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**2019 UPDATE**

REPORT  
Nº: 147451-AL

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# ALBANIA

## SYSTEMATIC COUNTRY DIAGNOSTIC





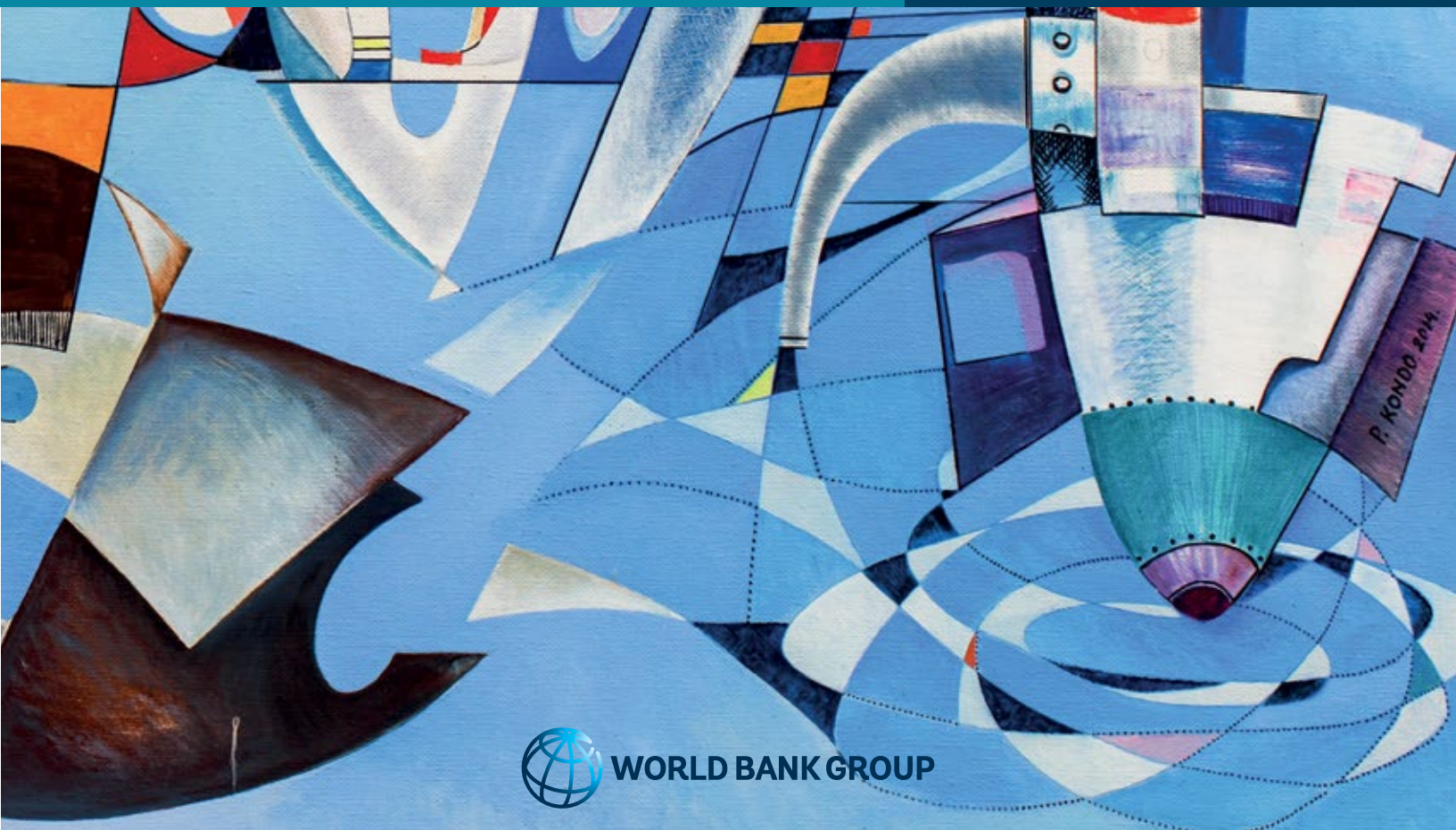


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People forge ideas, people mold dreams, and people create art. To connect local artists to a broader audience, this report features the “The Development Stages” by Pano Kondo, winner of the Albanian Contemporary Art Competition organized by the World Bank Office in Albania in 2019.

Graphic design by: Kilka Diseño Gráfico



**ASPIRE**

The Atlas of Social Protection - Indicators of Resilience and Equity

**BoA**

Bank of Albania

**BPO**

Business process outsourcing

**CEFTA**

Central European Free Trade Area

**DRM**

Disaster Risk Management

**EU**

European Union

**FDI**

Foreign Direct Investment

**GDP**

Gross Domestic Product

**GoA**

Government of Albania

**GVC**

Global Value Chain

**IFC**

International Finance Corporation

**ILO**

International Labor Organization

**IMF**

International Monetary Fund

**INSTAT**

Institute of Statistics, Republic of Albania

**LGBTI**

Lesbian, gay, bisexual, transgender and intersex

**MAP REA**

Multi-Annual Action Plan for the Regional Economic Area

**MFE**

Ministry of Finance and Economy

**MTBP**

Mid-Term Budget Plan

**NCD**

Non-Communicable Disease

**NEET**

Not in Employment, Education, or Training

**NPL**

Non-Performing Loan

**NRW**

Non-Revenue Water

**OECD**

Organization for Economic Co-operation and Development

**OSCE**

Organization for Security and Co-operation in Europe

**PEFA**

Public Expenditure and Financial Accountability

**PFM**

Public Financial Management

**PIM**

Public Investment Management

**PPP**

Public-Private Partnership

**SCD**

Systematic Country Diagnostic

**SOE**

State-owned enterprise

**SOGI**

Sexual Orientation and Gender Identity

**TAP**

Trans-Adriatic Pipeline

**VAT**

Value Added Tax

**WDI**

World Development Indicators

**WTTC**

World Travel and Tourism Council

**CURRENCY EQUIVALENTS**

Exchange Rate effective March 5, 2020

Currency Unit – Albanian Lek (LEK) 1.00 = US\$ 0.009

US\$ 1.00 = LEK 109.79

Government's Fiscal Year

January 1 – December 31

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## BENCHMARKING COVERAGE AND COUNTRY ACRONYMS

The regional aggregates used in this report, and country acronyms are defined as follows:

- **Western Balkans (WB6):** Albania (ALB), Bosnia and Herzegovina (BiH), Kosovo (KOS), North Macedonia (MKD), Montenegro (MNE), Serbia (SRB)
- **European Union (EU28):** Austria (AUT), Belgium (BEL), Bulgaria (BGR), Croatia (HRV), Cyprus (CYP), Czech Republic (CZE), Denmark (DNK), Estonia (EST), Finland (FIN), France (FRA), Germany (DEU), Greece (GRC), Hungary (HUN), Ireland (IRL), Italy (ITA), Latvia (LVA), Lithuania (LTU), Luxembourg (LUX), Malta (MLT), Netherlands (NLD), Poland (POL), Portugal (PRT), Romania (ROU), Slovak Republic (SVK), Slovenia (SVN), Spain (ESP), Sweden (SWE), United Kingdom (GBR)
- Comparisons with non-EU high income economies are done occasionally when EU data is not available or to highlight distance to frontier.



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**Since the first Systematic Country Diagnostic (SCD) was prepared in 2015, Albania has stabilized its macro-fiscal situation and improved GDP growth.** Between 2008 and 2014, the weakness in the global economic environment, particularly among Albania's main trade partners, caused a decline in exports, remittance inflows and external credit conditions. With fiscal vulnerabilities unraveling, the crisis lowered growth, destroyed jobs and increased poverty. In response, the Government of Albania implemented a fiscal adjustment program that brought down the budget deficit (reaching 1.8 percent of GDP by 2018) and the economy gradually recovered: job creation, investment, and exports increased, and poverty fell by 2.3 percentage points (in 2014-2017), while GDP grew on average by 3.2 percent per year. Structural reforms in some areas have also moved forward, including in justice, energy, and territorial administration.

**In late 2019 and the first half of 2020, Albania was struck first by a historic earthquake and then by the global COVID-19 pandemic.** In November 2019, Albania was struck by a 6.4-magnitude earthquake, killing 51 and displacing 17,000 people. As Albanians started the reconstruction process, supported by a pledged EUR1.15 billion financial assistance package from the international community, a second crisis hit. In March 2020, Albania was forced to take unprecedented public

health measures to slow the spread of the global COVID-19 epidemic, a highly contagious virus that can cause respiratory illness in people. Measures included severe restrictions on international and domestic travel as well as the mandatory closure of public meeting places such as restaurants and schools. While the virus is yet to be contained at time of writing of this SCD update, these two crisis are expected to severely depress economic activity in Albania in 2020.

