that no one is left behind, the government needs to support educational and labor market institutions in their efforts to upskill and reskill workers and connect them to better jobs. Here more needs to be done. While, Albanian students can expect to receive 13 years of education by age 18, schooling does not translate into effective learning opportunities. Adjusting for learning outcomes, the effective years of schooling are equivalent to only 9.0 years, which means that 3.9 years of an average student's time spent in school do not result in learning. Moreover, public education spending (3.3 percent of GDP in 2019) lags far behind the average in the EU (4.7 percent of GDP) and the Western Balkans (3.9 percent of GDP). Key CEM recommendations under Priority 1 include:

- **Addressing constraints to learning**, including by: (i) increasing education spending, such as improving teacher development and career progression incentives as well as upgrading learning environments (e.g., to facilitate digital learning); (ii) improving education spending efficiency, such as by moving forward with the implementation of school network optimization; (iii) strengthening the quality of education, such as modernizing the teacher training and career progression framework as well as setting minimum national standards for preschool education; (iv) implementing targeted support for students who fell behind due to learning disruptions during the COVID-19 pandemic; and (v) increasing instructional time in key subjects in conjunction with other quality improvements;
- **Upgrading the university system**, including by: (i) fully implementing the university quality assurance framework; and (ii) implementing regular graduate tracer studies to monitor the performance of the university system and ensure that curricula stay relevant for the labor market; and
- **Connecting Albanians with the labor market**, including by (i) improving the quality of vocational education and training (VET) programs for the youth; and (ii) fully implementing the ongoing reform of active labor market programs (ALMPs) to help workers transition to new employment. This will involve efforts to deepen private-public collaborations and systematically monitor the performance of programs to identify further opportunities to strengthen the effectiveness of the VET and ALMP framework.

ES5. Priority 2: Increasing firm productivity and creating better job opportunities. Much of Albania's recent economic expansion has occurred in relatively low-productivity and low-paying sectors such as basic manufacturing and small-scale tourism. In terms of

GDP per person employed (constant 2017 PPP US\$)— a proxy for labor productivity—Albania underperforms relative to regional peers in the Western Balkans and the gap widened in 2015–19. Reversing this trend is currently Albania’s key growth challenge. Within-firm productivity needs to grow faster, and economic activity within and across sectors needs to shift toward higher value-added businesses. The country could greatly benefit from the implementation of reforms aimed at upgrading firm productivity. For example, if the productivity of Albanian firms could catch up to the Western Balkans average, GDP per employed would grow by 40 percent. Higher productivity would encourage firms to increase hiring, compete for workers, and raise labor compensation, thereby creating more and better job opportunities for all Albanians. This will, however, require reform as Albania ranks only 81st out of 140 countries in the World Economic Forum 2019 Global Competitiveness Ranking. Key CEM recommendations under Priority 2 include:

- **Improving the business environment**, including by: (i) adopting a permanent new investment legal framework; (ii) strengthening contract enforcement and legal security; and (iii) continuing to streamline government-business interactions and the digitalization of government services;
- **Strengthening the entrepreneurship and innovation ecosystem**, including by: (i) increasing access to finance; and (ii) ensuring proactive and continuing support to entrepreneurs throughout the life of the business; and
- **Integrating Albania into the global economy to overcome the limitations of the country’s small domestic economy**, including by: (i) adopting border trade facilitation measures; (ii) upgrading national quality infrastructure to ensure that Albanian products meet the standards necessary to access advanced markets such as the EU; and (iii) scaling up Albania’s foreign direct investment (FDI) attraction and retention programs.

ES6. Priority 3: Building a more sustainable growth model. In a post-COVID world, a narrow focus on aggregate GDP growth will not be enough to meet Albania’s aspirations. First, growth needs to become greener. For instance, more than 70 percent of Albanian waste is mismanaged.¹ Second, growth needs to become more resilient. For instance, earthquakes and floods alone are expected to cause on average damages of US\$147 million in Albania every year (World Bank Disaster Risk Finance Diagnostic for Albania 2020). Third and finally, growth needs to become more inclusive, especially since Albania’s poverty rate lingers at 30.8 percent (at US\$5.5 per day; 2011 PPP; 2021 latest estimate). In the long term, environmental sustainability underpins the sustainability of the country’s core economic sectors (e.g., tourism and agriculture), and better preparation against shocks could mitigate their adverse impact on growth. Inclusive growth is key for social cohesion. Through more green, resilient, and inclusive development (GRID), Albania can ensure that growth gains are sustainable. Key CEM recommendations under Priority 3 include:

- **Moving toward a greener development model**, including by: (i) continuing efforts to decarbonize and depollute the economy, such as greening transportation and investing in energy efficiency; (ii) strengthening waste management, such as expanding service coverage to the entire territory and encouraging recycling; and (iii) protecting Albania’s natural assets such as its beaches and forests;
- **Reinforcing resilience against disasters**, including by: (i) implementing structural measures such as building earthquake-proofing infrastructure; (ii) implementing non-structural measures such as enforcing risk-informed land zoning, adopting an earthquake insurance law, and designing a comprehensive disaster risk financing program; and (iii) strengthening disaster preparedness through improved warning and emergency response capacities and the development of new financing instruments (e.g., a dedicated disaster reserve fund to provide rapid financing and mobilizing private sector capital); and

¹ World Wide Fund for Nature (WWF). 2019. *Stop the Flood of Plastic: How Mediterranean Countries can save their seas*.

- **Protecting vulnerable groups**, including by: (i) making healthcare more accessible (e.g., by reducing out-of-pocket expenditure); (ii) creating a more meaningful unemployment insurance framework (e.g., by increasing the benefit level); and (iii) broadening the coverage of the social safety net. Spending increases need to be gradual and consider the available fiscal space and their effects on incentives in the labor market.

ES7. Priority 4: Strengthening public finances. While Albania had made steady progress in reducing its high public debt before the pandemic, these gains were reversed during the crisis. The World Bank projects that the COVID-19 crisis will push Albania's public and publicly guaranteed debt² up to 78.6 percent of GDP by end-2021, significantly above the Western Balkans 6 (WB6)³ average of 59 percent. Coming out of the crisis, Albania is expected to face additional spending needs to upgrade its economic growth model, including to implement many of the recommendations proposed by this CEM. To reduce the public debt and finance necessary public spending as the recovery from the COVID-19 crisis strengthens, Albania needs to create fiscal space. While existing government spending needs to be deployed more effectively to ensure value for money, revenue mobilization through a comprehensive medium-term revenue strategy that strengthens tax policy and improves tax compliance will be key. Albania's public revenues are projected to total 27.8 percent of GDP in 2021, significantly below the WB6 average of 36.4 percent. Key CEM recommendations under Priority 4 include:

- **Bolstering the personal income tax (PIT)**, including by: (i) eliminating non-neutrality in the PIT system by taxing self-employed workers similar to how wage earners are taxed; (ii) developing a holistic approach to reduce informality in the labor market and improve compliance; and (iii) broadening the set of taxpayers required to file comprehensive annual tax declarations;
- **Increasing value-added tax (VAT) revenues**, including by: (i) reducing the VAT exemptions and reduced rates; and (ii) improving compliance risk management as real-time online reporting of invoices (the fiscalization agenda) is fully implemented; and
- **Strengthening the credibility of fiscal policy, including by demonstrating a sustained political commitment to the fiscal rule**, including by upgrading Albania's organic budget law to the status of a legal code.

ES8. While this CEM identifies key reform priorities for Albania, policy measures need to be coupled with firm political commitment and investment in government capacity to ensure successful implementation. The CEM aims to offer a structured contribution to the renewal of Albania's reform program as it emerges from the COVID-19 crisis, laying out 4 core priorities for the country's way forward. The road ahead for Albania is long, and the identification of reform priorities needs to be followed by the effective implementation of new policies. This means embedding priorities into the agenda of top-level Albanian decision-makers, adopting the necessary changes in the country's legal framework, and ensuring that ministries and local officials translate policy changes into actual improvements in the daily lives of Albanians.

ES9. Smart sequencing of the reform program will be crucial to focus government implementation capacity and secure sustainable development gains. In the first instance, existing ongoing reform efforts need to be brought to conclusion and fully implemented. Large multi-year structural reforms need to be broken down into concrete achievable intermediate steps. To ensure the sustainability of reforms, the institutional capacity of concerned government bodies needs to be enhanced in terms of human resources, mandates, and accountability frameworks. Finally, programs requiring significant increases in government spending should only be implemented as public revenue mobilization gains materialize and fiscal space becomes available. The World Bank Group looks forward to continuing to support Albania on its reform journey.

² The estimate includes arrears to the private sector.

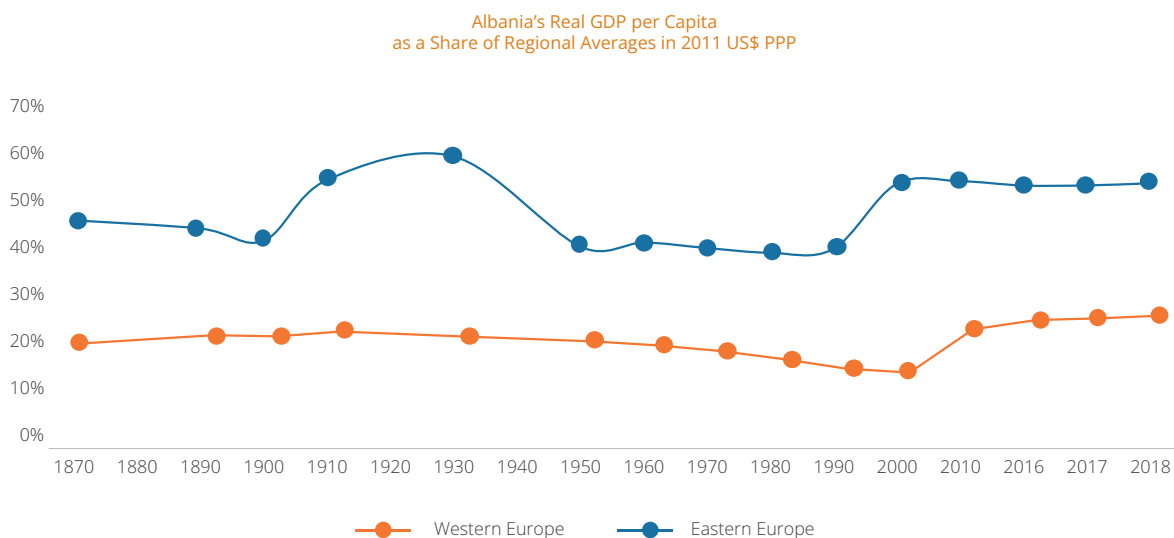
³ The WB6 is made up of Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia, and Serbia.

Chapter 01

Economic Context

1. Since the early 1990s, the adoption of democratic and economic reforms has transformed the lives of Albanians, bringing the country's living standards closer to those of developed economies. Early liberalization, trade and financial opening, and a commitment to structural reforms supported growth and poverty reduction. Albania transitioned from being the poorest country in Europe in 1945–1989 to achieving middle-income status in 2008. The economy grew by an average of 9 percent between 1992 and 1996, with income per capita increasing by more than 50 percent. Policies that reintroduced the free movement of people and incentivized the allocation of resources from agriculture to manufacturing, construction, and services accelerated productivity and gross domestic product (GDP) growth. However, the first decade after the fall of communism was also marked by setbacks: poor institutional capacity, lack of knowledge about the market economy, and inadequate financial regulation led to the spread of large financial pyramid schemes, culminating in about one-third of the population investing in them by 1996. The abrupt collapse of the pyramid schemes in 1997 resulted in unprecedented civil unrest, which had a deep impact on people's lives and welfare. The resumption of structural reforms and privatization, coupled with a favorable global economic outlook, led to an economic expansion of 6.2 percent between 2000 and 2008, and the poverty rate halved from 25.2 percent to 12.5 percent in the same period. Substantial migration provided for large remittance inflows, while continuous labor reallocation away from agriculture pushed up wages, further increasing domestic consumption. Albania's per capita GDP rose from less than 16 percent of the average of western European economies in 1990 to 25 percent in 2010, and the country achieved upper-middle-income status in 2009 (Figure 4).

Figure 4. Gaps in living standards between Albania and the average of European countries have been large and persistent.



Source: Maddison Project Database, Albania's Real GDP per capita as percent of regional averages in 2011 US\$ PPP

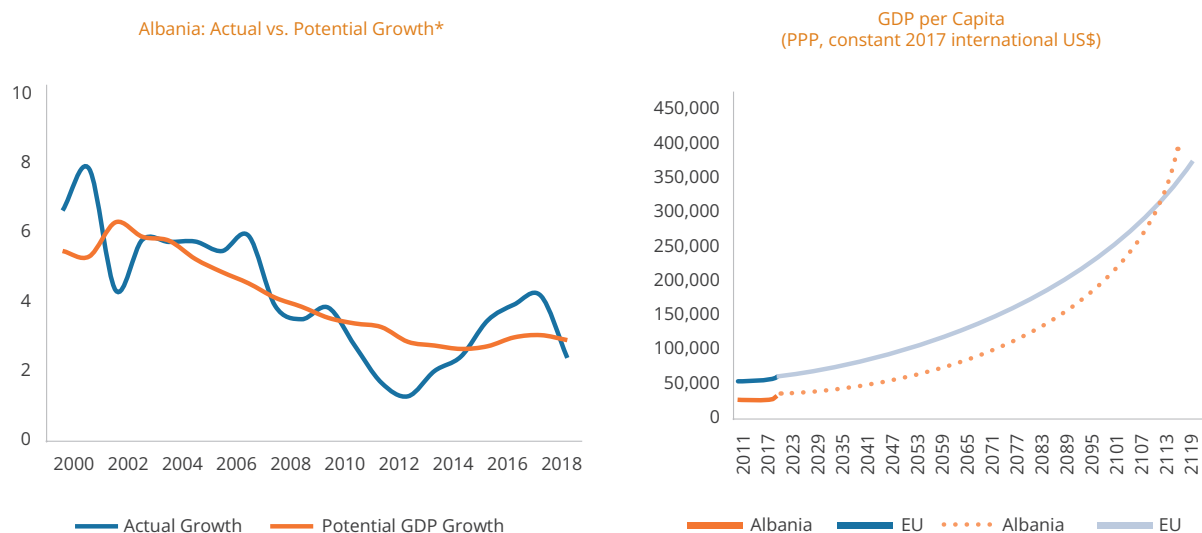
2. The global financial crisis of 2007-08 and the eurozone sovereign debt crisis of 2011-12 exposed the underlying weaknesses of Albania's growth model and exacerbated its macroeconomic imbalances. Despite the country's high growth rates recorded in 2000–08, important emerging vulnerabilities were threatening the sustainability of growth. With a domestic-oriented growth model, supported by foreign financing flows to aid consumption, GDP growth slumped to an annual average of 2.6 percent between 2000 and 2008 as foreign financing fell (Figure 5). The 2015 World Bank Systematic Country Diagnostic found that despite an increase in investment spending before the crisis, physical capital investments (both private and public) have not prioritized high-return investments. Weak property rights and low labor force participation have led to an underutilization of capital and labor. Additionally, the reallocation of resources from rural to urban areas has not fully translated into aggregate productivity gains due to disincentives emanating from low institutional quality, poor access to conflict resolution systems, and an unreliable energy supply.

3. Between 2008 and 2014, the impact of the global financial crisis and a sharp deterioration in the external environment weighed on Albania’s exports, remittance inflows, and external credit conditions. This dampened domestic demand and led to a fall in GDP growth. While not technically a recession, macroeconomic indicators deteriorated across the board. Between 2010 and 2014, net employment fell by about 143,000 jobs,⁴ as key job-creating sectors such as construction contracted. Unemployment reached 17.5 percent of the labor force in 2014, and youth unemployment reached 39 percent in the same year. The poverty rate (measured at US\$5.5 per day in PPP) reached 39.3 percent in 2012, and non-performing loans (NPLs) peaked at 25 percent of the loan portfolio in 2014. As Albania resorted to fiscal policy to support demand while public revenues weakened, the fiscal deficit widened to above 5 percent of GDP in 2013, and public and publicly guaranteed debt rose to above 70 percent of GDP in the same year.

4. On the demand side, the economic slowdown was marked by a shift in the country’s economic growth drivers. External demand played a more prominent role as exports and the resilient agriculture sector helped stave off a recession. The contribution of consumption to growth diminished but remained positive, while the collapse of investment spending had a negative impact on growth. The economic slowdown caused household income to contract, and the national headcount poverty rate reached 14.3 percent in 2013.

5. Albania’s growth performance, poverty levels, and macroeconomic fundamentals gradually improved between 2014 and 2018. Supported by a fiscal adjustment and macroeconomic stabilization, the GDP growth rate gradually recovered from a low of 1.0 percent in 2013 to 4.1 percent in 2018, although cyclical factors appear to explain a significant part of the growth acceleration. Structural reforms regained momentum when the country became a candidate for European Union (EU) accession in 2014, boosting sentiments for investment and growth. Meanwhile, fiscal policy focused on reducing the public debt, mainly through a reduction of public spending. Structural reforms tackling rigid expenditures (e.g., subsidies to energy state-owned enterprises), the deficit of the pension scheme, and state-owned enterprises’ utility arrears reduced public spending from 32.2 percent of GDP in 2014 to 29.4 percent in 2019. However, sustaining high growth rates and macroeconomic balances has proven challenging in the face of large environmental shocks such as droughts, floods, and earthquakes. The continued prominence of the agriculture sector and an overreliance on hydropower have intensified the economy’s exposure to weather-related shocks.

Figure 5. Growth accelerated in 2014–18, but a convergence of living standards will take a long time at current potential growth rates.

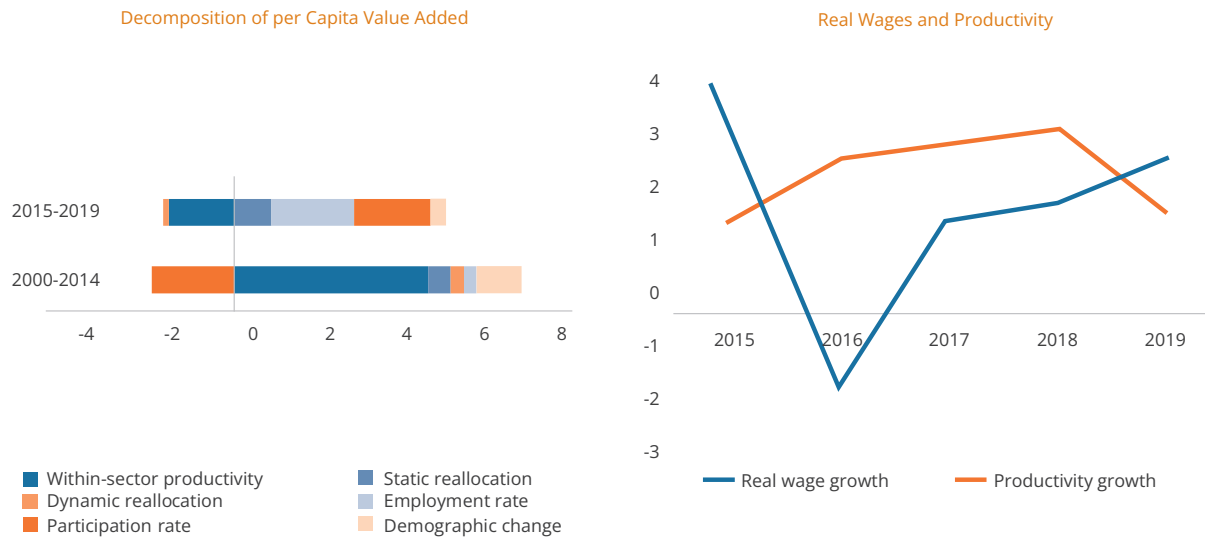


Source: World Bank staff calculations using INSTAT data.
 Note: Potential growth estimated as a function of changes in capital stock, structural employment and TFP using a Solow decomposition.

Source: World Bank staff calculations using INSTAT data.

⁴Internal Labour Organization (ILO). Employment is based on the labor force survey (LFS).

Figure 6. While value added per capita has increased, this has largely been due to a rise in employment and a shift in labor toward higher paying/more productive sectors. However, within-sector productivity had a negative contribution to growth in the recent years.



Source: World Bank; World Development Indicators (WDI).

Note: Total employment data come from the Macro Poverty Outlook for Albania, and employment data come from the WDI (based on ILO estimates). Working age population: people aged 15-64.

Source: INSTAT; World Bank; WDI.

Note: Wage data are based on information collected by the GDT. Total factor productivity (TFP) is calculated as a Solow residual.

6. Labor market trends improved between 2014 and 2018. The economy added roughly 204,800 jobs⁵ in 2014–18, and the unemployment rate and the youth unemployment rate stood at 11.4 percent and 21.5 percent, respectively, in 2019. Out of the total jobs added within this period, about 60 percent of jobs went to male workers, almost all jobs went to workers aged 25–54, and one-third of all jobs went to women aged 25–54, with a larger share going to more educated women. The new jobs were equally split among education levels. Meanwhile, most of the job creation was concentrated in sectors with lower-than-average wages such as manufacturing, trade, transport, and agriculture (although the health sector, which typically has higher wages, also grew). Indeed, real wage growth was much lower after 2014 than it was before the crisis: real wages increased by close to 10 percent per year before 2008 (faster than productivity), while real wages only increased by around 2 percent per year between 2014 and 2018.

7. While growth and job creation has been a key driver of poverty reduction, inclusive social policies remain important. Between 2002 and 2008, an increase of 1 percent in GDP was associated with a reduction in poverty of 0.9 percent (about half a percentage point). In the same period, households in the bottom 40 percent of the income distribution experienced annual growth in mean consumption of 4.4 percent, slightly above the national average of 3.6 percent. The contraction of the economy between 2008 and 2012 hit the bottom 40 percent hard, and their average consumption fell by 1.2 percent per year, slightly below the national average of 1.3 percent. Between 2014 and 2017, the elasticity of poverty growth fell, and a 1 percent increase in GDP resulted in a 0.8 percent poverty reduction (less than one-third of a percentage point). Meanwhile, the mean consumption of households in the bottom 40 percent grew at 2.4 percent annually, below the pre-crisis level but still much higher than the national average of 0.7 percent. While recent data are not available, the World Bank estimates that the poverty rate could have increased between 1.0 and 3.9 percentage points in 2020 due to the 2019 earthquake and the coronavirus disease 2019 (COVID-19) pandemic.

8. Despite the long-term improvement in living standards, Albania’s working-age population continues to shrink as people emigrate in search of better job opportunities. The Albanian diaspora represents 57 percent of the country’s current population, one of the highest in the world. The Balkan Barometer in 2019 showed that 50 percent of people in Albania would consider living and working abroad. ⁶ While Albania’s population of 2.8 million in 2020 has remained constant since the early 1980s, it has aged rapidly due to the continuous emigration of working-age Albanians and a decline in the fertility rate, from 3.4 in 1980 to an average of 1.62 in 2015–20. In 2020, births exceeded deaths by

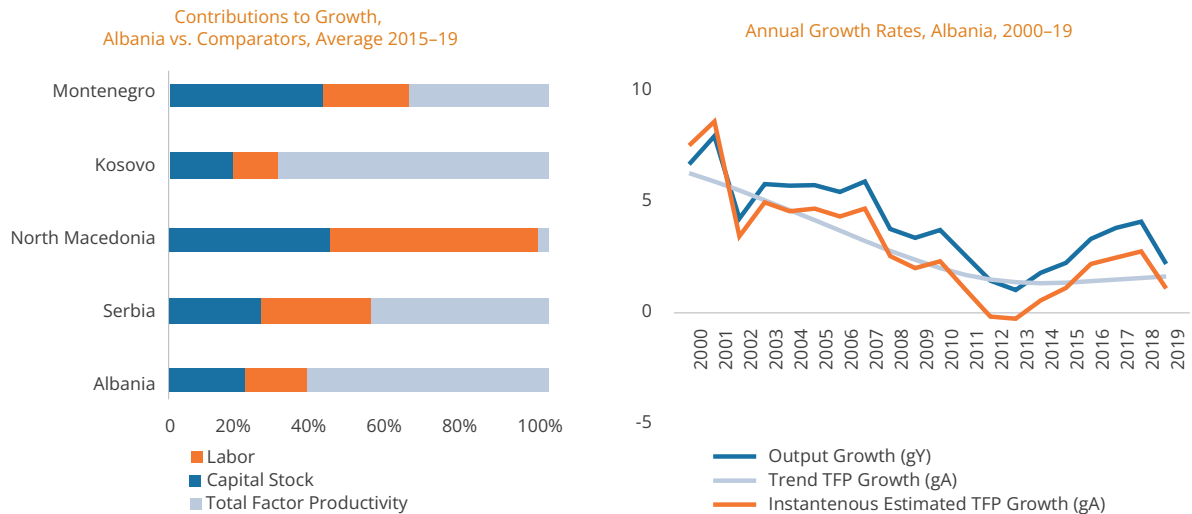
⁵ ILO, based on LFS.

⁶ *Pushing on a string? An evaluation of regional economic cooperation in the Western Balkans*, Stefani Weiss, 2020, <http://aei.pitt.edu/103198/>.

only 470 – much lower than 10,345 in 2016. These demographic changes present important challenges for future human capital and the labor market, as well as for the sustainability of the pension scheme.

9. Albania's productivity trends are worsening, an indication that production inefficiencies could lead to lower levels of economic growth (or even stagnation) in the long run. Productivity growth was the main driver of the country's GDP growth between 2015 and 2019, and the country's level of productivity growth is the second highest among the countries in the Western Balkans. However, declining productivity trends could mean that Albania's growth may decelerate or even stagnate in the absence of productivity-enhancing structural reforms.

Figure 7. Long-Term Growth as a Function of Productivity.

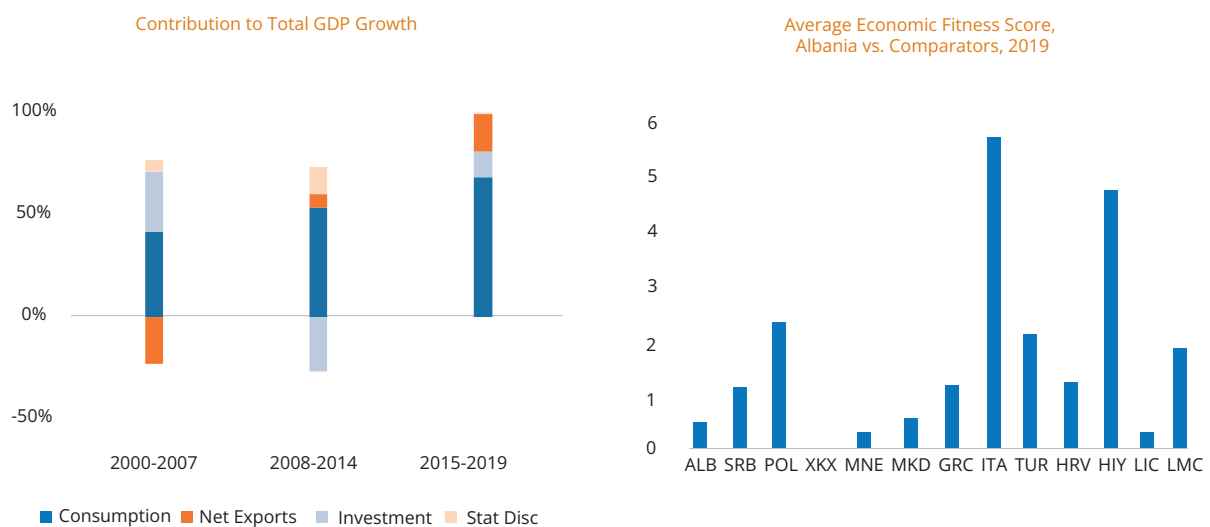


Source: World Bank staff calculations based on data from statistical agencies.

Source: World Bank staff calculations based on data from statistical agencies.

Note: Instantaneous TFP is calculated as a Solow residual. Trend TFP is HP-filtered Instantaneous TFP. The HP filter is calculated until year 2100 and smoothed at 100.

Figure 8. While GDP growth has become more diversified, the country needs to increase productivity growth to ensure the sustainability of the growth model.



Source: World Bank staff calculations based on INSTAT data.

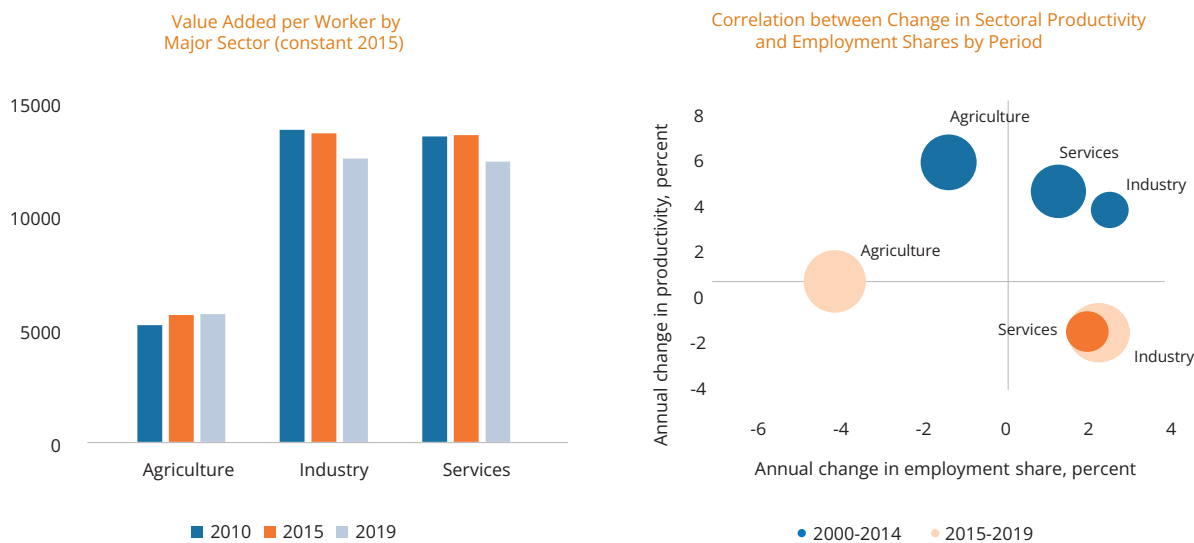
Source: Observatory of Economic Complexity.

Note: Economic fitness is a country-level metric based on the diversification and complexity of a country's competitive exports. Higher ECI points to a more diversified and complex export basket.

10. Albania’s GDP growth continues to be driven by domestic consumption. Ensuring the sustainability of the country’s growth model would require an increase in productivity growth. Before the COVID-19 pandemic, Albania’s macroeconomic indicators were improving, although the country was increasingly relying on consumption. Since 2014, renewed job creation, improvements in credit conditions, and the inflow of remittances have all contributed to the growth in domestic consumption. Investment also picked up, in part due to the implementation of two large foreign-financed projects, the Trans-Adriatic Pipeline and the Devoll hydropower plant, both of which have been completed. Persistently high debt levels and lack of fiscal space constrain the ability of the government to contribute further to capital formation, while business environment constraints, limited financial market development and entrepreneurship support and, a small domestic market constrain private sector business opportunities – hampering the country’s ability to transform savings into productive private investment. Despite the fast expansion of services exports in sectors such as tourism, business processing operations, information and communication technologies (ICT), and textile and garment manufacturing, Albanian products remain relatively unsophisticated and concentrated in a few markets. During the COVID-19 pandemic, it has become evident that Albania’s exports remain vulnerable to external shocks, and the declining trend in productivity could translate into lower economic growth in the long run.

11. The transition of labor away from agriculture into services and manufacturing has not translated into an increase in value added per capita. This is mainly due to the transition of primarily unskilled agricultural workers to services and manufacturing. Albania’s production structure is gradually shifting toward services and to some extent manufacturing, while agriculture is stagnating. While growth and an increase in employment have been recorded in tourism, manufacturing, financial services, professional services, and ICT, value added per capita in these sectors has decreased.

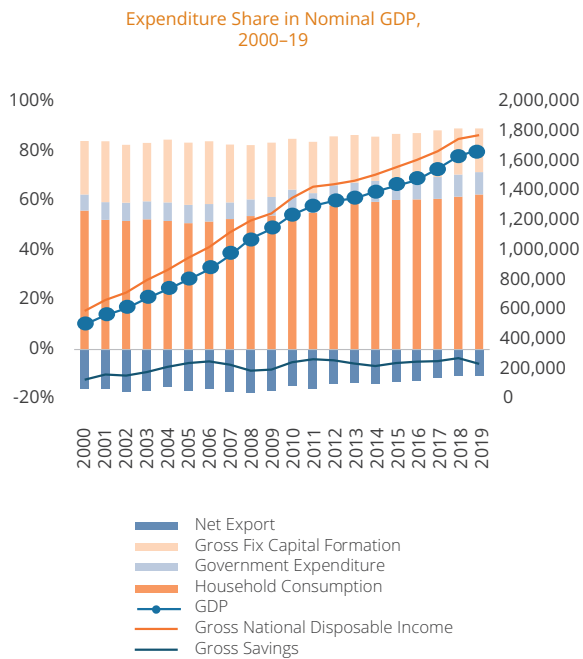
Figure 9. Unskilled workers have transitioned out of agriculture to small inefficient services firms and labor-intensive manufacturing firms.



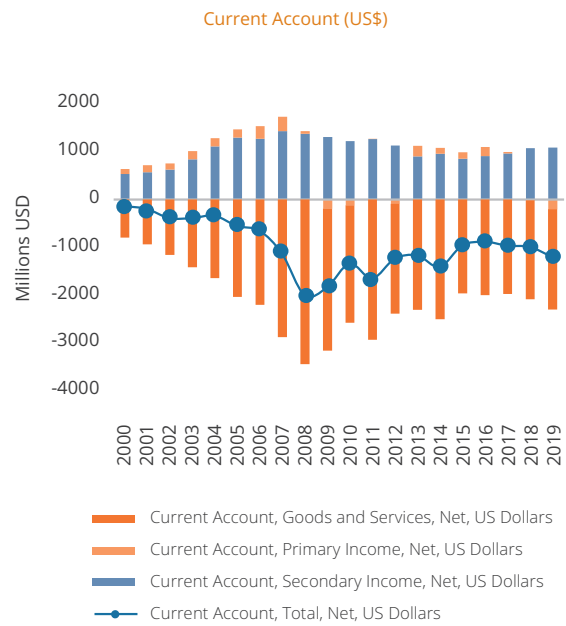
Source: INSTAT and ILO.
 Note: Total employment is based on administrative data, and employment data come from the WDI (based on ILO estimates). Working age population: people aged 15-64.

Source: World Bank staff calculations based on INSTAT data.
 Note: Economic complexity is constructed using export data at the product-country level.

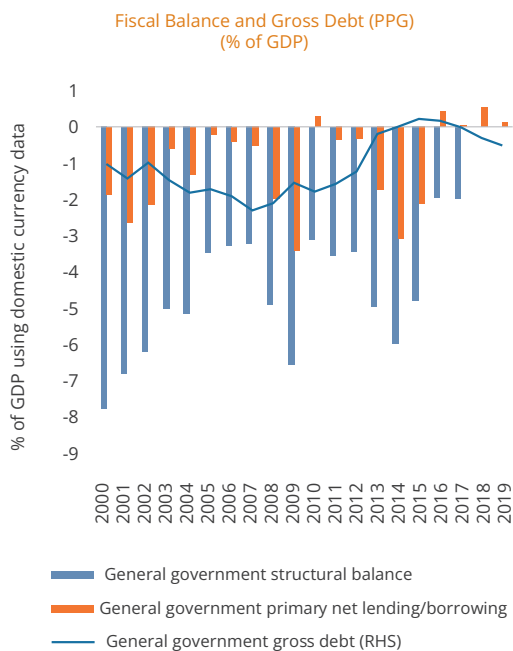
Figure 10. While Albania's economic indicators improved in 2015-19, significant vulnerabilities remain.



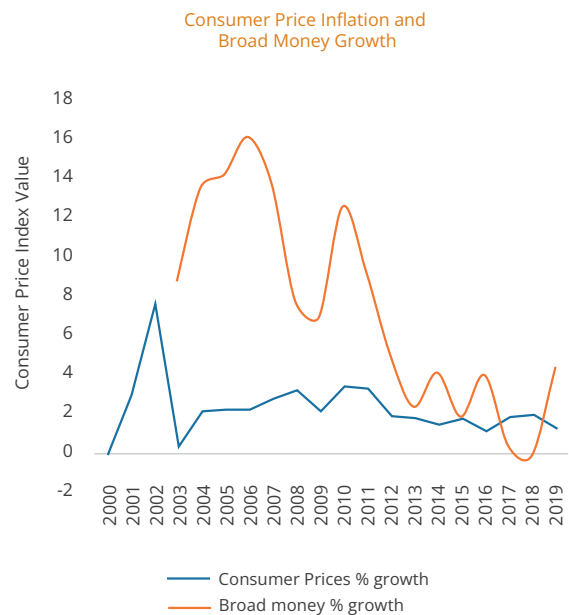
Source: World Bank staff calculations.



Source: World Bank staff calculations.



Source: World Bank staff calculations.



Source: World Bank staff calculations.

12. Foreign direct investment (FDI) is needed to sustain investment rates and increase the return on investment through higher productivity. Albania's economic indicators improved in 2015-19, although significant vulnerabilities remain. While the share of consumption in GDP has increased in recent years, net savings have stagnated, and the share of investment in GDP has declined. Since there is limited fiscal space for public investment, and domestic private sector investment has remained subdued, foreign capital inflows would not only support much needed investments but also contribute to productivity growth through technology transfers. With services exports and labor-intensive manufacturing gaining momentum, the structurally wide current account deficit has gradually narrowed. However, exports are undiversified, and the current account is still largely financed by remittances, which makes it vulnerable to adverse shocks in the economies hosting Albania's migrants.

13. The current pandemic has demonstrated the importance of crisis management and preparedness in ensuring the sustainability of economic growth. In 2019, a severe drought, followed by a devastating earthquake, disrupted Albania's gradual economic recovery. The earthquake, which registered 6.3 on the Richter scale, resulted in at least 51 fatalities and inflicted damage equivalent to an estimated 7.5 percent of Albania's GDP in 2018, or 26.4 percent of its gross fixed capital formation. The tourism and construction sectors were hit the hardest. Meanwhile, a major drought during the first half of 2019 cut electricity production, and the completion of two large FDI-financed projects in the energy sector further slowed economic activity. As a result, the country's annual GDP growth rate fell from 4.0 percent in 2018 to 2.2 percent in 2019.

14. The COVID-19 crisis has had an adverse impact on an economy already devastated by the earthquake in 2019, with growth contracting by 3.3 percent in 2020. The lockdown that started in March affected several key sectors, resulting in a severe economic contraction, and official travel and tourism restrictions, along with social distancing, affected both supply and demand. Given the structure of the economy, the loss of sales and profits had a disproportionate effect on small and medium-sized enterprises (SMEs). Private consumption and investment decisions were delayed by uncertainty about the end of the crisis as the number of infections rose gradually during the year. In 2020, investment contracted by 2.0 percent, and private consumption declined by 2.4 percent.⁷ Fewer garment processing orders led to a 12.4 percent drop in goods exports, and tourist visits plunged by 60 percent. However, net exports contributed to growth given a sharp contraction of imports in response to a slackening of private demand. Despite structural challenges, labor market indicators improved relatively quickly after the initial lockdown and once the economy started to reopen. In the summer of 2020, employment bounced back, with tourism and earthquake reconstruction efforts partly absorbing the loss of manufacturing jobs.

15. Increased public spending on social services and earthquake reconstruction has alleviated the impact of the pandemic on poverty. Albanian authorities introduced wage subsidies, increased social spending, and launched two credit guarantee windows through commercial banks to ease salary payments and release financing for working capital and investment needs. As a result, public spending rose from 29.4 percent of GDP in 2019 to 33.0 percent of GDP in 2020. To help SMEs, the authorities introduced tax deferrals and further value-added tax (VAT) exemptions, which contributed to public revenues falling from 27.2 percent of GDP in 2019 to 26.3 percent of GDP in 2020, despite grants financing reconstruction. Moreover, the wider fiscal deficit and the extension of post-COVID-19 guarantees for the private sector caused the public debt to soar from 67.4 percent of GDP in 2019 to 77.2 percent of GDP in 2020.⁸ Albania's debt-to-GDP ratio rose during the pandemic for the first time since 2017. While the country's fiscal rule mandates that the debt-to-GDP ratio declines every year until it reaches 45 percent of GDP, it includes an emergency escape clause that was applied in 2020.

16. With inflation low, the Bank of Albania maintained an accommodative monetary policy by lowering the monetary policy rate and injecting liquidity into the banking system. In response to the COVID-19 pandemic, the Bank of Albania lowered the base policy rate by 50 basis points to a new historic low of 0.5 percent in March 2020. To support the banking system's liquidity buffers, it also abolished the ceiling on short-term central bank loans, and it introduced macroprudential tools such as lowering the capital requirement for government securities in foreign exchange to help banks finance government borrowing in foreign currency (there is ample foreign currency liquidity in the domestic market).

⁷ Does not include statistical discrepancy.

⁸ Includes general government arrears to the private sector.

17. The COVID-19 crisis substantially diminished Albania's growth prospects for 2020, but the GDP growth rate is expected to return to its long-run potential level of 3-4 percent over the medium term. Largely due to the dramatic slowdown in the tourism sector, which accounts for 26 percent of Albania's economic output, the country's GDP contracted by an estimated 6.7 percent in 2020, among the worst in the region. Meanwhile, weakening labor markets in Western Europe are affecting remittance flows and undermining domestic consumption, and the combination of depressed tourism exports receipts and lower remittance inflows is weakening the external accounts. Falling tax revenues, coupled with increased expenditure pressures related to the pandemic, are expected to reverse the declining trend in fiscal deficits and debt levels. Slowing economic activity and elevated uncertainty are also expected to weigh on private investment and consumption, with especially negative implications for SMEs and the manufacturing and tourism sectors. Government spending is projected to be the sole contributor to GDP growth in 2020, as revamped public spending in response to earthquake reconstruction and COVID-19 mitigation efforts continues. The annual GDP growth rate is projected to rebound to about 7.2 percent in 2021, although this projection hinges on the easing of lockdown measures—especially travel restrictions—as well as a swift recovery in the supply of tourism services, a rebound in external demand for tourism, continued countercyclical policies to sustain domestic demand, and effective policies to support the private sector. Over the medium term, Albania's annual GDP growth rate is projected to average about 3.8 percent.

18. In the wake of the COVID-19 pandemic, fostering a robust and sustainable recovery will require significant changes in Albania's labor market. As the reallocation of labor away from agriculture is expected to continue, it is crucial to equip workers with the skills necessary to succeed in the labor market and access high-productivity job opportunities. Labor shifts need to be preceded by an improvement in skills and technological readiness. This means that the government's long-term policy needs to also focus on investing in people, especially early childhood education.

19. Efforts to accelerate productivity growth also need to be supported by measures to improve the business environment, remove obstacles to efficient capital reallocation and foreign capital inflows, and increase access to finance. Given its small domestic market, Albania's economic growth hinges on its ability to increase international trade linkages and use FDI to access capital and increase technology transfer. In addition, the country needs to find new sources of productivity to move to a faster and more sustainable growth path, which would require the authorities to: (i) shift the economy toward higher value-added segments within industries in which Albania maintains a competitive edge; and (ii) diversify the economy toward new, high-productivity manufacturing and services sectors that are integrated into regional or global value chains.

20. To sustain economic growth and ensure it translates into poverty reduction, the country needs to improve its capacity to deal with disasters, including climate change, and protect its natural resources to promote a greener future and increase access to economic opportunities for all. Insurance mechanisms need to be in place and deployed quickly to protect the most vulnerable groups and limit the impact and duration of disasters and shocks. Besides preparedness, Albania needs to protect its environmental assets and contribute to a greener future. Finally, to strengthen social cohesion and support its reform agenda, the government needs to enhance the coverage of the social protection system to ensure that the most vulnerable people in society are protected.

21. Moreover, efforts to unlock productivity-driven long-term growth will require the deployment of additional fiscal resources. Albania has relatively large untapped potential sources of public revenues, which could be mobilized by increasing the tax base. To this end, tax policies need to be streamlined to reduce incentives to engage in aggressive tax planning, and the tax administration needs to better address cases of noncompliance.