**As Albania overcomes these challenging times, it will be crucial to look forward and to tackle with renewed vigor Albania's reform agenda ahead - the development gains achieved in recent years need to be protected and Albania's development model needs to be upgraded to deliver faster and more inclusive growth.** Per-capita GDP is still at only around 1/3 of the average EU level, and, at current growth rates, convergence could take more than one generation.<sup>1</sup> Indeed, in 2017, close to 4 in 10 Albanians still lived with less than US\$5.5 per day, a poverty rate similar to the one in 2008. As Albania moves closer to commencing formal negotiations toward European Union membership, it needs to take advantage of the reform incentives that this process offers to create more favorable conditions for faster, inclusive and sustainable economic progress to its citizens.

**The SCD Update aims to identify Albania's binding constraints for faster progress against the current political backdrop and on-going trends.** The Update takes the analysis of the original 2015 SCD as a baseline and reviews the progress and outstanding issues in light of recent evidence (including WBG-led analyses on productivity, finance, labor markets, gender, urban development, agriculture, fiscal policy and others). It then ana-

<sup>1</sup> Assuming that Albanian and EU GDP per capita (PPP 2011 international \$) continue to grow at their average rate over the period 2008-18, GDP per capita would equalize in 2071.

lyzes how further progress can be achieved, using the EU accession process as an anchor for reform and considering three important trends in the country: the shift towards the global economy, which needs to be reinforced to produce higher quality jobs; the on-going decentralization process, which calls for higher local government capacity to reduce spatial inequality; and the changing social contract and falling working-age population, which highlights the importance of inclusive policies to expand access to economic opportunities. The Update organizes the analysis around **three Strategic Objectives** and identifies corresponding priority policy areas to achieve sustained progress.

**Strategic Objective 1: Integrating into the global economy.** Albania's economic progress continues to rest on a vulnerable model, as domestic consumption, hydroelectric production, textile and garment exports, and FDI concentrated in large energy-related projects have driven most GDP growth since 2014. Job creation took place mainly in low-wage sectors, and real wages grew three times more slowly than pre-2008. Subsistence and small-scale agriculture continue to employ the largest share of the workforce (38 percent); and labor force participation has increased modestly, both for women and men. *Given Albania's small domestic economy, accelerating the country's integration into GVCs is a pathway to sustained growth and formal job creation, through access to larger and more affluent markets, a greater talent pool, financing opportunities, new technologies and more sophisticated production inputs.*

**Strategic Objective 2: Making local governments more effective.** In 2014 Albania embarked on a major local government reform to increase municipalities' administrative, regulatory and service competencies and financial autonomy, while reorganizing them into fewer units to create economies of scale. The results of this pro-

cess have been modest so far and Albanians still face significant spatial inequality in access to jobs and services, while the major cities continue to face unplanned growth and congestion. Further, while rising environmental risks are jeopardizing the development of key economic sectors such as agriculture, fisheries and tourism, local governments have limited capacity to manage natural resources effectively and to implement coordinated urban and territorial development plans. The decentralization of disaster risk management also complicates the application of preparedness and response plans to address the risk of disasters such as the earthquakes of 2019. *Local government strengthening is key to increase the competitiveness of urban centers while improving service delivery in rural areas to foster more inclusive growth.*

**Strategic Objective 3: Enhancing social and economic inclusion.** Following the crisis, poverty reduction has been modest relative to the pre-2008 period, due to modest wage gains—Albania still has the lowest average wages in the Western Balkans, in purchasing power parity. Human capital gaps exclude a large share of the workforce from formal jobs, resulting in low wages and no social security, while safety nets have limited coverage and generosity. Women and minority groups continue to face barriers to job opportunities and equal wages. The lack of good jobs prevents workers from accumulating savings, while the population is aging. *Higher and more efficient spending in health and education, combined with targeted activation services would increase access to formal employment, while better targeted safety nets would better protect the poorest.*

**To achieve these Strategic Objectives, Albania needs to prioritize policies around 5 key areas.** The Update analyzes the main constraints that Albania faces to achieve the three Strategic

Objectives described above, based on the most recent evidence available, on internal and external consultations, and in alignment with the EU accession process. These constraints span across all sectors and levels of government, and thus isolated efforts to address them would not be sufficient. The five policy areas tackle constraints to growth and inclusion; while the first three are critical to increase competitiveness both for firms and workers, the last two would contribute the most to increasing inclusion.

**Fostering competitive markets.** Lowering non-tariff barriers, fighting corruption, reducing legal uncertainty, curtailing the informal sector and increasing managerial know-how would boost the competitiveness that Albanian businesses need to participate in Global Value Chains (GVCs) and to strengthen backward linkages to domestic producers. A more skilled workforce, a high-quality infrastructure, and a deeper and more diversified financial sector are needed so that firms can embark in higher value-added industries. Innovation and digitalization initiatives can help firms become more efficient and promote business models that integrate better with GVCs.

**Enhancing efficient investment in human capital.** Starting with early childhood and throughout the life cycle, investment in human capital needs to be higher and more efficient. In education, higher investment in teacher training and assessment is a priority, together with output-based financing; and health services need to rely more on day and outpatient care, while implementing the hospital master plan. Increased attention in human resources in areas where shortages are more severe is also a priority.

**Upgrading infrastructure, improving disaster resilience and energy diversification.** To accelerate its progress towards meeting EU standards,

Albania needs to continue investing in transport infrastructure (maintenance especially) and digital connectivity to increase the flow of goods, people and information within and across borders. At the same time, the annual losses in infrastructure from recurring floods and the losses caused by earthquakes such as those of 2019 compel to prioritize disaster resilient infrastructure investment. To minimize energy security and financial risks, Albania needs to continue upgrading electricity infrastructure to reduce distribution losses, diversify the energy base towards solar and gas and expand financial buffers in the hydropower sector.

**Strengthening the capacity of local government to raise revenues and deliver services.** To reduce spatial inequality of services and opportunities it is critical to enhance the capacity of the local governments at all levels, including their accountability towards communities. Greater taxation powers, transfers from the center conditional on results, inter-municipal coordination, and an adjustment of the competencies to local resources and capacity would help to strengthen local service delivery. Better coordination between national and local governments is critical to implement territorial development policies that support growth of dynamic and connected cities and more productive rural areas. In some rural areas, targeted policies can help develop agrobusiness, fishing, or tourism, while other areas need to ensure basic needs are covered and facilitate mobility by investing in human capital.

**Strengthening the redistributive efficiency of the state.** Albania needs to strengthen an inclusive growth model. The integration of social assistance and labor intermediation services is crucial to ensure that vulnerable people have greater access to income opportunities to boost them into the middle class and ensure better protection later in life. A smoother transition from school to

work would help young people reduce the risks of unemployment and inactivity. Finally, reducing informality by increasing tax compliance is the only sustainable way to ensure a more equitable society, but this can only happen if the taxation and redistribution systems are transparent and accountable.

**Finally, Albania also needs to continue improving the pre-conditions and the sustainability of economic and social gains in three broad areas.** First, *strengthening rules-based government*, including the process of professionalization of civil service; advancing the justice

reform process and land administration reform, and reinforcing the fight against corruption and organized crime. Second, *achieving a stable macroeconomic environment*, to preserve the gains in fiscal sustainability of the last 5 years and invest more resources to raise competitiveness and inclusion, while managing future risks. Third, *strengthening protection of natural resources* to support the development of key sectors and increase resilience to climate change, by improving the quality and enforcement of regulations, and the national-local coordination, in accordance with the EU acquis.



**Having reached middle-income status over a decade ago, Albania now needs to accelerate progress to boost shared prosperity and attain the country's aspirations.**

Having emerged in the early 1990s from a 50-year authoritarian, isolationist regime as the poorest country in Europe, Albania is today a middle-income country and at the cusp of starting formal negotiations for membership in the European Union—a remarkable achievement. Yet, Albania's emergence has also been marked by a series of setbacks – including a macro-fiscal crisis in 2008-14. Today, Albania's economy has re-emerged and is in recovery, but the pace of development lags behind Albania's aspirations. Progress towards the Twin Goals and convergence to EU-living standards need to accelerate. At current GDP growth rates, a child born in Albania today would be more than 50 years-old by the time the country reaches the living standards of the EU.<sup>2</sup> Albania needs faster, more inclusive and more sustainable growth.