22. Based on the country's economic context, this CEM presents potential reforms for Albania to accelerate long-term sustainable and inclusive economic growth. Once the emergency of the COVID-19 pandemic is over, the government needs to pursue a structural reform agenda that makes it possible for workers as well as firms to leverage global economic opportunities while protecting the most vulnerable members of society. To this end, Chapter 2 focuses on the need to equip workers with in-demand skills and link them to labor market opportunities, while Chapter 3 deals with the importance of ensuring the competitiveness of the country's businesses. Chapter 4 discusses the need to build a more sustainable growth model, including promoting a green recovery,

preparing for disasters, and sharing the benefits of economic growth with all. Finally, Chapter 5 deals with the urgency of creating fiscal space to ensure the sustainability of public finances. Whenever appropriate, Albania will be benchmarked to the performance of peer countries to demonstrate the potential gains from the successful implementation of structural reforms. This CEM will select as Albania's benchmark comparators the Western Balkans 6 (WB6), the seven small transition economies of Europe (STEE7), and EU countries (Box 2).

Table 1. Baseline Macroeconomic Growth Projections for Albania

ALBANIA	2018	2019	2020	2021^e	2022^f	2023^f
Real GDP growth (percent)	4.1	2.2	-4.0	7.2	3.8	3.7
<i>Composition (percentage points):</i>						
Consumption	3.1	2.5	-3.8	3.9	1.9	2.7
Investment	0.7	-0.9	-1.0	3.1	-0.4	0.5
Net exports	0.2	0.6	0.8	0.4	2.2	0.4
Exports	1.4	2.0	-8.6	6.6	3.9	2.1
Imports (-)	1.1	1.4	-9.4	6.4	1.6	1.6
Consumer price inflation (percent, period average)	2.1	1.4	1.6	2.4	2.8	3.0
Public revenues (percent of GDP)	27.5	27.4	26.3	27.8	27.4	27.4
Public expenditures (percent of GDP)	29.2	29.4	33.0	34.0	30.0	30.0
<i>Of which:</i>						
Wage bill (percent of GDP)	4.5	4.6	4.8	5.0	4.5	4.4
Social benefits (percent of GDP)	11.6	11.9	12.9	12.6	12.0	11.8
Capital expenditures (percent of GDP)	4.8	4.5	6.0	8.0	6.0	5.0
Fiscal balance (percent of GDP)	-1.7	-2.0	-6.8	-6.7	-2.8	-3.0
Primary fiscal balance (percent of GDP)	0.5	0.1	-4.7	-4.6	-0.7	-0.6
Public debt (percent of GDP)	64.9	63.7	75.1	75.4	74.9	73.1
Public and publicly guaranteed debt (percent of GDP)	69.5	67.9	77.2	78.6	76.7	74.9
<i>Of which:</i>						
External (percent of GDP)	30.4	29.1	35.9	38.6	35.3	32.4

ALBANIA

ALBANIA	2018	2019	2020	2021 ^e	2022 ^f	2023 ^f
Goods exports (percent of GDP)	7.7	6.6	6.1	7.6	7.5	7.5
Goods imports (percent of GDP)	30.1	29.7	28.9	33.9	33.5	33.1
Net services exports (percent of GDP)	8.7	9.3	8.1	10.6	13.0	13.6
Trade balance (percent of GDP)	-13.7	-13.8	-14.7	-15.7	-13.0	-12.0
Net remittance inflows (percent of GDP)	5.2	5.2	5.1	4.7	4.7	4.7
Current account balance (percent of GDP)	-6.8	-8.0	-8.8	-9.4	-8.1	-7.0
Net foreign direct investment inflows (percent of GDP)	8.0	7.6	6.8	6.6	7.4	7.0
External debt (percent of GDP)	65.2	60.5	64.7	59.3	53.9	52.9
Real private credit growth (percent, period average)	-3.0	1.5	5.2	—	—	—
Nonperforming loans (percent of gross loans, end of period)	11.1	8.4	8.1	—	—	—
Unemployment rate (percent, period average)	12.3	11.5	11.7	—	—	—
Youth unemployment rate (percent, period average)	23.1	21.5	20.9	—	—	—
Labor force participation rate (percent, period average)	59.4	60.4	59.5	—	—	—
GDP per capita, PPP (current international \$)	15,101	15,433	14,816	—	—	—
Poverty rate (percent of population)	32.4	31.8	32.6	30.8	29.3	—

Source: Country authorities, World Bank estimates and projections.

Note: Youth unemployment rate is for the labor force aged 15-29.

Statistical discrepancy contribution is divided at the ratio of 80 percent and 20 percent between Consumption and Investment respectively.

Change in inventories is included in Investments.

Poverty rate calculations based on ECAPOV harmonization using SILC-C data. Nowcasted/projected values start at 2019. Income measures in the SILC and consumption measures in the HBS are not strictly comparable. Poverty is defined as living on less than \$5.5/day per person in revised 2011 PPPs.

Box 1. Estimating the Impact of Structural Reforms on Growth

The implementation of structural reforms could boost Albania's potential growth and accelerate its convergence with the EU. Structural reforms can boost GDP growth through their impact on the three standard inputs of a production function: (i) capital accumulation, (ii) labor utilization, and (iii) total factor productivity (or efficiency). Based on the assumption that Albania has the capacity—in terms of plans and resources—to promptly and simultaneously implement reforms, it is possible to simulate the change in annual GDP growth from closing the gap in critical structural areas relative to the best performer in the Western Balkans over a period of 10 years. Under the new growth scenario, income convergence toward the EU could accelerate significantly.

Structural determinants of potential GDP growth are identified by separately studying capital, labor, and productivity—the channels through which these determinants may work. The analysis builds on the approach introduced by Bouis and Duval (2011), Barnes et al. (2013), and Johansson et al. (2013), and elaborated on by Egert and Gal (2016). The model is based on a standard Cobb-Douglas production function with capital, labor, and technical efficiency. Cross-country reduced form panel data regressions are estimated for the capital-output ratio and the employment rate. Technical efficiency is estimated with a stochastic frontier analysis, which allows for the computation, for a given sample of countries, of the maximum amount of output, given the factors of production and technology available and conditional on structural and macro variables. The analysis highlights the role of crucial structural characteristics in accelerating growth, including: institutional quality; labor market rigidities/regulations; product market regulations and competition; digital economy; and climate/environment considerations (Table 2).

The impact of each structural reform on growth depends on the comparator country and the number of years to close the gap. The analysis focuses on the growth potential of closing the gap with the best performer in the Western Balkans in each of the identified structural reform areas within a 10-year time horizon. This explains why critical areas like government effectiveness are expected to contribute the least to economic growth. For example, the best performer on the government effectiveness index in the Western Balkans (Montenegro) is still among the worst performers in the world, with an index of 0.16 (compared to the maximum of 2.5). Therefore, while the analysis does not intend to set reform targets or forecast potential growth, it shows that a reform agenda that is well-implemented could generate substantial growth benefits, which should motivate the political support for reform.

Our analysis finds that structural reforms could add up to 5.2 percentage points to Albania's GDP growth rate. Reforms that aim to improve regulatory quality, digital connectivity, human capital, product and labor market regulation, and financial development would contribute the most to economic growth. This higher level of economic growth would help Albania close its income gap with other EU countries over the next three decades—substantially faster than under a no-structural reform scenario.

Source: Barnes, S., Bouis, R., Briard, P., Dougherty, S., and M. Eris, 2013, The GDP Impact of Reform: A Simple Simulation Framework, OECD Economics Department Working Papers No. 834; Bouis, R., and R. Duval, 2011, Raising Potential Growth after the Crisis: A Quantitative Assessment of the Potential Gains from Various Structural Reforms in the OECD Area and Beyond, OECD Economics Department Working Papers, No. 835; Egert, B., and P. Gal. 2016. "The Quantification of Structural Reforms in OECD Countries: A New Framework." Economics Department Working Paper No. 1354, OECD, Paris; Johansson, A., Y. Guillemette, F. Murtin, D. Turner, G. Nicoletti, C de la Maisonneuve, P. Bagnoli, G. Bousquet, and F. Spinelli. "Long-term Growth Scenarios." Economics Department Working Papers No. 1000, OECD, Paris.

Table 2 . Role of Structural Characteristics in Accelerating Economic Growth

Pillar	Indicator	Source
Institutions	Government Effectiveness	WGI
ICT Adoption	Individuals using the internet (% used in last 3 months)	WDI
Business Dynamism	Number of days and procedures to start business	Doing Bus
Human Capital	Index of human capital	Penn
Product Markets	Taxes (top marginal and income rate)	Fraser
	Business Regulations	Fraser
	Tariffs (trace weighted average tariff)	Fraser
Labor Market	Labor Market Regulations	Fraser
Financial System	Credit to Private Sector	WDI

Note: WGI: Worldwide Governance Indicators; WDI: World Development Indicators; Penn: Penn World Tables; Fraser: Fraser Institute Index of World Freedom; Doing Bus: World Bank Doing Business Indicators.

Figure 11. Structural Reforms, GDP impact, and Channels.

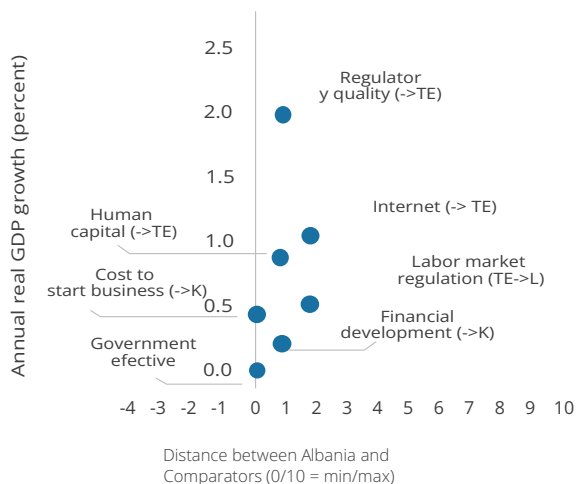
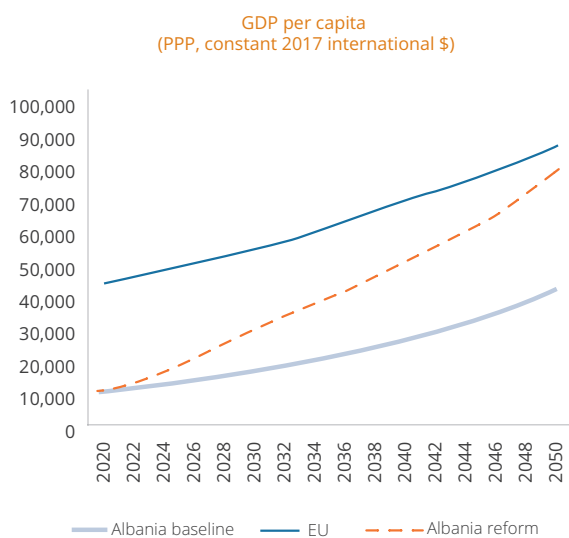


Figure 12. Convergence of Income per Capita with the EU.



Source: WGI; WDI; Penn; Fraser; Doing Bus.

Note: World Bank staff calculations are based on a convergence over 10 years.

Source: World Bank staff calculations based on WDI data.

Note: This exercise assumes that the additional growth resulting from closing the gap with the best WB6 performer extends over a decade, which is consistent with the estimation stochastic frontier analysis methodology. If Albania were to embark on further reforms or set higher targets, convergence could be achieved much faster.

Box 2. Albania's Peer Countries

Throughout the CEM, benchmarking Albania against peer groups will be done to guide the analysis. This will include the Western Balkans, which are broadly at a similar level of development as Albania—though Albania is the only country in the region that was not part of the former Yugoslavia and therefore does exhibit some structural differences compared to the rest of this group. This will also include the STEE7, which offer an attainable and yet aspirational target for what can be achieved through a gradual transition towards a market-based economy and integration with the EU. Finally, the report will benchmark against the EU itself – reflecting Albania's aspiration to join the EU and become an advanced economy.

- **Western Balkans 6 (WB6):** Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia, and Serbia.
- **Seven small transition economies of Europe (STEE7):** Bulgaria, Croatia, Estonia, Latvia, Lithuania, the Slovak Republic, and Slovenia.
- **European Union countries (EU28):** Belgium, Bulgaria, Czech Republic, Denmark, Germany, Estonia, Ireland, Greece, Spain, France, Croatia, Italy, Cyprus, Latvia, Lithuania, Luxembourg, Hungary, Malta, Netherlands, Austria, Poland, Portugal, Romania, Slovenia, Slovakia, Finland, Sweden, and the United Kingdom.

Due to data availability issues, the report will also selectively use alternative (but related) peer groups when necessary. These include:

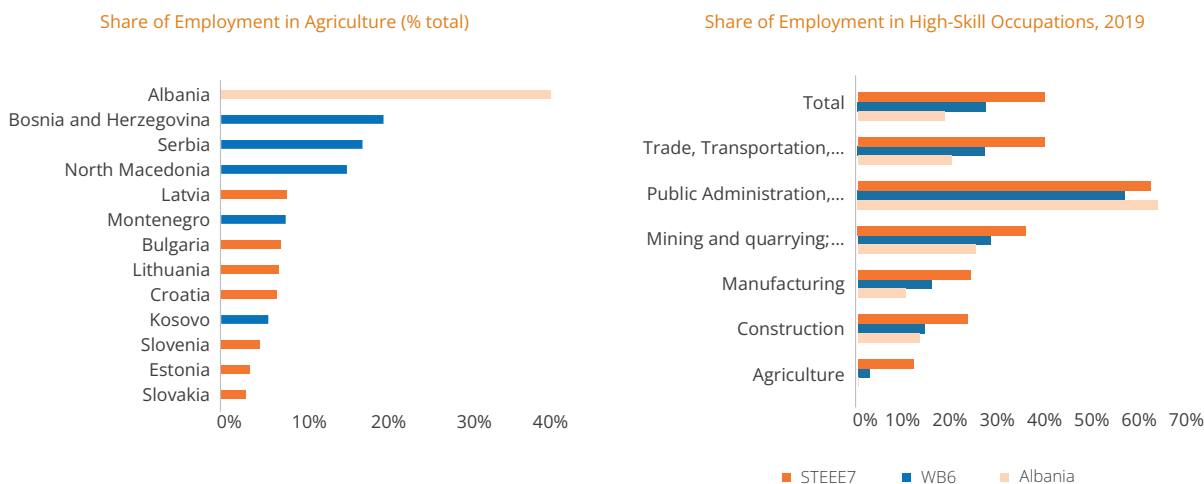
- **European Union countries (EU27):** EU28 minus the United Kingdom.
- **South East Europe European Union countries (SEE EU):** Bulgaria, Croatia, Slovenia, and the Slovak Republic.
- **Baltic:** Estonia, Latvia, and Lithuania.

Chapter 02

Investing in People

23. To unlock higher incomes, the nature of Albanian jobs will need to radically change in the coming years. New job creation in manufacturing and services is already gradually reducing the share of agricultural jobs in total employment. However, if Albania’s sectoral employment shares were to fully converge to Western Balkans averages, 267,000 additional jobs (20 percent of total employment) would need to shift from agriculture toward manufacturing and services in the coming years (Figure 13). Given sectoral wage differentials,⁹ the potential for income growth through sectoral transformation remains large. In addition, within sectors, the low sophistication of the country’s businesses reflects the relatively low share of high-skilled employment in Albania. As firms upgrade, the demand for high-skilled labor will rise. For example, if Albania’s share of high-skilled labor increased to the average of the Western Balkans, 111,000 workers (9 percent of total employment) would still need to be transferred from low- and medium-skilled jobs to high-skilled jobs. Chapter 1 discusses that the productivity gains Albania experienced so far are mostly explained by shifts of the population from low productive agriculture to relatively more productive services and industry. However, to sustain aggregate productivity gains, better skills and technology are needed to support within sector-productivity growth in all sectors, including agriculture.

Figure 13. To transition employment shares toward Western Balkans averages, Albania would need to shift 267,000 jobs into manufacturing and services, and 111,000 workers would need to move to high-skilled jobs.



Source: World Bank staff calculations using ILO 2019 data.

Source: World Bank staff calculations using ILO 2019 data.

24. Global trends further reinforce the need for Albanians to adapt to a new labor market. Countries across the globe are moving away from labor-intensive occupations toward more cognitive-intensive jobs, including those that use nonroutine analytical and interpersonal skills. These changes in the labor market are generating a premium for higher-order cognitive and socio-emotional skills. For example, workers using so-called “new economy” skills and technologies are remunerated 25 to 40 percent higher than their peers with the same level of education who are performing more traditional tasks.¹⁰ Albania will require a workforce able to navigate an increasingly technology-driven economy and a workplace that demands a combination of skills associated with greater adaptability. However, a large portion of current job creation in Albania occurs in less competitive sectors and firms where workers continue to spend much of their time doing routine tasks—the type of work that is at the greatest risk of automation.¹¹

25. To help its workforce adapt to future changes, Albania needs to invest in its people. Human capital investments enable structural change and would allow the country to upgrade its current economic model. Albania’s entrepreneurs need access to a workforce with strong foundational and advanced technical skills to build high-productivity businesses. Additionally, education and active labor market policies are key to ensuring that no Albanians are left behind. Given structural transformation and economic

⁹ In 2019, mean nominal monthly earnings totaled US\$336 in the agriculture sector, lower than US\$477 in the economy overall (ILO). Shifting a worker from the agriculture sector to a job earning the national average would lead to a 40 percent earnings increase.

¹⁰ World Bank. 2019. *World Development Report 2019: The changing Nature of Work*.

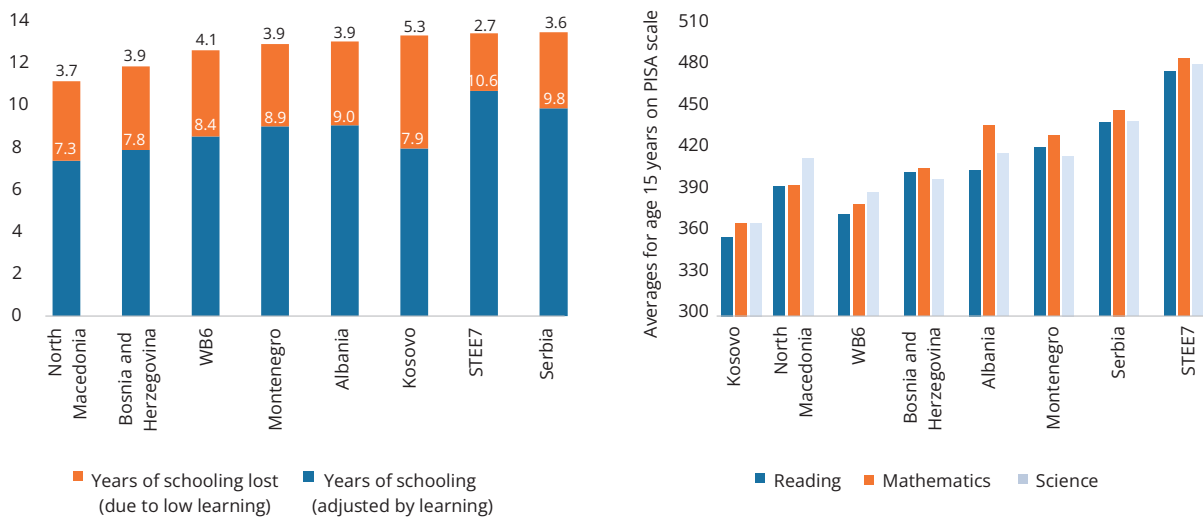
¹¹ World Bank and wiiw *Western Balkans Labor Market Trends 2020*. The demand for creative problem-solving socio-emotional skills is anticipated to grow because they complement automation.

dislocation, many old jobs are at risk of being phased out. Adapting workforce skills to the new economic reality and helping workers reconnect with the labor market are crucial to ensure that all Albanians can find new and better employment.

26. In Albania, schooling does not translate into effective learning. The country's score of 0.62 on the World Bank's Human Capital Index (HCI)¹² means that children born today will only be 62 percent as productive when they grow up as they could have been if they enjoyed complete education and full health. Albanian students can expect to receive 13 years of education by age 18, although this schooling does not translate into effective learning opportunities. Adjusting for learning outcomes, the effective years of schooling are equivalent to only 9.0 years, which means 3.9 years of an average student's time spent in school do not result in learning (Figure 14).

27. Despite improvements, the country's educational outcomes still lag international standards. The Programme for International Student Assessment (PISA) measures student performance in reading, mathematics, and science—key cognitive skills critical for developing job-relevant skills. While Albania showed substantial progress in all three subjects measured by PISA between 2009 and 2018¹³, its scores remain low, with about 42.2 percent and 52.0 percent of 15-year-old students scoring below basic proficiency (Level 2) in mathematics and reading, respectively, in 2018. While its scores are higher than those of some peers in the Western Balkans, they are significantly lower than the average of the STEE7—equivalent to over 2 years of schooling in reading and 1.5 years of schooling in mathematics.¹⁴ Disparities in learning outcomes persist. Students in the bottom income group lag their peers in the top income group by approximately 66 PISA points (equivalent to almost 2 years of schooling), and urban students outperform their rural peers by approximately 33 PISA points (equivalent to almost 1 year of schooling). In surveys, Albanian youth report low satisfaction with the current education system.¹⁵

Figure 14. Years of Schooling and PISA Scores.



Source: World Bank staff calculations using HCI (2020) and PISA 2018 data.

28. Low educational outcomes contribute to Albania's skills gap, which is holding back the economy and preventing the creation of more and better jobs. A 2017 study by the Center for International Development identified a lack of productive know-how as a key constraint on Albania's economy. According to the 2017 Skills Towards Employment and Productivity (STEP) Employer survey for Albania,

¹² For a detailed discussion on the methodology on the HCI, please see: *The Human capital index 2020 update*, World Bank.

¹³ Albania's PISA score for science declined slightly in 2018.

¹⁴ For PISA, 25 to 30 points are equivalent to what students learn in 1 year of schooling. Source: OECD. 2019. *PISA 2018 Results (Volume I): What Students Know and Can Do*.

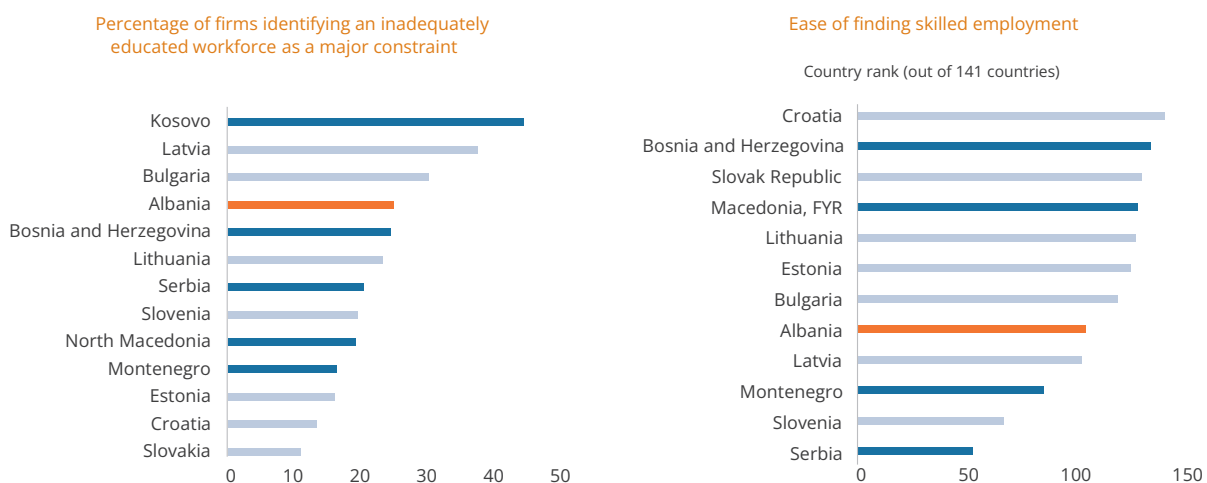
¹⁵ Friedrich-Ebert-Stiftung. 2019. *Youth Study Albania 2018/2019*; Eurostat. 2019. *Individuals who have basic or above basic overall digital skills by sex. Indicator: tepsr_sp410*.

which draws from a nationally representative sample of 600 firms, 51 percent of firms that try to hire workers face difficulties because job applicants lack the required skills and/or there were no or few applicants. These ‘skills constrained’ firms find that job applicants lack the job-specific technical skills as well as the interpersonal skills necessary to be effective on the job, especially for higher-skilled occupations. At least as perceived by employers, the skills gap mostly affects young people and first-time labor market entrants, which points to challenges related to the quality and relevance of formal education and vocational education and training (VET) in Albania.

29. The COVID-19 pandemic exacerbated pre-existing inequities, led to learning losses, and will likely push even more students into functional illiteracy and widen learning gaps. Like other countries, Albania closed schools during the pandemic and implemented various forms of remote teaching. A simulation analysis by the World Bank shows that learning may have dropped by approximately 9 PISA points (the equivalent of approximately three months of schooling) for school closures lasting on average four month and with remote teaching provided.¹⁶ The different access to and effectiveness of remote teaching may have further widened learning gaps. Research is still emerging on the impact of school closures on children’s learning and wellbeing. However, there is evidence to confirm that learning losses are significant, in reading and math for many students, especially for younger children and the disadvantaged.¹⁷ These learning losses are likely to have detrimental long-term consequences on educational attainment and labor market outcomes. The COVID-19 crisis provides an opportunity to focus on quality learning for all by investing in learning recovery strategies and policies that make education more inclusive, effective, and resilient for all children in the long term.

30. Albania’s skills gap results in and is exacerbated by a lack of linkages between the working-age population and the labor market. The pervasiveness of long-term unemployment means that many jobseekers suffer from a protracted lack of contact with the labor market. This means that they risk losing (or, in the case of new labor market entrants, never gaining) relevant skills and work habits. The informal nature of many jobs and the dominance of low-productivity work, particularly in agriculture, effectively prevent investments in upskilling, perpetuating the cycle of poverty and underemployment. For this reason, establishing an effective system of active labor market programs (ALMPs) to underpin a sustainable labor market recovery with a readily employable workforce should be among the highest priorities of Albania’s government.

Figure 15. Lack of workforce skills and skills mismatch remain key economic constraints.

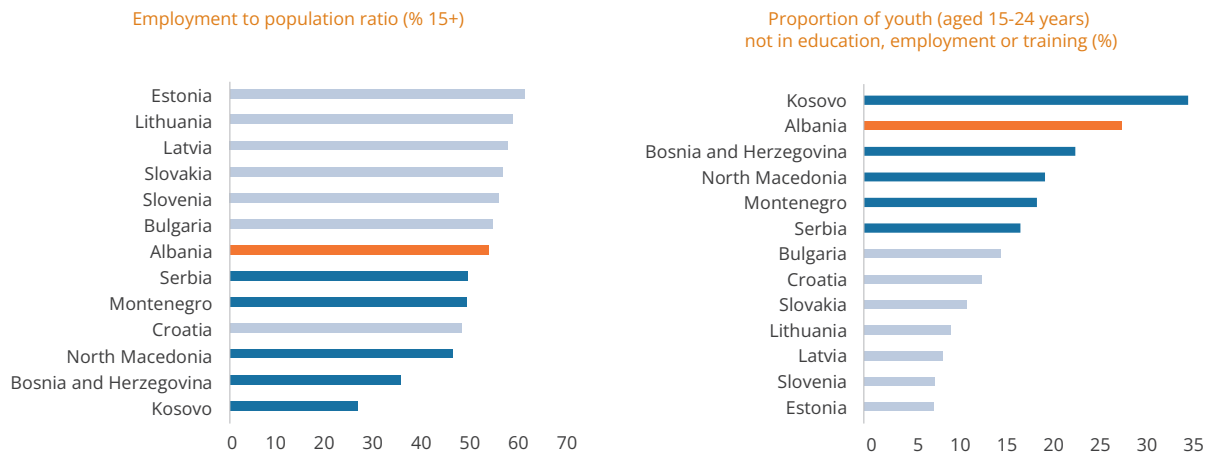


Source: Enterprise Survey (latest year by country).

Source: World Economic Forum’s Global Competitiveness Report 2019.

¹⁶ World Bank. 2020. *Simulating the Potential Impacts of COVID-19 School Closures on Schooling and Learning Outcomes: A Set of Global Estimates*.
¹⁷ Donnelly, Robin, Harry Anthony Patrinos. 2021. *Learning loss during COVID-19: An early systematic review*. *Covid Economics*, 77(5): 145-153. Available at: <https://cepr.org/sites/default/files/CovidEconomics77.pdf#page=150>.

Figure 16. While Albania's employment rate is the highest in the Western Balkans, vulnerable groups (e.g., youth) lag behind.



Source: ILO 2019.

31. This chapter presents key reforms that Albania can adopt to strengthen educational outcomes, skills development, and linkages between workers and the labor market. Given the positive externalities of an educated and skilled workforce, as well as the constraints facing households that try to improve their human capital, the Government of Albania has a key role in providing an education system that can prepare people for the jobs of the future. Moreover, active labor market policies and incentives for lifelong learning are needed to facilitate job transitions and ensure that the workforce continues to reskill and upskill. To ensure Albanians can acquire the skills necessary to meet the needs of the labor market, the authorities should consider: (i) fostering foundational skills development through quality pre-university education; (ii) building on the foundation of higher education reforms; and (iii) ensuring lifelong learning and skills for accessing better jobs.

Fostering Foundational Skills Development through Quality Pre-University Education

32. Albania's gaps in youth educational outcomes are partly due to low public spending on education. In 2019, public education spending totaled 3.3 percent of GDP, far below the EU average of 4.7 percent of GDP and lower than the average of the Western Balkans of 3.9 percent of GDP (Figure 17). Albania's overall spending on education has remained around 3.3-3.4 percent of GDP during the last several years, with the majority of funding going to preprimary, primary, and secondary education. Public education spending as a share of total public spending ranged from 10 to 12 percent over the last decade. Given tight budgets, Albania spends approximately 80 percent of its education budget on salaries, higher than the average of neighboring countries and the EU (Figure 18). This leaves limited fiscal space for improving the quality of education, including professional development and capital investments to enhance the quality of the learning environment.

Figure 17. Public Education Expenditure as Share of GDP.

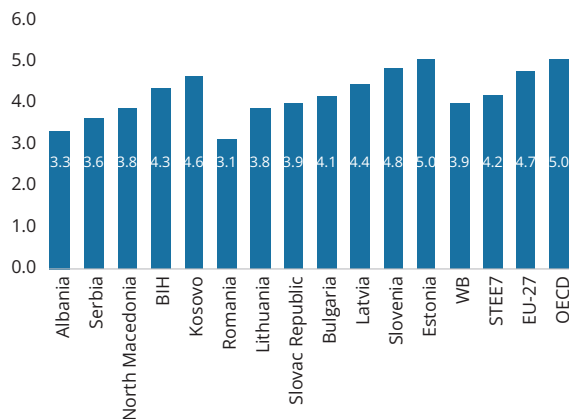
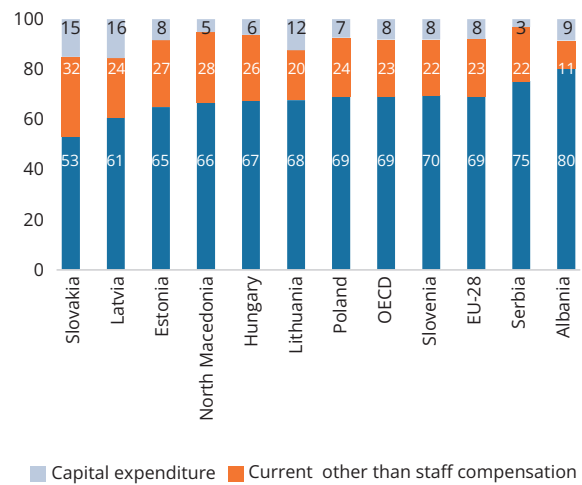


Figure 18. Distribution of Public Education Expenditure by Economic Classification.



Source: Eurostat for EU countries; UNESCO UIS for Serbia and OECD; IMF data for Kosovo; agency for statistics for Bosnia and Herzegovina; BOOST database for North Macedonia, INSTAT 2019. UNESCO UIS; BOOST database for Albania (2019).

Source: Eurostat for EU countries; UNESCO UIS for Serbia and OECD, IMF data for Kosovo, Agency for statistics of Bosnia and Herzegovina, BOOST database for North Macedonia, INSTAT 2019. UNESCO UIS; BOOST database for Albania (2019).

33. In addition to the need to increase spending on education, an analysis of the basic education school network suggests that Albania can improve the quality of education expenditure.

Between 2000 and 2020, the national average student-teacher ratio dropped from 23 to 16 in primary education, from 18 to 9 in lower secondary, and from 14 to 13 in upper secondary education.¹⁸ Although these ratios are still comparable to EU averages, student-teacher ratios and class sizes vary dramatically between municipalities. While enrollment is high in large cities (e.g., Tirana, Kamez, and Durres), with large class sizes and double shifts, schools in rural areas are small, with more than one-third of students housed in multigrade classrooms, which is suboptimal for both teachers and learners. About half of all primary schools, mostly satellite schools, operate with fewer than 50 students.¹⁹ There is potential for creating fiscal space for quality investments and potential for measures to optimize the school network to better facilitate the use of multigrade classrooms. For example, a careful study of the distribution of administrators and teachers could inform options to improve municipal or regional school networks, and the authorities could retrain teachers or redeploy them to areas where there is a shortage of teachers.

34. Albania’s low and inefficient spending on education is potentially due to the absence of mechanisms to allocate resources in pre-university education, a fragmentation of responsibilities, and low incentives for resource management.

Funding formulas constitute an effective means of allocating differentiated funding based on needs and addressing disparities. Although the Law on Pre-University Education (approved in 2012 and updated in 2015 and 2018) provides the basis for introducing a per-student financing mechanism, most resources allocated to basic and upper secondary education are input based. Moreover, the process of allocating resources is complex. The Ministry of Education, Sports and Youth (MoESY) centrally manages approximately 79 percent of resources (e.g., for salaries, training, and other costs) allocated through a special grant to regional offices, but there is no clear accountability over the use of these resources or learning outcomes. While the Law on Pre-University Education gave schools more autonomy with respect to financial management, schools generally do not have financial autonomy, and school directors, who have limited decision-making ability, are still held responsible for the quality of education in their schools. Implementing a per student funding formula and allowing greater autonomy would require improvements in monitoring and evaluation to ensure the authorities can track results and enforce accountability for learning outcomes.

¹⁸ Data accessible at: <http://www.instat.gov.al/al/temat/tregu-i-pun%C3%ABs-dhe-arsimi/arsimi/#tab2>.

¹⁹ Data from Ministry of Education, Youth and Sports for school year 2018/2019.

To foster foundational skills development through quality pre-university education, the authorities should consider:

- Protecting and improving education spending to address learning losses and investments to improve learning for all.** In the short term, the authorities should consider expanding spending on learning recovery programs to address the impact of COVID-19 on learning. These could be done by introducing and expanding recovery learning programs targeted to those with greatest learning loss and most disadvantaged, such as tutoring programs, one-to-one or small-group instruction time, or accelerated learning programs.²⁰ Extending learning time at school (e.g., after-class, summer schools, etc.) for students from disadvantaged backgrounds on key subjects (e.g., reading and math) could also help alleviate the disparities. Such programs should be preceded by rapid assessments of learning outcomes to pinpoint learning losses and target the support. To make the education more inclusive and resilient in the long term, the authorities should consider expanding digital infrastructure to ensure access (devices) and connectivity and expanding and strengthening digital skills of teachers and digital pedagogy.
- Improving education spending.** This could be done by: (i) gradually raising spending on education in underfunded areas, including professional development and capital investments to enhance the quality of the learning environment, as fiscal space becomes available; (ii) redeploying resources to mitigate the impact of declining school age population by implementing a strategic plan for gradual school network optimization; and (iii) fully implementing a transparent per student financing formula.
- Strengthening the teachers' skills and performance incentives to improve student learning outcomes.** A growing body of research indicates that teachers are the most important school-based determinant of student learning.²¹ Over the last decade, Albania has focused on improving teacher compensation to attract and retain skilled teachers. Since 2007, teachers' salaries have increased significantly (139 percent), bringing them closer to the national average for other professionals, and entry requirements to the teaching profession have become stricter.²² However, although gross monthly salaries for upper secondary school teachers are closer to the national average of other professions (only 5 percent lower), remuneration remains low for teachers in the critical formative years of education (preschool and primary levels). Furthermore, efforts to improve the content and relevance of teacher training—both for new recruits and seasoned teachers—have been slow. In this context, it is crucial to provide practical and continuous professional development support for teachers, such as continuous coaching, peer mentoring programs, and peer-to-peer learning opportunities. This is particularly important since teachers need support in implementing Albania's curriculum reform aimed at creating a competency-based and student-centered education system. Finally, career progression relies heavily on years of experience, an accumulation of minimum in-service training credits, and an assessment that is primarily an examination that does not account for performance. An effective teacher career progression structure connects higher career stages to higher levels of competency, additional roles and responsibilities, and a salary scale that compensates teachers for taking on additional tasks. Exploring the possibility to revise and strengthen the current career structure to incorporate these elements has the potential to increase teacher motivation as well as accountability. Exploring the possibility to revise and strengthen the current career structure to incorporate these elements has the potential to increase teacher motivation as well as accountability.

²⁰ World Bank, 2021. *Accelerating Learning Recovery*. Available at: <https://thedocs.worldbank.org/en/doc/75bdb5f2c03f19f0642db1c941193f8d-0140042021/related/Recovery-updated-09-27-2021.pdf>.

²¹ World Bank. 2018. *World Development Report 2018: Learning to Realize the Promise of Education*.

²² Albania raised the minimum grade threshold for admission to initial teacher training programs from 6.5 to 7.5 (out of 10). The academic qualifications required for entering the teaching profession were upgraded to a master's degree for basic and upper secondary teachers and a bachelor's degree for preschool teachers.

- Strengthening the ability of schools to assume leadership over school-level improvements.** School leadership plays a crucial role in school performance. Effective leadership means having school principals actively: (i) helping teachers improve their teaching and learning practices; and (ii) managing school resources (Hargreaves and Fullan 2015). In Albania, school leaders are expected to perform administrative tasks and fill instructional leadership roles, but they have traditionally received little to no support or training in how to perform their roles effectively. Historically, school leadership has not been viewed as a distinct professional role, and school leaders have been evaluated on their performance as teachers rather than as school leaders. The School for Directors (Shkolla e Drejtoreve), established in 2017, intends to provide a career path for school leaders by providing mandatory preservice training and certification procedures.²³
- Strengthening and developing an integrated education information and management system, which could inform education policy, support strategic planning, and encourage system improvements.** Albania should consider introducing an integrated information system to monitor education performance. To date, the authorities have started to establish some of the components integral to system evaluation, including a modern education management information system with student level data. Albania also conducts national and international student assessments. However, there is no school mapping, and data on school infrastructure are not readily available. Given the dual challenge Albania faces in terms of overcrowded urban schools and underused rural schools, a robust school map is needed to allow the government to continuously assess the school network and make informed decisions about school network optimization. A strengthened and integrated education management and information system that produces regular analysis would contribute to efforts to improve educational performance and strengthen the accountability of institutions to meet national goals.²⁴
- Consider increasing instructional time by lengthening the school day.** Shortage of instruction time may also lead to suboptimal learning outcomes in Albania. The length of compulsory education in Albania is similar to that in most EU countries, where full-time compulsory education is 9 to 10 years on average, but Albanian students receive fewer hours of instruction than their European counterparts. In primary education, a student in Albania receives on average 150 hours of instruction less per year than EU students.²⁵ The shortage of instruction time during compulsory education can lead to inadequate time for students to develop competencies in critical subject matter, such as math and reading, as well as other skills necessary for adult life. Efforts to increase the quality of education should accompany efforts to increase instruction time, and the costs should be carefully analyzed.²⁶ The demographic decline provides an opportunity to consider extending the school day in the long run. Expanding the school day by increasing time spent on quality learning, remedial work, and extracurricular activities would contribute to better education outcomes, especially for vulnerable students, although such plans need to be planned well, costed, and targeted in a context of limited funding.

²³ The Albanian-American Development Foundation will fund the school for its first 10 years of operation. The school began piloting the preservice training curriculum in 2019.

²⁴ The Ministry of Education, Sports and Youth (and UNICEF) are finalizing the National Education Strategy 2021-2026, which raises the importance of the monitoring of sector performance.

²⁵ European Commission/EACEA/Eurydice. 2018. *Recommended Annual Instruction Time in Full-time Compulsory Education in Europe – 2017/18. Eurydice – Facts and Figures*. Luxembourg: Publications Office of the European Union.

²⁶ Since 2018, Albania has piloted an after-school program for primary school students that extends the hours children spend in school. The program is designed to help students complete their homework in school—after the regular school day—and combines academic support with enrichment activities in other areas, such as culture and sports. The program is optional, not targeted to academically or socially disadvantaged students, and uses teachers who have free hours. It is largely perceived as an alternative childcare option

- **Closing learning gaps for children who may otherwise be left behind.** Learning gaps have narrowed in the last two decades, mainly through a significant improvement in the performance of lower-performing groups, namely students from households in the bottom income quintile, students from households in rural areas, and boys. Meanwhile, the performance of higher-performing groups (students from households in the top income quintile, students from households in urban areas, and girls) increased, albeit by a smaller rate (approximately 1 year of schooling). Similarly, the gaps in access to preschool and secondary education narrowed due to the improvement of rural students and students from households in the lowest income quintiles. As the government increases its efforts to increase the efficiency of the education system and scale up education spending, more resources should be targeted to benefit students from disadvantaged backgrounds and students who live in rural areas.
- **Improving the coverage and quality of early childhood education and care (ECEC), including to level the playing field early for disadvantaged students.**²⁷ Attending preschool is associated with better learning outcomes. PISA 2018 results showed that, on average, students in Albania who attended at least 1 year of preschool were 1 year of schooling ahead of students who did not, regardless of socioeconomic status. Better access to high-quality preschool for all children, with an emphasis on children from disadvantaged backgrounds, can reduce inequality in educational outcomes early and provide equal opportunities for disadvantaged students. This is especially important in Albania, where students in the bottom income group lagged their peers in the top income group by approximately 66 PISA points (equivalent to approximately in 1.5 years of schooling). Over the last few years, efforts to strengthen the quality of preschool education have included: (i) increasing financing through a revised per capita financing formula; (ii) revising the curricula; and (iii) the development of learning standards and an evaluation framework for each age group. However, the implementation of these efforts remains limited. Additionally, while Albania has relatively high enrollment rates for preschool (78 percent in 2019), the latest Demographic and Health Survey shows that the net attendance rate of students from the lowest income quintile continues to be lower than that of students from the highest quintile, with the greatest differences in preschool (20 percentage points). Meanwhile, the decentralization of responsibility for preschool to municipalities has brought to the forefront the need for a well-coordinated strategy across all stakeholders (i.e., central and municipal government authorities, schools, and parents) to ensure that vulnerable groups, in particular students of low socioeconomic status, are targeted for enrollment. Furthermore, the benefit of preschool depends on the quality of schools and programs, but Albania does not measure child development outcomes and school readiness, resulting in no data to inform policymaking. Therefore, it is crucial for Albania to introduce instruments to measure child development outcomes and school readiness and develop and use the feedback to develop targeted policies to strengthen quality.

²⁷ In Albania, ECEC includes kindergartens and a preparatory class (grade 0).

Box 3. Access to Childcare as a Lever for Labor Force Participation

Albania's labor market had been improving up until the COVID-19 outbreak, especially for women, for whom rising employment rates (by almost 10 percentage points between 2010 and 2019) were a result of increased labor force participation.²⁸ However, the pandemic highlighted the unequal burden of domestic work, including childcare, which limits women's labor force participation and employment opportunities and increases the wage gap.²⁹ Since 2020, the decline in labor force participation and employment has persisted among women, in part because many women with children had to change their working arrangements to cope with the domestic challenges posed by the pandemic.³⁰ It has been widely documented that having children can push mothers to leave the labor market, which, even if temporary, may thwart career opportunities and earnings.³¹ In Albania, where women are still considered the primary caregiver, their labor force participation was almost 17 percentage points below that of men in 2020, even with parental leave policies in place that benefits both parents.