**The 2015 Systematic Country Diagnostic (SCD) identified four major constraints for Albania to achieve the Twin Goals and converge to EU living standards.** First, the domestic-oriented-growth model supported by foreign flows financing consumption and investment does not generate high and sustained growth. Sec-

ond, Albania under-utilizes its physical and human assets. Physical capital investment (private and public) did not prioritize high-return investment and returns have been falling. The country's land resources are under-utilized because of insecurity of property rights which leads to farm fragmentation and uncontrolled growth of urban settlements. The labor market remained structurally weak, with low labor force participation and employment rates, significant informality and outmigration, despite a large share of working age adults in the population and strong growth in the early 2000s. Third, low institutional quality, reflected in an ineffective judicial system and an inconsistent application of the rule of law, an unreliable energy supply, and a limited safety net system create distortions in the allocation of resources and the productive use of Albania's endowments. Fourth, Albania is highly exposed to several risks: the close links between Albania and some European economies can generate significant changes in demand for Albanian exports and workers; the degradation of Albania's natural resources jeopardizes competitiveness and the livelihoods of people in sectors such as agriculture and others; and systemic exclusion undermines social progress by reducing gains from growth for some groups and eroding trust in institutions.<sup>3</sup>

**The SCD Update revisits the constraints identified in the SCD and provides a fresh perspective on policy priorities in light of recent evidence and developments in the country.** While the SCD was built upon a broad evidence base, it identified key knowledge gaps, especially regarding labor markets.<sup>4</sup> The Update incorporates recent analytical work done in the country,

<sup>2</sup> Assuming that Albanian and EU GDP per capita (PPP 2011 international \$) continue to grow at their average rate over the period 2008-18, GDP per capita would equalize in 2071.

<sup>3</sup> A detailed summary of the 2015 SCD is provided in Annex 1: Main findings and priorities identified by the first-generation SCD "Next Generation Albania" (World Bank, 2015).

<sup>4</sup> See Annex 4: Knowledge Gaps.

including WBG-led analyses on productivity, finance, labor markets, gender, urban development, agriculture, fiscal policy and others. It then analyzes how further progress can be achieved, using the EU accession process as an anchor for reform and considering three important trends in the country: 1) the shift towards the global economy, which needs to be reinforced to produce higher quality jobs; 2) the on-going decentralization process, which calls for higher local government capacity to reduce spatial inequality; and 3) the changing social contract and falling working-age

population, which highlights the importance of inclusive policies to expand access to economic opportunities. In addition, the SCD Update revisits progress in key cross-cutting areas that constitute pre-conditions for development: economic stability, institutional quality, and sustainable management of natural resources. The Update does not intend to deliver an exhaustive analysis at the sectoral level, as did the first-generation SCD, and instead discusses key sectoral issues, referring the interested reader to the relevant sectoral analytical work for details.



**At conception of the SCD in 2014, Albania faced a prolonged macroeconomic crisis.**

Between 2008 and 2014, 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 GDP growth fell to an average of 2.4 percent a year. While not technically a recession, headline GDP figures masked the extent to which Albanians were affected by the crisis. Between 2010 and 2014, net employment fell by about 22 thousand jobs, as key job-creating sectors such as construction declined. Unemployment reached 17.5 percent of the labor force in 2014, and youth unemployment reached 39 percent. Poverty (as measured at US\$5.5 per day in PPP) increased to 39.3 percent by 2012. 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 increased above 5 percent of GDP. Public and publicly guaranteed debt rose to above 70 percent of GDP. In 2014, Albania entered into a three-year IMF program, a series of development policy financing operations with the World Bank and EU support programs.

**In the period 2014-18, annual economic growth gradually recovered and accelerated to over 4 percent.** The growth recovery since 2014 was driven by domestic consumption fueled by renewed job creation, improvements in credit conditions and the inflow of remittances (Figure 1). Investment also picked up, in part thanks to two

large foreign-financed projects, the Trans-Adriatic Pipeline (TAP) and the Devoll hydropower plant. Exports grew especially in textiles, leather and apparel, minerals, and tourism. From the production side, labor and capital accumulation contributed the most to growth, and to a lesser extent a recovery in total factor productivity (Figure 2).

**Albania's economy continued to open to international trade and investment, but exports and FDI remained narrow.**

Albania has committed over the years to take part in global trade. Today, in addition to being an EU accession candidate, Albania is member of the World Trade Organization (WTO) and the Central European Free Trade Area (CEFTA), signed an agreement with the European Free Trade Association, and participates in the Multi-Annual Action Plan for the Regional Economic Area (MAP REA) for the Western Balkans. Between 1992 and 2014 exports of goods and services grew from 12.5 to 28.2 percent of GDP, while the net inflow of foreign direct investment (FDI) went from 3.1 to 8.7 percent of GDP, showing a significant increase in economic exchange between Albania and the rest of the world. The positive trend was less pronounced thereafter, and by 2018, exports reached 31.7 percent while FDI remained at 8.0 percent of GDP. Despite their significance in economic activity, Albanian exports continue to be unsophisticated and limited to few products and destinations, while FDI remains highly concentrated in a few large projects.

**The fiscal deficit has been contained in the period 2014-18, but public debt and the current account deficit remained high.**

The government began a fiscal consolidation program in 2014, supported by the IMF, the World Bank, and other partners, which introduced measures to improve tax collection, reduce the fiscal burden of pensions and energy subsidies, and clear outstanding arrears. This effort and the economic recovery led

FIGURE 1

Growth decomposition by expenditure components of GDP

Source: WB calculations based on INSTAT data

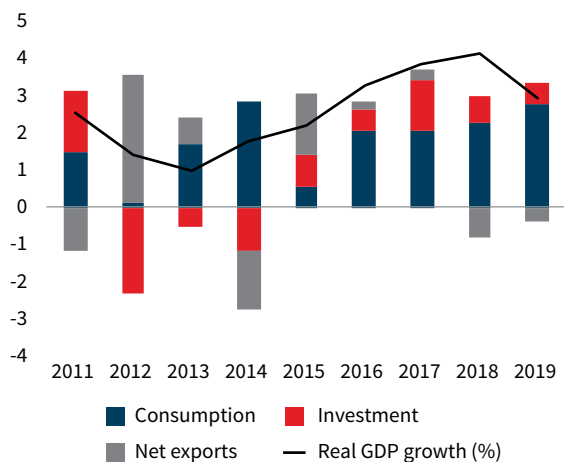


FIGURE 2

Growth decomposition using production function approach

Source: WB calculations based on WB WDI Database

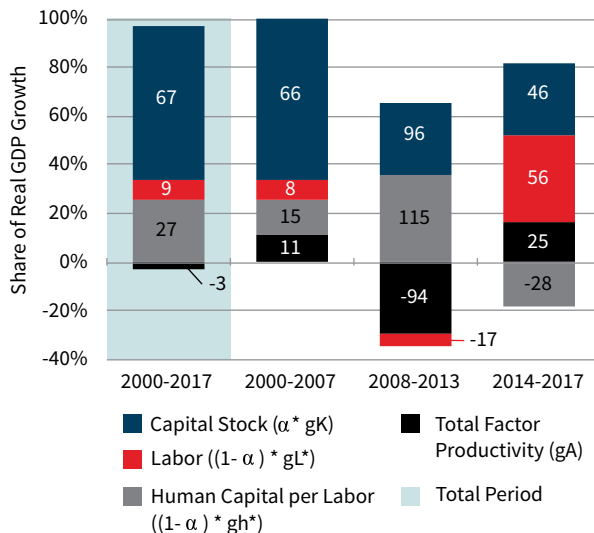


FIGURE 3

Fiscal deficit

Source: IMF WEO April 2019

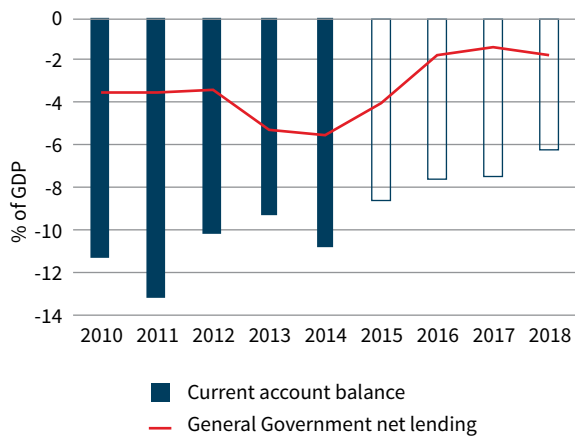
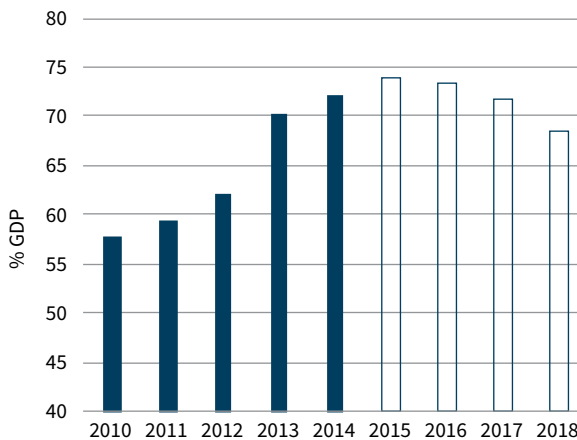


FIGURE 4

General government debt

Source: IMF WEO April 2019





to a steady decline in the deficit from 5.9 percent of GDP in 2014 to 1.8 percent in 2018 (Figure 3). Public debt is on a declining path, in line with Albania's fiscal rule, but the stock remains high at 69.6 percent of GDP (Figure 4) as of end-2018 (compared to a Western Balkan average of 50.2 percent), which is concerning given a weak public revenue base at 27.6 percent of GDP (compared to a WB6 average of 35.3 percent) and significant spending needs to close gaps in the social budget and infrastructure.<sup>5</sup> Meanwhile, the trade balance improved, supported by growth in tourism and business process outsourcing, and the current account deficit narrowed from 10.8 to 6.9 percent of GDP (expected for 2019), thanks also to continued strong remittance inflows from Albania's diaspora. The large and persistent current account deficit implies that the country will continue to rely on substantial FDI. Foreign-exchange reserves have remained stable over the past two years, covering over 6 months of imports of goods and services, thus helping to mitigate risks posed by the high level of external debt of 62.1 percent of GDP (of which 32.8 percent of GDP is public external debt). Albania's banks are liquid and well-capitalized and non-performing loans (NPLs) declined steadily from 25 percent in September 2014 to 11.1 percent in December 2018.<sup>6</sup> However, they are still the highest in the region, encumbering bank balance sheets and contributing to a reluctance to lend, particularly to the corporate sector.