To avoid widening labor gender gaps for parents, the authorities need to adopt policies that provide: (i) widespread access to childcare and fiscal incentives to work for second wage-earners; (ii) work-life balance for both men and women, including incentives for fathers to devote more time to care activities and more balanced parental leave; and (iii) workplace flexibility, including part-time and flexible working-time arrangements. These policies can especially benefit disadvantaged groups such as single mothers or minorities.³²

In Albania, the institutional responsibility for ECEC for children up to 3 years old lies with municipal governments, which provide center-based services (*çerdhe*), and is in part regulated by the Ministry of Health and Social Protection.³³ Preschool education for children aged 3–6 is more widely available, as it is part of the pre-university education system overseen by the MoESY. However, ECEC services are not regulated, so they vary significantly in quality and accessibility.³⁴ While over 80 percent of children aged 3–6 attended preschool in 2018,³⁵ attendance and quality at *çerdhe* are rarely monitored. This means that there are no data on the coverage of *çerdhe* for children aged 0–3, although anecdotal evidence suggests it is extremely low.³⁶

To increase access to ECEC in Albania, an appropriate regulatory and financing framework needs to be in place at the national level to ensure that municipal governments provide ECEC services that meet minimum quality standards. For financing, global best practices show several potential options, ranging from direct provision and subsidies to cash transfers and public-private arrangements. For quality, a national set of standards needs to be in place to guide municipalities and ensure minimum service quality across municipalities. The standards for ECEC need to be aligned with the pre-university system to ensure that ECEC contributes to learning readiness for children who enter preschool.

²⁸ INSTAT. 2021. *Employment rate by Sex, Age group, Education level, Type and Year*.

²⁹ OECD. 2018. *OECD Employment Outlook 2018*. OECD, Paris.

³⁰ UN Women. 2020. *The Impact of COVID-19 on Women's and Men's Lives and Livelihoods in Albania: Results of a Rapid Gender Assessment*. Women were 29 percentage points more likely to report a change in working arrangements than men.

³¹ OECD (2018).

³² Posadas, J. and Vidal-Fernandez, M. 2013. *Grandparents' Childcare and Female Labor Force Participation*.

³³ *The oversight of the MHSP is limited to food safety*.

³⁴ *The Law on Pre-University Education covers only the services provided from age 3 and onwards, and it creates a common framework for all municipalities, which is not the case for ECEC*.

³⁵ EC. 2019. "Key Data on Early Childhood Education and Care in Europe." 2019 Edition. Eurydice Report.

³⁶ *The exact number of çerdhes and children attending them is unknown. According to the National Agenda on Children's Rights 2017-2020, 41 municipalities reported a total of 93 çerdhes in 2016, with 20 municipalities reporting none*.

Box 4. The Impact of the COVID-19 Pandemic on Education

The school closures caused by the COVID-19 pandemic are expected to result in unprecedented learning losses in Albania and exacerbate preexisting learning challenges and inequities. Schools in Albania were closed from March to June 2020, and education continued to be disrupted throughout the school year 2020/2. During the school closures, the government introduced remote teaching and learning. However, due to the emergency nature of the remote-teaching initiative, the lack of interaction between teachers and students, and the different level of access to devices, the effectiveness of remote teaching has likely been much lower than that of traditional instruction. A World Bank simulation of the impact of COVID-19-related school closures on learning suggests that there may be learning losses, which can have a substantial negative impact on learning outcomes and basic proficiency levels in the medium and long term. The simulation suggests that learning in Albania may have dropped by the equivalent of 9 PISA points (or approximately the equivalent of 3 months of schooling) for all students, eroding learning gains made over the last decades. (Figure 19). The simulation assumes a student gains on average 40 PISA points of learning in a school year, that schools have been closed for around four months on average, and that remote learning in any country is half as effective as face-to-face learning. Learning losses are estimated to be even higher for students from lower socioeconomic backgrounds, including due to differential access to learning technologies across student groups (Figure 20). The widening of the learning gap and the income shock due to the pandemic could increase school dropout rates over the medium term (2021–23), particularly for disadvantaged students.

Figure 19. Simulation of Effect of School Closures on Reading Outcomes.

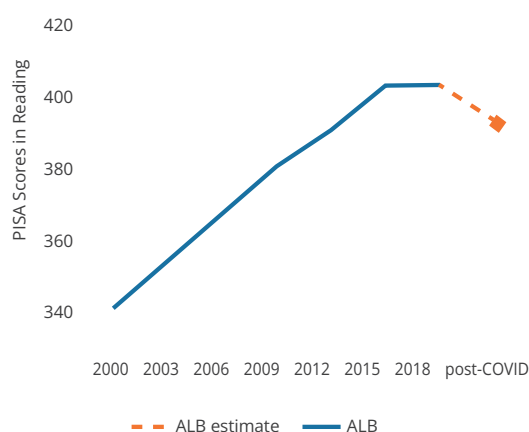
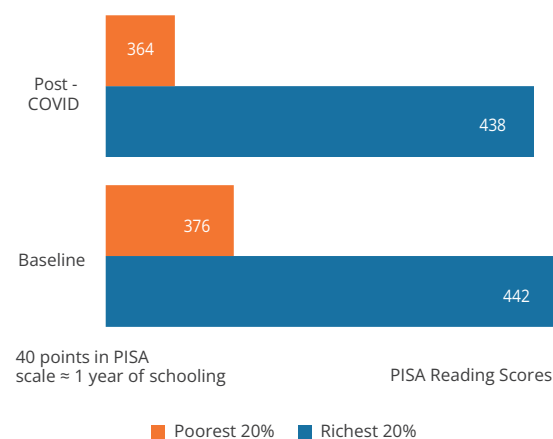


Figure 20. Simulation of Effect of COVID-19 on High and Low-ESCS Quintiles.



Note: Learning loss estimates: The World Bank has estimated the effects of COVID-19-related school closures on learning outcomes in 157 countries. The simulations use data on learning outcomes, years of schooling, and monthly wages to estimate the potential effects of school closures nationally and across socioeconomic groups. For global and regional estimates, see: World Bank. 2020. Simulating the Potential Impacts of COVID-19 School Closures on Schooling and Learning Outcomes: A Set of Global Estimates.

The need for remote teaching and learning during the pandemic has exposed weaknesses in pre-university education, including low digital adaptation. PISA 2018 data, although limited to secondary school students, provide an estimate of household readiness for online education. Access to digital learning by students and digital teaching by schools remain limited and highly dependent on students’ socioeconomic backgrounds. These data show that only 27 percent of students from poor socioeconomic backgrounds had a computer at home, while 48 percent had access to the internet. A large proportion of principals (especially those serving students from low socioeconomic backgrounds) reported that their teachers are unprepared or under-resourced. Similarly, more than 70 percent of schools did not have an effective online learning support platform at the start of the pandemic.³⁷

³⁷ Moreover, children in Albania express low confidence in their digital skills. In a 10-country comparative study, Albanian children aged 9-17 self-report a weak sense of their abilities related to online information seeking, critical evaluation, or safety.

Building on the Foundation of Higher Education Reforms

35. Albania should leverage higher education to meet national development goals. Enrollment in higher education almost tripled from 17 percent in 2004 to 60 percent 2019. While this level of participation in higher education places Albania above the average of the Western Balkans, it is still below the average of EU and STEE7 countries (Figure 21).³⁸ Moreover, there are challenges related to the quality and relevance of higher education, as higher education graduates in Albania have higher unemployment rates than their lower-educated counterparts (Figure 22). Employers in Albania, especially more dynamic and innovative firms, highlight the need of workers with higher skills. According to the World Bank 2019 Enterprise Survey,³⁹ 25 percent of the country's enterprises (and more than half of all foreign-owned firms) identified an inadequately educated workforce as a major constraint on their business development. The contribution of higher education to research and innovation is also limited in Albania. Research is mostly driven by individual staff initiatives,⁴⁰ and there is a low level of cooperation across universities and with non-academic stakeholders.⁴¹ Challenges related to the quality of education in Albania are also reflected in international rankings. For example, while in 2021 five 5 Albanian universities were included for the first time among in the top 400 universities in the Quacquarelli Symonds (QS) regional ranking for Emerging Eastern and Central Asia (EECA) in 2021, they all ranked among the bottom 50 universities of this regional ranking.⁴²

Figure 21. Gross Enrollment Rate in Tertiary Education, 2019.

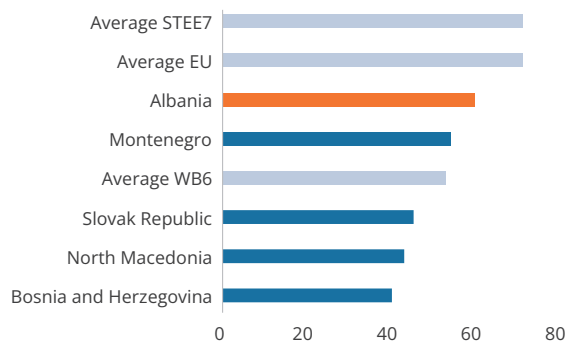
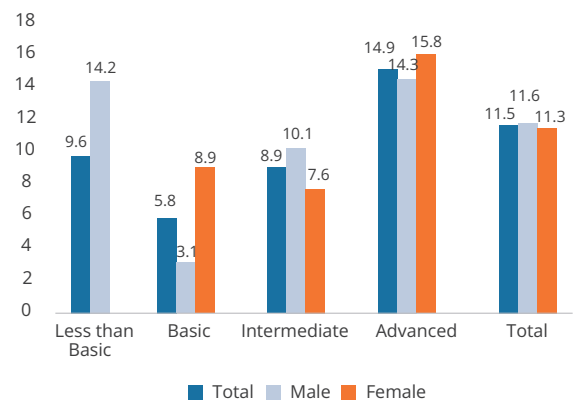


Figure 22. Unemployment Rate by Level of Education and Gender, 2019.



Source: World Bank EdStats (UIS).

Note: Latest data for North Macedonia and STEE7 countries are from 2018.

Source: Labor Force Survey, ILO database.

36. The shortage of skills identified by employers and the high level of unemployment among higher education graduates suggest a mismatch between the skills taught and the needs in the labor market. While economic transformation and plans to increase global competitiveness demand more advanced technological skills, most higher education graduates in Albania obtain degrees in business, law, social science, and health and welfare (Figure 23). The distribution of graduates by discipline in Albania is in line with the average of WB6 and STEE7, yet Albania has a smaller share of graduates in engineering disciplines, and the share of graduates in business administration and law, health and welfare, and education is higher in Albania, especially compared to WB6 countries. In addition, skills mismatches can be related to outdated curricula and teaching methods as well as to inadequate participation of the private sector in the formulation of graduate programs, lack of opportunities for students to gain job experience, and limited career services.

³⁸ There are currently 40 higher education institutions (HEIs) in Albania, of which 25 are private. The Draft National Education Strategy for Albania 2021–2026 (April 2021) indicates that enrolment in private HEIs has increased in the past three years, although it still represented less than one-fifth of total enrolment (18.5 percent) in 2019. Source: World Bank EdStats/UIS.

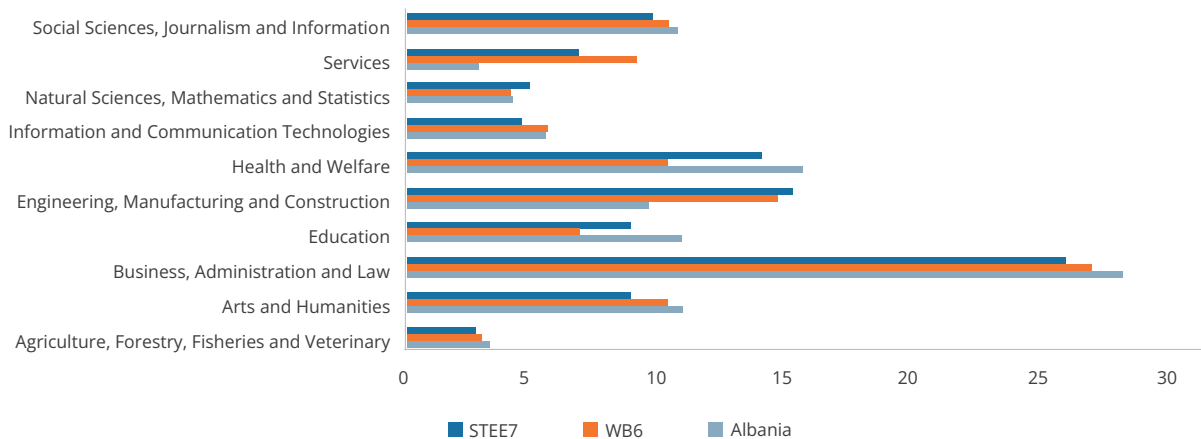
³⁹ Albania Enterprise Survey 2019.

⁴⁰ Ministry of Education, Sports and Youth (and UNICEF), National Education Strategy 2021–2026. April 2021 Draft.

⁴¹ Hach, K. and E. Trenchmann. 2019. Entrepreneurial and Innovation Ecosystem in Albania. European Union, Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH and Sida/the Swedish Embassy in Tirana (November).

⁴² Quacquarelli Symonds Emerging Eastern and Central Asia ranking 2021.

Figure 23. Tertiary Graduates by Field of Study, 2019.



Source: Source: Authors' calculations using World Bank EdStats data.

Note: Data for North Macedonia and all STEE7, except Croatia, are from 2018. Data for Croatia are from 2017.

37. Key measures to improve the quality and relevance of higher education have recently been introduced in Albania, but their implementation has been partial, and reforms remain incomplete.

Following the adoption of a new Higher Education Law in 2015, the government established the Quality Assurance Agency for Higher Education (ASCAL), increased the autonomy of higher education institutions (HEIs) with respect to academic and financial management, and introduced a performance-based financing system. However, although ASCAL carries out accreditation, the agency it is not yet fully aligned with the European Standards and Guidelines (ESG).⁴³ This is delaying membership to the European Network of Quality Assurance (ENQA), which is part of the pending steps for Albania's full incorporation to the Bologna Process. Crucially, students' participation in accreditation evaluations is not yet effective, and the Agency does not supervise the compliance of HEIs with the accreditation outcomes.⁴⁴ In 2018, the government approved a university pact, agreeing to reduce student fees and improve student services and infrastructure, and introduced a national students survey, which marked an important step toward assessing the quality of teaching and learning in higher education. Yet, key data on quality such as completion, graduates' skills, or staff qualifications are not systematically collected. An agency to allocate scholarships for excellent and in-need students, as well as students enrolled in disciplines considered key for national development, was created but it is not fully functional.⁴⁵ While the design of the higher education curricula has been aligned with the Albanian Qualification Framework, regular updates to the curricula, with a focus on learning outcomes, and initiatives to improve teachers' pedagogical skills are needed to enhance the overall quality of learning outcomes. These efforts to fully modernize higher education in Albania require significant additional investments given the historically low spending on education in Albania.

38. To ensure the necessary reforms are fully implemented, Albania should take stock of the strengths and weaknesses of the higher education system and identify critical pending issues to be addressed to bring its higher education system closer to the needs of the labor market and Bologna Process requirements.

Such a stocktaking analysis would help the authorities to pinpoint the needs of HEIs and customize assistance, which would increase the likelihood of successful implementation. A detailed analysis of the programmatic offering as well as students' profiles and progress is critical to plan smart investments aimed at modernizing the sector. To better align the relevance of education and training to the requirements of the job market, the government should facilitate the introduction and implementation of regular graduate tracer studies, support the creation of career services, and ensure the adoption of learning outcomes in the design of the curriculum. Finally, supporting research and innovation is key not only to improve the relevance of

⁴³ European Commission. 2020. *The European Higher Education Area in 2020. Bologna Process Implementation Report*. Luxembourg: Publications Office of the European Union.

⁴⁴ Ministry of Education, Sports and Youth (and UNICEF), *National Education Strategy 2021-2026*. April 2021 Draft.

⁴⁵ Ministry of Education, Sports and Youth (and UNICEF), *National Education Strategy 2021-2026*. April 2021 Draft.

higher education for economic and social development but also to raise the quality of teaching, which in turn would increase the relevance of graduates' skills and knowledge in their professional development.

To leverage higher education to meet national development goals, the authorities should consider the below key recommendations when planning strategic actions and investments in the sector:

- **Fully aligning the quality assurance system with ESG**, including revising and updating the quality assurance methodology to be more outcomes-oriented, as well as moving towards generating a quality culture in HEIs by strengthening of internal quality assurance and ensuring that accreditation recommendations are followed up and decisions are publicly available.
- **Updating study programs and their delivery methods**, including updating the content regularly with the participation of private sector and other stakeholders; redesigning curricula to include learning outcomes approaches and opportunities for short courses to better link teaching with skills needs and the application of knowledge; and training academic staff on modern teaching and learning pedagogies, especially in the use of modern technologies in the learning process.
- **Introducing and conducting regular and comprehensive data collection**, including by creating a regular graduate tracer system for all graduates to measure labor market outcomes, and collect data on quality indicators such as staff qualifications, student progression, and program offerings. Additionally, regular and detailed analysis of the data should be done to inform and plan smart investments aimed at modernizing the sector.
- **Creating or strengthening support services for students to improve**, including introducing career services, academic support to students and developing various partnerships with businesses focused on research collaboration and on-the-job training opportunities.
- **Making HEIs research and innovation more relevant for societal and economic needs**, including by creating research and technology transfer offices, supporting joint research projects across Albanian universities and with European and international partners, and increasing participation in doctoral studies, including by offering research degrees oriented toward non-academic professional careers.

Meeting Labor Market Needs: Ensuring Lifelong Learning and Skills Training

39. VET can be a bridge between school and a first job, but VET in Albania reaches a relatively small number of students and does not yet offer enough work-based learning or in-demand skills. Currently, only 18 percent of students enrolled in upper secondary education attend vocational programs, much lower than the Western Balkans average of 58 percent. Significant reforms (mostly legislative) have been implemented in recent years to improve the quality and image of VET,⁴⁶ although the country's novel legal VET framework has not yet been fully adopted – key sub-legal acts need to still be implemented.⁴⁷ Meanwhile, challenges remain, including: (i) regularly offering standardized work-based learning; (ii) a lack of standardization in regard to the amount and type of work-based learning; (iii) little involvement of businesses and labor unions in shaping the curricula; and (iv) difficulties for VET institutions to establish partnerships with employers interested in providing training. Many of the implementation challenges are

⁴⁶ Such as the Employment Promotion Law from 2019, the Albanian Qualifications Framework Law from 2018, or the new Vocational Education and Training Law from 2017.

⁴⁷ The novel VET law was adopted in 2017, however many of the 24 sub-legal acts it contains have not been issued. The United Nations Development Programme's recent review of Albania's vocational education specifically highlights the necessary operationalization of the revised Albania Quality Framework and secondary legislation for VET provider's financial autonomy. Source: UNDP (2020). *Review of Albania's Vocational Education Training System*.

due to the limited involvement of the private sector when formulating laws, given that their enactment depends on the participation and resources of private enterprises. Reforms such as the new VET Law in 2017 depend on the close involvement of the private sector in the design and delivery of training programs, but many of the mechanisms to channel the input from the private sector are either not functioning or are non-existent.⁴⁸ This means that VET programs that do require partnerships with the private sector, such as work-based learning, are based on personal relationships and therefore vary significantly across the country. As a result, the skills taught at many vocational schools are not needed by employers, and graduates of VET schools face significant challenges in transitioning from education to work. The German development agency Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) conducted a tracing study in 2017 that found that only 41 percent of graduates from vocational secondary schools were in a work relationship, and one-quarter were in neither education, employment, nor training (over half of them had unsuccessfully been looking for a job for more than 12 months).⁴⁹ To ensure skills are aligned with the needs of the labor market, the authorities need to ensure a standardized collection and dissemination of detailed labor market information on occupations and in-demand skills, and there needs to be closer involvement of employer and worker organizations in VET.

40. The National Agency for Employment and Skills (NAES) provides opportunities for lifelong learning and helps graduates of Albania's formal education system enter the labor market through ALMPs. The NAES is responsible for most of the public provision of adult learning through continuous VET and employment promotion programs (EPPs) for unemployed workers, and it also provides employment services for job matching. Continuous VET allows workers to access training opportunities and gain new skills, which is provided by the NAES through 10 vocational training centers (VTCs) across the country. EPPs, in turn, help workers gain valuable work experience (through wage subsidies, on-the-job training programs, etc.) and strengthen their connection to the labor market by mainly supporting the transition of young people into their first job. Finally, NAES employment intermediation services connect job seekers with vacancies and provide jobseekers with soft skills relevant to job searching.

41. Albania is currently undergoing a major reform of its active labor market policies. In 2018, spending on ALMPs (composed of EPPs and continuous VET) reached 0.02 percent of the country's GDP, significantly below the EU average of 0.39 percent of GDP. Among registered jobseekers at the NAES, the coverage of ALMPs only reached 18 percent. According to the 2020 Western Balkan Barometer, only 17 percent of surveyed Albanian firms make regular use of the public employment service (PES) when hiring new employees, and 49 percent report that they have never used it.⁵⁰ PES agencies, such as the NAES, in many countries have a poor reputation among jobseekers, which is one of the reasons few employers choose to collaborate with them. However, the relevance of the NAES has increased during the COVID-19 crisis, as the share of unemployed workers registered at the NAES increased from 43.1 percent in 2018 to 56 percent in the last quarter of 2020. The ongoing ALMP reform could build on this momentum.

42. Ongoing reform efforts open the door to strengthening the role of the NAES as the key institution responsible for facilitating labor market transitions. The passing of the new Employment Promotion Law in early 2019 laid the foundation for a more effective ALMP system. As part of the reform of the NAES, EPPs were redesigned, based on evidence, as eight programs, which is according to international best practice.⁵¹ The NAES is gradually expanding its list of partnering private sector employers, and the authorities have introduced a monitoring and evaluation framework for the new programs, although the information technology (IT) system needs to be operationalized. The Employment Promotion Law allows for the outsourcing of EPPs to non-public sector providers, which facilitates the crowding in of know-how from the private sector, but bylaws need to be adopted to put these provisions into practice.

⁴⁸ Examples include the non-functioning National VET Council or the establishment of so-called development units, whose responsibility is to "set up a cooperation mechanism with private companies to ensure availability of sufficient practical skills acquisition possibilities for students in work-place environments." Source: UNDP (2020). *Review of Albania's Vocational Education Training System*, pp. 9, 10, 103.

⁴⁹ GIZ. 2019. "Tracing Survey for Graduates from Vocational Secondary Schools in Albania in 2017-2018."

⁵⁰ Regional Cooperation Council. 2020. *Balkan Barometer 2020 Business Opinion Analytical report*.

⁵¹ The review of EU programs identified 7 types of programs: 1) intermediation; 2) preparation (e.g., job search preparation online and face-to-face, career and vocational guidance, women's networks, etc.); 3) wage subsidies (including for seasonal workers, work experience programs, internships, etc.); 4) entrepreneurship (training, financial support, etc.); 5) training (e.g., basic skills, digital skills, short and long vocational training, employer-led programs, and comprehensive employment programs); 6) apprenticeship (for youth) at vocational schools; and 7) public works.

43. The government has introduced a new model for engaging jobseekers that allows counsellors to use their time more efficiently, but the NAES continues to be constrained by a lack of human capital. Upon registration, a jobseeker is asked to fill out a profiling questionnaire, which segments jobseekers into three groups according to their distance from the labor market. This categorization is used to support decisions related to access to services and programs. Interviews are completed with the drafting of individual action plans (IAPs), with referral to appropriate ALMPs. This is a major improvement from earlier when programs were implemented through annual calls for applications, and when jobseekers could only enroll during specific times of the year. Counsellors, however, continue to have a large caseload, especially given the potential for an expanded client base following the pandemic.

44. There is little structure in the VTC system, despite the large share of ALMP budget allocations dedicated to continuous VET. Almost one-fifth of the budget allocated to ALMPs is currently directed toward providing short 3-9 month long vocational training courses. However, this type of training is not aligned with the national qualification framework, does not provide access to higher education, and is not targeted to adults. Instead, these courses are largely used by young adults as a shorter alternative to formal VET. The GIZ has supported the NAES with several reforms related to the VTC system in recent years. VTC trainers must now partake in mandatory didactic training, and the authorities introduced a graduate tracing system and a 2-week soft skills course called Start SMART. Start SMART is used for ALMP referral purposes and is mandatory for all registered unemployed workers who are considered furthest away from the labor market. Despite the introduction of reforms to standardize both the curricula and the process of establishing new courses, the provision of continuous VET in public training centers remains fragmented. International evidence suggests that using a wide range of service providers can result in more tailored, demand-led training. The outsourcing of services, which is contingent on having the necessary capacity to ensure service quality, could improve service delivery and allow for a targeted response to the needs of diverse groups in the labor market.

Box 5. From Job Preservation during the COVID-19 Crisis to Worker Reallocation Post-Pandemic

The Covid-19 crisis prompted extraordinary labor market support by the Albanian government. As part of its broad response, several successful employment programs were established to both preserve and reallocate jobs during the pandemic. To prevent dismissals, payments were made to workers affected by lockdowns and loan guarantees were issued to firms. As part of the first response package introduced in March 2020, the government issued three monthly payments equal to the minimum wage to workers of businesses that had temporarily closed because of COVID-19 restrictions. A total of 65,574 individuals received such payments, with a total of ALL 5.1 billion disbursed (equivalent to about US\$49 million). In the second package, during the last half of April 2020, additional one-off payments were made to employees of large enterprises that had temporarily closed due to the restrictions and to employees of smaller firms that could continue to operate.

The government also provided support to workers dismissed due to the pandemic, and additional ALMPs were implemented to support re-hiring efforts. As part of the second financial package in mid-April, support was provided to all dismissed employees, and 173,019 individuals received one-off payments of ALL 40,000, totaling ALL 6.9 billion (equivalent to about US\$67 million). Those who were eligible to receive unemployment assistance received double the amount between April and June 2020, a measure from which 2,823 jobseekers benefited. In addition, as part of the ALMPs, three wage subsidy programs were established with a focus on labor market reintegration for unemployed workers who had lost their jobs due to COVID-19. Two of these programs provided wage subsidies of half the minimum wage and paid the employers' share of social contributions for 4 months under one program and 8 months under another, benefiting a total of 1,161 individuals. The third program aimed at formalizing workers by covering the full cost of social contributions for 12 months if a self-identified informal worker received a formal employment contract. Through this initiative, the social contributions of 560 individuals were covered in 2020.

Employment indicators quickly recovered following the first wave of lockdowns, with employment reaching pre-COVID levels in the third quarter of 2020. Since then, however, employment numbers have dropped by almost 30,000, largely due to an increase in inactivity among the young and women. Limited fiscal space is likely to limit the government's ability to implement similar measures for a prolonged period. The International Monetary Fund has outlined how job retention policies can be powerful in reducing the unequal impact of the immediate shock of the crisis, while worker reallocation policies will be better at easing the adjustments required following the pandemic.⁵² Considering the need to create fiscal space, the Government of Albania may want to move part of the funding for job preservation toward supporting the re-allocation of workers across sectors or occupations after unemployment. This can be done by strengthening labor market policies such as job search assistance or ALMPs focusing on retraining or hiring incentives.

Figure 24. Spending on labor market programs declined between 2015 and 2018.

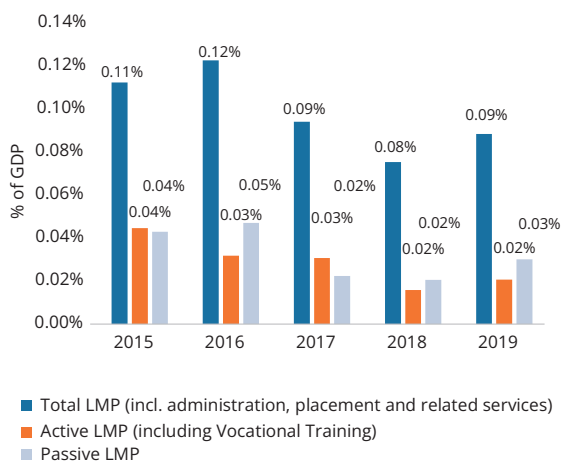
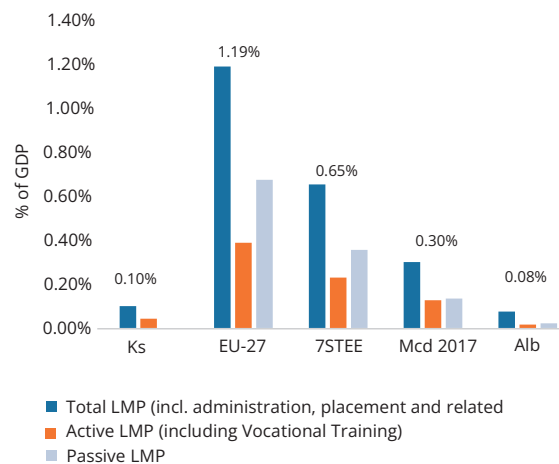


Figure 25. Spending on labor market programs is very low in Albania compared to benchmarking countries.



Source: EU-27/7STEE: Eurostat; Macedonia: SPEED; Kosovo: NESS Progress Report 2018; Albania: Administrative Data NAES.

Note: 7STEEs include Bulgaria, Croatia, Estonia, Latvia, Lithuania, Slovak Republic, and Slovenia. Total LMP is a combined measure of spending on administration, employment services, ALMPs, and passive labor market programs. Active LMP covers spending on all temporary interventions that aim to activate the unemployed such as vocational training, wage subsidies, or on-the-job training. Passive LMP includes early retirement programs and financial assistance that compensates individuals for the loss of wages or salary to support the unemployed during their job search (in Albania, this consists of only unemployment benefits).

45. For graduates who have transitioned into the labor market, employer-provided training can be an important source of lifelong learning. However, such training appears to be relatively uncommon in Albania. According to the 2017 STEP survey, very few of the country's firms provide training⁵³ to their employees, fewer than half as many as reported in other Western Balkan countries (Figure 26). On average, less than 15 percent of the country's firms provide internal or on-the-job training to their employees, and less than 5 percent support their employees with externally provided training. This is likely due to the dominance of small firms in the Albanian economy, as these firms are less likely to: (i) have sufficient overhead to pay for staff training; (ii) be able to allow staff time off work to attend training; and (iii) be able to identify skills gaps in their workforce. Indeed, companies that do provide training to their employees are generally large, export-focused, and foreign-owned, findings that are reinforced by the 2019 Enterprise Survey.⁵⁴ Employer-provided training has likely become more common during the COVID-19 pandemic, as the crisis accelerated the need for higher-order skills, specifically digital skills and, by extension, the willingness of employers to provide them. Evidence from the World Economic Forum suggests that many firms around the globe accelerated the digitalization of upskilling and reskilling during the pandemic.⁵⁵

⁵² IMF. 2021. *World Economic Outlook: Managing Divergent Recoveries. Chapter 3.*

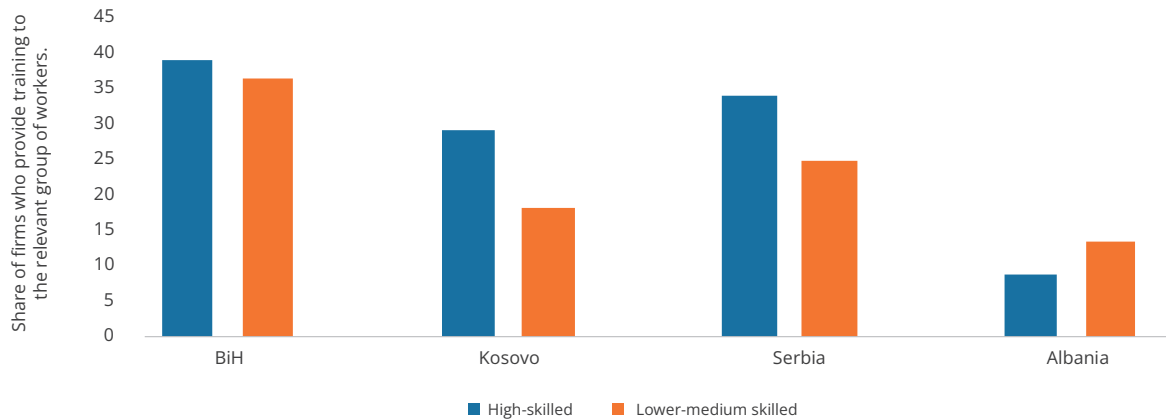
⁵³ *On-the-job training, internal-to-the-firm training, or externally provided classroom-based training.*

⁵⁴ *Unlike the STEP survey, enterprise surveys only sample companies with more than 5 workers. According to the Enterprise Survey, 46 percent of firms offer formal training to their workers. Source: <https://www.enterprisesurveys.org/>.*

⁵⁵ World Economic Forum. 2020. *The Future of Jobs Report 2020.*

In Albania, business process outsourcing firms, along with firms in other digital technology-intensive sectors (e.g., ICT and financial services), report significant investments in digital transformation and a focus on upskilling their workforce.⁵⁶

Figure 26. Compared to selected countries in the Western Balkans, Albanian firms are the least likely to provide on-the-job training to their employees.



Source: STEP Surveys Albania (2017), Kosovo (2015), Bosnia and Herzegovina (BiH) (2016), Serbia (2015).

Note: Following the International Standard Classification of Occupations classification, high-skilled workers include managers, professionals, technicians, and associate professionals. Lower-medium-skilled workers encompass clerical support, service workers, sales workers, skilled agricultural workers, construction, crafts and related trades workers, drivers, plant and machine operators and assemblers, and elementary occupations.

46. Low rates of employer-provided training in Albania reflect dynamics in the labor market, raising concerns regarding efforts to increase the supply of advanced skills. In Albania, higher-skilled occupations, which are likely to use nonroutine, nonmanual skills (i.e., the skills of the modern economy), are less likely to involve employer-provided training than lower- and medium-skilled occupations, despite an increasing number of firms facing a scarcity of skilled workers. According to the Enterprise Survey, the share of firms that report difficulties in finding workers with specific technical skills and knowledge increased from 6 percent in 2013 to 25 percent in 2019. Beyond the general constraints to employer-provided training in Albania, the emigration of workers with advanced skills disincentivizes firms to train their high-skilled workers (Box 6). According to data from the job-searching website LinkedIn, workers with highly specialized digital skills are leaving the country: out of the 15 skill groups with the largest net skill losses due to emigration, 13 are technical or specialized skills such as telecommunications and cybersecurity. Efforts to strengthen the NAES and VET should help to address some of these issues, as could a shift toward individual learning accounts.

47. Seasonal employment—particularly in tourism—creates an opportunity for reskilling and upskilling workers during the off-season. Short training programs can be offered to seasonal workers to train them or upgrade their skills during the off-season. The experience of countries with a significant share of seasonal employment (e.g., Croatia and Austria) could inform employment and training programs aimed at seasonal workers. On the one hand, these types of programs aim to preserve seasonal jobs and businesses, especially in the tourism sector (i.e., subsidizing off-season periods to maintain the labor supply in sectors that are important for the economy). On the other hand, short training programs could be attractive to seasonal workers who want to upgrade their skills to find other work, regardless if it is in a seasonal or non-seasonal sector.

⁵⁶ Risi Albania 2021 survey.

Box 6. Emigration, Brain Drain, and the Skills Gap

Albania's skills gap is worsened by persistent and large emigration due to many Albanians leaving the country in search of better job opportunities abroad. Albanians' desire to emigrate is ranked 3rd out of 160 countries in the Gallup World Poll, which finds that the desire to emigrate increased from an average of 36 percent of Albania's population in 2010–12 to 56 percent in 2013–16.⁵⁷ Driven by high levels of unemployment and underemployment, low incomes in both the formal and informal sector, limited social protection, and a low level of social services, the high rate of emigration has resulted in a sizeable (relative to the population) Albanian diaspora abroad.⁵⁸ As emigration has traditionally been pronounced among the young, dynamic, and educated, this brain drain has exacerbated the domestic skills gap.

While human capital flight is a challenge, it has also resulted in a large and vibrant diaspora that can be leveraged to transfer skills and know-how back to Albania. Many Albanians living abroad learn language skills, gain valuable experience from entrepreneurship or advanced professions, and develop international social networks. Albania has the highest number of students from the Western Balkans studying in developed OECD countries.⁵⁹ Albanians living abroad accumulate savings that can be used to start a business or support members of their home communities. Albania needs to ensure that emigrants who want to return can do so smoothly to encourage them to bring their skills and financial resources back home. While few emigrants report that they want to return to Albania,⁶⁰ return migration has become more common in recent years, reflecting improved economic prospects in the country and tightened immigration rules abroad. However, there has been little interest in utilizing existing "migration counters" that were developed to assist returnees with information to settle back in Albania, potentially reflecting limited outreach or poor service quality.⁶¹ The authorities need to expand agreements on the international recognition and transfer of pension rights and education degrees and make them more transparent, and pension transferability agreements also need to consider concerns related to fiscal sustainability.

While many migrants are unlikely to return to Albania, they can nonetheless transfer skills and know-how back to Albania through professional networks and investments. The diaspora can facilitate the transfer and adoption of foreign advanced production, management, and other practices into the Albanian market. Albanians abroad can also transfer knowledge about foreign markets and contacts with foreign companies, which could allow Albanian firms to enter export markets. These "diaspora externalities" could be deliberately nurtured by the government through, for example, trade and investment shows organized through the country's embassies.

⁵⁷ Esipova N., Ray J., Pugliese A. 2017. "Number of potential migrants worldwide tops 700 million," 8 June, Gallup News, 8 June, <http://news.gallup.com/poll/211883/number-potential-migrants-worldwide-tops-700-million.aspx> (last accessed 26 February 2018).

⁵⁸ World Bank: *Returnee Migrant Vulnerability Studies in 6 Balkan countries (currently work-in-progress, March 2018)*; conducted as part of ASA on Supporting the Effective Reintegration Of (Roma) Returnees in the Western Balkans (P160112).

⁵⁹ UNESCO (2017) *Global Flow of Tertiary-Level Students*. <http://uis.unesco.org/en/uis-student-flow>.

⁶⁰ A survey among Albanian students studying in EU countries showed that only 4 percent wished to return after finishing university or post-university studies. Source: Gëdeshi I., King R., *Research Study into Brain Gain: Reversing Brain Drain with the Albanian Scientific Diaspora*, UNDP, Tirana 2018.

⁶¹ *Return Migration and Reintegration in Albania*. 2013. INSTAT and OMI.

To ensure the skills of Albanians meet labor market needs, the authorities should consider:

- **Improving VET programs to ensure they provide students with the skills necessary to succeed in the labor market.** This includes: (i) institutionalizing the involvement of the private sector in the areas of course development, work-based learning, and accreditation and certification; and (ii) establishing a national model for the provision of work-based learning in VET, including an operational management information system for tracking outcomes and quality assurance.
- **Finalizing the reform of ALMPs to support labor market transitions.** This includes: (i) operationalizing the monitoring and evaluation framework for ALMPs to continue the evidence-based approach; (ii) enacting bylaws that make it possible to outsource ALMPs to private training providers and implement pilots; (iii) broadening the set of participating employers in new EPPs, and engaging them systematically, as well as piloting an employer-led training program; and (iv) considering raising ALMP budgets once the NAES has fully operationalized existing programs, and strengthened its implementation capacity.
- **Introducing individual learning accounts to allow workers to access training.** These accounts provide resources for training only when it is undertaken, which means that decisions regarding the direct provision of training are made independent of workers' employers or employment status. Funding could be derived from either a specific training levy or from the state budget (for more targeted purposes).
- **Introducing off-season upskilling programs targeted at seasonal workers in sectors such as tourism or agriculture.** The aim of these programs is to subsidize off-season periods to preserve seasonal jobs and businesses and/or upgrade the skills of seasonal workers to find other work within or outside seasonal sectors. The authorities could collaborate with non-public providers to offer modular trainings.

Conclusion

48. This chapter presented a series of policy priorities for Albania to better prepare its workforce for the future economy. The government needs to implement policies that target the education of the youth and active labor market policies that target the current workforce. Albania's workers need to be equipped with market-relevant skills, and the country's entrepreneurs need access to a pool of educated workers to build high-productivity businesses. Meanwhile, the adoption of policies aimed at the continuous reskilling and upskilling of the workforce would ensure that workers can adapt and take advantage of continuous technological change.

49. However, for education to have a positive impact on economic outcomes, workers need access to the right job opportunities. Albania's private sector remains small and shallow. For the educated workforce, there are limited job opportunities at high-productivity firms. The next chapter will address questions related to how Albania can create a better business environment and enable its productive firms to grow, how it can help spur entrepreneurship, and what is needed to better connect Albanian firms with the global economy.

Chapter 03

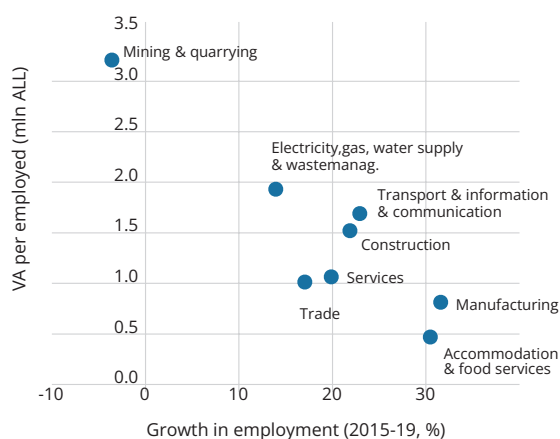
Increasing

Firm

Productivity

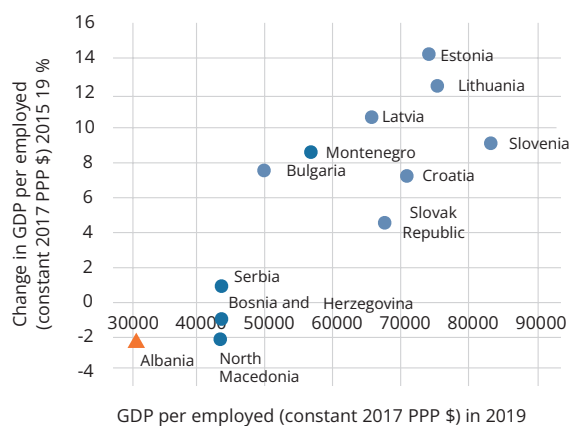
50. Increasing the productivity of firms is key to creating more and better job opportunities for all Albanians. Much of Albania's recent economic expansion has occurred in relatively low-productivity and low-paying sectors such as basic manufacturing and small-scale tourism (Figure 27). In terms of GDP per person employed (constant 2017 PPP US\$)—a proxy for labor productivity—Albania underperforms relative to regional peers, and the gap widened in 2015–19 (Figure 28). Reversing this trend is currently the country's key growth challenge. Within-firm productivity needs to grow faster, and economic activity within and across sectors needs to shift toward higher value-added businesses. The country could greatly benefit from the implementation of reforms aimed at increasing firm productivity. For example, if the productivity of Albania's firms could catch up to the Western Balkans average, GDP per employed would grow by 40 percent. Higher productivity would encourage firms to increase hiring, compete for workers, and raise labor compensation, thereby creating more and better job opportunities for all Albanians.

Figure 27. Growth skewed toward low-margin industries has depressed Albania's aggregate productivity growth.



Source: Instat Structural Business Survey.

Figure 28. Albania needs to reverse current productivity dynamics to converge with regional peers and create better job opportunities.



Source: World Bank WDI.

51. Albania's current productivity challenges are reflected in low firm capabilities. The economy is dominated by micro, small, and medium-sized enterprises (MSMEs), which represent 99.8 percent of all businesses, 82 percent of employment, and 72 percent of value added in the business sector.⁶² Despite some progress in formalization, informality remains widespread—informal employment is estimated at 99.4 percent in the agriculture sector and 33.2 percent in the non-agricultural sector.⁶³ The low sophistication of businesses is reflected in various proxies, such as the low share of firms with internationally recognized quality certificates, the low share of firms using technologies licensed by foreign companies, and the low share of firms with annual financial statements reviewed by auditors.⁶⁴

52. Broadening the economic base and breaking into new higher value-added sectors hold the promise of unlocking new growth drivers. While services and manufacturing are gradually growing, Albania remains a regional outlier, with an economy in which agriculture—primarily based on small-scale and subsistence farming—still makes up 18.5 percent of GDP.⁶⁵ In terms of the complexity of exports, Albania ranks 76th out of 133 countries on the economic complexity index, and the share of medium- and high-tech exports in total exports is significantly lower in Albania than in regional peers.⁶⁶ A staggering 91 percent of Albanian firms did not acquire external knowledge in the preceding three years, while 81 percent did not engaged in internal research and development in the same period, highlighting the challenges Albania faces in terms of innovation and adapting new technologies.⁶⁷

⁶² Instat, *Structural Business Survey (SBS), 2019 data*; MSMEs are firms with less than 250 employees.

⁶³ ILO based on 2019 Labor Force Survey.

⁶⁴ World Bank Enterprise Survey 2019.