**A slowdown of growth in 2019 highlights the continued vulnerability of the Albanian growth model.** Several internal and external factors explain the fall in growth in 2019. First, as domestic electricity production relies mostly on hydro power, a drop in rainfall slashed electricity production and forced an increase in imports to meet domes-

tic demand. Second, deteriorating global economic conditions reduced net exports and external financing. Third, the gradual completion of the TAP and Devoll construction projects depressed domestic demand. Fourth, continued domestic political tensions increased uncertainty and diminished confidence among businesses and households. Finally, the devastating earthquake on November 26<sup>th</sup> caused significant damages and losses and is estimated to have reduced GDP growth from 2.9 to 2.4 percent in 2019.

**At time of completion of this Update in 2020, Albania's economy has been severely affected by the global COVID-19 pandemic – plunging the economy into crisis.** To contain the spread of the virus, Albania has ordered the temporary lockdown of key economic sectors (such as restaurants, theaters and non-essential trade), limited the movement of people outside their residence to 6 hours per day as well as severely restricting domestic and international travel. Even during the permitted hours, consumers and workers are staying at home to take care of their family – including their children, since schools have closed – and to avoid contamination with the virus. Many industries – even if still permitted to operate – have been forced to restrict business (including textiles, mining, call centers and construction) to comply with social distancing requirements and travel restrictions. While some businesses are experimenting with remote work, productivity is likely reduced. Given unprecedented disruptions and uncertainty, non-essential spending by households and businesses is delayed. Export orders are collapsing in the face of severe economic dislocations in key trading partners, including Italy. It is looking more and more likely that Albania will face an exceptionally poor summer tourism season.

5 World Bank, *Western Balkans Regular Economic Report: Fall 2019* (2019).

6 The capital adequacy ratio was above 18 percent in December 2018.

**The Government is rolling out a series of economic support measures to help Albania weather this crisis – the fiscal stance will drastically loosen in 2020.** While a rebound of economic activity is expected once the impact of the virus can be contained over the coming months, the intervening economic disruption is likely to put severe stress on many Albanians. Many households will face economic hardship, as (i) jobs will be destroyed and (ii) some income earners will need to stay at home to take care of immediate family members, to stay in quarantine or to treat their own illness. To the extent that the crisis forces fundamentally viable businesses to shut down, rupture productive supply-chain relationships or let go of employees that have built up significant on-the-job knowhow, the shock can leave permanent economic scars. Banks enter the crisis with strong capital and liquidity buffers - but they will face adversity as their loans are not repaid according to schedule and their future business prospects diminish sharply. A strong policy support package is therefore needed to help the economy weather the crisis. While measures will evolve dynamically as the crisis progresses, it can be expected that the support policies – combined with a sharp economic slowdown – will drastically widen the 2020 fiscal deficit and increase public debt. Key measures include a credit guarantee fund to ensure lending to businesses that need to meet payroll as well as an increase in social transfers. Monetary policy is easing, offering unlimited liquidity to the banking sector and further lowering the policy rate, will further support the economy.

**To overcome these challenging times, it is crucial to tackle with renewed vigor Albania's reform agenda ahead – protecting recent development gains and adjusting the development**

**model to deliver faster and more inclusive growth.** A consumption-driven growth fostered the expansion of non-traded sectors and low-skilled employment. FDI in energy infrastructure and rain-fueled electricity exports boosted GDP growth but none significantly increased quality job creation across sectors, and FDI has not strengthened value chains connecting to regional and global markets. Gross fixed capital formation remained at around 24 percent of GDP throughout the period 2014-18. International trade in goods and services has grown but it trails Albania's peers and has not led structural transformation. While key industries for future growth in Albania, such as tourism and business process outsourcing have grown recently, the structure of employment across sectors has changed slowly in favor of manufacturing and services, and agriculture still employed around 38 percent of the workforce in 2019. Meanwhile, the private sector ecosystem consists of mostly small firms that invest little in technology adoption and process innovation, face a shortage of skills (especially managerial) and compete in a market with high informality, all of which diminish their growth potential.<sup>7</sup> The low productivity of the agricultural sector also contributes to spatial disparities in living standards and pushes people to migrate from rural areas, increasing urban congestion.

**Despite significant job creation between 2014 and 2019, the quality of jobs remains low.** After 2013, employment creation accelerated (Box 1). By 2018, employment had increased by roughly 221 thousand jobs, and by 2019 unemployment reached a low of 11.4 percent and youth unemployment fell to 21.5 percent. Of the total jobs added within the period, about 60 percent went to male workers, almost all to workers aged 25-54 years and equally split among education levels.

<sup>7</sup> One indicator of inefficiency among firms is productivity dispersion. In Albania, a firm in the top decile of productivity is close to four times as productive as a firm in the bottom decile, a difference twice as large as in advanced economies like the United States (Davies, 2019).

## BOX 1:

### Stylized facts about the Albanian labor market

Sources: Honorati, Johansson De Silva, Kupets, & Berger (2018) Ungerer & Shijaku (2018); INSTAT and EUROSTAT.

**Albania's employment rate still lags EU countries.** Around 66 percent of working-age adults (20-64 years) are employed in Albania (2018), compared to 73.2 percent in the EU-28; and the gender employment gap is 16.5 percentage points (vs. 11.6 in the EU-28). Albania's high NEET rate of 27 percent and a comparatively low rate of employment for the high-skilled segment of the labor force suggests that there are significant skill mismatches in the market. At around 11.5 percent of the labor force in 2019, unemployment remains high by European standards. Nevertheless, only half of the unemployed seek employment through state mediation services.

**Poorly paid and informal jobs are widespread.** The average remuneration rate of Albanian workers is the lowest among all Western Balkan countries (in PPP). Over 30 percent of jobs are informal. The share of part-time jobs and self-employed is the highest in the region. Low-productivity agriculture absorbs close to 40 percent of total employment, while manufacturing and services are underdeveloped.

**Close to 221 thousand new jobs were created between 2013 and 2018, driven by Albania's labor-intensive growth in textiles, tourism, other trade services, health and administrative services.** However, employment growth slowed since 2017. Large firms contributed with 75 percent of net job creation in the post-crisis period. This shift toward larger firms is consistent with a significant increase in the share of medium and large firms among new entrants. Sixty percent of the average net jobs are in Tirana region.

**Large scale emigration continues to be the most evident symptom of a lack of good jobs.** High levels of unemployment and under-employment, low wages, limited social protection and low provision of social services constitute the main motives for emigration.

One-third of all jobs went to women aged 25-54 years, with a larger share for more educated women. At the same time, 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: before 2008, real wages increased by close to 10 percent per year (faster than productivity), whereas between 2014 and 2018 real wages only increased by around 2 percent per year.<sup>8</sup>

**The pace of inclusion stalled following the recovery from the crisis, marking a break with the pre-crisis inclusive growth period.** During the early 2000s, Albania experienced significant poverty reduction together with robust and inclusive economic growth (about 6 percent per year in real terms). Poverty—measured as consumption per-capita below the upper-middle-income poverty line of US\$5.5 per day 2011 PPP—decreased by 18 percentage points between 2002 and 2008, a drop of 34 percent relative to 2002 (Figure 5). During this period, economic growth benefited disproportionately the bottom 40 percent of the income distribution, who experienced faster than

8 World Bank (2015) and World Bank & WiiV, SEE Jobs Gateway Database (2020).

average consumption growth, thanks mostly to wages increases. However, between 2014 and 2017, the poverty headcount dropped by 2.3 percentage points, with more than 90 percent of the change occurring between 2014 and 2015. Since 2015, poverty stagnated (it fell by 0.2 percentage points between 2015 and 2017) and by 2017, close to 4 in 10 Albanians still lived with less than US\$5.5 per day. Indeed, by 2017 the poverty rate was still above the 2008 level.<sup>9,10</sup>

**Poverty reduction was somewhat less responsive to economic growth between 2014 and 2017, compared to the pre-crisis period, and poverty is projected to have increased since then.** Between 2002 and 2008, an increase of one percent in GDP was associated with a reduction in poverty of 1.2 percent. After 2014, the elasticity of poverty-growth fell and a one-percent increase in GDP resulted only in a 0.8 percent poverty reduction (Figure 6). Shared prosperity was slightly higher during the pre-crisis period: between 2005 and 2008, the bottom 40 percent experienced an annual growth in mean consumption of 2.64 percent, above the average for the total population (1.25 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. Between 2014 and 2017, positive growth in the mean consumption of the bottom 40 was observed again, although slightly below the

pre-crisis level: in fact, the mean consumption of the poorest 40 percent averaged 2.44 percent annually, while it grew by 0.7 percent per annum for the total population. Early projections of poverty following the earthquake and the Covid-19 pandemic suggest that poverty will continue to hover around 40 percent in 2020, essentially wiping out any poverty reduction from recent growth years.