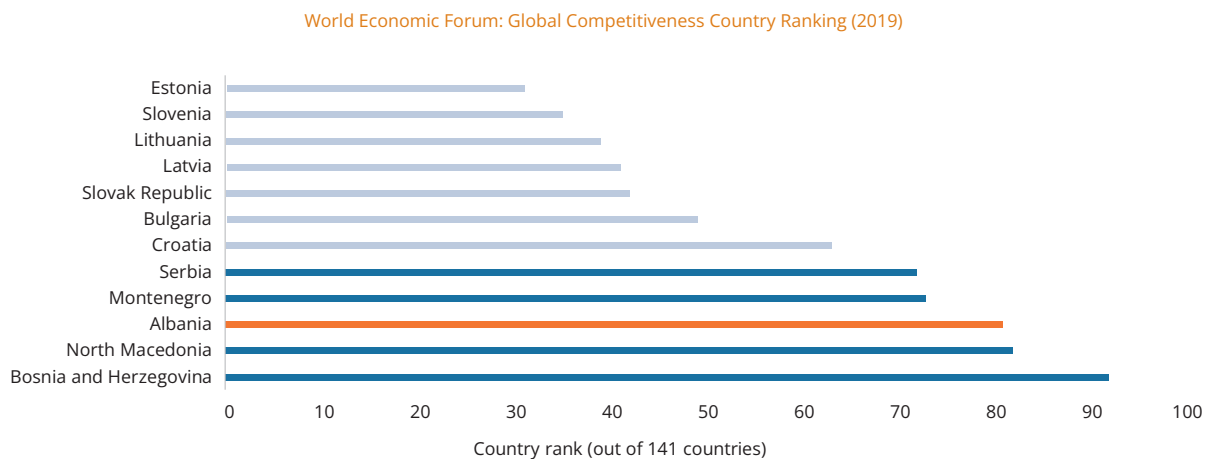
⁶⁵ World Bank World Development Indicators 2019.

⁶⁶ Harvard Country Complexity Ranking 2019.

⁶⁷ World Bank Enterprise Survey 2019.

53. To unlock stronger productivity growth, this CEM recommends a three-pronged approach. First, the authorities need to improve the business environment—including streamlining government-business interactions and ensuring fair competition between all firms—to lower the cost of doing business, incentivize investment, and ensure the growth of the country’s most productive businesses. Second, to ensure that businesses can take advantage of a strong business environment, Albania needs to proactively strengthen its entrepreneurship and innovation support framework by leveraging financing and know-how to facilitate investment and accelerate the growth of its still too shallow economic base. Third and finally, Albania needs to deepen its integration into the global economy. Given its small domestic market (population of 2.9 million), integration into the global economy—though both trade and FDI—remains a key growth driver for Albania. Access to international markets can unlock economies of scale in production, access to global know-how, and finance as well as spur market competition. There is a large opportunity to adopt reforms to strengthen Albania’s private sector. Country rankings—such as the World Economic Forum’s Global Competitiveness database—highlight the significant scope to make it easier to conduct business in Albania (Figure 29).

Figure 29. Albania lags regional peers in economic competitiveness rankings.

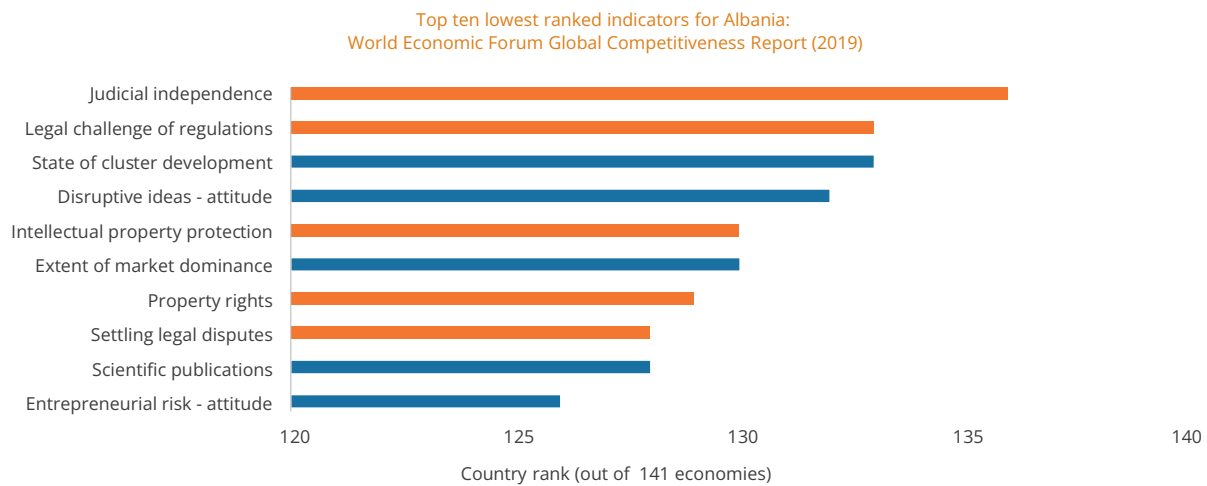


Source: World Economic Forum Global Competitiveness Report 2019.

Improving the Business Environment

54. Strengthening the legal environment and streamlining government-business interactions are among Albania’s most pressing priorities to improve the business environment. The 2021 World Bank Country Private Sector Diagnostic provides a recent comprehensive diagnostic of Albania’s business environment challenges and reform needs. This section therefore focuses on one particularly urgent constraint facing Albanian businesses: the challenging legal environment. Out of the top 10 lowest ranked indicators for Albania in the World Economic Forum’s Global Competitiveness Report 2019, 5 are related to the quality of the legal environment (Figure 30). High contract enforcement costs, including enforcement of property rights, deter investments. Frequent changes in laws, with insufficient private sector consultation, and uncertainty about how laws will be implemented make it difficult for businesses to plan. In this context, ongoing efforts to streamline business-government interactions could increase transparency, remove administrative discretion in the interpretation of laws, and remove transaction frictions for all parties.

Figure 30. A challenging legal environment is among Albania's most prominent business constraints.



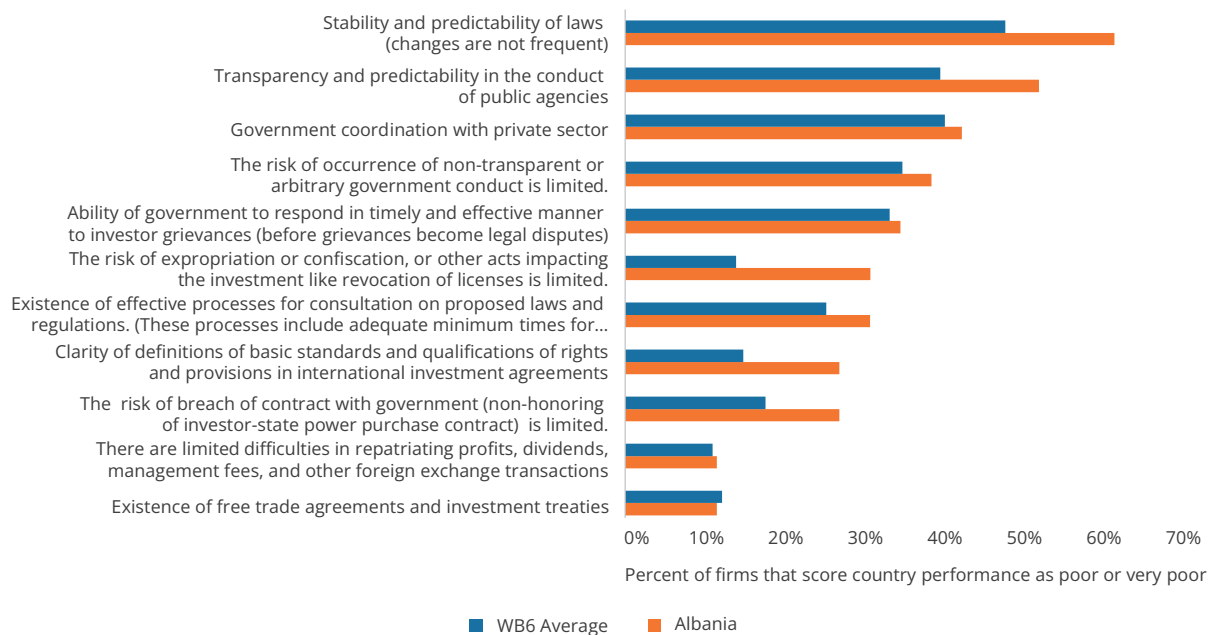
Source: World Economic Forum.

55. The current investment legal framework needs to be modernized. A country's investment legal framework, including its investment laws and international investment agreements, is a primary conduit for increasing investor confidence and attracting FDI. An investment law that is aligned with international best practices signals to investors that the country respects property rights and provides a conducive investment environment. At the same time, countries increasingly resort to modern investment laws as a primary conduit to anchor their sustainable development objectives and promote investments that contribute to green, resilient, and inclusive growth. However, Albania's current domestic legal framework needs to be updated to be in line with international standards and contribute to sustainable development goals. Albania's Law on Foreign Investment is from 1993. A 2015 Law on Strategic Investments helped to fast-track administrative procedures for eligible investments, although it was meant to serve as a temporary measure. Repeated temporary extensions—instead of adopting a permanent legal framework—have contributed to investor uncertainty about the future legal environment. Currently, Albania has an investor grievance mechanism in place to act as focal point for private sector complaints related to government action. However, the existing mechanism under the Ministry of State for the Protection of Entrepreneurship lacks the legal mandate and the institutional power to address grievances in an effective way. An investor survey conducted by the World Bank in 2019 found that over a third of interviewed firms in Albania rate the ability of the government to handle investor grievances in a timely manner as poor or very poor. To modernize the investment legal framework, the authorities should consider: (i) adopting a unified investment law, which establishes a permanent legal framework that provides rights and protections to investors, ensures a level playing field for all domestic and foreign investors, and adheres to sustainable development goals; (ii) adopting a model bilateral investment treaty (aligned with the unified investment law) as a blueprint for Albania's future international investment agreements; and (iii) strengthening the legal foundation for a fully functional investor grievance mechanism.

56. Businesses need further assurance that contracts can be enforced through the judicial system or other conflict resolution mechanisms. High contract enforcement costs, lengthy court processes, and unreliable judgments can significantly increase the cost of running a business and deter job creation. The country's ongoing and ambitious judicial reform, which is a key requirement for EU accession, is showing some positive results. For example, the vetting process for judges holds promise as an important anti-corruption measure, although in the short term the mass resignation of judges has resulted in vacant seats that need to be urgently filled to tackle the backlog of pending court cases. Also, the introduction of a regulatory framework for private bailiffs is an important step toward better collateral execution and contract enforcement, although the reform has been challenged before the Supreme Court, which is expected to render its verdict in 2021. To increase the efficiency and transparency of courts, electronic case management tools for judges and lawyers are needed. Moreover, an increase in the use and effectiveness of the alternative dispute resolution system and increased use of mediation could help businesses to resolve contract enforcement challenges faster and at a lower cost, reducing the caseload faced by the courts.

57. Frequent changes in laws, with ineffective private sector consultation, and uncertainty about how laws will be implemented make it difficult for businesses to plan. An investor perception survey among foreign investors in Albania carried out by the World Bank Group in 2019 revealed that almost two-thirds of the companies interviewed perceived frequent and unpredictable changes in legislation as a key binding constraint on doing businesses in Albania. Over half of investors surveyed also found the conduct of public agencies to be nontransparent and unpredictable. Despite the establishment of the Public Notification and Consultation Registry⁶⁸ to increase public engagement with citizens and the private sector, only 7 percent of the surveyed firms indicated that they were satisfied with the existing processes for consultation on proposed laws and regulations, and 42 percent of respondents found the government’s coordination with the private sector to be generally poor, higher than an average of 40 percent in the Western Balkans (Figure 31). Transparency and predictability in the decision-making around laws and regulations that apply to investors is key to enhance investor confidence and ultimately attract and retain FDI. Evidence from the World Bank’s Global Investment Competitiveness Report 2019/2020 finds that investor confidence and FDI flows increase with regulatory transparency, investment protection, and effective recourse. The effect of reducing regulatory risk can be sizeable. For example, gains in terms of increased FDI are comparable in magnitude to the investment-enhancing effects of trade openness.⁶⁹ Strengthening the underlying quality of the public administration—thereby ensuring the quality of legal changes, removing the need for rapid subsequent amendments, and reducing the scope for subjective legal interpretation—could play a key role in improving Albania’s legal framework

Figure 31. Frequent changes in laws, with insufficient private sector consultation, and uncertainty about how laws will be implemented make it difficult for businesses to plan.



Source: World Bank Group Survey of Foreign Direct Investors in the Western Balkans Region 2019; Investor Responses to Investment Protection and Retention.

58. Uncertainty about how laws are implemented could deter entrepreneurial activities and distort competition. An inconsistent application of laws by government agencies could: (i) increase the cost and risk of doing business, which in turn could deter business investment; and (ii) increase the likelihood of bureaucratic discretion, corruption, and decisions favoring politically connected businesses, which would distort fair competition.⁷⁰ To increase legal certainty, Albania needs to continue to bring down government arrears—which totaled 1.5 percent of GDP at end-2020—and execute all public payments due to the private sector (within standard

⁶⁸ <http://www.konsultimipublik.gov.al/>.

⁶⁹ *Global Investment Competitiveness Report 2019/2020 – Rebuilding Investor Confidence in Times of Uncertainty*, World Bank Group, 2020.

⁷⁰ *The Albanian Competition Authority and the State Aid Commission have a crucial role to play to block subsidies and other forms of state aid to guarantee competitive neutrality.*

legal delays). The government also needs to continue ongoing efforts aimed at modernizing the public procurement system (e.g., such as the implementation of electronic procurement and the adoption of the new 2021 public procurement law) to ensure that all bidders can fairly compete for government contracts. A key next step is to ensure that all government contracting authorities, as well as operators bidding for contracts, are fully trained to operate under the new procurement framework. Finally, the tax and customs framework needs to be further streamlined, which could be done by: (i) clarifying the interpretation of legislation; and (ii) continuing the transition from a system based on broad-ranging physical inspections to an electronic tax and customs declaration system with selected risk-based compliance inspections. In the 2019 World Bank Enterprise Survey, 93 percent of Albanian firms report having been visited by or required to meet with tax officials, much higher than an average of 37 percent in Europe and Central Asia.

59. The ongoing e-Albania initiative has been successful in streamlining business-government interactions. By moving government services online, Albania has reduced the time required for businesses to fulfill administrative steps while increasing transparency and reducing the scope for corruption. Since the start of implementation in 2013, the e-Albania initiative has integrated at least 53 electronic registers, which interact in real time. The electronic seal can be generated in real time for 45 documents with full legal value, which allows public employees to obtain citizens' legal documents on behalf of citizens, reducing the burden on the public to submit documentation to be eligible for public services. In addition, there are more than 750 electronic services, and 60 percent of the information in the application forms to access these services are prefilled with data from different electronic registers. According to the government, 94 percent of tax services are available online. Reducing the burden on the taxpayer lowers the cost of doing business and increases tax compliance. Going forward, it will be crucial to expand the functionality of the e-Albania portal, including transferring further services online, enhancing English language support for foreign investors, and integrating the investor grievance management mechanism on the platform.

60. Property rights remain a particularly salient problem in Albania. While unclear property rights, created by inaccurate land registries and cadasters, represent a crosscutting issue in all sectors, the absence of an efficient land market is most acute in agriculture and tourism. In agriculture, land fragmentation is a significant constraint on businesses trying to achieve economies of scale, and unclear ownership stifles incentives to invest in land. Similarly, tourism businesses need access to large plots of land with clear property rights to attract new investment projects.

61. The country has made some progress in certain areas of land administration. Land registration services have improved and cover most of Albania, and the authorities have created processes for privatizing land. For example, the Government of Albania initiated the Integrated Land Management Reform program in 2017. More recently, to address institutional fragmentation, the government created the State Cadastre Agency by combining several entities with somewhat overlapping mandates, including the Immovable Property Registration Office, the Agency for Legalization, Urbanization and Integration of Informal Areas and Buildings, and the Agency for Inventory and Transfer of State and Public Land. The legal framework was also updated with the adoption of the Law on Cadaster (2018) and the Law on Finalizing Transitional Ownership Processes (2020).

62. However, more needs to be done to resolve the ongoing challenges in the land sector. The government still needs to complete the privatization of agricultural land as well as the mechanisms to address informal settlements and inventories of public land. The restitution process has also stalled and been subject to litigation by affected former property owners at the European Court of Human Rights.⁷¹ Roughly 10 percent of land in Albania remains unregistered, most of which is located on the southern coast where a large Greek minority resides. A series of government decrees aimed at obtaining land for tourism projects have further undermined property rights, and cadastral boundaries are often inaccurate and do not reflect current land usage. Moreover, land records remain primarily paper-based due to the slow digitization process, and perceptions of corruption in land transactions are pervasive. Finally, informality is widespread, which impedes the collection of property taxes. Mistrust in land titles limit the usefulness of property as collateral to access credit and fund investment. To address the remaining challenges related to land administration in Albania, the government needs to fully implement its land reform program, which includes improving the capacity of the State Cadastre Agency, facilitating the transition of land, and updating the land registry.

⁷¹ Council of Europe Resolution, *Execution of the judgements of the European Court of Human Rights CM/ResDH(2018)349, involving sixteen cases against Albania.*

To improve Albania's business environment, the authorities should consider:

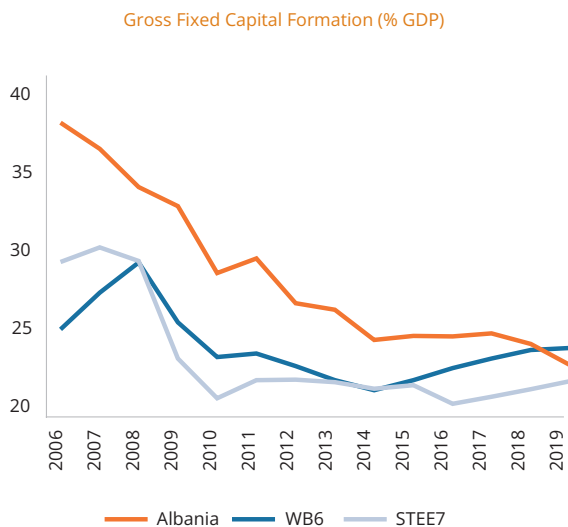
- **Reforming the investment legal framework.** This includes: (i) adopting a unified investment law, which establishes a permanent legal framework that provides rights and protections to investors, ensures a level playing field for all domestic and foreign investors and adheres to sustainable development goals; (ii) adopting a model bilateral investment treaty (aligned with the unified investment law) as a blueprint for Albania's future international investment agreements; and (iii) strengthening the legal foundation for a fully functional investor grievance mechanism.
- **Completing the ongoing judicial reform to strengthen the rights and obligations of businesses.** The government's medium-term policy priorities should be to: (i) complete the vetting process and fill vacant judicial posts; (ii) further strengthen the regulatory framework and introduce private bailiffs; (iii) invest in alternative dispute resolution mechanisms and mediation to resolve commercial disputes; (iv) strengthen the track record of investigating and prosecuting corruption cases; and (v) invest in the digitalization of judicial services to enable two-way communication between the courts and other parties in proceedings as well as the development of a comprehensive case management system for judges and prosecutors.
- **Continuing efforts to streamline government-business interactions.** This includes reducing the scope for bureaucratic discretion and the uncertainty about how laws are implemented by: (i) reducing government arrears; (ii) implementing the new public procurement framework; (iii) streamlining the tax and customs compliance framework; and (iv) ensuring more effective implementation of feedback received through private sector consultations in proposed laws and regulations. Ongoing efforts to digitalize government services through e-Albania and other initiatives are important to create the tools necessary to streamline government-business interactions.
- **Fully implementing the land reform program.** This includes: (i) improving the capacity of the State Cadastre Agency (e.g., improving service delivery, digitalizing the agency, and increasing accountability); (ii) facilitating the transition of land to its most productive use (e.g., completing the privatization of agricultural land, the restitution of land, and the public land inventory and formalization process); and (iii) updating the registry to ensure all land is registered and accurately reflects land boundaries.

Strengthening Entrepreneurship and Innovation

63. The smart mobilization of private finance and business support programs is needed to enable productive firms at all stages of the business lifecycle to leverage market opportunities and become more competitive. Businesses can only take advantage of a stronger business environment if they have access to the funding (public and/or private) necessary to invest and upgrade their capabilities. Yet, Albania's investment rate has declined rapidly over the last decade, and its level of gross fixed capital formation is now at the level of regional peers (Figure 32). However, a significant infrastructure gap between Albania and its regional peers still remains, and the capacity of Albanian firms is much lower than that of firms in neighboring countries.

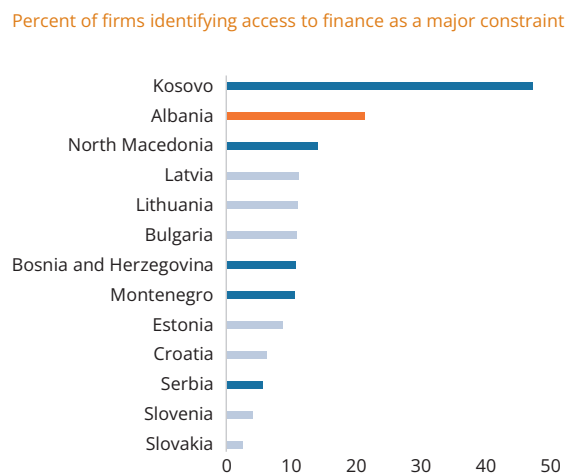
64. Albania's start-ups are still at a nascent stage, and they lack access to stable funding and institutional support. According to the 2019 Global Competitiveness Report, Albania ranks 117th out of 141 economies on entrepreneurial culture, and enterprise survey data show that 21.2 percent of firms in Albania identify access to finance as a major constraint on doing business, more than in any other regional peer country, with the exception of Kosovo (Figure 33). In Albania, there are few venture capital funds, crowdfunding initiatives, and/or angel investor networks that support start-ups or could help scale up MSMEs. While the donor community has launched several support programs for start-ups, most of these support the ideation phase for new businesses rather than provide seed funding to implement business ideas and advise young companies during their initial years. At early stages of development, Albanian MSMEs typically rely on internal sources of funding, including savings, retained earnings, or funding through the sale of assets.

Figure 32. Albania's investment rate has decline rapidly and is currently in line with the average of regional peers.



Source: World Bank WDI.

Figure 33. Challenges related to access to finance are more prominent in Albania than in most regional peers.



Source: Enterprise Survey (latest year available for each country).

65. As MSMEs mature, access to external finance is critical to fund investments, yet limited access to finance, particularly bank credit, is a key challenge in Albania.

The country's financial sector ranks 102nd out of 141 countries in the World Economic Forum's 2019 Global Competitiveness Report. Credit to the domestic private sector represents only 37 percent of GDP in Albania, lower than above 50 percent, on average, in regional peers. MSMEs—which constitute the backbone of the Albanian economy—face significant constraints in accessing finance, with 16 percent of small firms and 34 percent of medium-sized enterprises reporting access to finance as a major constraint to doing business in Albania.⁷² The overall MSME financing gap in Albania is estimated at 9 percent of GDP.⁷³ While the country's banking sector is extremely liquid and prevailing interest rates are low, Albanian banks are reluctant to lend to MSMEs, as they perceive the sector as risky, and the secondary market for movable and immovable collateral is limited. Other likely factors behind the low rate at which banks transform deposits into loans include: (i) a high level of NPLs, which poses a burden on banks' balance sheets; (ii) under-developed credit infrastructure; (iii) limited eligible demand for credit, given a lack of bankable projects due to limited economic opportunities; (iv) over-leveraged corporates; (v) widespread informality; and (vi) concerns regarding loan repayment behavior and the ability to enforce loan contracts.⁷⁴

66. The financial system is bank-centric, with shallow non-bank sectors and a small capital market.

Banks account for about 90 percent of assets in Albania's financial sector. Microfinance institutions, the second largest provider of finance, especially for micro enterprises in rural areas, face difficulties in either accessing affordable wholesale funding or appropriately risk sharing mechanisms. Financial leasing, which is particularly useful in leveraging investment in equipment and new technology, is limited mainly to motor vehicles, with a weak secondary market for repossessed equipment presenting the biggest constraint for its development. Moreover, there is limited practice of accounts receivable-based finance (e.g., factoring or invoice discounting), which can boost working capital for smaller enterprises and improve the performance and efficiency of supply chains.⁷⁵ Venture capital funds and/or angel investor networks that could support start-ups or scale up existing MSMEs are also missing, and the penetration of digital financial services

⁷² This is up from 8.4 percent in 2013, potentially reflecting an increase in the need for financing as the economy grows (World Bank Enterprise Surveys 2019).

⁷³ SME Finance Forum, IFC Enterprise Finance Gap.

⁷⁴ World Bank. 2018. "Albania MSMEs Finance for Growth Assessment."

⁷⁵ According to the World Bank MSMEs Finance for Growth report, only 4 percent of Albanian MSMEs use leasing, lower than the EU average of 24 percent, Serbia's 9 percent, and North Macedonia's 8 percent. Only 2 percent of Albanian MSMEs use factoring, lower than the average of 6 percent for EU countries, 4 percent in Serbia, and 5 percent in Montenegro.

is very low, limiting their potential to reduce information asymmetries and decrease transaction costs.⁷⁶ The promotion of digital transactions and efforts to digitalize the economy (e.g., through e-commerce) could increase MSMEs' access to finance. Both primary and secondary markets for corporate debt securities are underdeveloped, and the financial sector's contribution to mobilizing green finance is limited. Green loan portfolios are not well measured and are still small, and neither the government nor any corporate has so far issued a green bond. The recent adoption of framework laws on capital markets and payment systems is expected to catalyze a more vibrant and diverse non-bank financial system, providing a wider set of investment opportunities for the Albanian economy. Other measures to increase access to finance for MSMEs include creating a credit guarantee scheme; improving the country's financial infrastructure; and supporting factor and invoice discounting.

Box 7. Legacy NPLs, which are Expected to Increase because of the COVID-19 Crisis, Encumber Banks' Balance Sheets and Deter Lending.

Legacy NPLs encumber banks' balance sheets, and the pandemic is expected to result in an increase in NPLs, which could further deter new lending. Despite significant progress in reducing NPLs in recent years,⁷⁷ Albania's NPL ratio remains high at 8 percent as of March 2021.⁷⁸ Recent reforms, including write-offs, a new insolvency law, and an out-of-court NPL resolution framework (which was extended until end-2021 due to the pandemic), have contributed to a significant reduction of NPLs. However, important challenges remain. For example, the financial condition of Albania's largest corporate borrowers is weak, and loan write-offs by banks removed NPLs from their balance sheets but left borrowers trapped with unsustainable debt.⁷⁹ Borrower relief and other prudential measures implemented in response to the COVID-19 crisis are now gradually being phased out or tightened, with some measures (including loan restructuring efforts and favorable loan classifications) being carried over into the first quarter of 2021. As a result, the effects of the crisis are expected to become more visible on banks' balance sheets toward the second half of 2021, with a potential increase in NPLs as government measures expire and weak economic prospects put further stress on asset quality. Encumbered bank balance sheets could further tighten access to credit during the recovery—a key challenge for the financial system.

67. Beyond financing, Albanian businesses need access to know-how to improve their managerial skills and capabilities (also referred to as 'soft investments'). Albanian firms, especially small businesses, underperform their regional peers in know-how, firm capabilities, and innovation (Figure 34). This is partly due to financing constraints that prevent firms from making the necessary hard investments in machinery and equipment as well as the needed soft investments in consulting and training services. However, these capability gaps likely also reflect information gaps (i.e., firms underestimating the return on upgrading their capabilities or being unaware of investment opportunities) as well as status quo bias (i.e., the CEO or key business stakeholders resist implementing changes).⁸⁰ To encourage firms to improve their know-how, capabilities, and spending on innovation, the government could strengthen its business support programs for growing SMEs.

⁷⁶ According to the 2018 Venture Capital and Private Equity Country Attractiveness Index, published by the IESE Business School and EMLYON Business School (<https://blog.iese.edu/vcpeindex>), Albania ranks 103rd in the World, compared to 80th for North Macedonia, 82nd for Serbia, and 85th for Montenegro.

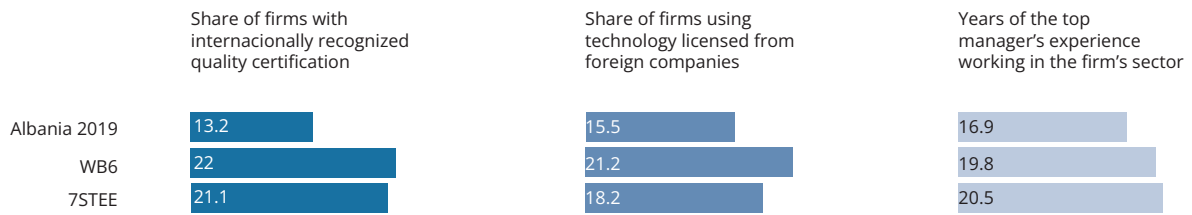
⁷⁷ The 2014 Financial Sector Modernization DPL and the 2017 Financial Sector DPL supported the Albanian authorities in undertaking a strong set of reforms to lower NPLs and enhance the stability of the financial sector. As a result, NPLs dropped from a peak of 25 percent in September 2014 to 8 percent in March 2021. Additional efforts are needed to tackle large defaulting multi-lender exposures.

⁷⁸ Compared to the Western Balkans and EU average of 5.3 percent and 3.0 percent, respectively, in mid-2019.

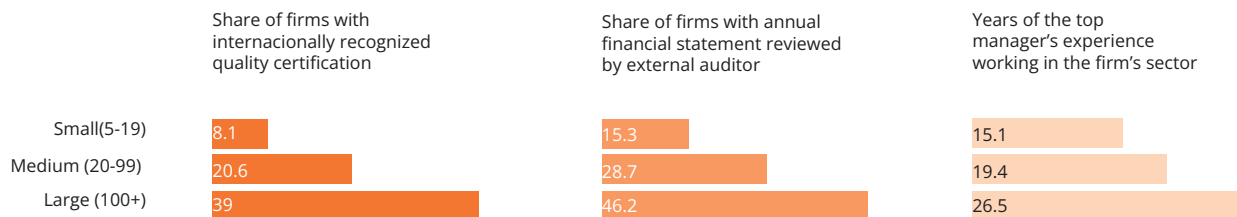
⁷⁹ For further information, see: World Bank Policy Note on COVID-19 and Non-Performing Loan Resolution in the Europe and Central Asia region - Lessons learned from the global financial crisis for the pandemic, December 2020; <http://pubdocs.worldbank.org/en/460131608647127680/FinSAC-COVID-19-and-NPL-Policy-Note-Dec2020.pdf>.

⁸⁰ Other factors likely include low returns on internal investment due to a shallow domestic customer base and limited competitive pressure.

Figure 34. Albanian firms underperform their counterparts in peer countries on quality certification, technology used, and managerial experience...



...with the situation being worse for small firms.



Source: The World Bank Enterprise Surveys

Box 8. Women Entrepreneurs Face Heightened Challenges and Require Dedicated Support.

While women entrepreneurs can have an important impact on the dynamism of the economy, they remain underrepresented in Albania. According to Albania's National Business Center, firms managed by women represented only 18.6 percent of total firms in 2019. Out of female-led businesses, 97.5 percent are MSMEs and more than half are concentrated in wholesale and retail or other services. Firms managed by women are less likely to use bank credit than their male-led counterparts, as only 13 percent of their total capital is financed through bank credit, lower than 20 percent for male-managed firms. Moreover, they rely heavily on equity to finance their operations, as equity accounts for 48 percent of their total capital, higher than 40 percent for firms managed by men. As a result, female business owners are more likely than their male counterparts to rely on short-term payables and other forms of long-term financing such as loans from family and friends.

As part of its broader commitment to promoting greater gender equality, Albania is taking steps to support female entrepreneurship. For instance, 2016 Life in Transition Survey data show that women own only 33 percent of land parcels and dwellings, far below the average of 49 percent in Europe and Central Asia. To rectify this, Albania has taken steps to strengthen the ownership rights of women by, for instance, ensuring that co-ownership of land acquired during marriage is fully reflected in the property register. Greater access to collateral may enhance access to finance and the ability of women to start a business. In addition, Albanian women remain disproportionately involved in child education, as only 10 percent of children aged 0–3 have access to organized daycare or crèche services. The government has therefore: (i) launched programs to subsidize access to daycare or crèche services for those in need; (ii) strengthened financing arrangements to ensure the quality of preschool education; and (iii) launched an after-school pilot enrichment program for school grades 1–9. Reducing the burden of childcare for parents should increase the opportunities for women to pursue their own working careers—including entrepreneurship.⁸¹

⁸¹ These and other reforms are supported by the Albania Gender Equality in Access to Economic Opportunities Development Policy Financing (DPF) of the World Bank and the French Development Agency (ADF).

Despite progress, the authorities need to do more to enhance the participation of women in business activities and reduce obstacles faced by female-owned firms. The government should consider adopting policies and developing support programs to stimulate women entrepreneurship and make it easier to establish a business, with a specific focus on the country's less developed regions. Targeted training programs/windows can be useful to increase capacity in terms of managing business operations, strategic decision making, business planning, financial management, etc. In addition, capacity building programs could be provided alongside financial support, including matching grants, credit guarantees, or soft loans. The World Bank Women Entrepreneurship Finance Initiative (we-fi) is currently piloting these types of interventions globally, and they could become potential blueprints for Albania.

To strengthen entrepreneurship and innovation, the authorities should consider:

- **Increasing access to early-stage financing for start-ups.** Given limited current private sector financing in Albania, the authorities would have to first strengthen existing government programs (e.g., programs funded by the Albanian Investment Development Agency, AIDA) and international donor initiatives that support start-ups. In particular, a shift is needed toward: (i) larger and more meaningful grants for individual companies; (ii) less cumbersome and digitalized application procedures, accompanied by inclusive communication campaigns to encourage take-up; (iii) closer monitoring of start-ups that receive grants to establish accountability for results and support entrepreneurs with mentorship; and (iv) more systematic impact evaluations to identify grant program features that have been successful, increasing the programs' value for money.
- **Strengthening incubator and accelerator programs.** A 2019 report on the entrepreneurial ecosystem in Albania identifies the need to establish a stronger incubator and accelerator ecosystem. Incubator programs need to: (i) accept applications throughout the year; (ii) offer close linkages with local universities and their entrepreneurship ideation programs; and (iii) offer close linkages with established industry mentors.
- **Strengthening business support programs for growing SMEs.** This includes upgrading the matching grant programs currently proposed by AIDA and strengthening measures aimed at incentivizing soft investments in business advisory services (BAS). BAS involves specialized business advice in areas such as business strategy, business functions (i.e., marketing, financial management, sales, etc.) human capital (e.g., managerial skills), and business law.⁸² The BAS programs could include grants, matching-grants, vouchers, or subsidies for managers to attend training programs or obtain advisory services from knowledge providers. Moreover, some countries provide SMEs with free online toolkits that cover a range of areas such as customer service, financial management, human resources, marketing, productivity, digitization, exports, etc.).
- **Increasing access to finance for MSMEs.** This could be done by: (i) transforming the targeted credit guarantee programs, which were launched by the government in response to the COVID-19 crisis, into a public credit guarantee scheme with a transparent governance structure and rigorous risk management and monitoring framework to incentivize bank lending; (ii) upgrading the country's financial infrastructure, which in turn can be done by improving the movable collateral registry to enable seamless real-time access and registration of notices of creation of security interests as well as by creating an enabling legal framework that would allow for the development of private credit bureaus; (iii) increasing the bankability of projects through targeted financial capability programs focused on improving MSMEs' financial reporting, financial management, and business planning; (iv) supporting the development of factoring and invoice discounting, including the increased use of electronic invoices, the development of platforms for reverse factoring or invoice discounting, and warehouse receipt financing in support of agribusinesses; and (v) adopting

⁸² Countries that have successfully implemented business advisory programs include South Africa, Colombia, India, Mexico, and Chile. In South Africa, marketing and finance training increased profits by 40–60 percent (Anderson and Macdonald 2017), and the productivity of micro enterprises in Mexico doubled after one year of local consulting services (Bruhn, Karlan & Schoar 2016).

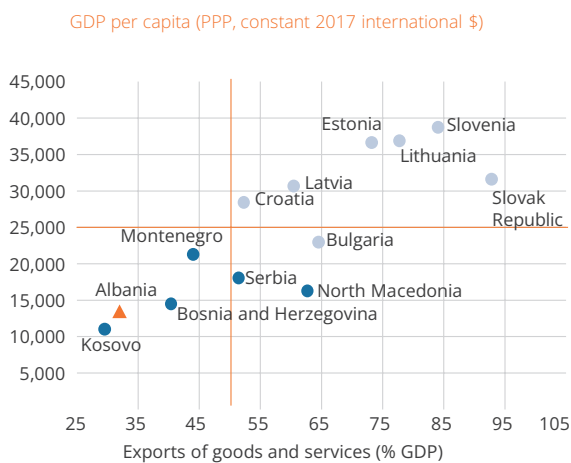
implementing regulations on capital markets and payment services to facilitate the entry of new financial intermediaries as well as the development of new products.

- Adopting policies and developing support programs to encourage women entrepreneurship.** This includes targeted training programs to increase the capacity of women-owned businesses in areas such as business management, strategic decision-making, business planning, financial management, etc. The government should also consider offering dedicated financial support to women entrepreneurs, including matching grants, credit guarantees, or soft loans.

Integrating Albania into the Global Economy

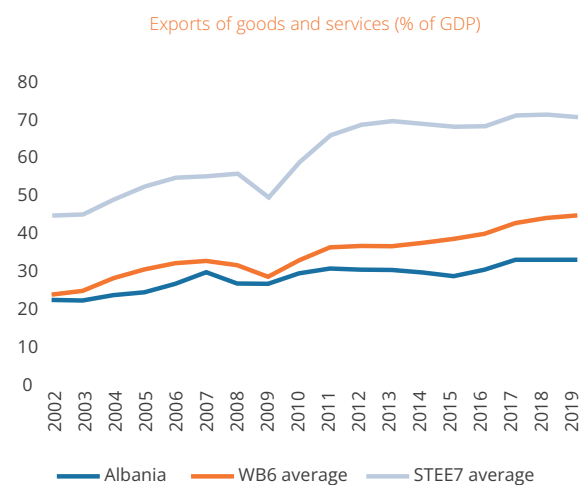
68. Given its small domestic market (population of 2.9 million), integration into the global economy— through both increased trade and FDI—remains crucial for Albania. Access to international markets can unlock economies of scale in production, increase access to global know-how and finance, and spur market competition. When coupled with smart private and public investments, deeper integration into the global economy could enable Albania to build a more internationally competitive economy. Among the small economies of South East Europe, openness to trade is strongly correlated with income. None of these countries have reached a GDP per capita level of US\$25,000 (PPP, constant 2017 international \$US) without raising their exports to above 50 percent of GDP.

Figure 35. Among the small economies of South East Europe, export performance is strongly correlated with income.



Source: World Bank WDI 2019.

Figure 36. Despite progress, Albania's export performance continues to lag that of regional peers.



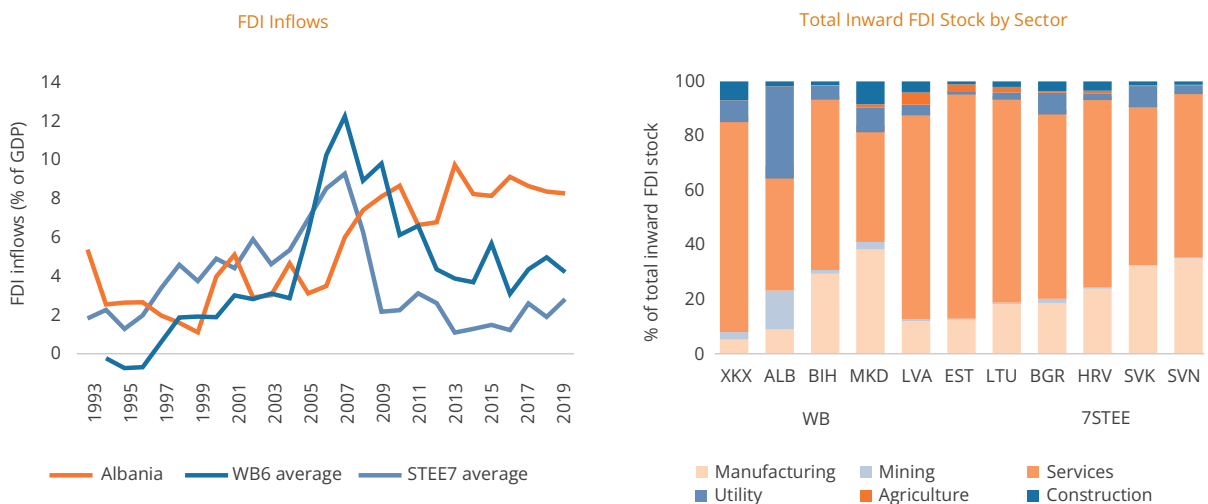
Source: World Bank WDI.

69. Despite recent improvements, Albania needs to strengthen its border crossing arrangements to promote its exports. Since tariffs with key trading partners have either already been removed or are at low levels, Albania needs to focus on reducing the time and cost of moving goods in and out of the country. This means tackling limited cooperation between border agencies, paper processing of customs documents at the border, and extensive physical inspections with limited risk prioritization. An important guidepost for this endeavor could be the full and effective implementation of the measures under the World Trade Organization's Trade Facilitation Agreement.

70. Crucially, Albanian products need to gain access to and become more competitive in foreign markets. For example, access to international food markets is still limited. Key animal products from Albania, including dairy, red meat, and poultry, are still not allowed into

the EU. To overcome these market access challenges, the country needs to invest in upgrading its national quality infrastructure. Despite the adoption of key legislation on food standards and traceability, secondary legislation is missing. Testing laboratories and monitoring procedures also need to be upgraded to ensure credible verification of compliance with requirements. Producers require access to more training and financing to ensure that their production methods meet EU standards. Beyond meeting formal quality requirements to enter the EU, Albanian firms need to be able to compete in advanced markets. In the agriculture sector, for instance, private sector certifications—such as Global Gap and organic labels—as well as an ability to reliably deliver orders at scale are critical to access EU supermarkets.

Figure 37. While Albania has attracted significant FDI in recent years, a large share has been in utilities and mining rather than in manufacturing and services.



Source: wiiw FDI database.

Source: wiiw FDI database.

71. FDI can be transformative for Albania’s economy. While FDI inflows and the presence of multinational enterprises (MNEs) can directly create local jobs, they can also generate substantial technology spillovers to the rest of the economy. Local suppliers upgrade their standards to do business with MNE affiliates in the country, and FDI can boost local firms’ productivity through demonstration and linkages effects. FDI can also contribute to deeper trade linkages and improved access to technology, industry know-how, and managerial practices. Finally, MNEs can create a pool of experienced and skilled local workers who can benefit the entire economy.⁸³

72. In response to the COVID-19 crisis, many multinationals are currently revisiting their supply chain arrangements, which could be an opportunity for Albania. Based on a June 2020 survey by EY, 90 percent of managers of multinational firms indicate that there will be a major change in their investment strategies after 2020, and 83 percent of firms said they will nearshore to low-cost areas. Another recent survey by Achilles shows that 75 percent of procurement professionals said that they had already begun or were planning to bring supply chains closer to home in 2021. Albania could position itself as a prime nearshoring destination to EU markets for multinationals pursuing localization strategies in light of current global trends. A World Bank survey of MNEs, conducted in December 2020, shows that fewer firms in Europe and Central Asia experienced an adverse impact on the reliability of their supply chains than firms in any other region.⁸⁴ The COVID-19 pandemic has also shown how dependent the global manufacturing industry is on production centers in East Asia, which has motivated countries and MNEs to consider diversifying their offshore destinations. Rising labor costs in certain countries in Asia as well as diversification needs are already driving some apparel and leather firms to relocate.

⁸³ Javorcik, 2004, 2008; Javorcik and Spatareanu, 2008; Havranek and Irsova, 2011; Irsova and Havranek, 2013; Liu, Wang, and Wei, 2009.
⁸⁴ Saurav, Abhishek; Kusek, Peter; Kuo, Ryan; Viney, Brody. 2020. *The Impact of COVID-19 on Foreign Investors: Evidence from the Quarterly Global MNE Pulse Survey for the Third Quarter of 2020.* World Bank, Washington, DC. <https://openknowledge.worldbank.org/handle/10986/34924>.

73. To take advantage of changes in global supply chains, Albania needs to adopt further reforms aimed at attracting and retaining FDI. The country has attracted significant FDI in recent years, mainly in large utilities and mining projects (Figure 37). There is opportunity to expand FDI in manufacturing and services, which could stimulate global value chain integration and upgrading in Albania. A strong and well-resourced national lead agency is required to attract higher levels of FDI inflows in these promising sectors. However, an underfunded and understaffed AIDA has too many competing mandates compared to its counterparts in regional peers. While Albania has made great progress in implementing the e-Albania initiative, AIDA could do more to leverage advanced digital technologies and solutions to attract and retain higher levels of FDI. This includes utilizing online marketing services, providing online self-service offerings for investors, and employing digital bots and other tools to target and identify investors, as well as implementing other digital services and tools that high-performing investment promotion agencies around the globe increasingly rely on.

To integrate Albania into the global economy, the authorities should consider:

- **Prioritizing the full and effective implementation of the measures under the World Trade Organization's Trade Facilitation Agreement.** This includes: (i) improving the cooperation between border agencies and standardizing the procedures for border controls; (ii) fully operationalizing pre-arrival electronic processing of customs documents; (iii) applying stringent risk management principles in all border agencies to reduce the level of physical inspections; (iv) operationalizing the Authorized Economic Operator program, which allows selected traders to cross the border under a lighter-touch inspection regime; (v) expeditiously implementing the National Single Window for Trade, which will serve as an online one-stop shop for processing all trade-related documentation and permits; and empowering the National Trade Facilitation Committee to lead the government's reform efforts.
- **Continuing to upgrade Albania's national quality infrastructure.** This includes: (i) completing the modernization of legislation; (ii) investing in laboratories and risk-based monitoring processes; and (iii) supporting businesses in upgrading their processes to meet EU standards.
- **Scaling up AIDA's successful FDI attraction and retention programs.** This includes: (i) streamlining the agency's mandate; (ii) increasing its staffing and resources; (iii) providing AIDA with relevant and needed technological tools and databases to allow it to offer better investor services; (iv) regularly reviewing high-potential sectors of Albania's economy, including as destinations for FDI; and (v) utilizing analytics to identify business environment bottlenecks in priority sectors and develop targeted FDI outreach campaigns to attract investors.

Conclusion

74. This chapter highlighted key measures to foster a more productive private sector in Albania. First, a stronger business environment, which necessitates efforts to strengthen the rule of law and government-private sector interactions, is crucial to accelerate private sector development. Second, measures that directly support entrepreneurship and innovation can play a key role in facilitating the growth of the country's most productive firms. Finally, as Albania's private sector develops, deeper integration with the global economy through increased trade and FDI will be key to overcome the limitations of the country's small domestic market.

75. However, for economic growth to contribute to sustainable development, Albania also needs to protect the environment, build resilience against shocks, and promote inclusive growth. Efforts to accelerate economic growth need to be aligned with measure to safeguard the environment to ensure that the country does not gradually erode its natural assets, which are vital for key economic sectors such as tourism and agriculture. Moreover, periods of economic upturns need to be used to build resilience against shocks—particularly natural disasters such as earthquakes and floods—that have in the past hampered Albania's development progress. The authorities also need to ensure that all Albanians benefit from economic growth. Inclusive growth is essential to effectively alleviate endemic poverty and build social consensus around further reform. The next chapter outlines key measures to build a more green, resilient, and inclusive (GRID) development model for Albania.

Box 9. Informality is a Key Cross-Cutting Obstacle to Business Growth.

Albania's informal economy is large, and informal economic activity (e.g., unregistered businesses, workers without contract, and businesses underreporting sales, wages, etc.) accounts for about a quarter of gross value added, similar to in other Western Balkan countries, but higher than in EU member countries such as Hungary and Czech Republic.^{85,86} About one-third of the country's workers are in the informal sector (over half if including agriculture), and the Hidden Employment Index indicates that 47 percent of Albania's employment has some level of informality.^{87,88} The agriculture, construction, and services sectors (e.g., trade, transport, and accommodation) tend to have a higher incidence of informal activity.

While the drivers of informality vary, they can generally be linked to either firms' limited growth prospects or costs associated with their formalization. In Albania, the costs of formalization come from, among others, the country's complex tax administration (firms make an average of 35 tax payments per year in Albania, more than double the regional average of 14); inaccessible construction permits (Albania ranks among the worst globally on dealing with construction permits); and costly procedures for going out of business. In addition, corruption, inadequate law enforcement, and lack of trust further reduce the perceived benefits of formality. Low access to finance, skills, input and output markets, and technology also contributes to low informality. For example, lack of financial literacy is common in Albania, undermining financial inclusion: only 40 percent of adults and about 75 percent of SMEs have access to a bank account. All these challenges fuel informality in Albania and reduce firms' growth potential and the benefits of formalization.

Informality holds back the development of Albania's economy. The presence of informal firms results in loss of government revenues⁸⁹ and hampers private sector development and the creation of more and better-quality jobs. Informal firms are only about 25 percent as productive as formal firms, and they pay lower wages and offer less protection to workers.⁹⁰ Moreover, informal firms avoid costly regulations (e.g., taxes, laws, and quality assurance), generating unfair competition, which 37 percent of Albanian firms identify as a major constraint to growth.⁹¹

To tackle informality, the government needs to adopt policies that increase the relative benefits of formalization for firms that have the capacity to formalize. In addition, it needs to pursue reforms aimed at improving business opportunities for firms while creating a business environment that is less difficult to navigate for entrepreneurs to make formalization more attractive for businesses. The authorities could offer micro and small firms simplified legal status that imposes less of a burden and is more tailored to their characteristics and needs. This simplified status does not only lower registration costs but also reduces operating costs and provides greater flexibility in business management. Another option is to grant intermediate legal status, which could incentivize informal businesses to transition to full formal status. Depending on the country, providing firms with intermediate status could make them eligible for targeted technical assistance and benefits that formal firms enjoy.

⁸⁵ Medina and Schneider, 2019. *Shedding Light on the Shadow Economy: A Global Database and the Interaction with the Official One*. CESifo Working Paper No. 7981.

⁸⁶ INSTAT, 2015. *National Accounts Methodology: Description of Sources and Methods Part A*, GNI compilation Albania

⁸⁷ ILO LABORSTA.

⁸⁸ SELDI. 2020. "Hidden economy in the Western Balkans 2020: Trends and Policy Options." Policy Brief No.11 <https://seldi.net/wp-content/uploads/2020/11/Hidden-economy-in-the-Western-Balkans-2020-brif.pdf>.

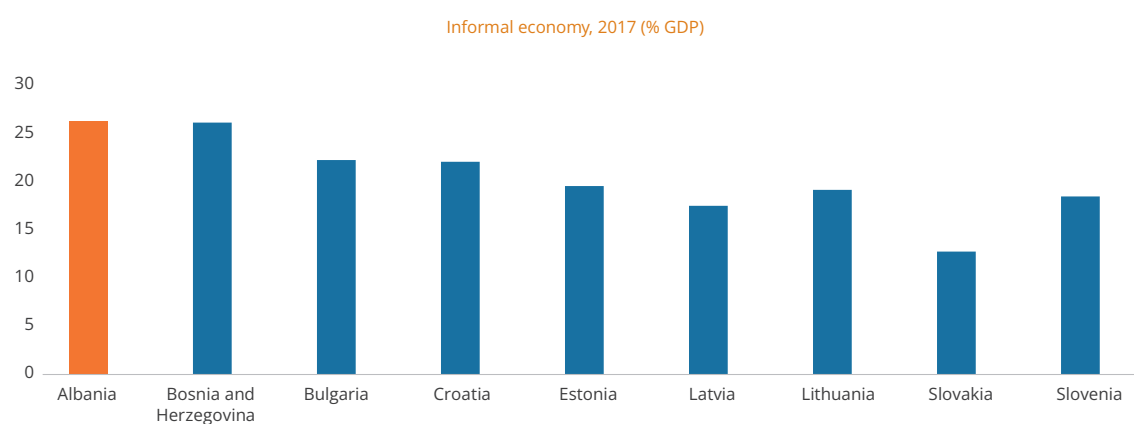
⁸⁹ For example, VAT evasion is estimated to represent about 30-40 percent of potential VAT revenue.

⁹⁰ For example, mean wages are 60 percent higher among formal firms of more than 10 employees relative to the overall workforce in firms of similar size.

⁹¹ Enterprise Surveys 2019.

Finally, targeting clusters of informal firms rather than individual informal businesses could be an efficient way to promote the growth of informal businesses by, for example, connecting them to the formal sector, thereby incentivizing formalization. This encompasses mapping linkages between firms, which can help to identify nodes, or points in the value chain covered by the cluster that informal firms or workers are located within. Those linkages can be achieved through the identification of sub-sectors and sub-industries (i.e., enterprises involved in the same business areas to form 'clusters') within a country where informality tends to be most prevalent. In supporting informal clusters, the difference in approach stems not from the type of policy intervention but the way in which the intervention is employed, i.e., reaching businesses through a coordinated manner and setting up a central body that supports the cluster. It is important to note that clusters come in many shapes and sizes, and 'cluster differentiation' serves to support targeted policy provisions. Examples of clusters include groundwork clusters, industrializing clusters, complex industrial clusters, etc.

Figure 38. Benchmarking the Prevalence of Informality.



Source: https://www.cesifo.org/DocDL/cesifo1_wp7981.pdf.

Chapter 04

**Building a
More
Sustainable
Growth Model**

76. A narrow focus on aggregate GDP growth will not be enough to meet Albania's aspirations — Albania needs to implement a more green, resilient, and inclusive development (GRID) model. Preserving the environment, preparing for future disasters, and protecting disadvantaged groups are all important policy objectives in their own right. But in the long term, these policy objectives are also paramount to ensuring the sustainability of GDP growth and increasing political support for growth-enhancing reforms. Environmental sustainability underpins the viability of core economic sectors such as tourism and agriculture. Better preparedness against shocks can mitigate the adverse impact of disasters on economic growth. Finally, inclusive growth is key to ensure social cohesion and to unlocking Albania's full human capital potential.

77. The COVID-19 pandemic has highlighted the need to build a more sustainable post-crisis economy. The unprecedented scale of policy action needed to mitigate the effects of the pandemic — as well as the opportunity to rebuild better following the crisis — has inspired societies all over the world to develop a greener, more resilient, and more inclusive long-term growth model. The effects of the current crisis have spread across borders, but social solidarity within and between nations offers an opportunity for change. Recognizing this, the 2021 World Bank-IMF Spring Meetings Development Committee, a ministerial-level forum that represents the 189 members of the World Bank Group and the IMF, urged the international community to renew its efforts to lay the groundwork for a GRID recovery.

78. This chapter reviews key challenges and presents reform recommendations for building a more sustainable growth model for Albania. The aim is to translate the GRID approach to the Albanian context and highlight reforms to protect the environment, build resilience against shocks, and promote inclusive growth (Figure 39).

Figure 39. Strengthening the Sustainability of Albania's Growth Model.



Promoting a Green Recovery

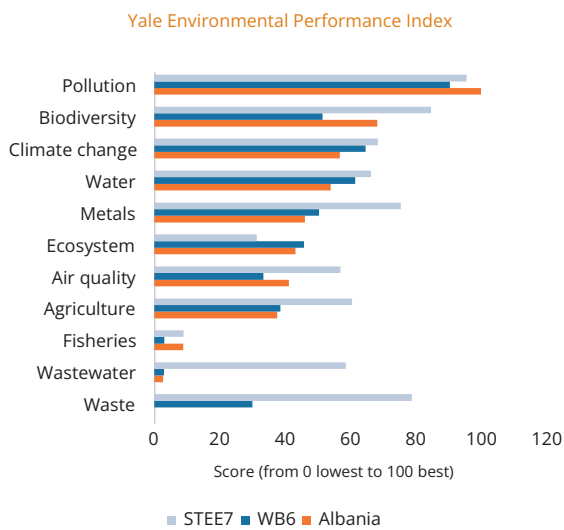
79. Global climate change and environmental degradation are key risks for the sustainability of Albania's development model.

As climate change raises average temperatures and disrupts precipitation, floods and droughts are likely to become more severe and common over time,⁹² increasing the risk to the lives and livelihoods of all Albanians. Albania — along with the rest of the international community—needs to do its part to mitigate the extent of global climate change while taking action to adapt to protect its citizens and its economy from the challenges ahead. Beyond climate change, environmental degradation —such as waste and air pollution — constitutes a direct risk to the health of Albanians as well as to the livelihoods of workers in key economic sectors such as tourism and agriculture, which depend on the sustainable management of the country's natural assets, including freshwater, land, and marine ecosystems (Figure 40). Only if the challenges of climate adaptation and mitigation, as well as environmental protection, are taken head on can Albania ensure that its economic growth gains are sustainable.

⁹² World Bank. 2020. *Disaster Risk Finance Diagnostic for Albania*.

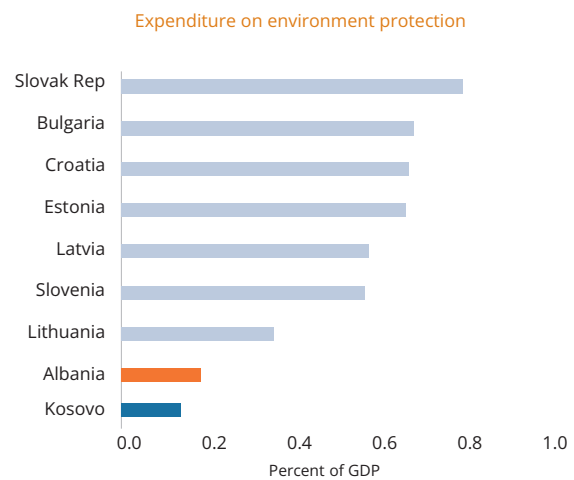
80. Recognizing the global challenge of climate change, Albania has made international commitments to develop a greener growth model. Under the 2015 Paris Agreement of the UN Framework Convention on Climate Change, Albania committed in its updated Nationally Determined Contribution (NDC) ⁹³ to reduce greenhouse gas (GHG) emissions by 20.9 percent between 2016 and 2030. In line with the 2019 European Green Deal (EGD) and its Carbon Border Adjustment Mechanism (Box 10), Albania, along with the other countries of the Western Balkans, has also signed up to the ambitious Green Agenda outlined in the 2020 Sophia Declaration. The Green Agenda consists of 5 pillars: (i) decarbonization (climate, energy, and mobility); (ii) circular economy; (iii) depollution (air, water, and soil); (iv) sustainable agriculture and food production; and (v) biodiversity. It will be supported by the European Commission's Economic and Investment Plan for the Western Balkans, which was adopted in 2020.

Figure 40. There are vast opportunities for making Albania's growth model greener.



Source: Yale Environmental Performance Index 2020. *

Figure 41. Albania's environmental protection budget is lower than that of regional peers, except for Kosovo.



Source: IMF GFS 2019.

81. Despite progress, more needs to be done to translate commitments into action on the ground. Albania lacks a national strategy for green growth, and no national policy document specifically refers to the green economy as a policy target.⁹⁴ Limited public finance dedicated to environmental protection as well as constrained institutional capacity are persistent constraints to achieving the Sustainable Development Goals. For example, while Albania's expenditure on environmental protection increased fivefold over the last 10 years, it was less than 0.2 percent of GDP in 2019, about four times lower than the average expenditure of green growth leaders in the STEE7.

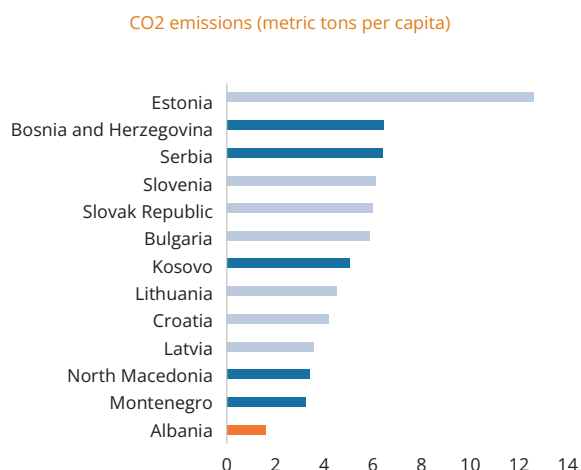
82. Albania's GHG emissions are low relative to regional peers, although further government action is needed to meet its international climate change commitments. Nearly all of Albania's electricity production is generated by hydropower, and there is limited heavy manufacturing, resulting in lower total and per capita GHG emissions relative to regional peers (Figure 42). However, road traffic, inefficient heating systems (including the burning of firewood and outdated boilers), and agricultural activity are all significant GHG contributors that need to be tackled. Rising incomes are likely to also put further pressure on emissions. In this context, climate action by both the government and the private sector is needed to meet Albania's NDC targets. In July 2019, Albania adopted the National Strategy on Climate Change for 2019–2030, with objectives to be achieved by 2050. The strategy focuses on energy, transport, agriculture, land use, and forestry. However, as noted in EU Accession Reports, Albania needs to take further steps to meet its climate change commitments if it is come closer to EU accession, as the EU has set new climate targets to achieve carbon neutrality by 2050 under the EGD.

* A value closer to 100 indicates better performance relative to other countries.

⁹³ Submitted on 12 October 2021. Available at: <https://www4.unfccc.int/>.

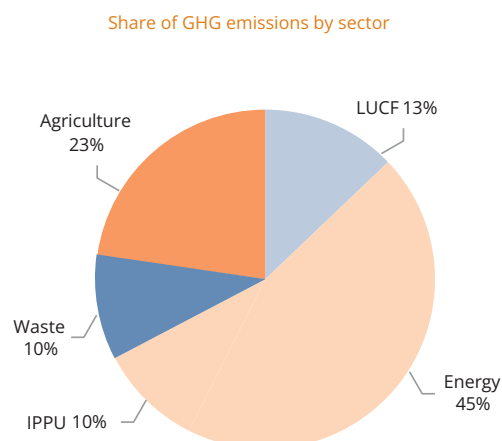
⁹⁴ UNECE. 2018. Albania Third Environmental Performance Review.

Figure 42. Albania's GHG emissions per capita are lower than those of regional peers.



Source: WDI 2016 (latest year).

Figure 43. Tackling GHG emissions will require policy action across a broad range of sectors.



Source: Albania revised nationally determined contribution 2021(2016 data).
 Note: FOLU = Forestry and Other Land Use; IPPU = Industrial Processes and Product Use.

83. Albania's GHG profile is dominated by emissions from energy consumption, especially of petroleum products used in the transport and industrial sector.

About half of all GHG emissions in the energy sector originate from the transport industry, followed by the manufacturing industry. The country's energy supply is dominated by crude oil (including liquefied petroleum gas), which makes up about 62 percent of the - total, followed by hydroelectric power at 24 percent and biofuels (mainly fuelwood for residential heating and cooking) at 10 percent, with natural gas (mostly used in industrial activities) and other renewables representing the remaining sources of energy. Electricity generation, on the other hand, relies almost exclusively on hydropower (98 percent), making the country highly vulnerable to climate change and undermining its energy security, particularly during dry spells in the summer months. Despite the still untapped potential of hydropower (only 50 percent of the country's hydropower potential is currently used), the current availability of electric power generation is insufficient to cover the country's electricity needs during dry periods, with imports supplementing 10–40 percent of the country's electricity demand annually. Furthermore, electricity losses in the transmission and distribution network represent about 22 percent of the annual electricity supply (both domestic and imported).⁹⁵ Albania's share of energy from renewable sources is much higher than the EU average: in 2019, the average share was 18.9 percent in the EU-28, much lower than 36.7 percent in Albania.⁹⁶ The share of electricity generated from renewable sources (as a percentage of gross electricity consumption) was even higher, at 88.5 percent compared to 34.1 percent for the EU-28. At the national level, Albania has also developed and adopted the National Energy Strategy for 2018–2030, the National Renewable Energy Action Plan for 2018–2020, the Law on Energy Efficiency in 2015, and the National Energy Efficiency Action Plan for 2017–2020, while the National Energy and Climate Plan is under preparation.

84. Diversifying Albania's energy supply with alternative clean sources and increasing energy efficiency would both improve the country's energy security and contribute toward climate neutrality goals.

Increasing the use of renewable sources of energy, other than hydropower, would reduce Albania's vulnerability of being dependent on a single source of energy that does not guarantee a constant supply of electricity. While progress on diversifying the energy supply has been slow, it is gaining momentum following a successful tender for a 140 MW solar power plant in mid-2020. Given that Albania is a net importer of electricity, which contributes to its substantial trade imbalance, investments in energy efficiency (on both the supply and demand side) would reduce the country's energy vulnerability. Coupled with the adoption of sound social and environmental standards, tapping into the country's other renewable energy sources could also contribute toward achieving a more secure and sustainable energy supply. In addition, the recent completion of the Trans-Adriatic Pipeline has provided the country with direct access to natural gas, further increasing the availability of a relatively

⁹⁵ UNECE Third Environmental Performance Review of Albania 2018.

⁹⁶ EUROSTAT, 2020. Renewable energy statistics. Available at: <https://ec.europa.eu/eurostat/>.

clean primary fuel (especially compared to distillate from crude oil and wood, Albania's most common primary fuel). However, tapping into this new source of energy would require a careful selection of users of natural gas (e.g., electricity generators and industrial applications) and targeted investments in the natural gas network to avoid stranding natural gas assets.

85. The transport sector is of particular importance for a greener and more sustainable Albania. EUROSTAT data from 2019 show that the relative share of transport in final energy consumption is - higher in Albania (40.2 percent) than in the EU⁹⁷ (29.4 percent) and the highest in the Western Balkans, resulting in transportation representing a significant share of the country's overall GHG emissions (60 percent of the total in 2014).⁹⁸ As a candidate country for EU accession, Albania has implemented a range of initiatives in the transport sector focusing on aligning Albania's legal framework with the EU acquis, resulting in an increase in FDI over the recent years.

86. Albania needs to take steps to ensure its transport sector is on a more resilient low-carbon development trajectory. The dominance of road transport among the different possible transport modes significantly contributes to the emissions of GHGs and other air pollutants in the country. Road transport makes up 99 percent of the volume of inland freight and passenger transport in Albania, followed by rail transport at 1 percent (and declining).⁹⁹ Furthermore, road transport represents 86 percent of all GHG emissions in the transport sector. Even though railway transport is more environmentally friendly than road transport, improvements in the rehabilitation, performance, safety, and competitiveness of the railway network are lagging. There is also a need to enhance multi-modal facilities and optimize logistics infrastructure, as seen by a significant deterioration in its Logistics Performance Index scores and rank compared to 2012.¹⁰⁰ Setting the country on a low-carbon urban mobility trajectory and tackling congestion in cities requires a shift to more sustainable modes of transport. This could be achieved through significant investment in urban mobility systems to improve the efficiency, quality, and coverage of public transport infrastructure, bicycle lanes, and footpaths. Motorization is also becoming an increasing challenge, as the country's car fleet increased by 29 percent between 2015 and 2019 (from 170 to 220 vehicles per 1,000 population). This has resulted in significant congestion, spatial consumption, and air quality deterioration in cities, in addition to increased GHG emissions. Furthermore, 60 percent of newly registered cars that enter the Albanian market are used, a sign of Albania's aging — and therefore more polluting — vehicle fleet. In this context, investments need to be coupled with an update to green policy instruments associated with motorization management.

Box 10. The EU's Green Deal and Carbon Border Adjustment Mechanism

Building on the Paris Agreement and the Sustainable Development Goals, the EU introduced the EGD¹⁰¹ on December 1, 2019, to achieve climate neutrality by 2050. Recognizing the challenges associated with the decarbonization of the European economy, the EGD is the compass that will guide the climate actions of governments, non-governmental organizations, and businesses in the EU. It offers a comprehensive framework for decarbonizing the EU economy, reducing pollution and waste, and placing sustainable development at the center of the European policy agenda. Albania needs to ready its economy for the EGD. The EGD will result in a transition that is likely to create significant additional costs for EU businesses. To avoid a transfer of economic activity to businesses outside the EU not subject to the EGD (which would undermine the EU's objective to reduce GHG emissions while hurting the EU economy), the EU is planning to introduce a Carbon Border Adjustment Mechanism (CBAM) that would effectively tax the import of carbon-intensive goods (if they are not subject to domestic carbon pricing schemes). The EU CBAM is the first tangible manifestation of the costs that could be faced by potential importers of selected goods from the most emission intensive and trade exposed sectors covered by the EU's Emissions Trading System (EU ETS), such as electricity, cement, fertilizers, steel, and aluminum.

⁹⁷ EUROSTAT, 2021. *Enlargement countries – energy statistics*. Available at: <https://ec.europa.eu/eurostat/>.

⁹⁸ World Bank Database, based on IEA data, <https://data.worldbank.org/indicator/EN.CO2.TRAN.ZS?locations=AL>.

⁹⁹ UNECE *Third Environmental Performance Review of Albania 2018*.

¹⁰⁰ World Bank *Logistics Performance Index*. Available at: <https://lpi.worldbank.org/>.

¹⁰¹ European Commission. "A European Green Deal." https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal_en.

The proposal stipulates that, from 2026, EU importers of these goods will be required to buy carbon certificates corresponding to the carbon price that would have been paid, had the goods been produced in the EU under the EU ETS. The price of these certificates will gradually approach full EU ETS price over 10 years, as free allowances in the EU are phased out by 10 percent a year. Once non-EU producers show that they have already paid for the carbon used in the production of the imported goods, the corresponding cost can be fully deducted for the EU importer. Since the EU is the largest trading partner for Albania, the CBAM is expected to eventually affect the terms of trade for carbon-intensive goods exported to the EU, unless the country levy comparable carbon pricing to producers at home.

The current CBAM proposal covers only direct emissions of carbon from the production processes of the selected goods. Going forward, however, the EU is likely to expand the CBAM to cover more sectors and more products after 2030. In the future, import tariffs could also cover emissions from electricity and heat used during production and eventually all emissions in the value chain of exporting companies, thus having a decisive impact on the country's competitiveness.

Before the full compliance with EU environmental acquis, interim incentives will be needed to attract investors in modern green assets and prevent further accumulation of brown assets. Fiscal policy will be central to making green investments attractive in the short term. Together with expected future compliance with EU laws, it would prevent further accumulation of polluting assets. The key will be to correct often distorted prices for goods to ensure that they convey incentives to reduce carbon emissions, and air and water pollution as well as enhance the sustainable use of natural resources. Excise taxes on polluting fuels and products provide the most obvious avenue for aligning fiscal incentives with green transition aspirations. Combined with explicit taxation of carbon emissions and local pollution, such a fiscal reform, would align national tax policy with incentives to implement EU environmental legislation and help negotiate a reduced CBAM and facilitate access to EU markets.

While most countries in the Western Balkans maintained relatively high reliance of exports from carbon-intensive sectors in the last decade, suggesting exposure to the low-carbon transition risk, Albania has made a major shift away from carbon-intensive exports—from 60 percent in 2013 to just 10 percent of total exports in 2019. Albania is also the only country in the Western Balkans that reduced the absolute value of exports from carbon intensive sectors in constant USD. This hedges the risk of the EU CBAM and other potential future “green” barriers to foreign market access.¹⁰² While some carbon-intensive Albanian industries may still face higher costs when exporting to the EU, there are also opportunities for the country's hydropower sector. If the CBAM eventually considers the source of domestic energy production, Albania's predominant hydropower sector could lower the import costs of electricity-intensive goods produced in Albania relative to regional peer countries—giving Albania a competitive advantage. To mitigate risks and take advantage of the opportunities posed by the CBAM, Albania needs to closely monitor how the EU ultimately chooses to implement the CBAM, evaluating what it means for the country and how the government could help businesses to navigate the transition period.

Table 10.1. Energy Excise Taxes in the Western Balkans and Selected EU Countries Compared to Proposed ETD Tax Rates

	Albania	Bosnia and Herzegovina*	Kosovo	Montenegro	North Macedonia	Serbia	Old ETD	New ETD proposal
Unleaded petrol €/liter	0.301	0.383	0.385	0.549	0.352	0.492	0.359 (10.53 €/GJ)	10.75 € per GJ
Diesel as a motor fuel €/liter	0.301	0.357	0.36	0.44	0.294	0.506	0.330 (8.55 €/GJ)	10.75 € per GJ

¹⁰² World Bank, 2021. *Western Balkans Regular Economic Report No.20. Greening the Recovery*. Washington D.C.

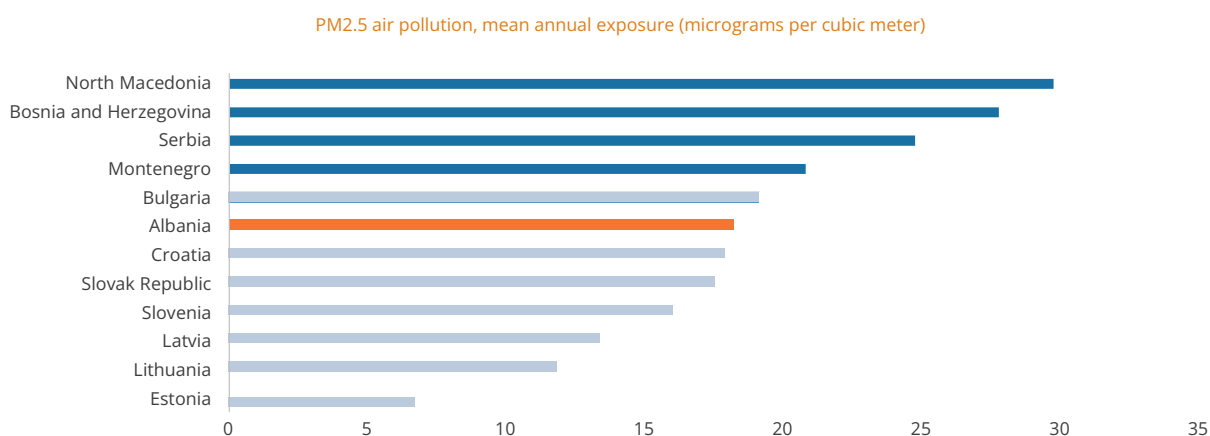
Diesel heating (non-business) €/liter	..	0.230	0.36.	0.207	0.102	0.066	0.021 (0.54 €/Gj)	0.9 € per Gj
Natural gas as a motor fuel €/Gj	0.065	0.230	0.150	0	0	0.216	2.6	7.17
Natural gas for heating and electricity (for business) €/Gj	0.065	0.230	0.150	0	0	0	0.15	0.6 €
Natural gas for heating and electricity (for non-business) €/Gj	0.065	0.204	0.150	0	0	0.056	0.3	0.6
Coal and coke (for business) €/Gj	0	0	0	0.3	0	0	0.15	0.9
Coal and coke (for non-business) €/Gj	0	0	0	0.3	0	0	0.3	0.9

Source: World Bank staff calculations, based on data from European Commission Ministries of Finance.

Note: *includes road fees; Gj=gigajoule.

87. Despite improvements in air quality in recent years, air pollution still poses a significant health risk to Albanian citizens, causing some 1,855 deaths annually.¹⁰³ Although air pollution in Albania is lower than in Western Balkan peers (Figure 44), urban areas such as Tirana, Elbasan, and Korçë are particularly affected. Key sources of air pollution include production processes and combustion plants, domestic heating, commercial and residential construction, and the increasing number of (old) vehicles in urban centers. Data from 2017 indicate that Albania's annual mean concentration of PM2.5 is 18.2 µg/m³, which exceeds the recommended maximum level of 10 µg/m³. For PM10, the average annual value for 2012 was 221 µg/m³, more than five times higher than the annual limit of 40 µg/m³.

Figure 44. Albania's air pollution is elevated but lower than that of Western Balkan peers.



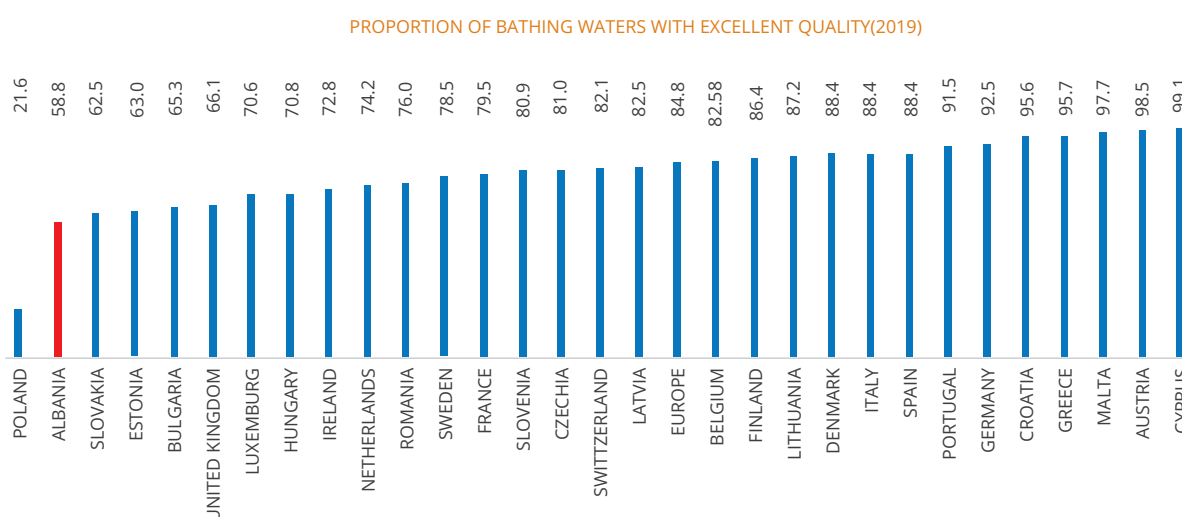
Source: WDI Database (latest year available).

¹⁰³ WHO, 2021. Global Health Observatory data repository.

88. Albanian authorities need access to better data on air quality to create informed strategies and policies. The current network for air quality monitoring does not provide an accurate picture of air quality and the health impacts of air pollution. There are too few monitoring stations, and the existing stations are often inaccurately positioned and have neither been properly maintained nor calibrated due to lack of funding,¹⁰⁴ with all of the country's monitoring stations reported as being turned off in 2020.¹⁰⁵ As a result, information on air pollution is limited, outdated, and largely inaccessible. In addition, the national air quality strategy of 2014 has not yet been implemented, and air quality plans for the most sensitive areas have not been prepared.

89. Despite recent progress in water resources management, there is insufficient monitoring of water quality, and water supply and sewerage services are inadequate. Albania has adopted a holistic strategy for water resources (involving a river basin administration, a water cadastre, and multi-sectoral support services) and created the Water Resource Management Agency to manage the country's water resources. However, the newly created water utilities managed by municipalities following the territorial reorganization (which replaced water user associations) have low capacity and few resources. Most of Albania's rivers are polluted in their middle or lower reaches. Available monitoring data and assessment criteria do not yet allow for a comprehensive assessment of the environmental state of water bodies that have not been identified, delineated, and characterized in accordance with the EU Water Framework Directive. More efforts are needed to complete, adopt, and implement pending river basin management plans. While the country has started to monitor the quality of bathing water, it is still at the initial stage in terms of profiling bathing water, monitoring cyanobacterial risks, and ensuring public participation. Despite continuous progress in improving the quality of bathing water, Albania still ranked second-to-last in bathing waters with excellent quality in Europe in 2019, according to the latest report of the European Environment Agency (Figure 45). There is also a lack of investment in water supply and sanitation. The country's water supply network is old and depleted, small water supply systems in rural areas are not integrated, and utilities have financial deficits, leading to large water revenue losses. The level of non-revenue water¹⁰⁶ on average was 64 percent in 2019, much higher than the average of 20 percent in the EU. More investments are needed to expand the sewage network and wastewater treatment to cover a higher share of the population and bridge the urban-rural divide. Irrigation and drainage services are also inadequate because of lack of funding for investments and insufficient coordination between the municipality, the line ministry, and regional irrigation and drainage departments.

Figure 45. Proportion of Bathing Water with Excellent Quality in Europe in 2019.



Source: WDI Database (latest year available).

¹⁰⁴ UNECE Third Environmental Performance Review of Albania 2018.

¹⁰⁵ European Commission Staff Working Document, 2020. Albania 2020 Report accompanying the 2020 Communication on EU Enlargement Policy.

¹⁰⁶ Non-revenue water is water that has been produced but lost before it reaches the customer.

90. Recognizing that waste management is a priority for the sustainable development of tourism and agriculture, Albania has strengthened the legal framework by aligning it with the EU acquis, although the implementation and enforcement of legislation on waste management needs strengthening.

Albania has been found to hold among the highest shares of mismanaged waste stream in the Mediterranean (73 percent), after Montenegro (95 percent) and Egypt (93 percent), followed by Libya (64 percent).¹⁰⁷ Currently, there are several legal and economic instruments in place to regulate, fund, and incentivize waste management efforts, including to protect the marine environment.¹⁰⁸ The new 2020–2035 national strategy for integrated waste management aims to incorporate circular economy principles into the national waste management system. Still, about 30 percent of the population is not serviced by waste management infrastructure, encouraging waste disposal in landfills or old dumpsites. Waste is often dumped illegally in rivers or lakes—ultimately polluting Albania’s waterways and coast. The construction of new incinerators also poses concerns in terms of compliance with the EU waste acquis, including the waste hierarchy principle and recycling targets.¹⁰⁹

91. Plastic waste in particular causes significant damage to Albania’s blue economy prospects such as coastal tourism and fisheries.

¹¹⁰ The Mediterranean Sea has amongst the highest levels of marine plastic pollution in the world, containing only 1 percent of the world’s waters and 7 percent of global microplastics,¹¹¹ with plastic being the most common type of litter found on its sea surface and floor. The issue is also becoming a growing problem within the Adriatic and Ionian Seas, as indicated by several recent beach survey studies which found that about 90 percent of marine litter items were made from plastic material, with more than half of it originating from shoreline sources, including poor waste management practices, tourism, and recreational activities,¹¹² with similar levels found in Albanian beaches.¹¹³ The potential impact of marine litter on coastal municipalities includes: (i) loss of amenity value and direct economic costs from public health risks; (ii) reduced recreational opportunities; (iii) negative publicity and reputation; and (iv) costs related to beach cleaning and waste collection and disposal. With 60 percent of the Albanian population living in coastal areas, the effects of intensive construction, growing coastal tourism, and inadequate waste management could lead to a deterioration in the quality of the coastal and marine environment. As the Albanian coastal economy continues to grow, it is vital to find ways to reduce plastic pollution and improving the solid waste management system, which can affect the performance of marine-based sectors, such as tourism, fisheries, and shipping, and cause a loss of valuable resources. Recycling triage at the source, deposit refund schemes, universal coverage of waste collection, waste treatment services, increased monitoring, and more waste pollution clean-up operations are all integral measures to ultimately reduce waste generation upstream, ensure waste is managed on land, and transition toward a circular economy.

92. Weak implementation and enforcement of waste management regulations is related to limited institutional capacity, lack of financial resources, and the absence of consistent data.

While the whole country needs to be covered by the solid waste management system, Albania lacks the financing to maintain the level of infrastructure needed for proper waste management, while there is also currently no penalty for dumping. Waste management in Albania is a municipal function, funded mainly by revenues generated from waste fees. The available funding covers mainly operational and maintenance costs, while the necessary capital investments are left unfunded. The low affordability of waste fees, low fee collection rates, and a lack of extended producer responsibility schemes¹¹⁴ result in limited revenues generated through these fees. The cost recovery of municipal waste management services at the national level is 73 percent, which reduces the willingness to further invest in waste infrastructure.

¹⁰⁷ WWF (World Wildlife Fund), 2019. *Stop the Flood of Plastic. How Mediterranean Countries Can Save their Sea.*

¹⁰⁸ These include a city cleaning fee, a port reception fee for waste, a landfill fee, a plastic bag fee, and a tax on plastic packaging and materials. For the protection of the marine environment from discarded waste, these include provisions for criminal offences for mismanaged waste and discharges into water. Examples of restrictive policy measures include the 2018 ban of lightweight plastic carrier bags and all kinds of non-biodegradable plastic carrier bags, and the total ban of all kinds of plastic bags (lightweight plastic carrier bags, very lightweight plastic carrier bags, and oxo-degradable or oxo-biodegradable plastic carrier bags), expected to enter into force on June 1, 2022.

¹⁰⁹ European Commission Staff Working Document, 2021. *Albania 2021 Report accompanying the 2021 Communication on EU Enlargement Policy.*

¹¹⁰ World Bank, 2020. *Realizing the Blue Economy Potential in Albania.* Washington, D.C.

¹¹¹ WWF, 2018. *Out of the plastic trap. Saving the Mediterranean from plastic pollution.*

¹¹² Vlachogianni et al., 2018. *Marine Litter on the Beaches of the Adriatic and Ionian Seas: An Assessment of their Abundance, Composition and Sources.* *Marine Pollution Bulletin* 131.

¹¹³ Gjyli, L., et al., 2020. *Marine litter on the Albanian coastline: baseline information for improved management.* *Ocean and Coastal Management* 187.

¹¹⁴ Extended producer responsibility involves adding all environmental costs associated with a product to its final market price.

93. Promoting the development of an environmentally, economically, and socially sustainable agri-food industry is a significant challenge for Albania. In 2019, primary production represented nearly 19 percent of GDP and 40 percent of national employment, while around 40 percent of the population lived in rural areas, with most of them working in agriculture. World Bank estimates¹¹⁵ show that agri-food is directly and indirectly responsible for almost half of economy-wide jobs in Albania. However, the sector has been facing several sustainability challenges. Agriculture is characterized by structural weaknesses, such as fragmented production structures, low productivity, and land tenure insecurity, which impede investments in technology upgrading and competitiveness. For example, farm production is mainly driven by subsistence needs, as the agri-food trade deficit remains stable, despite progress observed over the last decade in terms of increasing agricultural exports. Rural poverty has been persistent, with rural-urban disparities widening and a trend of rural depopulation in recent years.¹¹⁶ The natural resources sector has been unsustainably managed, with intensive production practices and a lack of know-how and technically qualified human capital undermining the sector's economic and environmental performance. There is very little investment in environmental protection, and production and income risk management and production insurance mechanisms are undeveloped.¹¹⁷ Moreover, intensive forestry and agricultural practices have led to severe erosion, particularly in remote uphill areas, while agriculture is considered the most climate-sensitive of all the country's economic sectors.¹¹⁸ Seasonal temperature and precipitation patterns are expected to become more volatile, with major implications for crop and livestock production patterns. Climate change also poses significant economic and social risks, given the large share of the Albanian population living in rural areas and depending on agriculture.

94. Considering the country's EU accession ambition, a decisive policy response is necessary to develop a competitive agri-food industry that has environmental and societal benefits. The country has implemented important institutional reforms in the agriculture sector, such as restructuring the Ministry of Agriculture and Rural Development, and adopting the National Agriculture and Rural Development Strategy 2014–2020 (for both direct support and rural development). However, agricultural public expenditure averaged only 0.27 percent of GDP in Albania between 2010 and 2017, lower than the EU average of 0.72 percent of GDP and the average of many regional peers (e.g., 1.27 percent of GDP in North Macedonia, and 0.51 percent of GDP in Bosnia and Herzegovina). Capital availability remains low, and smallholders have very limited access to credit, inputs, and output markets. Both rural development measures (which attract the bulk of agricultural public expenditure and mainly focus on farm competitiveness) and direct payments remain focused on production. Also, extension services and knowledge transfer mechanisms are underdeveloped in the agriculture sector, which is already characterized by a low-skilled workforce and modernization deficits.

95. There is considerable room for improvement in terms of achieving environmental goals in the agriculture sector, aligning with EGD priorities, and pursuing the country's green growth ambitions. As in the case of other Western Balkan countries, this issue has been overshadowed in Albania by production- and income-related sectoral issues. In a new policy framework, direct payments should be made conditional on good agricultural and environmental practices and not linked to intensification. While the country's rural development policy has supported the development of irrigation infrastructure, it should also focus on agri-environment, organic farming, and areas facing natural constraints. Also, future policies should directly address climate change, which could be done by: (i) investing in renewable energy production and technologies as well as emissions reduction and adaptation; (ii) improving institutional capacity; and (iii) investing in infrastructure, support services, and on-farm improvements. In terms of climate change, adaptation is key to the future of agriculture, including utilizing barriers to protect arable land from soil erosion; introducing drip irrigation and modernizing existing systems; planting native crops that would be resistant to changes in climate; and improving field and soil management, including minimum tillage and contour cropping to slopes.¹¹⁹ Moreover, Albania needs to do more to align with the EU's key water directives and policy enforcement to protect the environment.¹²⁰ Finally, to ensure the sustainable development of rural areas, the authorities should consider adopting the LEADER¹²¹ approach, modernizing farm physical assets, diversifying the economy, and pursuing rural infrastructure measures under the IPARD.