**The decentralization of government functions accelerated after 2014, but regional disparities in economic activity and living standards persist.** Advancing Albania's on-going decentralization process, major reforms took place in 2015 and 2017, as the number of municipalities was consolidated from 373 to 61, and a roadmap for local governments' fiscal autonomy and discipline was established. Still, this reform has not resolved significant overlaps in functions between the national and local levels and an unclear division of responsibilities that increases uncertainty; while low local government capacity constrains service delivery. As a result, poverty and economic development continue to have a strong geographic dimension. The wide dispersion of poverty rates across prefectures (e.g., Tirana has less than half of the poverty headcount as Diber) is correlated with the dispersion in GDP per capita, housing conditions, and the number of families receiving social assistance (Figure 7).<sup>11</sup> Generally speaking, prefectures along the Coast

9 Annex 2: Poverty profile.

10 Poverty estimates before and after 2012 should be compared with caution due to the change in the survey instrument used to measure households' living standards. From 2002 to 2012, poverty estimates in Albania relied on the Living Standard Measurement Survey (LSMS). The World Bank estimated (unofficial) poverty rates using the Household Budget Survey (HBS), which is conducted on a yearly basis since 2014 and was sporadically collected in earlier years. Even though both surveys provide consumption-based poverty estimates, they present important differences that limit their comparability, including sampling frame design, purpose of the survey, structure of the questionnaire, reference period of consumption goods, regional and temporal deflators, and treatment of missing values, among others. All these differences limit the analysis of the welfare aggregate across surveys, and the conclusions about possible changes in poverty levels between 2012 and 2014. The welfare aggregate calculated based on the Household Budget Survey of 2008 is not strictly comparable to the aggregate in 2014-2017 as it does not contain the same consumption items. Still, the poverty headcounts with the HBS 2008 and the LSMS 2008 are similar in magnitude (about 3.5 pp difference).

11 Data limitations prevent comparisons at the municipal level of living standards and economic indicators. To fill this gap, a mapping exercise was done for the SCD Update using publicly available satellite data to capture outcome variations across municipalities (World Bank, Albania Vulnerability Index, unpublished, 2019).

FIGURE 5:

### Poverty headcount and GDP growth

Note: HBS based poverty measures are not officially reported by INSTAT. Source: Authors with WDI, ECAPOV and HBS data

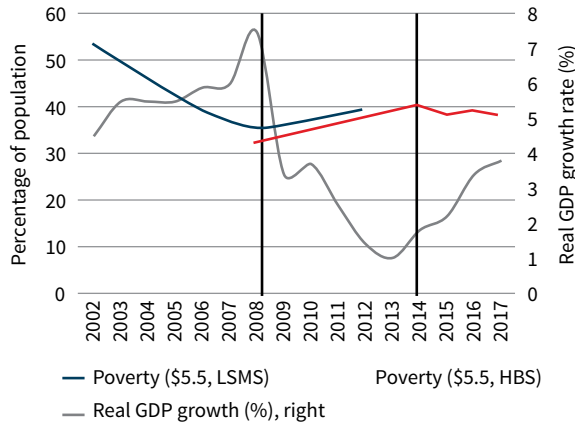


FIGURE 6:

### Elasticity of poverty to GDP growth

Note: Annualized elasticity. Source: Authors with WDI, ECAPOV and HBS data, various years

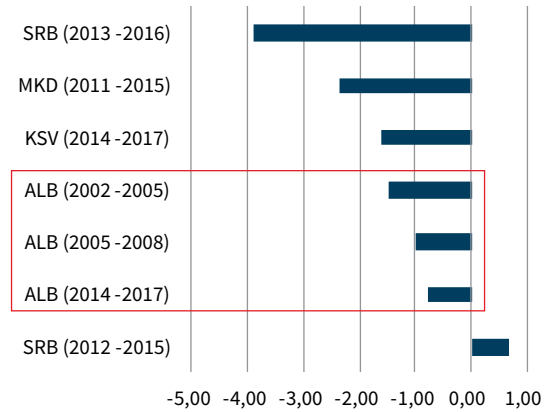


FIGURE 7:

### Ranking of prefectures by welfare indicator (circa 2017)

The rank is 1 for the best-performing prefecture. Source: Authors with data from INSTAT and World Bank, Albania - Location specific notes, Western Balkans Urbanization Review (2019)

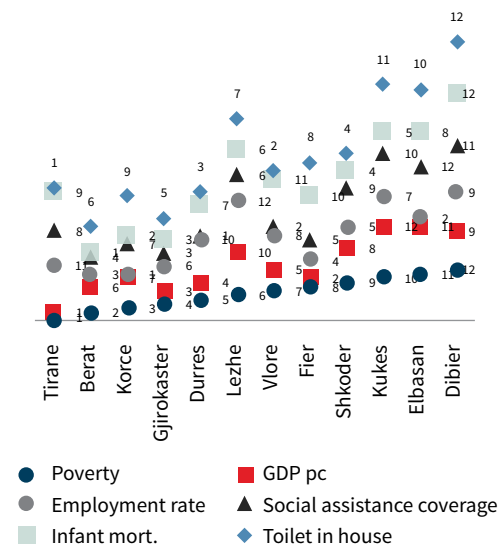
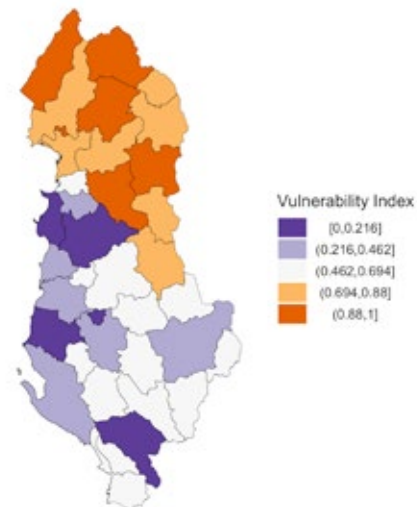


FIGURE 8:

### Vulnerability index for Albania's municipalities (circa 2016)

The vulnerability index combines exposure to natural hazards and economic capacity to adapt and respond to shocks. For Albania Vulnerability = Exposure - Economic activity - Connectivity. Rescaled value: a higher value represents higher vulnerability. Source: World Bank, Albania Vulnerability Index, unpublished (2019)



and South tend to be richer, have better living conditions and are less vulnerable to shocks than Central and Northern (Mountain) prefectures (Figure 8). For instance, Tirana, Fier and Durres accounted for over 60 percent of total GDP in 2017 and most active enterprises are concentrated there.<sup>12</sup> On the other hand, these prefectures also tend to have lower employment rates, which reflects in part the fact that many families in the poorer prefectures are older (and thus out of the labor force), or perform unpaid work.<sup>13</sup> Household-level regression analysis of the probability of being poor in 2017 shows a significant structural poverty component in Diber, Elbasan, Gjirokaster and Vlore (controlling for household demographic and economic characteristics). After controlling for the prefecture, the variables most significantly correlated with poverty are household head's education, household size, dependency ratio, and the share of employed working-age adults.

**The EU accession process has increased incentives to improve the rule of law, but perception of corruption remains prevalent, and trust is low.** As part of its commitment to EU accession, Albania has made notable progress in implementing reforms to comply with the EU's standards and rules in more than 30 different areas, but more efforts need to be made in particular on chapters 23 and 24 (Rule of Law and Fundamental Rights).<sup>14</sup> Recent vetting of judges has been positive, how-

ever, fundamentals are still weak: there are only 12 judges per 100,000 hab. (compared to 21 in EU) and court infrastructure is poor. There is a high perception of corruption in Albania, associated with weak and politicized state institutions and poorly functioning checks and balances. Between 2017 and 2019, Albania lost 15 positions in Transparency International's Corruption Perception Index, falling in 2019 to 109<sup>th</sup> place of 180 countries.<sup>15</sup> Prosecution and conviction of high-level officials has been dragging. Supervision over state-owned enterprises is limited. At the same time, political polarization has been growing. The Albanian parliament has not been able to function properly as a consensus builder and representative body, further undermining the already low trust in public institutions. Civil society advocacy and financial viability have been improved, but there is high dependency on international donors and lack of accessible public funds.<sup>16</sup>

**Albania has made efforts to ensure consistent and accountable policy-making and administration systems, but implementation remains limited.** Examples of legal reforms include the Public Financial Management reform strategy 2014-2020, the revised Organic Budget Law, and others. There has been some implementation progress, for instance, PFM monitoring, increased clearance of arrears, etc. Still, policy fragmentation at all levels of government, managerial focus

12 Tirana accounts for over 40 percent, and its share has been growing, in contrast to the shares of Durres and Fier. (INSTAT, Llogarite Rajonale ne Shqiperi Databaza Statistikore, 2019).