¹¹⁵ World Bank 2018. *Exploring the Potential of Agriculture in the Western Balkans: A Regional Report*.

¹¹⁶ JRC 2019. *Agricultural Policy Developments and EU Approximation Process in the Western Balkan Countries*.

¹¹⁷ JRC 2016. *Analysis of the Agricultural and Rural Development Policies of the Western Balkan Countries*.

¹¹⁸ World Bank 2018. *Exploring the Potential of Agriculture in the Western Balkans: A Regional Report*.

¹¹⁹ World Bank, 2015. *Country Partnership Framework for Albania 2015 – 2019*.

¹²⁰ European Commission 2020

¹²¹ *Links between Actions of Rural Development (Liaison entre actions de développement de l'économie rurale, LEADER) is designed as a separate axis of the EU Rural Development Program. It aims to mobilize and deliver rural development by encouraging local and innovative solutions rather than implementing a fixed set of measures. LEADER has proven to be an effective mechanism to drive local development.*

96. Institutional capacity building and modernization is essential to promote a sustainable agriculture sector in Albania. A multi-dimensional agricultural policy requires a well-functioning agricultural knowledge and information system that can address both short-term income objectives and longer-term sustainability objectives through the development and transfer of knowledge. Agricultural research and extension services should be reoriented toward a demand-driven and problem-solving agenda, and they need to receive more financial support. Both research and extension services should adopt a comprehensive approach to avoid trade-offs between various policy objectives (e.g., maintaining or increasing productivity together with ecosystem services). Private-public partnerships could be used to improve the effectiveness of advisory services, and the government should consider developing administrative capacity and instruments to implement its agricultural policy (e.g., an integrated administration and control system, a land parcel identification system, registers, etc.), along with evidence-based policy support to improve policy efficacy. Moreover, the authorities need to pursue land reform to address problems caused by the weak definition of ownership rights and the dysfunctional land market. Finally, building and/or strengthening farmers' production groups and cooperatives could help with the transformation of a fragmented agriculture sector dominated by small plots. These groups and cooperatives can play a critical role in linking smallholder farmers to finance, inputs, and output markets and promote investments aimed at improving both competitiveness and environmental sustainability.

97. Biodiversity conservation and the sustainable management of natural resources are hampered by weak local capacity following the transfer of forest and pasture management responsibilities to municipalities. One of the main priorities of the government over recent years has been the designation of new protected areas. Albania has 800 protected areas covering more than 16 percent of its national territory, with a target of reaching 17 percent as per the Aichi target of the Convention on Biological Diversity, according to the National Biodiversity Strategy and Action Plan. Although management plans have been developed for several protected areas, their implementation remains weak due to financial constraints of the National Protected Areas Agency, which is due to be improved through the recently created Special Fund for Protected Areas. Enhancing the protection of fragile ecosystems will also require strengthening enforcement of related legislation as environmental crimes are on the rise, and stricter application of environmental and strategic impact assessments (including cumulative impacts) for key sectors such as hydropower, transport, mining, tourism, and mining. As a result of natural resource degradation in recent years, the government has imposed strict moratoriums on hunting and logging since 2014 and 2016, respectively, with the exception of fuelwood used by local communities. Despite these efforts, the results of the most recent National Forest Inventory show that the share of Albania's territory covered by forests fell from 52.0 percent in 2004 to 45.7 percent in 2019.¹²² Overbuilding, land fragmentation, and high use of firewood for cooking and heating have all contributed to forest loss and degradation. An ongoing reform aims to clarify responsibilities for natural resource management across different authorities, including devolving ownership and management responsibilities for forests and pastures to municipal governments. However, while the reform holds the promise of strengthening the sustainability of forest management, municipalities face difficulties in meeting their new responsibilities and establishing competent forest management structures, with a considerable number of municipal forest offices being thinly resourced in terms of office facilities and staffing. Fire protection is a completely new function of local governments, which has been decentralized with no prior analysis of local capability to fulfill this function. The lack of financial and technical capacities for natural resource management at the municipal level increases the risk of further degradation of already overexploited forest and pasture areas. Therefore, it is crucial to fully operationalize the new framework for natural resource management, ensuring that all actors can meet their responsibilities under the new governance structure.

98. Albania's highly productive yet fragile coastal and marine ecosystems are under increasing pressure from unplanned urban development, pollution, and climate change. Albania's coastline lies within the Mediterranean biogeographical region, a global biodiversity hotspot supporting unique ecosystems. It hosts many wetland ecosystems, including three Ramsar sites of international importance that support the migration routes of wild fauna. Coastal lagoons and lakes cover an area of 10,600 hectares and serve as shelter for a wide range of aquatic life, fish, and wild birds, as well as attraction points for nature-based tourism. However, Albania's unplanned coastal development and intensive construction over the years have led to unmanaged waste disposal and lack of proper wastewater treatment facilities. The EU has pointed to the current policy gaps in marine and coastal management and has called for

¹²² Albanian National Forestry Inventory 2004 and 2019.

policies to manage fisheries and solid and water waste to reduce marine pollution. Albania has made progress in reforming fisheries management to meet the EU Acquis by implementing the Fisheries Strategy adopted in 2016, amending the Fisheries Law in 2019 and creating a directorate for fishery services, but more needs to be done with regards to small-scale fisheries. Adopting a “Blue Economy” development plan would enhance the sustainability of coastal and marine activities and address related environmental challenges.

Box 11. Realizing Albania’s Blue Economy Potential¹²³

The Blue Economy seeks to promote economic growth, social inclusion, and the preservation or improvement of livelihoods while at the same time ensuring environmental sustainability of the oceans and coastal areas.¹²⁴ With a coastline of 467 km along the Adriatic-Ionian Sea and a maritime economic zone equal to 40 percent of the country’s territory, Albania’s Blue Economy potential remains significantly untapped. Well-established marine-based economic sectors such as fisheries and coastal tourism could offer significant opportunities for Albania to achieve its national development goals, increase resource productivity, and contribute to green, inclusive, and resilient growth and job creation.

Expanding fishing and tourism would contribute to sustainable and spatially inclusive growth. The fisheries sector currently accounts for only 0.2 percent of GDP and is worth an estimated US\$22 million, mainly from marine capture fisheries, while aquaculture is worth around US\$8 million and mussel production about US\$10 million (INSTAT 2014). Both domestic and export demand can be expected to increase in the future, but the fisheries sector currently faces an uncontrolled, overexploitation of the fish stock and low productivity. Meanwhile, the World Travel and Tourism Council forecasts that tourism in Albania could generate US\$2 billion by 2028, but this will depend on the country’s ability to maintain a pristine coast, connect coastal and maritime-based tourism with offerings inland, attract more higher-spending environmentally and socially conscientious tourists, and further develop the tourism industry in a sustainable way.

Competing demands from multiple users in the coastal and marine space have resulted in suboptimal development or missed economic opportunities while imposing multiple stresses on finite coastal systems and resources. These include increasing demand for land and unregulated land use, poor environmental management of public spaces like beaches, urban development without adequate waste treatment facilities, and unattended pollution. A Blue Economy development approach could help to address these challenges by contributing to the health of marine resources and strengthening coastal resilience, reducing pollution, and promoting sustainable investments along the coastline. Guided by this vision, the Albanian government is preparing a National Blue Economy Program aimed at transforming Albania’s coastline into an engine of sustainable and inclusive development.

To protect natural resources and promote a green recovery, the authorities should consider:

- **Diversifying the sources of energy with sustainable alternatives.** This includes: (i) diversifying electricity production by tapping into other sources of renewable energy, particularly solar and wind; (ii) investing in the natural gas network, particularly for electricity generation and larger-scale industrial or commercial applications; and (iii) participating in initiatives to strengthen a well-functioning regional energy market.
- **Improving energy efficiency.** This includes: (i) continuing investments aimed at reducing electricity losses in transmission and distribution power grids; and (ii) promoting energy efficient measures and incentives, particularly in the building, power, and industrial sectors, which could involve a robust enforcement of energy performance standards

¹²³ World Bank, 2020. *Realizing the Blue Economy Potential in Albania*. Washington, D.C.

¹²⁴ World Bank and United Nations Department of Economic and Social Affairs 2017.

for buildings (e.g., by promoting the role of private and public energy service managers) as well as raising and enforcing electrical appliance standards.

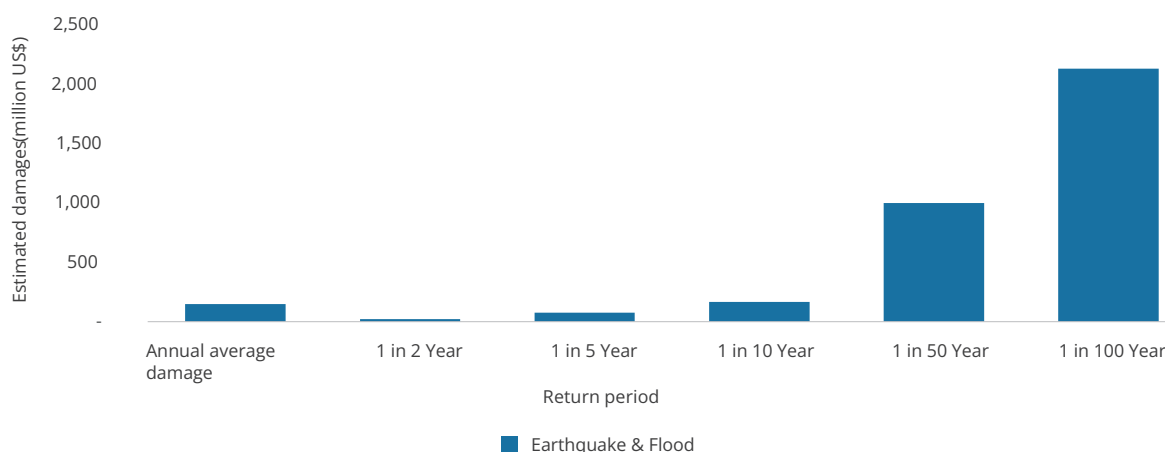
- **Adopting measures aimed at greening the transport sector.** This includes: (i) investing in green urban mobility to support clean and livable cities, which could be done by improving the efficiency, quality, and coverage of public transport systems, bicycle lanes, and footpaths as well as enhancing traffic management systems; (ii) updating the policy and regulatory framework to set incentives for greener motorization management (with a particular emphasis on vehicle emission standards and excises, fuel excise taxes, and inspection and importation practices) and creating an enabling environment for electric mobility; (iii) developing multi-modal transport and logistics infrastructure in select high-volume corridors, including investments in rail and road connectivity to ports (e.g., Tirana-Durres) for both passengers and freight; and (iv) strengthening the resilience of the transport system to address key vulnerabilities related to climate change and natural disasters, as well as creating sustainable funding mechanisms to sustain good state of repair.
- **Implementing measures to reduce and better monitor air pollution.** This includes: (i) raising public awareness on air quality by, for example, using an air quality index; (ii) improving the functionality of the air quality monitoring system to facilitate a transparent, comprehensive, and timely analysis of air quality by, for example, increasing the number of correctly positioned measuring stations and ensuring sufficient funding for their maintenance and calibration; and (iii) using more accurate data on air quality to develop and implement strategic air quality plans, both nationally and in areas most sensitive to air pollution.
- **Improving the quality of the water supply.** This includes: (i) enhancing water quality monitoring and reporting systems to ensure they are fully functional and aligned with EU requirements; (ii) completing, adopting, and implementing pending river basin management plans in line with the EU Water Framework Directive; (iii) implementing the national strategy for water supply and sewerage (including increasing the financial and technical capacity of national and local agencies) to expand the coverage of water supply and sanitation services across the country; and (iv) investing in the infrastructure needed to improve the quality of bathing water.
- **Reducing waste generation upstream and transitioning toward a circular economy.** This includes: (i) passing legislation on extended producer responsibility, ensuring that producers are liable for waste generated through consumption, (ii) implementing a ban on single-use plastics to curb plastic waste, (iii) encouraging recycling triage at the source; (iv) incentivizing deposit refund schemes; (v) extending waste collection and treatment services to all Albanians; (vi) enhancing the monitoring of waste pollution levels; and (vii) expanding waste pollution clean-up operations.
- **Accelerating sustainable agricultural growth.** This includes: (i) increasing and improving the targeting of agricultural public expenditure, including investments in extension services and infrastructure; and (ii) strengthening farmer associations and cooperatives, as both can be key vehicles for consolidating fragmented production, linking smallholders to finance, and promoting sustainable farming practices in line with the country's green growth ambition and the EGD.
- **Strengthening the sustainable use of natural resources and the stewardship of the environment.** A successful strategy to address these issues would require: (i) ensuring financing and effective implementation of protected areas management plans; (ii) strengthening the enforcement of environmental legislation, including environmental and strategic impact assessments for key sectors; (iii) strengthening municipal capacity for natural resource management, particularly for forests and pastures, as most of these functions are now municipal responsibilities, including funding, staffing, training, and authority to collect fines; (iv) completing the transfer and registration of pending forest and pasture lands to municipal authorities while considering capacity criteria; (v) completing the development and adoption of forest and pasture management plans for all municipalities; (vi) adopting and implementing a blue

economy development plan for coastal development that would ensure the sustainability of coastal and marine activities and address environmental challenges to avoid a rapid resource degradation from pollution, overfishing, and over-construction on the seashore.

Reinforcing Resilience against Disasters

99. The last two years reinforced how vulnerable Albania is to disasters. In November 2019, Albania was struck by a 6.3-magnitude earthquake, killing 51 and displacing 17,000 people. Damages to physical assets and losses were equivalent to an estimated 7.5 percent of GDP.¹²⁵ In March 2020, Albania was forced to take unprecedented public health measures to slow the spread of the global COVID-19 pandemic. By September 30, 2021, Albania reported almost 170,000 confirmed cases and 2,685 confirmed deaths.¹²⁶ The economy was hit hard by the pandemic in early 2020 when it was still reeling from the earthquake four months earlier. The COVID-19 crisis has increased Albania’s vulnerability to disasters by, for example, exacerbating poverty and eroding the government’s contingency reserves and fiscal space.

Figure 46. Modeled Risk Profile from the Combined Risk of Earthquakes and Floods in Albania.



Source: Risk profile is from AIR Worldwide’s catastrophe models for Earthquake and Flood in Albania.

Note: Damages to public assets are estimated to contribute 20–30 percent on top of commercial, industrial, and residential asset damages provided through the AIR Worldwide model. Values were provided in ALL, converted to US\$ using the US\$ to ALL exchange rate of 1 to 102.5. Index factors have been applied and all reported values reflect 2020 estimates. The return period is the time period over which one should expect to see a loss of the same or greater magnitude. For example, a 1-in-10-year return period refers to losses that are expected to be exceeded once per 10 years (i.e., in any given year, there is a 10 percent probability of this range of losses). Estimates do not mean disasters will occur only once every 10 (or 20 or 50) years.

100. Disasters in Albania can lead to sizeable economic damages, and disaster risks are likely to increase in the future. Earthquakes and floods alone are expected to cause damages of US\$147 million per year, according to the AIR Worldwide catastrophe risk model for Albania (Figure 46). Damages following a catastrophic earthquake could exceed US\$2 billion (or about 13 percent of GDP), and there is a 1 percent chance of an earthquake of that magnitude to happen in Albania each year. An estimated US\$17.6 billion worth of the country’s commercial, industrial, and agricultural assets are at risk of floods and earthquakes. As climate change raises the average temperature and disrupts precipitation, floods and droughts are likely to become more severe and common over time.¹²⁷

¹²⁵ Government of Albania, European Union, United Nations, and World Bank. 2020. “Albania: Post-Disaster Needs Assessment. Volume A Report/Tirana, February 2020.” https://reliefweb.int/sites/reliefweb.int/files/resources/albania_post-disaster_recovery_a_v9.0.pdf.

¹²⁶ World Health Organization (WHO), Albania: <https://covid19.who.int/region/euro/country/al>.

¹²⁷ World Bank. 2020. *Disaster Risk Finance Diagnostic for Albania*.

101. The Government of Albania is implementing a series of policy reforms to address the growing risk of disasters. These include introducing a Law on Civil Protection (2019), setting up a new National Agency for Civil Protection (Agjencia Kombëtare e Mbrojtjes Civile), and drafting a law on mandatory earthquake insurance for homeowners (currently under consideration). The government is also working on developing a national disaster risk reduction strategy, national disaster risk assessment, and a national plan for civil emergencies, and it is pursuing the implementation of the EU Floods Directive, which dictates a green, inclusive, and ex ante approach to flood risk management. The recent earthquake and pandemic, however, show that policy reforms without proper implementation, including the enactment of by-laws and sufficient budget allocations and capacity building, still leaves the country vulnerable to disasters. Recent World Bank assessments underline the need for further reforms to mitigate the risks of disasters and adverse shocks in Albania.¹²⁸

102. Investments in disaster resilience will contribute to a more sustainable growth trajectory and safeguard past development gains. Strengthening disaster resilience means investing in social, physical, and financial resilience. Comprehensive efforts aimed at improving the country's disaster resilience could help Albania reduce or mitigate the immediate and long-term impact of disasters on people's health and livelihoods, the country's budget, and economic growth, as well as contribute to more sustainable development. Physical and financial resilience are discussed below, and social resilience is discussed in the next sub-section.

103. Investments in disaster resilience should be evidence-based. However, there is limited access to disaster data in Albania, with inconsistent historical records on the impact of disasters and spending on disaster recovery; lack of comprehensive, detailed, and comparable catastrophe risk modeling; and limited understanding of the fiscal cost of disasters. This presents a substantial challenge for estimating the benefits of and priorities for risk reduction and developing more appropriate and cost-effective risk financing mechanisms.

Physical Resilience

104. Investments in physical resilience can save lives, reduce costly damages, and mitigate the impact of disasters on people's livelihoods and well-being. Investing in more resilient infrastructure is both profitable and urgent. From serving basic needs to enabling economic ventures, infrastructure services support well-being and socioeconomic development. Reliable water, sanitation, energy, transport, and telecommunications services are essential for raising the quality of life for all people and supporting economic growth of Albania. Access to basic infrastructure services is a central factor in the productivity of firms and thus of the entire economy, making it a key enabler of economic development.¹²⁹

105. Albania's buildings are vulnerable to disasters. Buildings need to be upgraded to ensure resilience against earthquakes, which is a particular challenge for private dwellings: 10 percent of Tirana's residents and 6 percent of Durres' residents live in high-risk multifamily buildings.¹³⁰ Disasters that affect the country's main transport corridors, representing some 1,500 km of roads, are estimated to cause damages and losses of over EUR 21 million per year. EUR 14.5 million worth of prioritized investments are needed to improve road resilience, but these investments would also provide positive investment returns.¹³¹

106. Infrastructure systems are under pressure to deliver resilient and reliable services. Interruptions to Albania's power, water, and transport systems are estimated to cause annual losses to firms equivalent to 0.42 percent of GDP, and households are, on average, willing to pay the equivalent of 2.3 percent of GDP to avoid water and power outages.¹³² The 2019 earthquake resulted in over EUR 33 million in damages and losses to infrastructure, the majority of which were public buildings, community-level infrastructure (including urban and rural transport), energy distribution systems, and railways.¹³³

¹²⁸ World Bank. 2020. *Albania Disaster Risk Financing Diagnostic*; World Bank. *Emergency Preparedness and Response Assessment and Investment reports for Albania, Report on Climate Resilient Road Assets in Albania*.

¹²⁹ World Bank. 2019. *Lifelines - The Resilient Infrastructure Opportunity*.

¹³⁰ World Bank & GFDRR. 2020. *Earthquake Risk in Multifamily Residential Buildings - Europe and Central Asia Region*.

¹³¹ World Bank. 2019. *Climate Resilient Road Assets in Albania*.

¹³² World Bank. 2019. *Lifelines - The Resilient Infrastructure Opportunity*.

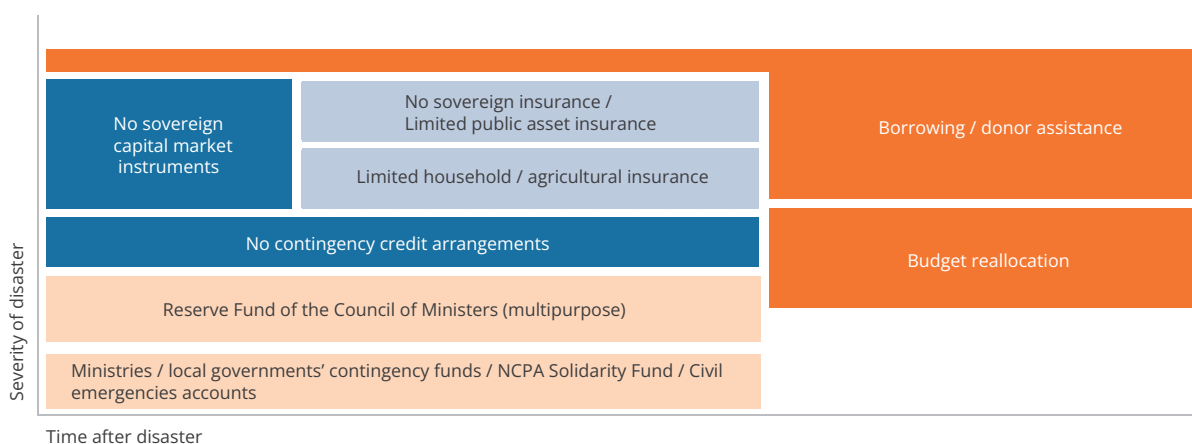
¹³³ Government of Albania, European Union, United Nations, and World Bank. 2020. "Albania: Post-Disaster Needs Assessment. Volume A Report/Tirana, February 2020."

Financial Resilience

107. The government shoulders the majority of post-disaster costs. These costs include, for example, the rehabilitation of public assets, restoration of public services, support to uninsured households and small enterprises, and fiscal transfers to local governments. Local governments are the first to respond in the aftermath of a disaster, but their financial capacity to absorb major shocks is limited. Government support to the reconstruction of private houses following a disaster is not explicitly covered by law in Albania. Nevertheless, in response to the 2019 earthquake, the government had already allocated more than US\$300 million to the Reconstruction Fund (which in part finances the rebuilding of individual dwellings and other earthquake-related costs) by end-2020.

108. The government finances post-disaster costs mainly through domestic public finances (Figure 47). The government only has a few pre-arranged sources of funds to cover post-disaster costs, with the reserve fund of the Council of Ministers being the main source available for any type of contingency. The country also faces a large catastrophe insurance protection gap, which is acute for households and farmers. Agricultural insurance is available but rarely purchased, with just a few commercial contracts signed in 2020. Currently, only 1-2 individual houses out of 100 have private catastrophe insurance coverage, and this coverage is driven to a large extent by mortgages. Albania has no sovereign insurance to provide budget support in the aftermath of severe disasters, and public asset insurance is limited.

Figure 47. Overview of Existing Risk Financing Instruments in Albania.



Source: World Bank. 2021. Disaster Risk Finance Diagnostic - Albania.

Note: Orange = budget retention instruments; light blue = risk transfer; blue = unavailable; light orange = partially available or partially operationalized. NCPA = National Civil Protection Agency

109. Following a disaster, the government could face a substantial funding gap,¹³⁴ which is expected to be financed through ex post sources of funds. With few pre-arranged funding sources, the authorities often have to rely on costly and disruptive ex post financing, such as budget reallocations, borrowing and additional taxation, or donor aid, which may take time to reach the country and could be fragmented. On average, the funding gap following disasters could exceed US\$130 million each year in Albania.¹³⁵ For example, the government’s response to the COVID-19 pandemic necessitated substantial borrowing and budget cuts. While much needed, more than half of the budget cuts incurred an opportunity cost of revenues foregone according to the World Bank.¹³⁶ This analysis finds that out of the lek 17.7 billion total underspent, lek 9.9 billion was intended for viable expenditure (which could have reasonably gone ahead, had funding been available) and therefore incurs an opportunity cost when it is cut. At the aggregate level, the estimated value forgone associated with COVID-19-related budget reallocations in 2020 totals lek 12.3 billion (US\$113 million), or 0.76 percent of GDP.

¹³⁴ The funding gap is the difference between available and needed financing that may have to be covered through ex post financing.

¹³⁵ World Bank. 2020. Albania Disaster Risk Financing Diagnostic.

¹³⁶ World Bank. 2021. The Impact of COVID-19-Related Budget Reallocations in Albania, <https://www.financialprotectionforum.org/publication/the-impact-of-covid-19-related-budget-reallocations>

This is modest when compared to the estimated direct impacts of COVID-19 on the economy (8 percentage points of GDP were lost compared to pre-COVID growth forecasts for 2020); but it is considerable when compared against the lek 19 billion spent on COVID-19 measures.

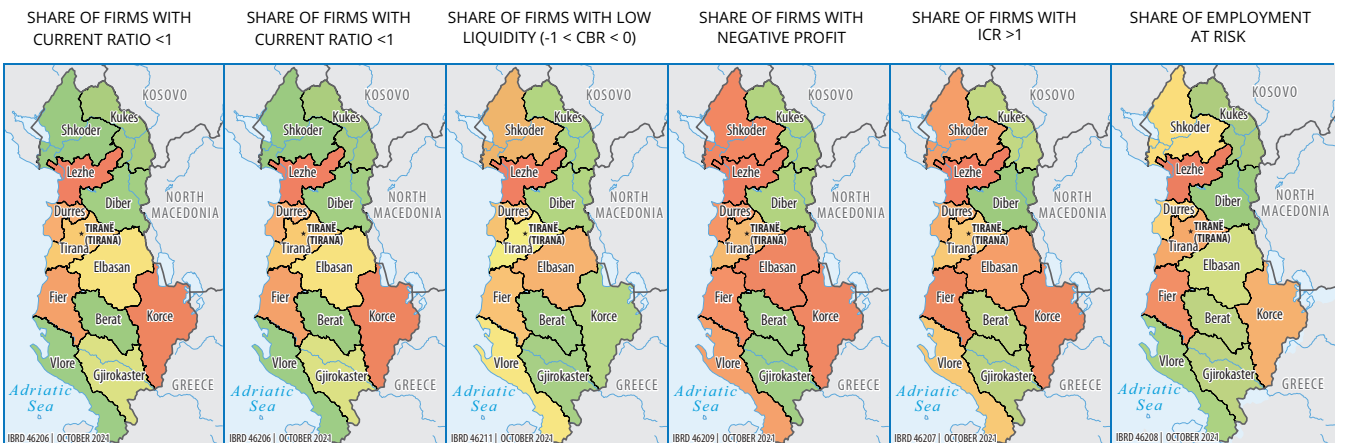
110. Disasters and major shocks can also have a severe impact on firms. A recent World Bank analysis finds that the compound impact of pandemic and disaster shocks, in the absence of any government interventions, can severely affect firms' viability by impacting their liquidity, profitability, and debt exposure. For example, such compound shocks could triple the number of firms that are unable to cover short-term debt: from 2,500 firms under the baseline scenario to more than 7,000 firms. Compound shocks could send a large share of firms into a liquidity crunch and cause their cash flows to contract quickly due to a collapse in revenue. Moreover, these types of shocks could exacerbate the debt vulnerability of firms and potentially lead to financial sector vulnerabilities.

111. The estimated impact on firms' financial vulnerability differs significantly depending on the size and age of firms and whether they are led by women or men. Compound shocks have a bigger impact on large than small or medium-sized firms in terms of being at a greater risk of reduced profits, high debt burden, and high share of employment at risk, likely driven by asset damages. Both male- and female-managed firms may become much less financially resilient following compound shocks, but the share of employment at risk is higher for female-managed firms. Moreover, young firms may be disproportionately more financially vulnerable under a pandemic and disaster shocks. Among firms with negative profit, the share of younger firms (less than 5 years old) is slightly lower than the share of older firms. However, the share of younger firms with less than 1 year of liquidity and current ratio under 1 is consistently higher than that of older firms. The share of employment at risk among young firms is also higher at 16 percent compared to 13 percent for older firms.

112. Firms located in Lezha and/or active in transport and food and accommodation services are projected to be the most vulnerable to the compound risk posed by a pandemic and a regional disaster. By almost all financial indicators, the region of Lezha has the highest share of firms that are projected to become vulnerable under compound pandemic and disaster shocks: 79 percent of firms in the region would have negative profits; 81 percent would have earnings unable to cover annual interest expenses; 39 percent would have liquid assets unable to cover short-term liabilities; 49 percent would have insufficient liquidity to cover 1 year of operating costs; and 18 percent of total employment in the region would be at risk (Figure 48). Furthermore, tax revenue in the region would be reduced by 97 percent. Albania's main economic centers—Tirana, Durres, and Vlora—have a medium level of vulnerability in terms of the share of vulnerable firms. Food and accommodation services are exposed to the highest liquidity risk and have the highest share of loss-making firms following the shocks: 91 percent of these firms are projected to have negative profits; 91 percent would have insufficient earnings to cover interest payments; and 61 percent would have insufficient cash flow to cover 1 year of operating costs. The transport and food and accommodation sectors are projected to have the highest reduction in tax revenue and share of employment at risk.

Figure 48. Financial Vulnerability by Region and Sector under Compound Shocks (Pandemic and Regional Disaster).

Region name	Share of firms with current ratio < 1	Share of firms with ICR < 1	Share of employment at risk	Share of firms with negative profit	Reduction in tax revenue (ratio)	Share of firms with low liquidity (-1<CBR<0)
Qarku i Beratit	0.24	0.46	0.08	0.40	0.26	0.28
Qarku i Dibrës	0.25	0.48	0.04	0.49	0.38	0.32
Qarku i Durrësit	0.35	0.69	0.13	0.72	0.74	0.42
Qarku i Elbasanit	0.32	0.72	0.09	0.76	0.68	0.43
Qarku i Fierit	0.35	0.74	0.16	0.74	0.68	0.42
Qarku i Gjirokastrës	0.30	0.49	0.08	0.41	0.34	0.30
Qarku i Korçës	0.36	0.74	0.14	0.76	0.86	0.33
Qarku i Kukësit	0.27	0.57	0.07	0.50	0.11	0.30
Qarku i Lezhës	0.39	0.78	0.18	0.79	0.72	0.49
Qarku i Shkodrës	0.24	0.72	0.12	0.76	0.80	0.43
Qarku i Tiranës	0.34	0.67	0.15	0.67	0.60	0.38
Qarku i Vlorës	0.26	0.67	0.07	0.70	0.75	0.40



Sector group	Share of employment at risk	Share of firms with ICR < 1	Share of firms with low liquidity (-1<CBR<0)	Share of firms with negative profit	Reduction in tax revenue (ratio)	Share of firms with current ratio < 1
Transportation & storage	0.20	0.70	0.45	0.78	0.78	0.43
Food & accommodation services	0.19	0.88	0.61	0.91	0.97	0.68
Agriculture, forestry and fishing	0.18	0.70	0.26	0.69	0.70	0.44
All other manufacturing	0.15	0.70	0.40	0.72	0.73	0.37
Other services	0.15	0.66	0.34	0.68	0.49	0.39
Wholesale & retail	0.13	0.68	0.44	0.67	0.71	0.25
Manufacture of textiles, apparel, leather and related products	0.12	0.66	0.35	0.69	0.69	0.35
Construction	0.09	0.59	0.30	0.59	0.57	0.24
All other sectors	0.08	0.54	0.20	0.56	0.10	0.37
Mining and quarrying	0.04	0.87	0.48	0.89	0.93	0.44

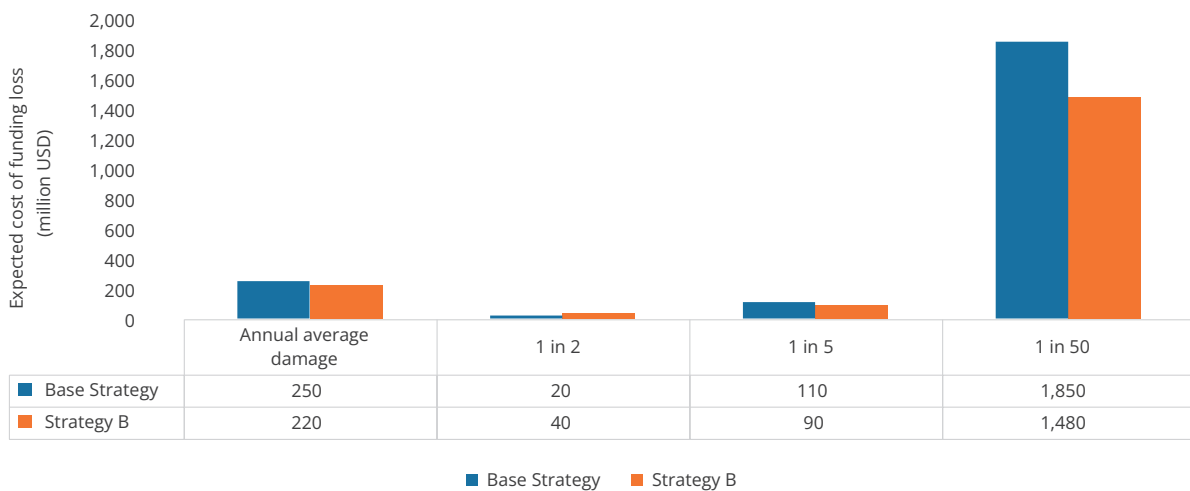
Source: World Bank staff estimates.

Note: ICR = interest coverage ratio; CBR = cash burn ratio. ICR indicator in heat maps is defined as ratio of earnings before interest, tax, and depreciation (EBITD) to short-term borrowing. Red, yellow, and green represent high, medium, and low vulnerability, respectively: red corresponds to higher (worse) values of the financial indicators, yellow corresponds to medium values, and green corresponds to the lowest values (color intensity is proportional to the range of values of the indicators).

113. The effects of disasters on the private sector can put a strain on the public budget. The impact of compound shocks on firms in Albania is also expected to reduce tax revenue: reduced firm profits could cut the government’s corporate income tax revenues by more than 60 percent. It is likely that under such a scenario, the government would have to mobilize funding to provide sizeable support packages to firms, which is what has happened during the COVID-19 pandemic.

114. Having pre-arranged financing in place helps governments respond timely and cost-effectively to disasters, and strengthening the financial resilience of the private sector could help to mitigate the impact of adverse events. Savings can be generated by adopting a risk layering approach that combines different instruments such as reserve funds, contingent credits, and risk transfer instruments (e.g., insurance and capital market instruments). For frequent events (e.g., those with a 1-in-2-year return period), the government’s current approach results in minor savings by avoiding some up-front costs, but costs could be almost 25 percent higher than under the risk layering approach for more infrequent events (e.g., a 1-in-50-year disaster) (Figure 49). Comprehensive risk-sharing arrangements for households and the private sector could also be used to reduce the government’s contingent liabilities and mitigate the impact of disasters on people’s well-being and livelihoods.

Figure 49. Expected Opportunity Cost of Funding Losses for Disasters of Different Magnitude by Strategy.



Source: World Bank staff estimates.

Note: Base Strategy refers to the government’s current approach. Strategy B is an example of a more diversified risk layering strategy that includes contingency credit and insurance, in addition to existing risk financing instruments. Insurance is triggered only when losses exceed the attachment point, which means that Strategy B is more costly for years with lower damage costs but presents significant savings in case of more severe events.

To better prepare Albania against shocks and mitigate the impact of adverse events on economic growth and people’s well-being and livelihoods, the authorities should consider:

- **Strengthening Albania’s physical resilience to disasters.** This includes: (i) assessing earthquake resilience and seismically reinforcing critical and sensitive infrastructure such as first responder facilities (e.g., fire and police stations), hospitals, and schools and providing sustainable finance for resilience of critical infrastructure, including for maintenance to ensure state of good repair; (ii) continuing previous natural hazard risk assessments and mitigating risks related to the main transport corridors (including roads, railroads, and bridges); (iii) ensuring that residential dwellings adhere to EU building codes in terms of seismic resilience, which would involve capacity building in the construction industry and improving the inspection and enforcement capacity of the GOA; and (iv) fully implementing the EU Floods Directive.
- **Improving Albania’s financial preparedness to manage disaster-related contingent liabilities and increasing the financial resilience of households and the private sector.** This includes: (i) developing and implementing a

comprehensive disaster risk financing program to define post-disaster priorities and combine different sources of funds to address disasters of different frequency and severity; (ii) optimizing the use of the public budget by introducing new risk financing instruments, including a dedicated disaster reserve fund to provide contingency financing, which could be backstopped by risk transfer mechanisms, a contingency line of credit, and a public asset insurance program or strengthening the use of existing risk financing instruments, such as proactive planning of budget reallocations; (iii) reducing government contingent liabilities and mobilizing the private sector to address households' post-disaster costs by adopting a mandatory residential buildings earthquake insurance law and increasing the penetration of agricultural insurance; (iv) adopting a strategic approach to support firms' financial resilience following pandemics or disaster shocks by, for example, introducing a mix of targeting and time-bound financial instruments (e.g., tax deferrals, lines of credit, credit guarantees, or equity investment/guarantees) that firms, including micro enterprises as a most vulnerable group, can access during adverse events (these instruments could be designed to crowd in private capital and adhere to green, resilient, and inclusive principles); and (v) strengthening data and analytics to make more informed decisions on financial resilience.

Sharing the Benefits of Economic Growth

115. Despite economic growth, Albania's poverty rate has remained stubbornly high and is estimated to have increased during the COVID-19 pandemic. While GDP per capita increased by an average of 23.8 percent between 2011 and 2019, the incidence of poverty remained relatively stable over the same period (Figure 50). In 2017 (latest data), 33.8 percent of the population lived on less than US\$5.5 per day, 2011 PPP.¹³⁷ The poor, including in Albania, are most affected by disasters, with long-lasting impacts that undermine gains in human capital and poverty reduction.¹³⁸ While Albania implemented a policy package with broad measures to mitigate the impact of the COVID-19 crisis on the economy and the poor, the pandemic is expected to result in a significant setback for the country's fight against poverty.

116. Across Albanian society, key demographic groups are falling behind. Poverty and economic development continue to differ widely across regions, with the central and northern (mountain) prefectures having higher poverty rates, a significantly lower share in economic activity, and lower employment rates than the rest of the country. Moreover, the participation of Roma and Egyptians (who represent around 3 percent of the population) in the education system and labor market is low. For example, only 66 percent of Roma children aged 7–15 are enrolled in education, much lower than 96 percent of non-Roma children; only 18 percent of the Roma are employed, lower than 56 percent nationally; and only 27 percent of the Roma population is covered by health insurance, lower than 45 percent of the non-Roma population.¹³⁹ Albania's female employment rate is 13 percentage points lower than that of men,¹⁴⁰ and the average gender pay gap is 10 percent.¹⁴¹

¹³⁷ Between 2002 and 2008, an increase of 1 percent of GDP was associated with a reduction in poverty of 1.2 percent. After 2014, the elasticity of poverty-growth fell, and a 1 percent increase of GDP resulted in only a 0.8 percent poverty reduction (World Bank staff calculations). Faster growth is necessary but not sufficient to promote inclusion—even if growth comes with more job opportunities.

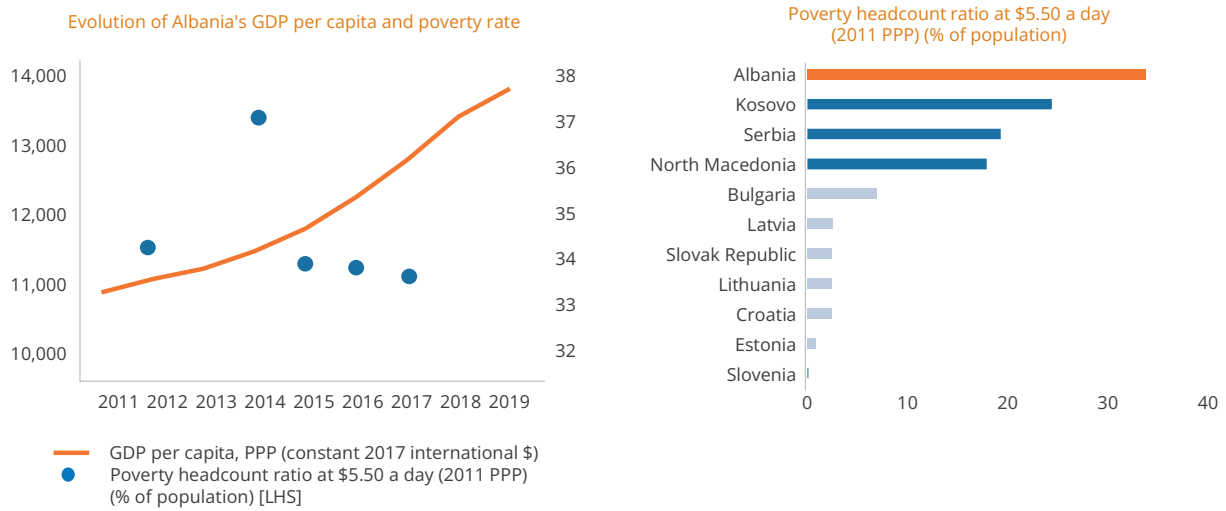
¹³⁸ Hallegatte S et al. 2017. *Unbreakable: Building the Resilience of the Poor in the Face of Natural Disasters*. Climate Change and Development. Washington, DC: World Bank.

¹³⁹ Robayo-Abril, Monica, and Natalia Millán. 2019. "Breaking the Cycle of Roma Exclusion in the Western Balkans." Washington, DC.

¹⁴⁰ *Western Balkans Labor Market 2020*, World Bank and Vienna Institute for International Economic Studies (wiiw).

¹⁴¹ Albanian Statistical Institute (INSTAT).

FIGURE 50. Despite economic progress, Albania's poverty rate has remained stubbornly high.



Source: WDI Database.

Source: WDI Database (2017–19, latest year available)

117. To reduce the incidence of poverty, measures to create more job opportunities for all Albanians need to be complemented by an effective social protection framework to insure households against shocks and protect minimum living standards. Chapters 2 (labor supply) and 3 (labor demand) of this CEM discussed key measures to grow the economy. Out of these, reforms that aim to increase the labor force participation of disadvantaged groups are particularly important for poverty reduction. However, while necessary, these measures may not be sufficient to fight poverty and increase economic inclusion. During an economic crisis (e.g., the COVID-19 pandemic), government support for vulnerable groups plays a critical role in protecting livelihoods, supporting the economy, and preventing households from falling back into poverty. Such support has also been identified as being critical to the transition toward a green economy.¹⁴²

Box 12. Albania's Income Support Measures Only Partially Mitigated the Impact of the COVID-19 Crisis on Poverty, Pointing to the Need for Better Preparedness for Future Shocks.

One of the first measures Albania took to mitigate people's income losses from the pandemic was to temporarily double the amount of the transfer provided by Ndhima Ekonomike (NE).¹⁴³ The program also suspended the obligation to reapply for support for beneficiaries approaching the end of their 3-month eligibility period. Steps were also taken to simplify application processes and move these online to comply with social distancing measures. Thus, the number of beneficiaries enrolled in NE increased by 11 percent. Moreover, the government provided a one-off payment (ALL 16,000) to 4,524 households who had applied to NE between July 2019 and April 2020 but were not active beneficiaries.

In addition, the government introduced a two-part financial package for firms, to prevent job losses. The first package (DCM No. 254 and DCM No. 7 from April 2020) provided wage subsidies for firms with annual income up to 14 million ALL, in the form of transfers of ALL 26,000, equivalent to the minimum wage, to all registered workers for 3 months.

¹⁴² European Commission. "A European Green Deal." https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal_en.
¹⁴³ For April, May, and June. The value was then again doubled from January 2021 for six months.

In total, there were 69,897 applications covering 125,053 individuals. Of these, 65,632 individuals received financial assistance (corresponding to 39,020 taxpayers). The cost of this package amounted to ALL 5,114,070,000.

The second package (DCM Nr. 305 from April 2020) provided a one-time 40,000 ALL subsidy to employees of enterprises that were affected by lockdowns and laid off workers who were not eligible for the first package. In total, 173,019 individuals from 43,410 entities received the payment at a total cost of ALL 6,920,760,000. In addition, the government introduced two programs later in 2020: one to compensate workers in the public transport sector with a one-time payment of ALL 26,000 (which benefited 4,553 employees), and one to support the implementation of security protocols in SMEs in the manufacturing sector, and included two payments of ALL 2,000, for which 457 taxpayers applied on behalf of 23,320 employees, for a total cost of ALL 93,280,000.