13 While all prefectures have employment rates below the EU average (73 percent for the group 20-64), there is a 17 percentage-point gap between the prefecture with the highest employment rate (Korce, 62 percent) and the lowest (Lezhe, 45 percent). Durres, Lezhe and Tirana have employment rates below 50 percent.

14 Progress towards meeting the EU acquis has been slower in Albania than in the other three Western Balkan candidate countries (Serbia, Montenegro and North Macedonia), especially in the fundamental areas of Rule of Law, and Economic Development and competitiveness, but also in non-fundamental areas such as Consumer and Health protection or Science and Research, where North Macedonia has progressed faster.

15 According to Freedom House, there are no "Full Democracies" that score below 50 on the CPI. Albania scores 36, corresponding to a "Hybrid Regime". See also the Country Private Sector Diagnostics (International Financial Corporation, 2020 (forthcoming)).

16 United States Agency for International Development (USAID); Bureau for Democracy, Conflict and Humanitarian Assistance; Center of Excellence on Democracy, Human Rights and Governance; FHI 360; International Center for Not-for-Profit Law (ICNL) (2019)

on processes rather than the achievement of results, and the lack of delegation of responsibility to middle management are some challenges that prevent a more significant change in the efficiency and transparency of the government. E-services are growing but not fully developed. The reorganization of various ministries has put further pressure on their capacity to advance reforms effectively. Finally, the system of training and vetting public officials to improve capacity is still limited.

**Recent events highlight the environmental challenges Albania faces, with social and fiscal implications.** Strategic sectors for the economy and for the livelihood of many poor Albanians depend on the sustainable management of the country natural resources, including freshwater, land, and marine ecosystems. The expansion of these key sectors has potential positive effects on all the main challenges for Albania: growing more open, by growing exports higher up in the value chain; balancing urban and rural development by creating more opportunities for jobs in

rural areas; and shifting inclusion policies so they address the needs of the most vulnerable, by generating more resources to deliver better services for all Albanians. Climate change represents an important threat to these resources, as floods and periods of intense heat are likely to become more frequent and extreme. Mismanagement of the resources, in part due to absent policies or implementation gaps, is undermining the potential of these sectors to grow in value and importance in the future. In addition, Albania is under-prepared physically or financially for disaster events like the earthquakes that occurred in 2019. On September 21<sup>st</sup> a 5.6-magnitude earthquake with epicenter near Durres caused damages to close to 600 homes, and triggered power cuts and other material losses. On November 26<sup>th</sup> at least 50 people died in a 6.4-magnitude earthquake, the strongest in 40 years, which again hit Durres. Aside from the human and material losses and the trauma they cause on the population, the cumulative fiscal costs of disaster recovery will put further pressure on Albania's vulnerable fiscal situation.<sup>17</sup>

<sup>17</sup> The recent Post-Disaster Needs Assessment estimates that total damages and losses of the November 26 earthquake amount to 985.1 million EUR, while total recovery needs are estimated at 1.1 billion EUR (Government of Albania, 2020).

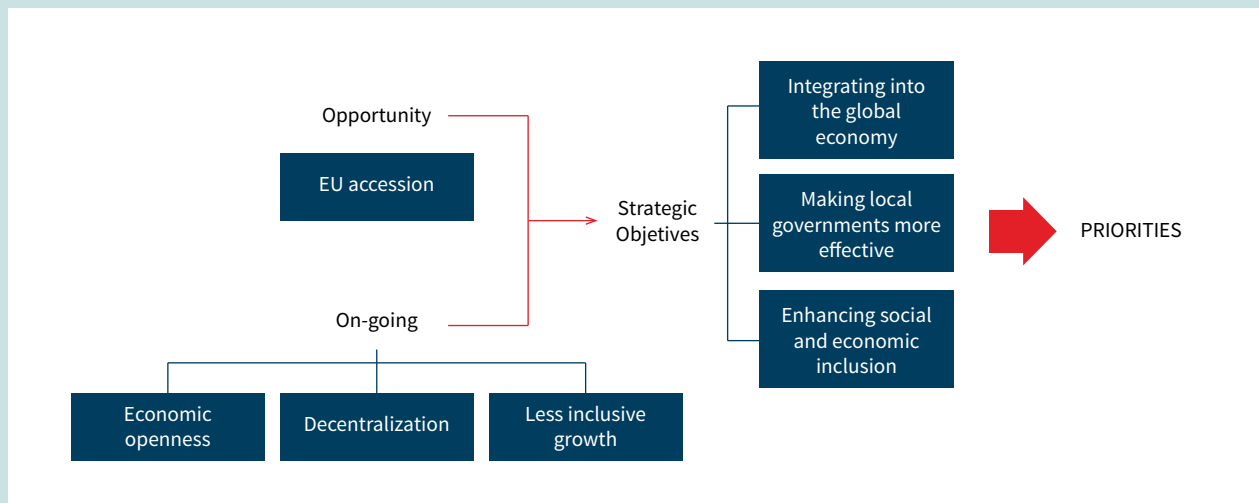


**The SCD Update proposes to identify the priorities for Albania to accelerate progress in the context of the recent trends and the EU accession process.** Following consultations internally and with Albanian stakeholders, the SCD Update organizes the analysis around three main Strategic Objectives: first, the need to strengthen the open-economy, productivity-driven growth model; second, the need to strengthen the decentralization process to balance territorial development; and third, the need to strengthen the social contract by increasing economic and social inclusion. Policies that address these objectives could achieve a true structural transformation that

raises productivity, generates quality and inclusive jobs, and is sustainable. A greater integration into the regional and global economy is needed to drive demand that transforms and generates opportunities in line with a more educated labor force. Given Albania's small size and still relatively shallow domestic market, further progress on integrating into the regional and global economy is a key pathway towards greater productivity and higher incomes. Its dependence on agriculture and high rural poverty call for strengthening local service delivery and modernizing the agriculture sector, while enhancing the benefits and competitiveness of urban areas. Further, the low access to good job opportunities for many Albanians, coupled with falling and aging population calls for strengthening economic inclusion.

**The success of policies to achieve the Strategic Objectives will depend on whether the country is able to consolidate the pre-conditions of sustainable growth.** First, Albania needs institutions that fit a modern economy, and here

FIGURE 9.  
The SCD organizing framework





the EU presents a roadmap that is already producing some results. Lower corruption and a solid rule of law enhance public trust and facilitate economic transformation. Second, progress in fiscal and macroeconomic stability need to continue to enable the country to manage shocks and grow fiscal resources to deliver better services and protect the most vulnerable. Finally, Albania is blessed with a bounty of environmental assets that can

be a major contributor to the transformation of the economy, provided that there is a clear strategy to utilize these resources sustainably, rather than deplete them. The SCD Update proposes then policy priorities that address the Strategic Objectives and also strengthen the pre-conditions, as depicted in Figure 9.



**Given the limitations of Albania's small domestic economy (population: 2.9m), the continued shift towards global markets can be a key pathway towards creating more and better jobs.**

The Western Balkans represent a population of close to 18 million – and beyond lies the European Union with its more than 500 million. Economic integration can facilitate access to a larger and more affluent customer base, a greater pool of qualified workers, additional sources of financing, new technologies and more sophisticated production inputs. A larger market, with an even playing field in which all firms can compete, can reorient production inputs from less productive industries to more competitive enterprises - encouraging innovation as well as skill and technology transfer from more developed markets.<sup>18</sup> This process is particularly valuable for countries like Albania, whose domestic markets are relatively small and lack advanced businesses. Traditionally, among small countries, high income per capita is closely correlated with trade openness (see Figure 10).<sup>19</sup>

**The potential for a stronger trade integration remains significant.** For example, in 2018, exports of goods and services reached 31.7 percent of GDP – still far behind the 60.3 percent of GDP reached by Northern Macedonia, which

leads the WB-6 in terms of exports (Figure 11). While Albania is gradually taking advantage of its location in the Adriatic – with Mediterranean climate, significant coastline, rivers and mountains – and significant historical heritage to grow its exports in tourism services, the exports gap remains particularly pronounced in goods. In 2018, Albania exported 7.7 percent of GDP, as opposed to 42.3 percent of GDP in Northern Macedonia. More firms are exporting directly or indirectly (16.4 percent in 2019, compared to 12 percent in 2013), which suggests that Albania is gradually seizing opportunities in the global marketplace, but the gap to the ECA-average of 19.2 percent remains significant.<sup>20</sup> Besides quantity, the quality of Albanian exports can also be improved. In 2017, only 3.6 percent of Albania's merchandise exports were in medium of high-tech industries – as opposed to 59.6 percent in North Macedonia. With close to 50 percent of exports going to Italy, Albania can also gain from diversifying export destinations.<sup>21</sup> A range of sectors of Albania's economy have the potential to be key drivers of export performance in the years to come.<sup>22</sup>

**While Albania's overall FDI performance has been strong in recent years, with yearly inflows around 8 percent of GDP, it has had limited success in attracting FDI that establishes new companies in Albania (so-called greenfield investment).** The majority of Greenfield investments in Albania have been market-seeking (driven by an investor's intention to establish production facilities in the host economy, with the ultimate intent of supplying goods and services to the host country's market), while less than 1 percent has been

18 Shu & Steinwender (2019) provides a useful literature review of the impact of trade liberalization on firm productivity and innovation.

19 Brookings (2018)

20 World Bank Enterprise Surveys (2019).

21 See Rovo & Portugal (2019). The assessment of the trade performance of the WB-6 through a full gravity model also finds low trade openness in the Western Balkans, including Albania. See European Commission (2018).

22 See Annex 3: Strategic sectors for Albania's export-oriented growth model and International Financial Corporation (2020 forthcoming).

FIGURE 10:

Country size, trade openness and income relation in Europe and Central Asia

Source: World Bank World Development Indicators (WDI)

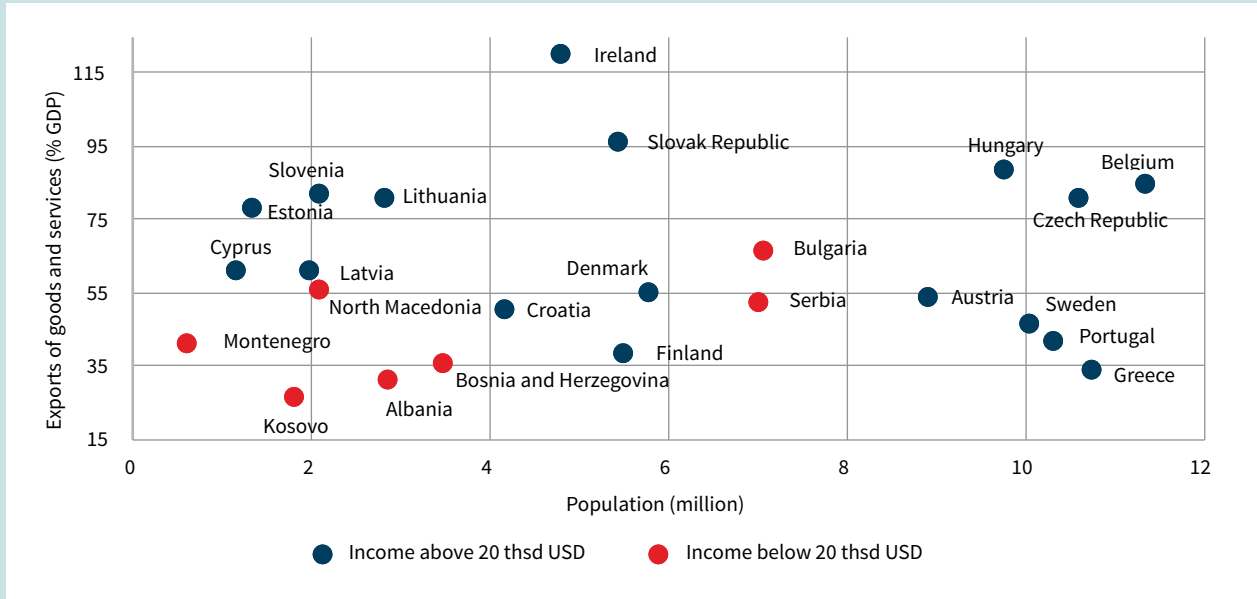


FIGURE 11:

Albania’s trade performance vis-a-vis Western Balkan peers (magnitude and quality)

Source: World Bank World Development Indicators (WDI); 2018 data

Source: World Bank World Development Indicators (WDI); 2017 data; data for Kosovo not available

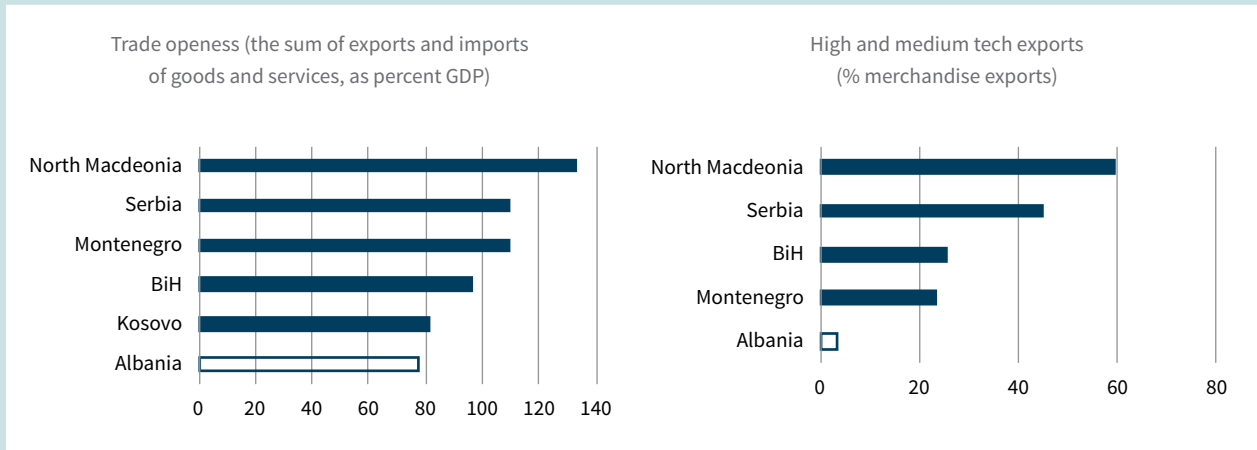
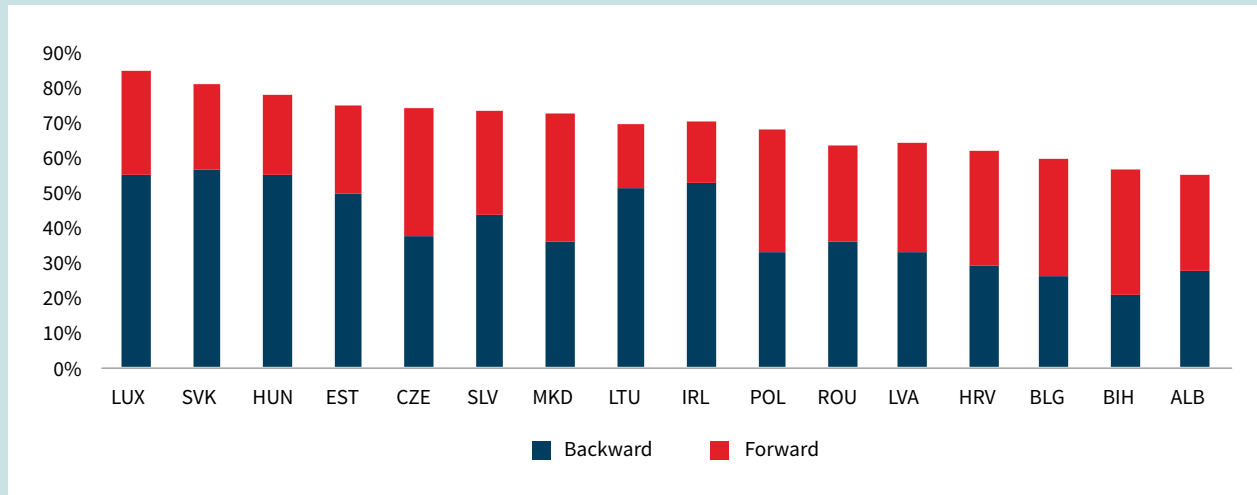


FIGURE 12:

Backward and forward participation in GVCs

Source: Authors with data from UNCTAD-Eora GVC Database



efficiency-seeking (when investors seek to increase cost-efficiency of production, by taking advantage of various location-specific competitive factors, such as knowledgeable workforce, supply of key inputs, and like transport or logistics). This is important because efficiency-seeking investment is export-oriented and has the potential to help Albania improve the productivity of its workforce and connect domestic suppliers to Global Value Chains. Between 2011 and 2016, 17 percent of Greenfield investment projects were in transport and logistics services, followed by 13 percent each in financial services and business services. Since FDI is a key source of external financing, can introduce advanced know-how into the country and link Albania to Global Value Chains, it is key that a favorable investment environment for foreign investors is created. Albania needs a broad

investor base, including FDI with strong integration with the rest of the economy.<sup>23</sup>

**Integration into global value chains (GVCs) holds the promise to boost incomes.** The *World Bank World Development Report 2020 Trading for Development in the Age of Global Value Chains* highlights the potential for GVCs to boost incomes, create better jobs and reduce poverty.<sup>24</sup> Already, the integration of Albania with the Italian garment industry illustrates the potential for exploiting such synergies. The rapid growth of business process outsourcing (BPO) industry also holds significant promise. Still Albanian GVC participation has continuously fallen since 2014 and remains the lowest in the region at 55 percent of gross exports (Figure 12). Backward linkages have also declined, suggesting increased participation in low value-added levels of the GVC.