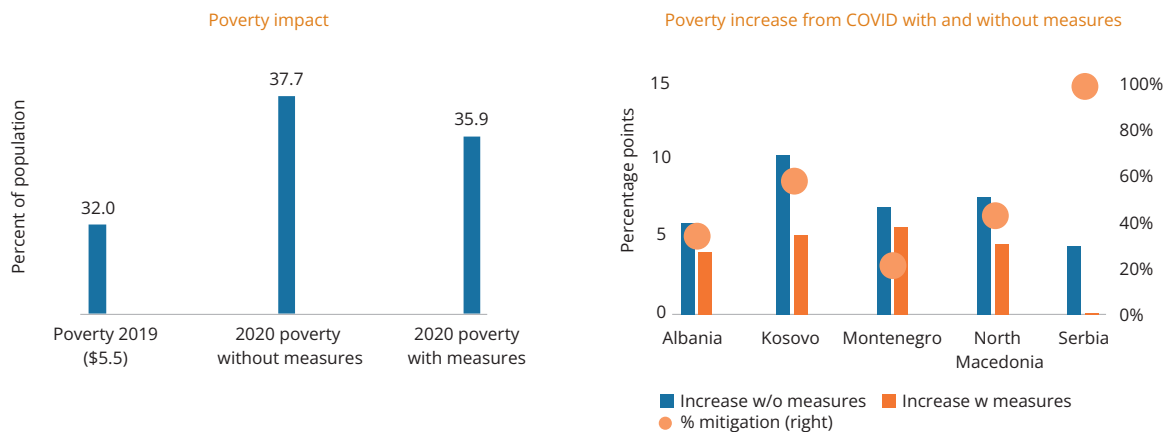
In the absence of real-time data on the impacts of the pandemic on poverty, the World Bank estimated a range of possible impacts through a simulation method. This method considers the first-order approximation of the impact of the COVID-19 pandemic in 2020, by sector and employment type. Sectors are classified as highly impacted, moderately impacted, or relatively unimpacted by mobility and business restrictions. Furthermore, self-employed workers are assumed to have suffered an income shock twice as large as that of wage employees. Three scenarios are created for the duration of the crisis (1, 2, and 3 quarters) and the scenario that is most likely to reflect the observed severity of the crisis at the macro level is reported. In Albania, the most likely scenario supported by macroeconomic indicators is of a 2-quarter income loss. It is also assumed that annual private transfers (e.g., remittances) fell by 10 percent to capture the shock to non-labor income. Finally, this detailed microsimulation incorporates the mitigating effect of selected government response measures, as described above.

Dimensions of Income	Detailed Microsimulation (1, 2, 3 quarters of income loss)
Labor income	
Sector of activity	Differentiated impact according to lockdown and demand changes
Type of worker	Self-employed workers suffer a shock twice as high as twage workers
Non-labor income	Annual private transfers reduced by 10 percent

The simulation suggests that poverty in Albania could have increased by as much as 4 percentage points, equivalent to 112,000 new poor, but this number could have been 30 percent higher in the absence of any government intervention. This is because of large income losses for workers in quintiles 2–4 of the income distribution. As the figure below shows, in the absence of any mitigation measures from the government, poverty would have increased by close to 6 percentage points. However, incorporating the measures results in a smaller increase in poverty, close to 4 percentage points, which represents a mitigation of about 30 percent of the shock. Compared to other Western Balkan countries, Albania's measures did less to mitigate poverty increases than in Kosovo and North Macedonia, even though the absolute number of new poor (pre-measures) is within a close range.¹⁴⁴ Part of the reason for the low efficiency of these measures is that it covered a larger percentage of the existing poor (pre-pandemic) than the new poor, whereas the non poor also benefited in a significant proportion. One of the weaknesses of Albania's response is that it was not able to reach a large number of people who worked in the informal sector and were not already registered with or benefitting from the NE program in early 2020. In contrast, North Macedonia modified the eligibility criteria of its poverty-targeted social assistance program (the Guaranteed Minimum Assistance) to expand coverage to newly poor households, and Kosovo introduced a new program for households with no formal income and who were not receiving other forms of government assistance.

¹⁴⁴ Serbia is a special case, as it introduced a universal transfer that essentially wiped out any effects.

Figure 51. Simulations on the Covid19 impact on poverty.



Source: World Bank simulations based on income data for 2017 from SILC for Albania, Montenegro, and Serbia. For North Macedonia, data are from 2018 SILC; and 2017 Household Budget Survey (HBS) for Kosovo. Welfare is estimated in US dollars using revised 2011 PPPs.

Looking forward to the next crises, Albania could benefit from putting in place a system that rapidly expands targeted income support to poor and vulnerable households. Drawing on global experience and Albania's recent investments in the NE program, this could be achieved by establishing in advance of a crisis the procedures to identify and enroll potential beneficiaries into the NE, thereby harnessing its management information and beneficiary payment systems. Determining eligibility can be complex, with trade-offs between accurately identifying only those people affected by a crises and the speed of the response. An initial analysis can begin to illustrate these options.

118. Albania's unemployment protection framework remains rudimentary. Unemployment benefits protect workers against hardship when they lose their employment and need to search for a job. However, Albania's unemployment benefits are low and determined as a flat rate of 50 percent of the national minimum wage, paid for 3 to 12 months¹⁴⁵ (which translates to a replacement ratio of 25 percent for Albanians earning the average wage). By contrast, general practice in regional peers is to link benefits to the previous salary level (with net replacement ratios averaging 50–90 percent). Moreover, the coverage of unemployment protection in Albania remains limited. In 2020, at the height of the COVID-19 crisis, only 2.4 percent of Albania's unemployed workers (as estimated by INSTAT) received unemployment benefits. While this could reflect eligible unemployed workers deciding that low unemployment benefits are not worth claiming, it could also reflect the fact that many Albanians are not eligible for benefits (e.g., not fulfilling the minimum contribution history for unemployment insurance) or require more support to apply for benefits. As a result of low generosity and coverage, aggregate unemployment insurance contributions far exceed benefits paid out, lowering the incentives for workers to seek formal employment and pay social security contributions (SSCs) in the first place.

119. Past reforms of the social safety net have strengthened the performance of the overall social protection system, although coverage remains low. The Ndhimja Ekonomike (NE) program is a core pillar of the country's social safety net, as it is the main program that provides Albanians with a minimum level of subsistence to protect against extreme poverty. The 2018 reform of the NE revised eligibility criteria and targeting procedures. Targeting is now in line with peer countries: only 2 percent of benefits are estimated to be disbursed to the top income quantile. However, coverage remains limited, as only 23 percent of the poorest quintile is covered by the NE, according to the 2019 SILC database. Benefit levels trail other social benefits and have fallen in real terms. Currently, the benefit level¹⁴⁶ for a household consisting of one adult member is equal to only 6.5 percent of the minimum wage, 13 percent of the

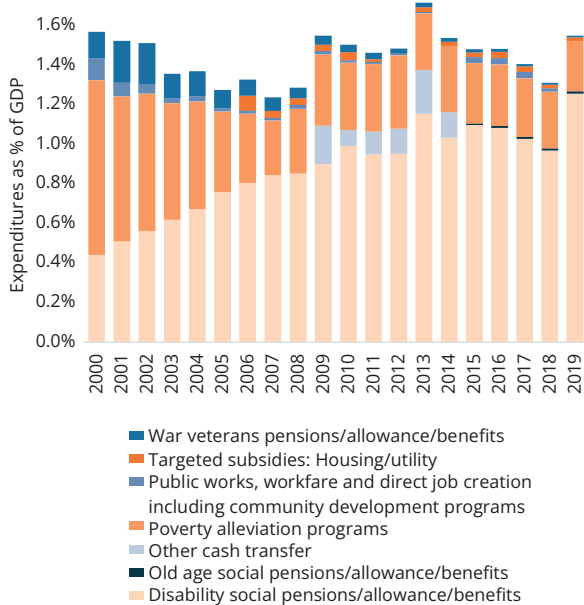
¹⁴⁵ An additional 5 percent increase is offered for dependent children.

¹⁴⁶ This analysis is based on the amounts set out in legislation. NE beneficiaries are also entitled to an energy benefit, school year (education) benefit, and vaccination benefit. This analysis excludes these other benefits.

unemployment benefit, and 25 percent of the social pension.¹⁴⁷ According to the 2019 SILC, the benefit is equivalent, on average, to 25 percent of the income of the poorest quintile. During the COVID-19 crisis, Albania has temporarily doubled NE benefits—providing much needed support to the poor at a time when few other income opportunities are available.

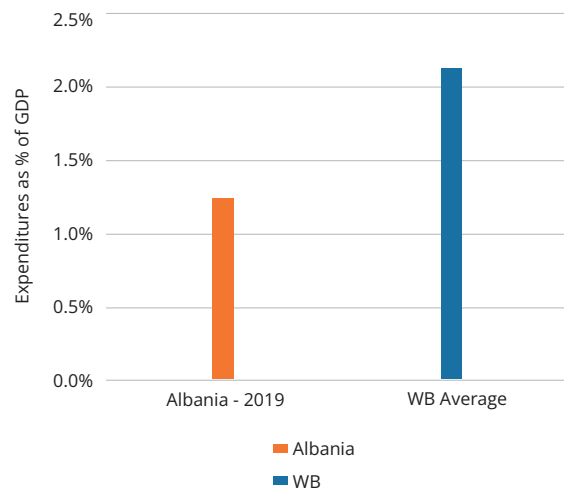
120. There are also ongoing reforms to improve the targeting of disability payments. Spending on disability benefits already represents 75 percent of total spending on social assistance (Figure 52). A reform to strengthen the targeting of benefits to make sure they reach the intended beneficiaries is under way.¹⁴⁸ While this reform included changes in the benefit levels, this change was not underpinned by an analysis of the additional costs arising from different types of disability and rather set in relation to the social pension (the basic payment is equivalent to 41 percent of the minimum wage). To ensure the social inclusion of people with disabilities, this reform needs to be matched by a strong case-management system that enables the authorities to identify and help people to access the right services and continue to monitor and guide beneficiaries. It also needs to be combined with the establishment of a range of services that persons with disabilities need, from medical, educational, and vocational rehabilitation services to measures that promote work opportunities for persons with disabilities (e.g., the introduction and enforcement of a quota system for employers or financial and technical support to employers to adapt the workplace to needs of the person with disabilities').

Figure 52. Spending on Social Assistance by Area, 2000–19.



Source: Social Protection Expenditure and Evaluation Database (SPEED). 2020. Database, Washington, DC: World Bank.

Figure 53. Benchmarking of Social Assistance Spending across WB6.



Source: SPEED. 2020. Database, Washington, DC: World Bank.

121. While the 2015 pension reform has strengthened old age protection, coverage needs to be expanded and the pension system needs to be prepared for ongoing demographic changes. The last round of pension reform measures, implemented in 2015, strengthened the link between contributions and benefits as well as broadened coverage. The reform included: (i) modifying the pension formula to redistribute benefits toward beneficiaries with the lowest pensions; (ii) increasing the gradual retirement age; (iii) phasing out and streamlining the special and subsidized pension regimes for farmers, parliamentarians, and miners; and (iv) introducing a noncontributory social pension to the elderly who do not qualify for contributory pension.¹⁴⁹ As a result, the average pension benefit

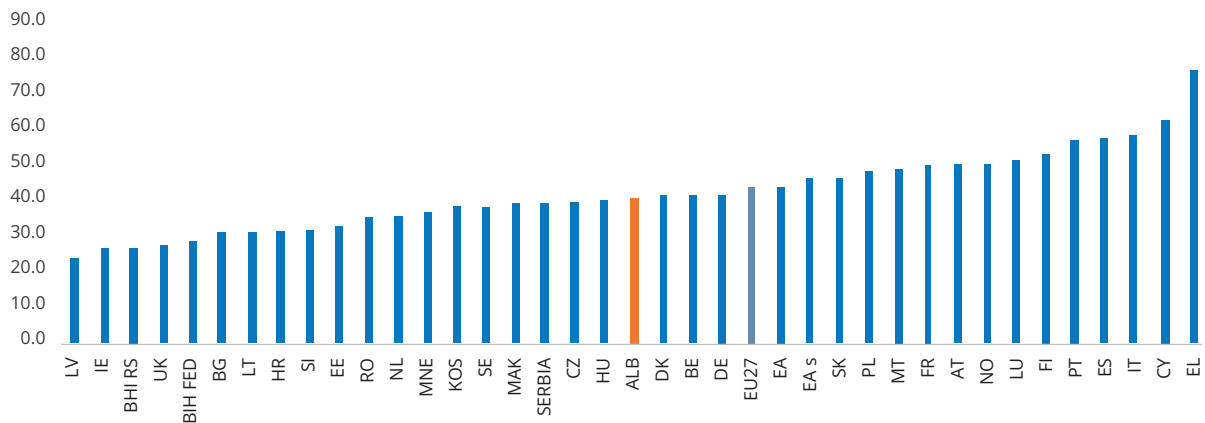
¹⁴⁷ WB staff calculations for note on NE benefit adequacy prepared for the Ministry of Health and Social Protection, 2021.

¹⁴⁸ The reform aims to transform the medical assessment into a bio-psycho-social assessment to reflect the new concept of disability as an interaction of functional impairments caused by a disease with psychological and social factors.

¹⁴⁹ This social pension is means-tested and is provided to people aged 70 and over who have been Albanian residents at least for the last 5 years. The social pension is equal to the partial pension calculated at 15 years of insurance pegged to the minimum wage.

was equivalent to slightly more than 41 percent of the average gross wage in 2016, which is close to the EU27 average (Figure 54). Albania's pension expenditure totaled 7.4 percent of GDP in 2018, below the average of the Western Balkans and the EU27. The deficit between pension spending and contributions, which is covered by the government, was 1.7 percent of GDP in 2018. Going forward, it will be crucial to ensure that the pension system remains fiscally sustainable as Albania's population ages and emigration continues. The creation of additional retirement savings vehicles can supplement pensions.

Figure 54. Average Pension to Average Gross Wages.



Source: EU Aging Report 2018, Public pension agencies in Western Balkans countries.

122. Financial support to disadvantage groups needs to be complemented with social services and employment support. Social services represent a very small (1.1 percent) and decreasing share of social protection spending. A Social Fund was established in 2018 to improve the transfer of funds for social services to municipalities. Unsurprisingly, the coverage of social care services is insufficient, and social services are mostly provided by non-public institutions, with funding from donors or charities. Services tend to be concentrated in urban areas, resulting in large geographical disparities. While both central and local government authorities are involved in the provision of social services, local governments have a principal role in their planning, financing and delivery. Nonetheless, almost half of local governments lack the capacity and experience to provide social services. There is therefore an urgent need to create the necessary local capacity to provide services for people in need, including children deprived of parental care, the elderly, and people in other vulnerable situations. This needs to be accompanied by a strengthened role of the central government to ensure minimum standards are met, including through monitoring the provision of services to beneficiaries. Combining social services with employment support, such as the ALMPs described in Chapter 3, can help promote the economic inclusion of poor and vulnerable people. The government recognized the need for integrated service provision in the National Exit Program for NE beneficiaries, which has been stalled due to the COVID-19 pandemic.¹⁵⁰

¹⁵⁰ The NE provides time-bound support of 5 years to beneficiaries (with the exception of some categories of people, such as people under 16 years of age and caregivers), which makes the provision of integrated services to promote their employment all the more urgent.

Figure 55. Health Expenditure per Capita, 2018.
(Current Expenditure, US\$)

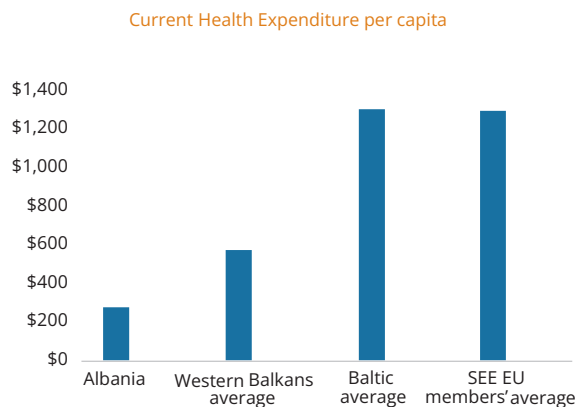
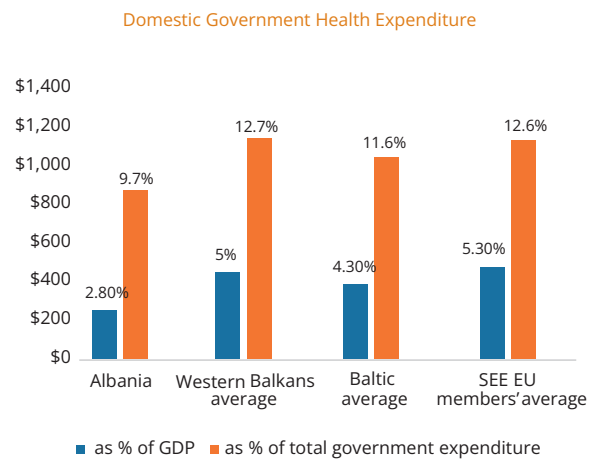


Figure 56. Domestic Public Health Expenditure, 2018.
(Share of GDP and General Government Expenditure)



Source: WDI database (last updated 02/17/2021).
Note: Western Balkans = Bosnia and Herzegovina, Serbia, Montenegro, North Macedonia, and Kosovo; SEE EU = Bulgaria, Croatia, Slovenia, and Slovak Republic; Baltic = Estonia, Latvia, and Lithuania.

Source: WDI database (last updated 02/17/2021).
Note: Western Balkans = Bosnia and Herzegovina, Serbia, Montenegro, North Macedonia, and Kosovo; SEE EU = Bulgaria, Croatia, Slovenia, and Slovak Republic; Baltic = Estonia, Latvia, and Lithuania.

123. Low public spending on health care leads to high out-of-pocket (OOP) expenditure, which deters low-income households from seeking medical care and exposes Albanians to the risk of catastrophic health expenditure and poverty.

In 2018, Albania spent US\$275 per capita on healthcare, less than half of the average of Western Balkans countries, and around one-fifth of the average of Baltic and SEE EU countries (Figure 53). In 2018, domestic public health expenditure as share of GDP was 2.8 percent of GDP in Albania, much lower than the average of 5 percent for Western Balkans countries, 4.3 percent for Baltic countries, and 7.3 percent for SEE EU countries (Figure 56). In addition, Albania has a high share of OOP spending on health care, mainly driven by the low level of health insurance coverage (given the large informal sector) and spending on outpatient medicines, while other contributing factors include co-payments for services and diagnostics, lack of coverage for dental care, and informal payments.¹⁵¹ In 2015 (last data available), 12.5 percent of Albanian households, around 399,000 people, experienced catastrophic OOP expenditure, out of which 80 percent were from the two poorest income quintiles. High OOP health expenditure¹⁵² is especially common among people aged 60 and over, as well as among households with children.

To strengthen social cohesion and to ensure effective support for all, the authorities should consider:

- Gradually increasing the adequacy of key social protection programs.**

This includes: (i) linking unemployment benefits to the previous salary level; (ii) raising the unemployment benefit replacement rate; (iii) regularly reviewing the adequacy of all social assistance programs; and (iv) increasing public expenditure on health to enable a better benefit package, which will help reduce OOP health care spending and providing a co-payment exemption for the poor. Efforts to increase spending need to be gradual, in line with available fiscal space, and implemented in parallel with measures to improve the efficiency and effectiveness of services, such as implementing an output-based provider payment system and strengthening primary health care.

¹⁵¹ Tomini F, Tomini S. *Can people afford to pay for health care? New evidence on financial protection in Albania.* Copenhagen: WHO Regional Office for Europe; 2020.

¹⁵² The share of households with OOP payments that are greater than 40 percent of the household capacity to pay for health care. A household's capacity to pay for health care is defined as total household consumption minus a standard amount to cover basic needs. The standard amount is calculated as the average amount spent on food, housing, and utilities by households between the 25th and 35th percentiles of the household consumption distribution, and this standard is also used as a poverty line (basic needs line) to measure impoverishing health spending.

- **Gradually broadening the coverage of the social protection framework.** This includes: (i) broadening the coverage of the NE social safety net, including in response to shocks; (ii) implementing proactive outreach campaigns to ensure Albanians take advantage of available support; (iii) continuing to streamline and digitalize programs to make the application process smoother; and (iv) designing social protection schemes to also cover Albania's large informal and/or self-employed workforce, which could include a voluntary savings account (with government support) to incentivize all Albanians to build additional buffers against shocks.
- **Complementing financial support with social services.** This includes: (i) strengthening the capacity of local governments to prepare plans for social services to be supported by the Social Fund; (ii) enhancing the capacity of the central government to set minimum standards for service provision and to inspect and evaluate social services; and (iii) putting in place a case management system to help ensure that beneficiaries receive the full range of benefits and services they require, including employment support.

Conclusion

124. This chapter highlighted key priorities for Albania to shift toward a more sustainable growth model. In a post-COVID-19 world, higher GDP growth rates will not be enough to meet the aspirations of Albania. Growth cannot come at the cost of degrading the environment, underinvesting in crucial resilience infrastructure against future disasters, or neglecting to protect those most in need. These other challenges also need to be addressed in Albania to achieve sustainable and inclusive growth.

125. To finance the investments necessary to achieve sustainable growth and address these challenges, Albania needs to increase its fiscal space. The country is likely to emerge from the COVID-19 crisis with elevated public debt levels and a limited revenue base. Yet, upgrading its development model will require additional public spending. The next chapter of this CEM reviews key elements of a strategy for strengthening public finances and for equipping Albania with the resources it needs to achieve its growth aspirations.

Chapter 05

Strengthening Public Finances

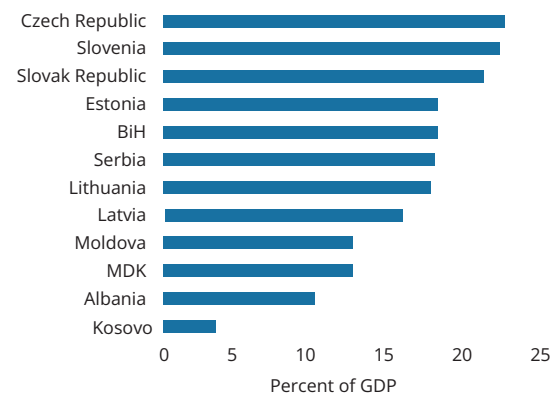
126. To support growth and protect the most vulnerable citizens, Albania needs to increase its fiscal space. It needs to increase spending on education, health, and social protection to match the level of investment in human capital in peer countries. Additional investments are also needed in waste management, forests, and the marine ecosystem to mitigate the impact of economic growth on the environment, and more resources are required for upgrading the country's infrastructure and improving trade facilitation to enhance market access. However, additional spending needs cannot be met by further increasing the debt burden. At 77.4 percent of GDP in 2020, the country's debt is high and faces relatively large rollover risks. Albania's debt level is the second highest among the WB6. As explained in Chapter 1, previous fiscal consolidation efforts tackling current spending rigidities have already yielded gains in terms of lowering the burden on public finances. Tax policy and administration reforms have also helped to consolidate the budget. Yet Albania's revenue mobilization continues to be lower than that of its peers.

127. Fiscal space should be primarily created through revenue mobilization. Albania's level of public tax revenues is the second lowest among the WB6 (Figure 57). Most of the country's revenues are generated through indirect taxes, with the VAT being the main contributor. Yet, due to widespread informality and a narrow tax base, VAT productivity is low at only 54 percent, compared to the EU average of 61 percent.¹⁵³ Moreover, revenues from direct taxes are eroded by significant underreporting of income and labor informality. While the personal income tax (PIT) is key to redistribute income, under-declaration and its interaction with other direct taxes increases the complexity of the PIT and makes it less progressive, equitable, and efficient than other taxes.

Figure 57. Composition of Tax Revenues.



Figure 58. Revenues from PIT, CIT, and SSC.



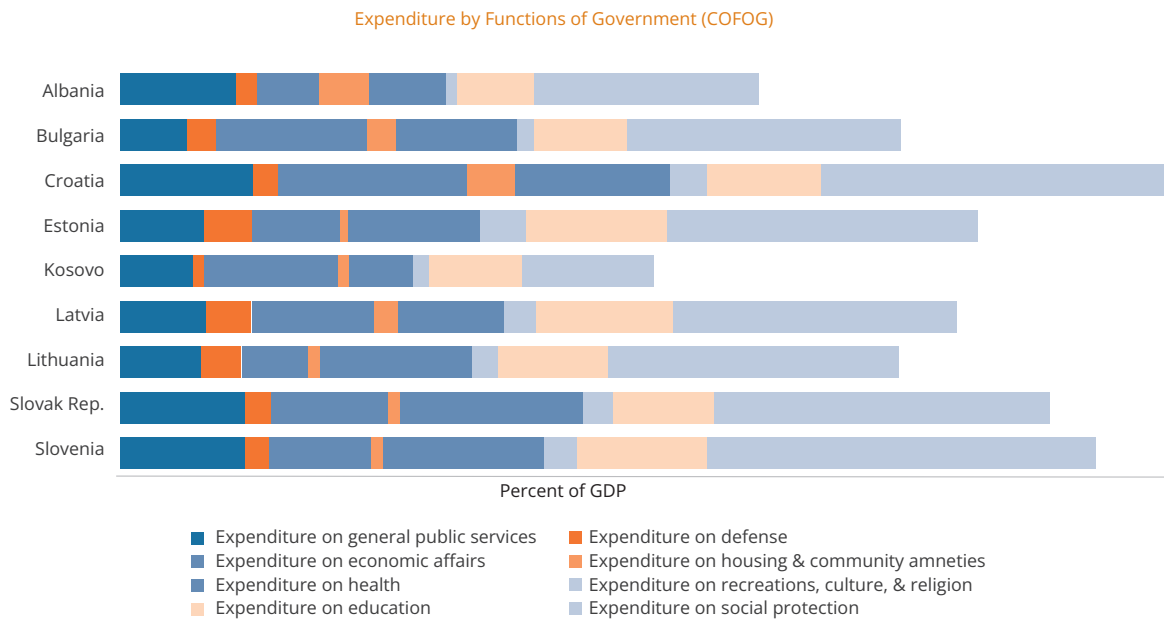
Source: IMF GFS 2019.

128. Albania is working toward adopting a medium-term revenue strategy. The strategy is expected to set priorities in the areas of tax administration and tax policy over the coming 5 years. For its successful implementation, the authorities need to assign a dedicated function in the Ministry of Finance and Economy (MoFE) to collect data and develop expertise for policy and cost-benefit analysis. Likewise, the General Directorate of Taxation (GDT) needs additional capacity to be able to: (i) transition to compliance risk management; (ii) use data to detect and prevent tax evasion; and (iii) gain the trust of taxpayers. A fiscal contract for compliance needs to be viewed as a government wide action, as the low quality of public spending, an unequal tax burden, and perceived corruption erode the trust of taxpayers.

¹⁵³ IMF estimates. https://www.imf.org/external/np/fad/tpaf/files/vat_c_efficiency.xlsx.

129. To support growth-enhancing reforms and protect the most vulnerable, the authorities need to increase both the level and efficiency of public spending. Public spending in sectors such as health, education, and social protection is lower in Albania than in most other peer countries (Figure 59). The proposed reforms outlined in Chapters 2, 3, and 4 need to be supported with additional spending, over the medium term. Some of these costs could be mitigated by efficiency reallocations within sectors (e.g., in education, health, or infrastructure) and by further streamlining public financial management to reduce hidden implementation costs. Finally, Albania needs to better direct public spending to address the challenges and opportunities identified in the Green Deal.

Figure 59. Expenditure by Government Function.



Source: IMF GFS 2019.

130. Fiscal space needs to be created through revenue mobilization. This chapter presents policy options to: (i) create fiscal space by mobilizing more revenues; (ii) increase the efficiency of public spending; and (iii) assess the impact of public spending on the sustainability of public finances.

Mobilizing Revenues

131. Albania needs to rebuild fiscal space by increasing revenues. This would require both increasing tax compliance and addressing tax loopholes. These two measures are interconnected: efforts to increase taxation to certain segments would result in further tax evasion and avoidance if not accompanied by efforts to strengthen the tax administration. Likewise, tax administration costs could be significantly reduced with a simpler and more stable tax code. Albania generates less revenues from the VAT, PIT, and SSCs than any of its comparator countries. While Albania's taxes are comparable or higher than those of peers, the low revenue generation capacity is an indication of a narrow tax base and/or inefficient enforcement and collection. Due to work informality, compliance is particularly low for the PIT and SSCs. Recent tax policy reforms have further narrowed the tax base, while frequent changes to the tax code have increased the compliance costs for taxpayers and introduced elements of non-neutrality in the tax framework.

Table 3. PIT, CIT, and VAT, Albania and Peer Countries

	PIT on employment income*	CIT	VAT
Albania	Progressive 0% under ALL 30,000 13% ALL 30,001-150,000 18% above ALL 150,001	15%	20%
Bulgaria	Flat; 10	10%	20%
Croatia	Progressive 20% below HRK 360,000/y 30% above	18%	25%
Estonia	Flat 20%	20%	20%
Kosovo	Progressive 0% under 960 4% 960-3,000 8% 3,000-5,400 10% above 5,400	10%	18%
Latvia	Progressive 20% under 20,004 23% 20,004–62,800 31% above 62,800	20% (effective 25%)	21%
Lithuania	Progressive 20% under 81,162 32% above 81,162	15%	21%
Slovak Republic	Progressive 19% under 176.88 times subsistence level (30,256.38 EUR/y) 25% above	21%	20%
Slovenia, Republic	Progressive 16% under 8,500 26% 8,501-25,000 33% 25,001-50,000 39% 50,001-72,000 50% above 72,000	19%	22%

Source: PWC.

Note: EUR/y unless otherwise specified.

Improving Fiscal Policy Formulation

132. Options to raise revenues through the tax policy should be weighed against the costs in terms of business competitiveness and the poverty incidence. Bringing self-employed workers under the labor taxation scheme, reducing VAT exemptions, and increasing own-source revenues for local governments are estimated to mobilize additional revenues equivalent to 1.5 percent to GDP, assuming behavioral incentives remain unchanged (Table 4).

Table 4. Policy Options to Raise Public Revenues

Policy options	Estimated revenue impact
Bringing the self-employed under the labor taxation scheme	0.07 percent of GDP*
Introducing an intermediate tax bracket for ALL 80,000 (Between ALL 30,000 and ALL 150,000) at 18 percent.	0.13 percent of GDP*
Increasing the maximum PIT rate for income earners above ALL 22,000 to 30 percent.	0.15 percent of GDP *
Introducing comprehensive income under the PIT	0.03 percent of GDP*
Reducing VAT excises and national tax exemptions	0.2 percent of GDP ^[1]
Increase property taxes	0.5 ^[2]
<i>Source:</i> World Bank estimates based on tax return data for 2019	
[1] IMF estimate [2] IMF estimate	

133. Direct income taxes raise less revenues in Albania than in comparable countries. While Albania's PIT system is relatively simple when compared to peer countries, its progressivity and efficiency could be improved. The country's personal income tax system has only two non-zero tax brackets, low rates, and no allowances. However, the interaction between the progressive PIT, the business profits tax, the simplified profits tax, and SSCs generate certain distortions and non-neutrality. Multiple and different thresholds for SSCs and the PIT fragment the income tax base and make the system less progressive in certain segments. The current tax system provides incentives for workers performing identical economic activities to choose self-employment (under the business profits tax) over employment (under the PIT).

134. Albania's labor tax wedge is relatively lower than the average of regional peers and OECD countries (Figure 60).¹⁵⁴ However, labor tax wedges are high in the case of low-income workers, especially among part-time workers who earn below the minimum wage (Figure 61). This is mainly due to the minimum SSC base being set at the minimum wage, which makes formal part-time, low-wage work costly for both employers and employees. This may have various implications for the labor market outcomes of low-wage workers, from increased non-compliance in the formal sector (resulting in formal workers receiving less than the minimum wage) to higher levels of informal employment and unemployment.¹⁵⁵

¹⁵⁴ The tax wedge measures the difference between the labor costs to the employer and the corresponding net take-home pay of the employee.

¹⁵⁵ See also: World Bank. 2020. *Western Balkans Labor Market Trends 2019*.

Figure 60. Labor Tax Wedge vs Peer Countries.

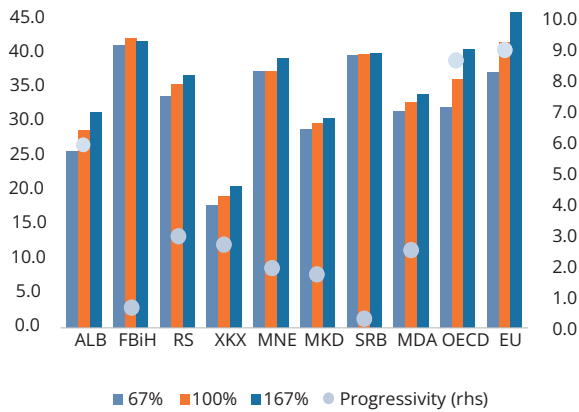
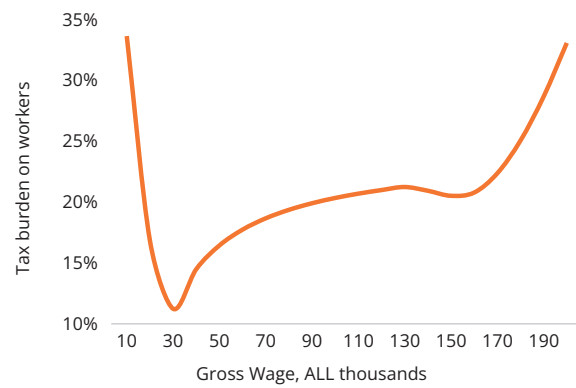


Figure 61. Tax Wedge for Low-Income/Part-Time Earners.



Source: World Bank staff calculations using PWC and OECD 2020 data.

Note: OECD includes only OECD member countries that apply one SSC rate independently of income level. Progressivity is measured as the difference between the tax wedge at the minimum and maximum income levels at 67 percent and 167 percent of the average wage, respectively. The tax burden is computed as the sum of the PIT and the employee's SSC as a share of gross wages.

135. Widespread underreporting undermines the progressivity and equity of the PIT. Around 40 percent of employees declare that wages are below or at the zero-tax income bracket, pointing to a tendency to underreport and bunching around the minimum income (Figure 64).¹⁵⁶ For example, to reduce underreporting for high-income earners, the PIT and social security thresholds could be harmonized to reduce complexity.

Figure 62. Albania has few PIT brackets (non-zero).

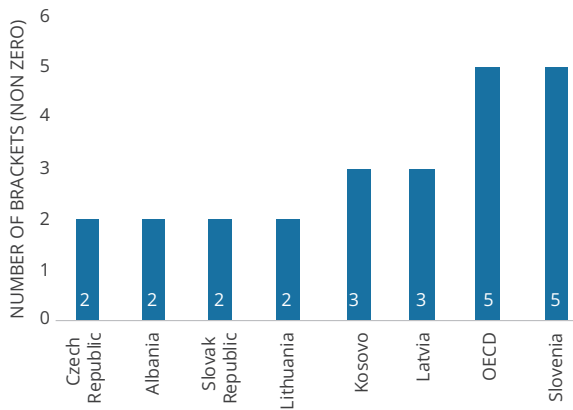
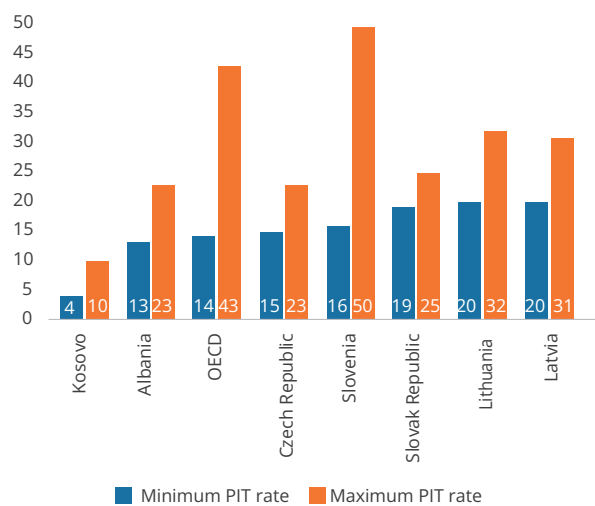


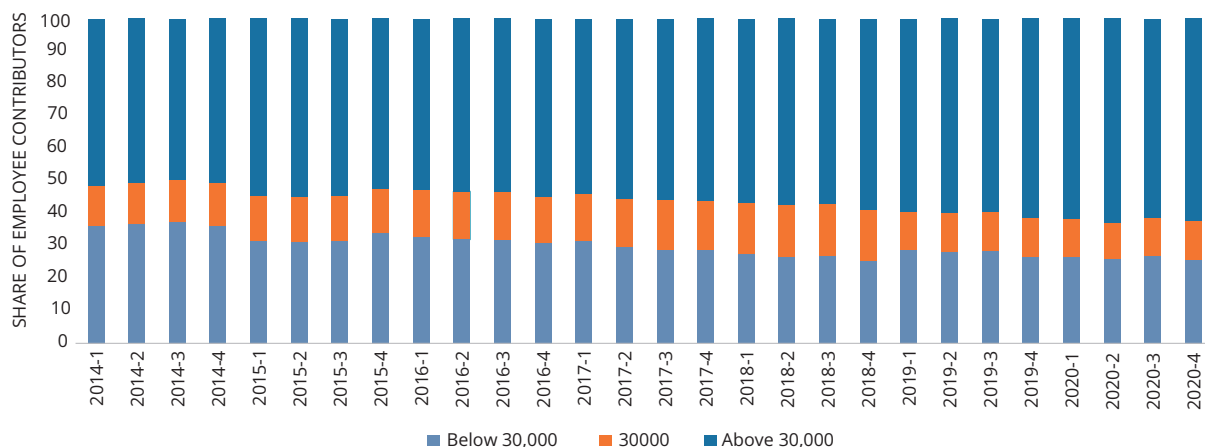
Figure 63. Albania has lower minimum and maximum PIT rates than peer countries.



Source: World Bank staff calculations using PWC and OECD data.

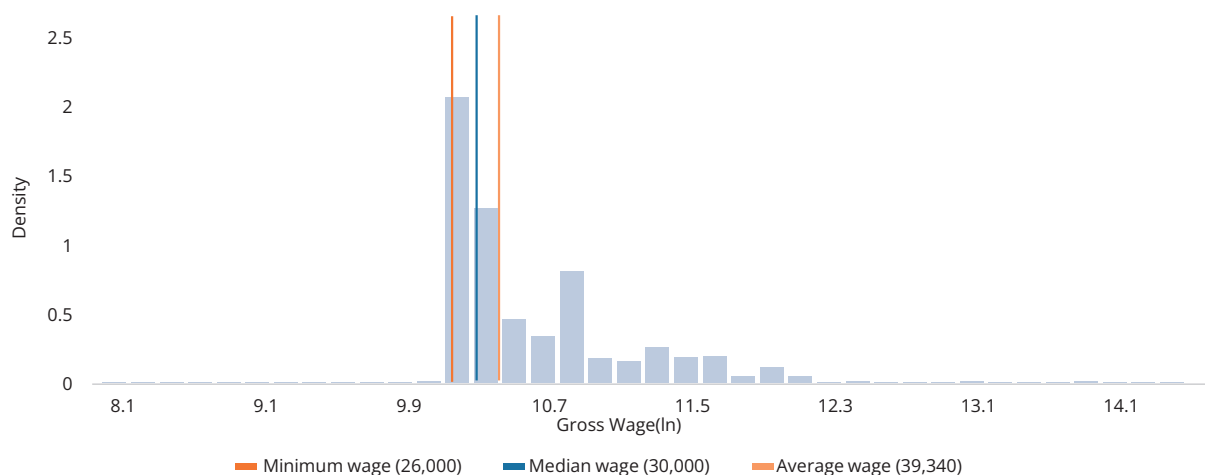
¹⁵⁶ Bunching occurs when taxpayers have the tendency to avoid brackets with relatively high tax rates by clustering around income levels where tax rates increase (“income kinks”), resulting in distorted distribution of income close to these kinks. In Albania, at the minimum income threshold, a 1 percent increase in the marginal tax rate may result in a reduction in reported income of 0.25-0.36 percent.

Figure 64. Around 40 percent of employees report monthly earnings below the taxable minimum.



Source: World Bank staff calculations.

Figure 65. Almost 99 percent of reported self-employed wages are below the taxable minimum.



Source: World Bank staff calculations.

136. The government needs to treat income from self-employment the same way as income from employment. Self-employment is the second most important employment form in Albania, and the number of self-employed workers (as a share of total employment) is much higher than in peer countries. According to the 2018 SILC, there are more than 375,000 self-employed workers in the country (including subsistence farmers) and almost 549,000 employees. Based on administrative data, almost 98.7 percent of reported self-employed earnings were zero entries in 2019, and of the remaining ones the largest share was concentrated at the minimum wage for SSCs. This points to not only the prevalence of self-employment among low-income earners but also to widespread underreporting. Self-employed workers, even if unincorporated, register as entrepreneurs with the National Registration Centre for tax purposes and are liable for taxes on profit. Unincorporated self-employed contractors register with the National Registration Centre as a 'natural/physical' person.¹⁵⁷ Self-employed workers registered as natural/physical persons mostly operate in professional services, including as accountants, architects, business consultants, computer programmers, dentists, engineers, medical professionals,

¹⁵⁷ According to the latest amendment to the Income Tax Law, starting January 1, 2021, every taxpayer with a business that generates an annual turnover above ALL 14 million during the fiscal year would be subject to a tax rate of 15 percent. For taxpayers with a turnover below ALL 14 million, the tax rate is 0 percent and the tax base is the taxable profits.

or lawyers. Out of the 8,000 self-employed physical persons in Albania, more than 60 percent are lawyers, dentists, and information technology workers.

137. This arbitrage opportunity for self-employed workers, especially for high-income earners, is due to an effective income tax gap of 21.4 percentage points between the two tax systems. In contrast to other countries, including the WB6, Albanian law does not explicitly include labor income from self-employment among the sources of income subject to the progressive PIT. Since labor income from independent activities is not covered under the PIT, self-employed workers can arbitrage between the PIT and CIT, register as entrepreneurs, and pay zero taxes for any income below ALL 14 million instead of the PIT.^{158 159} The set of thresholds and tax rates under the business profits tax (i.e., zero and 15 percent) interact with the progressive PIT structure to distort labor decisions.

138. More than ALL 1 billion in revenues could be generated by applying the progressive PIT to self-employment income. This would increase both overall and mean revenue collection, with some variation across professions. Even though self-employment is mostly prevalent among low-income and low-skilled workers, the extension of the progressive PIT would not translate into an increased tax burden for these workers due to the PIT exemption for any income below ALL 30,000 (EUR 244). However, those with earnings above the non-zero tax income threshold would be subject to a significantly higher PIT, increasing both revenues and the progressivity of the PIT.

Figure 66. Total and Average Revenues from Physical Persons: CIT (2019) vs. PIT (Simulations).

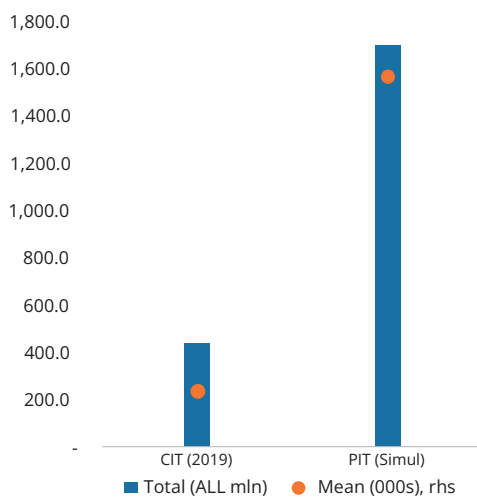
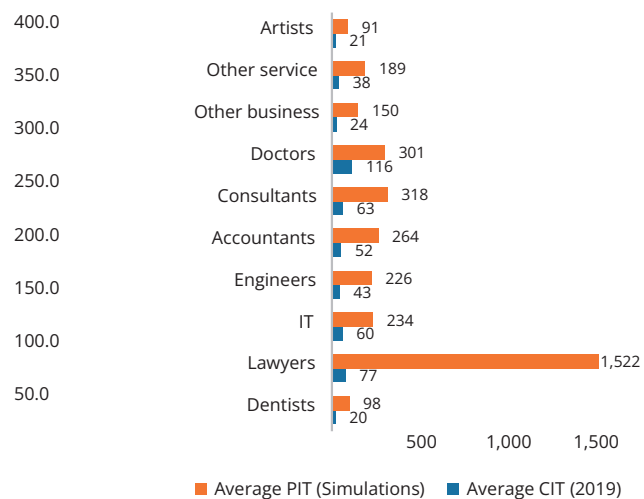


Figure 67. Average Revenues from Physical Persons by Profession: CIT (2019) vs. PIT (Simulations).



Source: World Bank simulations using GDT data.

139. In general, a broad reform of the PIT system should aim to strengthen progressivity while securing more revenues. While the Albanian PIT was designed to achieve vertical equity by taxing higher income levels at higher rates, it could be made even more progressive by revising the tax brackets and associated rates, introducing an intermediate tax bracket, and aligning the top income threshold for SSCs to the PIT. The introduction of a higher tax rate for top income earners could raise more revenues than the introduction of an intermediate tax bracket. The introduction of an intermediate tax bracket of 18 percent for income at ALL 80,000 (between ALL 30,000 and ALL 150,000) is expected to yield about ALL 1.2 billion in tax revenues, and increasing the maximum PIT rate for income above ALL 220,000 to 30 percent is expected to yield almost ALL 1.4 billion in revenues.¹⁶⁰

¹⁵⁸ An international comparison of highest tax rates applied to self-employed across EU countries can be found at: https://www.agn.org/iagn/AGN_Shared_Content/Publications/EU/2017SelfEmployed.pdf.

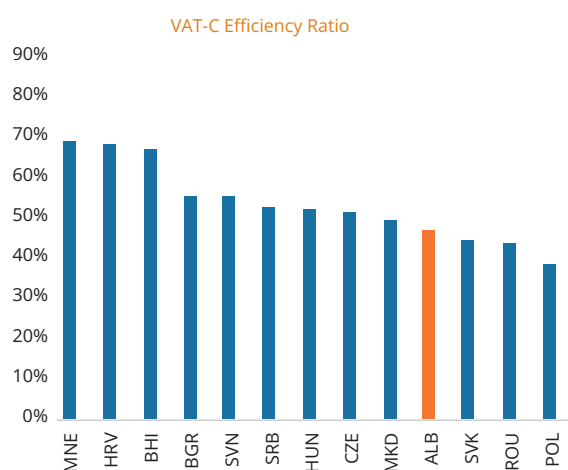
¹⁵⁹ A worker earning ALL 14 million in annual (net) income (ALL 1,116,666 per month) could lower his or her effective income tax rate from 21.4 percent under the PIT to 0 percent by reorganizing as self-employed and declaring a turnover below the VAT threshold (ALL 10 million) and a monthly salary equal to the minimum wage. From a firm's perspective, hiring a self-employed contractor over an employee would result in cost savings of more than 30 percent, on average.

¹⁶⁰ The PIT scenarios are applied on a baseline reflecting the income tax framework in place in 2021.

140. Over the medium term, the authorities could improve the PIT system by further aligning taxation across different income sources. In Albania, personal income sources other than labor (e.g., capital and dividend income) are taxed at a lower, and uniform, rate than employment, which may inhibit the redistributive role of the PIT system. As capital income is concentrated at the top of the income distribution, making its taxation more progressive could not only generate more tax revenues but could also, more importantly, collect a greater proportion of revenues from top income earners. Based on 2019 annual declaration data, applying the current progressive schedule of the PIT to all income sources would generate additional ALL 1.4 billion in tax revenues.

141. Moreover, reducing tax exemptions, including for VAT, could yield an additional 0.2 percentage points of GDP per year in tax revenues. While Albania's VAT and excise rates are comparable with those of peer countries and in line with international standards, VAT exemptions and reduced rates amounted to 4.7 percent of GDP in 2019. Exemptions are a poor instrument to support vulnerable groups or incentivize sectors. Instead, the government should consider providing direct subsidies to targeted groups or sectors, which are easier to monitor, control, and contain. A significant share of the country's VAT exemptions are standard exemptions on government-provided goods and services such as public health, defense, etc. Still, there is scope to increase public revenues by removing VAT exemptions on private education and health care, non-prescription medicines, fee-based financial services, and the first sale of newly built property. These exemptions are likely to benefit the most well off, and their removal is not expected to increase poverty.

Figure 68. Albania's VAT efficiency is lower than that of its peers.



Source: IMF TA report on the medium-term revenue strategy.
 Note: Ratio of actual VAT revenues to theoretical revenues from a perfectly enforced VAT levied at the uniform standard rate on all final consumption.

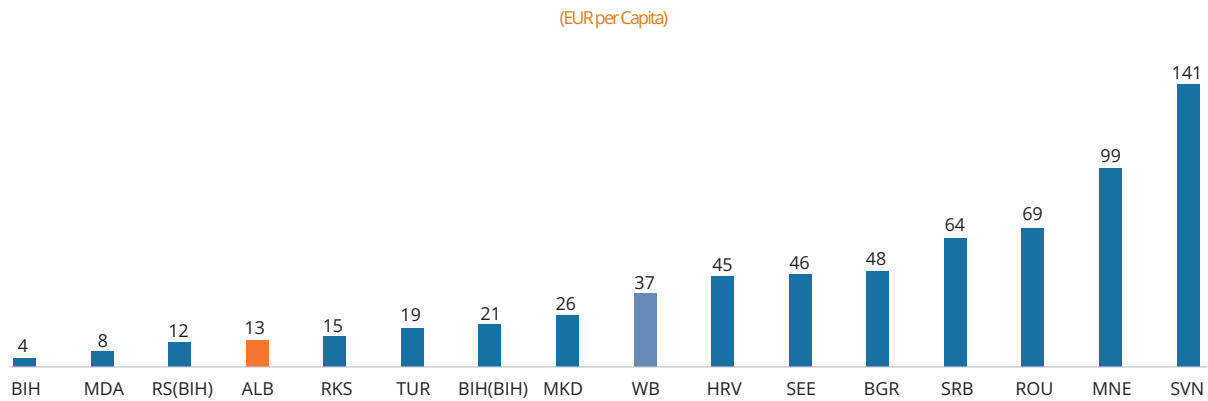
Figure 69. More than half of lost public tax revenue is due to exemptions.

	% of GDP
Estimated potential VAT (i+ii+iii)	16.3%
(i) VAT collected	7.9%
(ii) Estimated compliance gap	3.7%
(iii) Estimated tax expenditure (a+b+c+d+e)	4.7%
(a) Small supplier threshold	2.8%
(b) Reduced rates	0.0%
(c) Government services (public schools etc.)	1.0%
Education	0.5%
Healthcare	0.5%
(d) Sector exemptions	0.9%
Games of chance	0.2%
Building construction	0.2%
Pharmaceuticals	0.2%
Financial intermediation	0.2%
Trade unions, political parties, religious org.	0.2%
Other	0.0%
(e) Interactions	0.0%

Source: MoFE.

142. Property and environmental taxes are efficient sources of public revenues that are underutilized in Albania. While both are designed on the right principles, their tax rates are very low, and the broad range of exemptions keep revenues below the average of peer countries. Moreover, there are challenges related to the development of the comprehensive cadastre, which would record, link, and update information on properties and taxpayers, and the capacity of municipalities to administer the property tax in a decentralized manner. Yet, property and environmental charges and fees could be an important source of local government revenue. For example, raising the property tax rate once the fiscal cadaster has been fully developed could yield an additional 0.3–0.5 percent of GDP in revenues. Similarly, local governments could consider increasing own-source revenues through fees and charges for waste collection through a combination of higher charges and enforcement.

Figure 70. Property Tax Revenues in South East Europe, 2019.



Source: World Bank staff calculations.

Strengthening Compliance

143. To mobilize additional revenues, Albania needs to improve tax compliance and broaden the tax base. The previous section discussed the need for better policy formulation to reduce the scope for tax planning. This section focuses on the other equally important part of revenue mobilization: improving the capacity of the tax administration.

144. There is a large VAT compliance gap in Albania. Underreporting income is common in the country, especially in trade, construction, and services. Since 2015, the government has relied on anti-informality campaigns, which in time have become more sophisticated and have targeted several high-risk sectors, with positive results. Fiscalization (i.e., the adoption of fiscal laws to combat informality in the retail sector), which started in 2021, is expected to improve the availability of real-time information about economic activity and improve VAT collection by an estimated 10–15 percent when fully implemented, according to the government. However, fiscalization would increase the administrative burden of working with large data volumes if it is not accompanied by simplification and compliance cost reduction. Policy responses need to consider different risks in each industry and prioritize sectors where the risk is substantial, such as construction (e.g., by introducing reverse charging to prevent tax losses in the subcontractor supply chain), professional services, and trade.

145. The government needs to adopt an integrated approach to tackling undeclared/underdeclared labor. Differences in labor market data between administrative data and the labor force survey indicate a significant extent of undeclared work and underreported wages. The government has recently started to expand the use of instruments to reduce unreported/underreported labor, including behavioral incentives and improved analytics and data sharing among agencies to detect unregistered work and underreporting. The government needs to adopt a comprehensive approach in dealing with underreported work that involves a variety of instruments, ranging from increased detection and penalties for misreporting to indirect instruments tackling both norms and regulations around formal institutions.¹⁶¹ Improved administrative capacity needs to be complemented with a more comprehensive reporting and understanding of taxpayers' sources of earnings. The tax authorities' legally recognized instruments also need to be expanded to include indirect wealth valuation. Finally, the tax authorities need to invest in measures to educate taxpayers and build a culture of trust.

146. The range of individuals that file an annual income declaration needs to be expanded. While there is a law that requires the filing of an individual income declaration only for those individuals whose annual income is above ALL 2 billion, only 13,176 people filed such a declaration in 2019. PIT withholding data from the same year suggest there were at least 10,963 people fulfilling the threshold

¹⁶¹ RRC. 2018. *Diagnostic Report on Undeclared Work in Albania*.

criteria from wage income alone. The filing of annual earnings needs to be extended to include more taxpayers, which could be done by lowering the filing threshold. Currently, the GDT only sees a limited portion of economic activity, which limits its ability to ensure compliance. Potential reforms include extending the filing requirement while reducing the administrative burden on taxpayers through pre-filing returns and using third-party information.

147. Since 2020, the country's tax filings include workers with more than one job. The relationship between tax authorities, business, and the public needs to be strengthened to reduce undeclared work and unfair competition driven by the tax code. The GDT should explore the possibility of obtaining data from banks on the interest credited to the accounts of Albanian residents. Access to this information would allow the GDT to prefill tax returns, boosting the level of voluntary compliance, and the planned unit focused on individuals with high net wealth would be able to estimate the value of financial assets. As a signatory to the Convention on Mutual Administrative Assistance in Tax Matters and 41 bilateral tax conventions, Albania has a rich network of relationships it can use to access tax information. Using and requesting international tax information should become established practice in GDT units that manage cross-border tax issues, most notably the Large Taxpayer Directorate and, in due course, the unit focusing on individuals with high net wealth.

148. The GDT needs to broaden its instruments for auditing, detecting, and taxing unexplained wealth. To address tax evasion and informality, tax administrations have developed techniques to recompute the income of taxpayers via indirect methods. These can range from a relatively simple comparison of declared income with known expenses to a much more detailed and forensic reconstruction of assets, liabilities, income, and expenses. However, courts in Albania do not recognize the validity of these types of indirect methods, insisting that the GDT should have direct evidence that income has been received and not reported. The GDT should approach MoFE about changing the tax administration law to allow the use indirect methods to recompute income when it has been established that a taxpayer's tax return and records are incomplete and/or inaccurate. The onus should be on the taxpayer to demonstrate that the missing income came from a legitimate source.

149. The GDT can develop new or build upon ongoing initiatives to encourage disclosure of offshore assets, including untaxed domestic funds and assets. Albania is committed to begin the automatic exchange of financial account information under the Common Reporting Standard framework by 2020 to detect the transfers of untaxed funds to offshore locations.

150. To reduce the high cost of compliance, the GDT could rationalize post-filing procedures. The cost of paying taxes is higher in Albania than in many other countries, reflecting challenges related to the country's tax policy and administration. In terms of the tax administration, issues that arise after filing are especially acute. The VAT refund process, for instance, is cumbersome, as taxpayers must make a formal request for a refund instead of automatically receiving it. Furthermore, the request for a refund can trigger an audit, and the refund is only issued once the audit is complete. It can take 37 working days before a refund is issued. The audit process is equally fraught with difficulty. Taxpayers are frequently asked to produce information that the GDT should already have access to. VAT refunds should be automated but also subject to a risk assessment to determine whether an audit is needed. Information streams should be rationalized to avoid asking taxpayers for the same information twice. Finally, the government should consider shifting the responsibility for refunding arrears to the Treasury and implementing the automatization of penalties in case of arrears (in compliance with the Law on Tax procedures).

151. The GDT could further facilitate compliance by improving taxpayer education and support. While the GDT has increased the staff capacity of its taxpayer services department, it does not yet have a taxpayer service strategy—although one is under development. The taxpayer service strategy needs to lay out how the GDT can proactively support voluntary tax compliance among taxpayers and how it can quickly and cost effectively address inquiries and issues raised. The implementation of such a strategy could improve compliance rates and result in: (i) improved education/communication offerings to better target taxpayers; (ii) a segmented approach to tax administration; and (iii) better internal coordination of tax administration efforts and resources.

152. Finally, strengthening taxpayers' trust in the tax system by reducing tax uncertainty could potentially improve compliance. Tax uncertainty is a major concern for taxpayers in Albania and could be improved by providing taxpayers with better support and guidance. The GDT should more frequently publish a schedule for technical bulletins and guidance to remove any ambiguity about how

the tax code will be applied. Information campaigns need to be tailored to each group of taxpayers, from simple explanatory material for micro businesses to more complex in-depth information for businesses that seek further clarification. In addition, the GDT could do more to engage with its stakeholders and address their concerns, and it needs to improve existing public consultation mechanisms, as taxpayers do not perceive them as credible.

To mobilize additional public revenues, the authorities should consider:

- **Increasing the productivity of the VAT.** This includes: (i) reducing VAT exemptions; (ii) inserting reverse charging in the construction sector; and (iii) strengthening Compliance Risk Management as fiscalization advances.
- **Reforming the PIT system.** This includes: (i) bringing self-employment under progressive taxation and improving the progressivity of the PIT by revising tax brackets and aligning SCCs to the PIT threshold; (ii) increasing annual declaration filings and introducing income withholding for self-employed workers through the companies that contract them; and (iii) taxing unexplained wealth by increasing the capacity of the tax administration and exploring legal interventions to acknowledge the validity of using indirect methods to compute wealth.
- **Reducing the cost of compliance.** This could be done by developing a comprehensive taxpayer service strategy.

Strengthening the Efficiency of Public Spending

153. Albania has made substantial progress in improving public financial management over the last 5 years. Improvements have been made in forecasting revenue, controlling expenditure payment arrears, strengthening commitment controls, and increasing the transparency of the budget (e.g., related to fiscal risks and contingent liabilities and public procurement) (PEFA 2017). The authorities also introduced a fiscal rule that included steps to introduce more realistic macro forecasting and binding medium-term budget ceilings. Adherence to fiscal rules has improved due to the inclusion of fiscal risks and a list of public-private partnerships in the 2019 budget proposal. Starting in 2023, the fiscal rule is also expected to include a primary balance target.

154. However, significant gaps remain that prevent an efficient allocation and execution of public spending. These gaps originate from the unreliable Medium-Term Budget Framework, along with its weak linkages to the annual budget process; inadequate monitoring of spending, including arrears at both the central and local government level; lack of enforcement of commitment controls; and inadequate financial management and control (Sigma report, European Commission assessment).

155. The current legal and regulatory framework provides the basis for proper coordination and alignment between overarching strategies, such as the NSDI II-3, sectoral strategies, the Medium-Term Budget Plan, and annual budget documents. However legal changes alone are insufficient to address alignment challenges if they are not accompanied by legislative scrutiny of the Medium-Term Budget Plan and supporting measures such as the development of instruction manuals, capacity building, and the adoption of clear government mandates. For example, several road transport investment projects implemented in 2014–18 were not included in the Albania National Transport Plan II (2010) or the transport sector strategy, and the economic rationale of these projects had not been documented. In addition, new investment decisions do not adequately consider maintenance needs to ensure the quality of service delivery over the life of the asset. The appraisal and selection of investment projects continues to be fragmented and depended on the source of funding, and the process for public-private partnerships is separate from that of public investments. Government agencies with multiple mandates have overlapping competencies, which weakens the ability of the government to manage and monitor the selection, design, and implementation of investment projects. Consolidating decision-making processes and strengthening the public investment management unit under MoFE (and including management of public-private partnerships under the same umbrella) are necessary to increase consistency in the selection of investment projects and ensure value for money.

156. Weaknesses in the reporting of spending data, including key performance indicators, hamper the efficient reallocation of spending. For example, health providers are often financed through line-item input-based budgeting, which considers neither the productivity, efficiency, nor quality of service provision and incentivizes neither the coordination nor integration of care. Health facility budgets are predominantly determined based on inputs (historic costs), even though in primary care they should reflect the population in primary health care centers.¹⁶² While line-item budgets allow for strong central control and predictable expenses, the level of financing facilities receive is not directly dependent on any output or outcome metrics, which does not incentivize health facilities to provide more services or more efficient and better quality care. Furthermore, the absence of case-based payment systems means that hospitals do not conduct case-based cost managerial accounting, which contributes to inefficient service delivery, such as long hospital stays or inefficient use of medicines and consumables.

157. Budget monitoring needs to be further streamlined to ensure that expenditures do not exceed budgets and result in arrears. The Albanian Government Financial Information System (AGFIS) currently covers 15 budget institutions, representing around 74 percent of total public spending. The government needs to expedite the process of enrolling other major budget institutions into the AGFIS to further control spending and arrears as well as automate payroll through the Human Resources Management Information System. However, the government needs to address the reasons for the low level of compliance in the budget institutions that already have direct access to the AGFIS and are using it to manage and monitor budget execution and arrears (e.g., with preventive and detective controls). New arrears are still generated because commitment controls are not de facto operational, and there is no structure in charge at MoFE to ensure compliance with the three-year ceilings through the AGFIS. At the local government level, data show that about one-third of Albanian municipalities face financial difficulties due to accumulated arrears, while 6 out of 61 municipalities are in financial distress, with the ratio of the stock of arrears to total local government expenditures higher than 50 percent. Lack of commitment control is further exacerbated by the local governments' carryover practices and poor reporting practices, resulting in hidden deficits.

158. Severe cost overruns and delays in executing investment projects undermine spending efficiency. Key contributing factors include a lack of quality project preparation documents, that outdated reference pricing guidelines by the government, and a culture of granting project deadline extensions through simplified procurement procedures. MoFE needs to strengthen the quality control of project preparation documents by: (i) building staff capacity; (ii) ensuring simplified procurement procedures for project extensions are only granted under stringent conditions; and (iii) adopting time-based contracts for engineering companies that supervise the implementation of construction projects, ensuring flexibility in case of delays.

159. The government has improved the quality and accessibility of information on public finances, but it needs to better adhere to international standards. According to the 2017 Open Budget Survey, Albania has since 2015 increased: (a) the availability of budget information provided in the Audit Report and the Pre-Budget Statement; and (b) the number of published budget execution reports. However, lack of alignment with international government accounting practices (accrual-based accounting) and the absence of European System of Accounts (ESA) 10 standards prevent a comprehensive view of fiscal vulnerabilities and create room to deviate from the fiscal rule. The complexity and decentralized nature of accrual accounting (aligned with International Public Sector Accounting Standards) has slowed its implementation in Albania. The adoption of accrual accounting reporting would allow the authorities to access complete and accurate government financial data, which could inform public decision-making and enable policymakers to: (i) better understand all assets and liabilities, which is invaluable for effective medium-term financial planning; (ii) better manage current and contingent liabilities, including arrears; and (iii) implement proper asset management practices by assessing whether assets are currently used effectively and efficiently to deliver public services. Enhanced financial reporting practices provide the foundation for the implementation of effective control systems and internal and external audits, both of which are important to strengthen management accountability. The absence of a comprehensive financial reporting framework in Albania has led to the implementation of few financial audits, which in turn has resulted in a lack of validation of financial information.

¹⁶² World Health Organization. 2018. *Primary health care in Albania: rapid assessment*. https://www.euro.who.int/_data/assets/pdf_file/0011/373718/alb-phc-ra-eng.pdf.

160. Government entities also struggle to fully implement financial management and control legislation. There is limited managerial accountability in Albania because: (a) most authority is centralized; and (b) managerial accountability is not working vertically with subordinate organizations. This has hampered effective and efficient service delivery and monitoring of performance across sectors. Therefore, further work is needed to strengthen institutional arrangements and change the work culture. Shortcomings in the country's control framework are noted across central and local government authorities, and there has been limited implementation of modern risk management practices. Furthermore, weak capacity of finance units in terms of staff, skills, and resources makes it difficult to establish clear roles and responsibilities and achieve public sector objectives. Also, the impact of internal audits is undermined by a lack of understanding of international standards by both auditors and managers and a focus on compliance and regularity audits. To improve the relevance of audits, the authorities need to upskill internal auditors and align internal audit practices with international standards.

161. Albania needs to improve its external audit capacity to establish a well-functioning public financial accountability and assurance mechanism. While the Supreme Audit Institution carries out the full range of audits in Albania, most of its audits are compliance audits that focus on determining irregularities as well as highlighting any relevant material issues and systematic and control risks. The State Audit Institution does not regularly conduct financial audits. Instead, it focuses on: (i) aligning audit practices with international standards by identifying opportunities to improve systems or address potential improvements in the efficiency and effectiveness of public service delivery; and (ii) improving the communication with legislative and other stakeholders to ensure they follow up on audit recommendations, thereby enhancing the impact of audits.

To strengthen the efficiency of public spending, the authorities should consider:

- **Improving the prioritization of public spending.** This includes: (i) enhancing the country's project investment management capacity in terms of selecting investment projects, including public-private partnerships; and (ii) implementing performance-based budgeting to ensure the efficient reallocation of expenditure between sectors.
- **Strengthening budget execution.** This includes: (i) fully rolling out the AGFIS and enforcing the implementation of commitment controls among budget users; (ii) limiting carryover practices among local governments; and (iii) strengthening financial reporting.
- **Enhancing accountability and transparency.** This includes aligning the country's financial and non-financial performance reporting practices with international standards.

Strengthening the Credibility of Fiscal Policy

162. Albania has a fiscal rule in place which mandates that the debt to GDP to decline every year with respect to the previous year, until it reaches 45 percent of GDP. The rule, which came to force in 2017, gives the government enough discretion regarding the speed of fiscal consolidation by not requiring the government to commit to a specific target in each year. Exceptions to this rule are also included in the form of specific exception clauses, which the government can employ when fiscal policy needs to respond to large economic shocks. Such a clause was invoked in 2020, giving the government the discretion to increase support to the economy and leading to an increase in the public debt to 77.2 percent of GDP, up from 67.4 percent in 2019. Starting from 2024, Albania is going to target a positive primary balance.

163. Fiscal consolidation reversals could erode the credibility of fiscal policy, increase the refinancing risk for the country's debt, and reduce public support for further consolidation efforts. Albania had a good track record with establishing credibility for its fiscal rule and bringing public debt down between 2017 and 2019. Such consolidation helped create buffers to support the economy in 2020, and close financing gaps through successful commercial borrowing at relatively low interest rates in 2018 and 2020.

However, the fiscal rule was suspended in 2021 through a normative act resulting in an increase in spending on infrastructure, and the achievement of a positive primary balance originally sanctioned in 2023 was postponed to 2024. Public debt is now projected to reach 78.6 percent of GDP in 2021, before it gradually declines to 66.4 percent in 2026.

164. Albania’s debt sustainability analysis shows that the country’s gross financing needs will be high at an average of 23 percent of GDP per year between 2022 –2026. Although set to decline in a baseline scenario, Albania’s debt trajectory is vulnerable to a growth shock, an interest rate shock, and—with the share of foreign exchange debt increasing, –an exchange rate shock. Public debt is expected to stabilize at 87 percent in 2026 in an adverse scenario, with growth being 2.5 percentage points lower than in the baseline, the exchange rate depreciating by 15 percent, and interest rates going up by around 400 bp for two consecutive years.

Figure 71. Debt to GDP Baseline Projections and Sustainability Analysis.

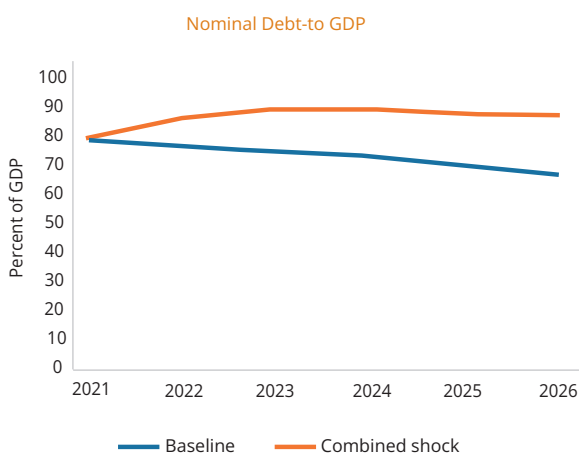
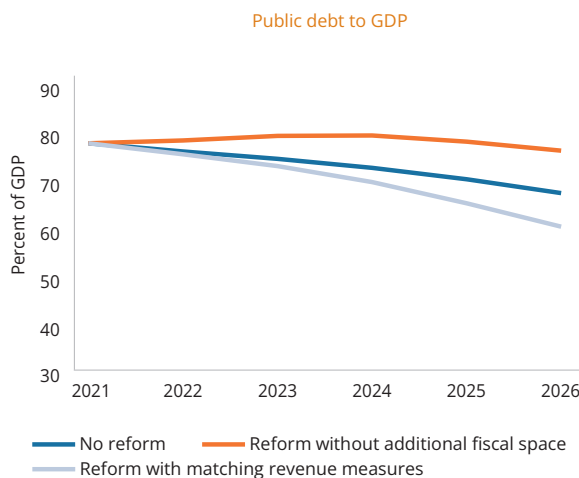


Figure 72. Public and Publicly Guaranteed Debt Reform Scenarios.



Source: World bank Staff calculations.

165. In the previous chapters of this CEM, the reforms suggested to improve the country’s growth prospects are likely to require increased government financing over the medium run, including efforts to reduce gaps in human capital, improve firms’ productivity, reduce social disparities, and preserve the environment. While a detailed costing of all reforms is beyond the scope of this report, in a scenario seeing a spending increase of around 3.4 percent of GDP per year,¹⁶³ public debt would stay at 77.2 percent of GDP in 2026, with gross financing needs estimated at an average of 27.7 percent of GDP per annum over the same period (Figure 81).

166. However, the country was able to mobilize additional revenues by implementing the set of tax policy options presented in section 2 of this chapter, achieve the expected results through fiscalization, and achieve a comparable compliance on direct taxes as the average of WB6, the country’s debt prospects could improve substantially. Gross public debt to GDP would decline by more than in the baseline scenario at 58.2 percent of GDP in 2026, although additional consolidation beyond the medium term could be achieved through unlocking growth (as explained in Box 1). The reform implementation is not dependent on the budget availability only, which is why the above demonstration does not intend to specify a desired consolidation path. However, it indicates that many of the reforms outlined in this CEM are affordable from a debt perspective only if matched with additional revenue measures.

¹⁶³ Includes increased spending in education, an expansion of active labor market policies, environmental protection, social protection, national quality infrastructure, and guaranties to support the private sector.

To strengthen the credibility of the fiscal rule, the authorities should consider:

- **Eliminating discretion in suspending the fiscal rule outside exceptional situations.** Achieving fiscal consolidation relies on a strong political commitment to observe the fiscal rule. Setting realistic revenue targets, strengthening budget execution and mitigating fiscal risks should alleviate the pressure on the overuse of normative acts within budget years, including the suspension of the fiscal rule.
- **Upgrading debt management.** This includes urgently filling open positions at the debt management department of MoFE.

Conclusion

167. Albania needs to create fiscal space in order to support the broad agenda of reforms seeking to unlock private sector growth, build the necessary skills for the labor force of tomorrow, and ensure growth sustainability through a green recovery, disaster preparedness, and inclusion. Albania's revenue collecting potential can be increased primarily through measures tackling noncompliance, in particular with regard to indirect taxes and income taxes. Additional mobilization of property and environmental taxes would better support the local government service delivery, given the very low share of own-source revenues in their total revenues.

168. This chapter concludes that, in general, tax policy in Albania is broadly aligned with OECD standards and the region. However, exemptions with regard to VAT, excises, and national taxes erode the tax base and create opportunities for noncompliance. A different tax treatment of the self-employed, relative to paid employees, creates legal loopholes and reduces the fairness of the tax system. Finally, large wage undeclaration needs to be addressed, since informality undermines the progressivity of the income taxation system and creates an unfair competition environment for the formal market.

169. While public spending is likely to remain high during the ongoing pandemic and to accommodate the implementation of reforms to enhance growth, additional spending needs to be timed with the creation of additional fiscal space. Albania's debt is currently high and subject to high refinancing risk. This is especially a concern in current times of high uncertainty with regard to the recovery in global demand, interest rates, and investor risk appetite. Albania needs to adhere to a more (de facto) stringent fiscal rule – except in case of tightly defined exemptions prescribed by law – and strengthening the credibility of the budget by limiting the purpose and frequency of in-year changes through normative acts.

Albania Country Economic Memorandum Conclusion

170. Coming out of the COVID-19 crisis, Albania stands at a crossroads. Given the sharp contraction of Albania's economy linked to the 2019 earthquake and the subsequent COVID-19 pandemic, gradual normalization of economic activity in 2021 has been associated with a strong economic recovery. However, this hides ongoing structural weaknesses in Albania's pre-crisis development model. It is now crucial for Albania to return to the hard work of completing its unfinished structural reform agenda—ensuring that Albania continues on its long-term development journey towards convergence with the EU.

171. This CEM has outlined four key priorities around which Albania should focus its reform efforts. Albania needs to refocus attention on the pre-crisis reform agenda and accelerate its long-term economic growth rate, including by spurring productivity growth, building human capital, and supporting investment. On the labor supply side, this means investing in people and supporting workers' transition to better employment (Priority 1), while on the labor demand side, this means accelerating firm productivity growth and creating better job opportunities (Priority 2). Albania should also use the current crisis to set its aspirations higher. Beyond achieving higher economic growth, policymakers need to strengthen the quality of the country's socioeconomic development model. Through more GRID, Albania could ensure the sustainability of economic growth (Priority 3). Foundationally, this CEM highlights the need for Albania to create fiscal space to support its growth priorities (Priority 4). The COVID-19 crisis has driven public debt to new heights, and upgrading Albania's growth model—including by implementing many of the reforms proposed in this CEM—would require further public spending. This makes it a priority to improve public financial management and create additional fiscal space.

172. While this CEM identifies key reform priorities for Albania, policy measures need to be coupled with firm political commitment and investment in government capacity to ensure successful implementation. The CEM aims to offer a structured contribution to the renewal of Albania's reform program as it emerges from the COVID-19 crisis, laying out 4 core priorities for the country's way forward. The road ahead for Albania is long, and the identification of reform priorities needs to be followed by the effective implementation of new policies. This means embedding priorities into the agenda of top-level Albanian decision-makers, adopting the necessary changes in the country's legal framework, and ensuring that ministries and local officials translate policy changes into actual improvements in the daily lives of Albanians.

173. The four CEM priorities, while distinct, interact dynamically and need to be implemented as a holistic package. For instance, investing in people and increasing firm productivity needs to go hand in hand. Without adequate job opportunities, skilled workers will emigrate. Without skilled workers, firms cannot access higher value-added activities. Equally, Albania's green transition interacts with increasing the capabilities of the private sector (green technologies and clean energy are key investment opportunities for Albania) and strengthening public finances (green public investments will require fiscal space, while environmental taxes can become more important sources of revenue). Only with a holistic approach to reform can Albania unlock the full development benefits of its reform efforts.

174. Smart sequencing of the reform program will be crucial to focus government implementation capacity and secure sustainable development gains. In the first instance, existing ongoing reform efforts need to be brought to conclusion and fully implemented. Large multi-year structural reforms need to be broken down into concrete achievable intermediate steps. Albania needs to develop the institutional capacity to design, adopt, and monitor the results of reforms (Box 13). Finally, programs requiring significant increases in government spending should only be implemented as public revenue mobilization gains materialize and fiscal space becomes available. The World Bank Group looks forward to continuing to support Albania on its reform journey.

Box 13: Albanian Government Reform Capacity: Challenges and Solutions

-To accelerate the adoption and implementation of the policy recommendations provided in this report, it would be important to strengthen the Albanian government's capacity to design, adopt, implement, and monitor reforms. The below is a brief summary of the challenges and potential avenues for addressing such challenges.

Background and Challenges

Albania has made progress in strengthening its capacity to implement public policy reforms. This includes building the capacity in line ministries to implement regulatory impact assessments, the adoption of public consultation guidelines and heightened public transparency, the establishment of integrated Information and Communications Technology (ICT) systems for planning and delivering services, and the progressive implementation of the 2015-2022 public administration reform (PAR) and the 2014-2022 public financial management (PFM) reform strategies.

In spite of progress, a number of challenges remain. At the macro-level of public institutions, available indicators show that there are weaknesses in public sector and institutional effectiveness in Albania. For example, the Worldwide Governance Indicators (2020) show that Albania remains below the average of the EU-27 for the 6 indicators, (i) political stability; (ii) government effectiveness; (iii) regulatory quality; (iv) rule of law; (v) control of corruption; and (vi) voice and accountability. Furthermore, in terms of reforming the public administration, the latest report from the European Commission (EC), (2021), notes that Albania is only "moderately prepared" to reform its public administration.

At a more granular level, key issues with regards to reform design and implementation include:

- *Implementation gap.* There remains a reform implementation gap on at least two levels in Albania: (i) a gap between the national policy and legal framework, on the one hand, and the adoption and implementation of the said framework in line ministries and public institutions, on the other hand; and, (ii) a gap between the capacity of local governments and administrations to adopt and implement new reforms, notably with certain 'lagging regions' in the interior falling behind.
- *Civil Service capacity.* The capacity of the public bureaucracy to implement reforms has been limited by staff turnover, weaknesses in human resource management (e.g., political rather than merit-based recruitment), and weaknesses in technical and financial capacity.
- *Coordination issues.* Many of the remaining reforms require complex coordination. There are weaknesses in reform coordination between sectoral ministries (i.e., horizontal coordination) and central and local government institutions (i.e., vertical coordination).
- *Government and public accountability.* There are limitations in the scope and depth of public consultation in reform design and implementation, and limitations in the transparency of information (e.g., on public policy, or Open Data). This limits the ability of all members of society to have a stake in—and hold the government accountable for—reform implementation.

Avenues for Capacity Strengthening

Based on national and international best practices, a number of actions could be taken, including in the areas of:

- *Collaborative Leadership and Coordination.* Government reform leadership and coordination capacity should be strengthened. This includes strengthening the capacity of the 'centre of government' (usually at the level of the Prime Minister's Office) in the monitoring of reform implementation; establishing inter-ministerial reform 'task forces' charged with developing and monitoring specific and achievable reform action plans; and designing and implementing of capacity building programs for reform design and uptake (e.g., through trainings on executive leadership).

- *Strategic Communications.* Communications capacity for reform is critical and is normally built into two key areas ⁽ⁱ⁾: reinforcing the government’s internal communications capacity, so that all government agencies are aware of and implement new reforms; and ⁽ⁱⁱ⁾ external communications to raise awareness of the need for and implementation of reforms.
- *Building Reform Alliances.* Reform alliances need to be built by identifying reform champions, both in the government and civil society, and developing strategies for compensating and/or convincing those actors that are against the reforms or are likely to lose from a given reform.
- *Change Management.* Public institutions need to develop and finance change management strategies for each specific reform to ensure that all relevant stakeholders are aware of key reforms and incentivized and capacitated to adopt reforms.
- *Civil Service Quality.* The quality of the civil society could be strengthened through improved human resources management and introduction of performance management systems, improving the capacity of public investment management systems.
- *Public Support.* There is a need to increase the effectiveness of public involvement in and support for selected reforms. This can be done through heightened consultation, strengthened partnership with civil society organizations, increased transparency, and strengthening of accountability mechanisms (e.g., via parliamentary involvement).

Table 5. Summary of Policy Recommendations

Priority	Area	Reform	Sequencing
1. Investing in people	Fostering foundational skills development through quality pre-university education	Improving education spending, including school network optimization and redeploying funds to cover spending gaps such as in capital investment	A first step would be to adopt a school re-optimization plan, which may already generate some savings during implementation and thus may allow for funds to be redeployed toward other spending items, including infrastructure, professional development, and student support programs. Increases in the spending envelope need to be timed to align with gains in revenue mobilization and the availability of additional fiscal space.
		Strengthen teachers' skills training and performance incentives	While regulatory changes may be introduced relatively quickly, implementation will require a sustained multi-year effort.
		Strengthen the ability of schools to assume leadership over school-level improvements	While regulatory changes may be introduced relatively quickly, implementation will require a sustained multi-year effort.
		Strengthen existing student assessments and develop an integrated information system for monitoring learning outcomes	While regulatory changes may be introduced relatively quickly, implementation will require a sustained multi-year effort.

1. Investing in people	<i>Fostering foundational skills development through quality pre-university education</i>	Consider increasing instructional time by lengthening the school day	Teachers need to be compensated for higher workload or additional teachers need to be hired. The resulting increases in the spending envelope need to be timed to align with gains in revenue mobilization and the availability of additional fiscal space.
		Close learning gaps for children who may otherwise be left behind	A first step would be to continue programs to close COVID-19 learning gaps. Larger increases in the spending envelope need to be timed to align with gains in revenue mobilization and the availability of additional fiscal space.
		Improve the coverage and quality of early childhood education and care	While regulatory changes may be introduced relatively quickly (e.g., obligatory national minimum standards for local government service providers), proper implementation is going to involve additional fiscal resources. Increases in the spending envelope need to be timed to align with gains in revenue mobilization and the availability of additional fiscal space.
	<i>Building on the foundation of higher education reforms</i>	Strengthen the quality and relevance of higher education	Reforms in the area are ongoing. Full implementation will require a sustained multi-year effort.
		Create or strengthen career services	Reforms in the area are ongoing. Full implementation will require a sustained multi-year effort.
	<i>Meeting labor market needs: Ensuring lifelong learning and skills training</i>	Improve vocational education and training programs	Reforms in the area are ongoing. Full implementation will require a sustained multi-year effort.
		Finalize the reform of active labor market programs	Increases in the spending envelope need to be timed to align with gains in revenue mobilization and the availability of additional fiscal space.
		Introduce individual learning accounts	Technical work to prepare the reform can start immediately. Reform implementation is a multi-year effort.
		Introduce off-season upskilling programs targeted at seasons workers in sectors such as tourism and agriculture	Depends on fiscal space yet to be created, but may benefit from private collaboration.

2. Increasing firm productivity	<i>Improving the business environment</i>	Reform the investment legal framework	In a first step, draft laws in the pipeline—such as the Unified Investment Law—need to be approved. While regulatory changes may be introduced relatively quickly, demonstrating to investors that the investment legal framework has strengthened in practice will require a sustained multi-year effort.
		Complete the ongoing judicial reform	Reforms in the area are ongoing. Full implementation will require a sustained multi-year effort. Judicial staffing constraints need to be overcome.
		Continue efforts to streamline government-business interactions	Reforms in the area are ongoing. Full implementation will require a sustained multi-year effort.
		Fully implement the land reform program	Reforms in the area are ongoing. Full implementation will require a sustained multi-year effort.
	<i>Strengthening entrepreneurship and innovation</i>	Increase access to early-stage financing for start-ups	Increases in the spending envelope need to be timed to align with gains in revenue mobilization and the availability of additional fiscal space.
		Strengthen incubator and accelerator programs	Increases in the spending envelope need to be timed to align with gains in revenue mobilization and the availability of additional fiscal space.
		Strengthen business support programs for growing small and medium-sized enterprises	Increases in the spending envelope need to be timed to align with gains in revenue mobilization and the availability of additional fiscal space.
		Increase access to finance for micro, small, and medium-sized enterprises	Increases in the spending envelope need to be timed to align with gains in revenue mobilization and the availability of additional fiscal space.
		Adopt policies and develop support programs aimed at encouraging women entrepreneurship	Increases in the spending envelope need to be timed to align with gains in revenue mobilization and the availability of additional fiscal space.
	<i>Integrating Albania into the global economy</i>	Prioritize the full and effective implementation of the measures under the World Trade Organization's Trade Facilitation Agreement	Reforms are ongoing, but reform progress also depends on reciprocal efforts by partner countries
		Enhance the National Quality Infrastructure	Increases in the spending envelope (for laboratories, improved inspections regime, etc.) need to be timed to align with gains in revenue mobilization and the availability of additional fiscal space.
		Scale up the Albanian Investment Development Agency's successful foreign direct investment and retention programs	(i) Streamline the agency's mandate to focus on core promotional activities. (ii) Provide adequate staffing and resources aligned with the mandate and equip the agency with relevant technological tools to offer better services to investors. (iii) Regularly review and align high-potential sectors for investment attraction.

3. Building a more sustainable growth model	<i>Promoting a green recovery</i>	Diversify the sources of energy with sustainable alternatives	Increases in the spending envelope need to be timed to align with gains in revenue mobilization and the availability of additional fiscal space.
		Improve energy efficiency	Increases in the spending envelope need to be timed to align with gains in revenue mobilization and the availability of additional fiscal space
		Adopt measures aimed at greening the transport sector	Increases in the spending envelope need to be timed to align with gains in revenue mobilization and the availability of additional fiscal space
		Implement measures to better monitor and reduce air pollution	Increases in the spending envelope need to be timed to align with gains in revenue mobilization and the availability of additional fiscal space.
		Improve the quality of the water supply	Strengthening the performance of water management facilities, including their financial viability and governance, is a first step in ensuring the quality of service delivery
		Reduce waste generation upstream and transition toward a circular economy	Adopting the legal framework on the extended producer responsibility can be a first step. Increases in the spending envelope to incentivize the adoption of technologies to reduce waste need to be timed to align with gains in revenue mobilization and the availability of additional fiscal space.
		Accelerate sustainable agricultural growth	Increases in the spending envelope need to be timed to align with gains in revenue mobilization and the availability of additional fiscal space.
		Strengthen the sustainable use of natural resources and the stewardship of the environment	Reforms in the area are ongoing. Full implementation will require a sustained multi-year effort.
	<i>Reinforcing resilience against disasters</i>	Strengthen Albania's physical resilience to disasters	New infrastructure investments need to be screened against climate change/ Adopting secondary legislation and guidelines is therefore a necessary first step. Increases in the spending envelope need to be timed to align with gains in revenue mobilization and the availability of additional fiscal space.
		Improve Albania's financial preparedness to manage disaster-related contingent liabilities and increase the financial resilience of households and the private sector	As a first step, the draft laws in the pipeline—including the mandatory earthquake insurance law—need to be adopted.
	<i>Sharing the benefits of economic growth</i>	Gradually increase the funding for key social protection programs	Increases in the spending envelope need to be timed to align with gains in revenue mobilization and the availability of additional fiscal space
		Gradually broaden the coverage of the social protection framework	Increases in the spending envelope need to be timed to align with gains in revenue mobilization and the availability of additional fiscal space.
		Complement financial support with social services	Full implementation will require a sustained multi-year effort, including building up staffing capacity at the local level.

4. Strengthening public finances	<i>Mobilizing revenues</i>	Increase the productivity of the value-added tax	Ongoing reform. MTRS needed in the short term.
		Reform the personal income tax system	Ongoing reform. MTRS needed in the short term.
		Reduce the cost of compliance	Ongoing reform. MTRS needed in the short term.
	<i>Strengthening the efficiency of public spending</i>	Improve the prioritization of public spending	Institutional and human resources capacity constraints prevent implementation.
		Strengthen budget execution	Reform is ongoing. A review on the use of within-year normative acts may be a short-term gain.
		Enhance accountability and transparency	Reform is ongoing but human resources constrain further progress. Weak institutional capacity and overlapping mandates between government agencies are constraints to faster reform.
	<i>Strengthening credibility of the fiscal policy</i>	Strengthening the credibility of the fiscal rule	Full implementation will require a sustained multi-year effort, demonstrating a sustained political commitment to the fiscal rule.
		Upgrading debt management	Reforms in the area are ongoing. Full implementation will require a sustained multi-year effort.

(i) See, for example: https://ec.europa.eu/commission/presscorner/detail/en/qanda_21_5276

(ii) See, for example: https://ec.europa.eu/commission/presscorner/detail/en/qanda_21_5276