23 See Financial Times fDi Markets database.

24 World Bank, *World Development Report 2020, Trading for Development in the Age of Global Value Chains* (2019)

**Significant emigration is a symptom of limited economic opportunities at home, which in turn exacerbates Albania's skills shortage – yet Albania's diaspora can also represent an opportunity for further integration into the global economy.** Driven by high levels of unemployment and under-employment, low incomes both in formal and informal sectors (sometimes paid with delay), limited social protection and low provision of social services, many Albanians have left the country. Currently around half a million Albanians live abroad. to develop a sizeable diaspora abroad (relative to population).<sup>25</sup>As emigration has been traditionally particularly pronounced among the young, dynamic and educated, this brain drain has exacerbated the domestic skills gap. Yet, the diaspora also remains a potential connector between Albania and the rest of the world. Remittances are – and will remain – an im-

portant source of funding for the economy, but they can be channeled towards productive investment rather than consumption. Returnees can bring new ideas and invest in local businesses, though they represent a small share of the diaspora. Albanians abroad, on the other hand, could serve as anchors to develop Albanian trade with neighboring countries.<sup>26</sup>

**Integration goes beyond economics alone - the path towards EU membership is an opportunity to strengthen Albania's institutions and to transform society.** The 35 chapters of the EU accession process range from the reform of purely economic institutions all the way to fundamental rights of its citizens and rule of law. As such, the process offers an external anchor for transformation of Albania's institutions towards a more free, just and open society.

25 INSTAT & International Organization for Migration (2013).

26 Felbermayr, Grossmann, & Kohler (2015); Parsons & Vézina (2018); Rauch & Trindade (2002) among others find that migration can strengthen trade ties.



**Trade restrictions continue to hold back exports and imports.**<sup>27</sup> According to the most recent WTO trade policy analysis in 2016, Albania has a liberal trade regime, with relatively low tariffs for importers and no export duties or taxes. Similarly, Albanian exporters face relatively low tariffs in their current market destinations, although applied tariffs (both simple and trade weighted) for non-agricultural products are relatively high among peer comparators (Source: WTO). Despite favorable trade conditions as by the existing trade agreements (including EFTA AND CEFTA), Albania's export expansion may be constrained by the lack of agreements with potential trade partners, gaps in the coverage of existing agreements and also by the likely existence of non-tariff measures (NTMs). For example, quality standard for agricultural products constitutes one of the main constraints for exports from Albania. Albania's quality certification processes are insufficient for export to the EU-28, as well as usually too costly or hard to obtain within the country for smallholders.<sup>28</sup> Other non-tariff barriers relate to non-automatic licensing and cumbersome procedures. For example, as emerged also during interviews of the World Bank with firms, agribusiness processors need to apply for authorization to operate; cumbersome procedures are in place in the import/export (as well as in public procurement) which require in addition

mandatory translation of all the documentation into Albanian; service sectors also face numerous barriers to trade, including several types of work authorizations needed in Albania to allow for labor mobility.<sup>29</sup> In terms of border procedures, according to the 2019 enterprise survey, it takes on average 1.1 days to clear exports through customs (1.8 days for imports). While this is ahead of many other countries in the ECA region, more can be done - including establishing more joint border crossings with neighboring countries and encouraging adoption of simplified border procedures for Authorized Economic Operator (AEOs).

**However, the key challenge is to nurture a more competitive and innovative private sector that can successfully integrate into the global economy - this requires further efforts to strengthen Albania's underlying business environment.** Albania's Structural Business Survey highlights that the productivity of Albanian firms is still at only 10-15 percent of their EU counterparts. The Harvard Center for International Development Economic Complexity Index ranks Albania at 78<sup>th</sup> place out of 133 countries. The 2019 World Global Competitiveness Report ranks - out of 141 countries - Albania 117 in entrepreneurial culture, 126 in attitudes to entrepreneurial risks and 132 in the readiness of companies to embrace disruptive ideas. The latest World Bank Enterprise Survey reports that Albanian firms are introducing more new products and spending more for R&D and process innovation - but they continue to significantly lag regional peers (Figure 13). In part, this know-how gap reflects Albania's historical legacy of international isolation under a command economy; it takes time for the emerging private sector to fully transition towards a more

27 For more detailed analysis of Albania's trade performance and constraints, see also [Rovo & Portugal \(2019\)](#).

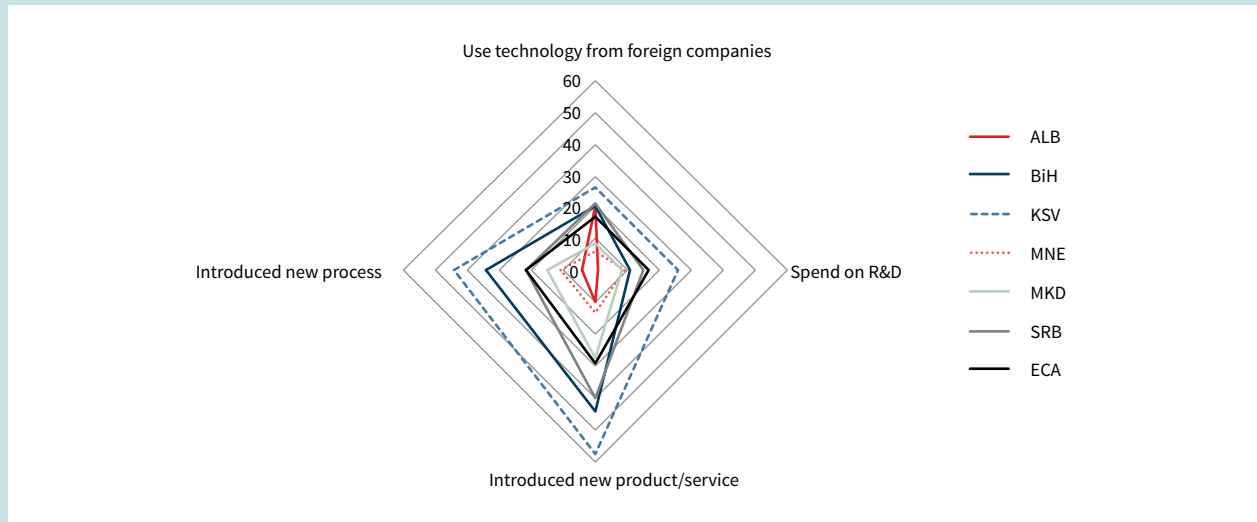
28 World Bank, [Competitive Fruit and Vegetable Products in Albania, FCI in Focus \(2018\)](#).

29 [Handjiski & Sestovic \(2011\)](#).

FIGURE 13:

Albania vis-a-vis peer countries in firm-level innovation and technology adoption (% firms)

Source: World Bank Enterprise Surveys (2019)



advanced production base.<sup>30</sup> However, in part this also reflects continued weaknesses in Albania’s business environment that need to be tackled.

**Widespread informality remains a particularly notable bottleneck for Albania’s private sector.** According to the International Labor Organization (ILO), 31.9 percent of employment in Albania is informal (2016). Without documentation, informal firms are cut out from access to formal finance, key government support services as well as exporting. Firms in fact have a disincentive to grow and upgrade, preferring to stay under the radar to avoid being detected by the Authorities, penalized and becoming subject to the costs of formalization, including paying taxes and complying with business regulations. But informal firms do not just hold themselves back. In the 2019 enter-

prise survey of the World Bank, 37 percent of firms report that the country’s large informal sector is a major constraint, creating unfair competition and holding back the growth of formal businesses. Besides strengthening the enforcement through anti-informality campaigns, the likely path to formalization of Albania’s economy is to strengthen the business environment – incentivizing formalization by strengthening its benefits while reducing its costs. The IFC’s Country Private Sector Diagnostic will provide an in-depth analysis of the constraints to a more competitive and dynamic private sector in Albania (Box 2).

30 In the textiles, apparel and leather sector for example, the average EU firm is 5 times more productive than the average Albanian firm. This means that the Albanian garment firm needs 5 times as many workers to produce the same output as the average EU firm. Comparing Albanian firms with each other, the productivity of a firm at the top 10 percent of the performance distribution is close to 4 times as high as for a firm in the bottom 10 percent of the sector. See also Brookings (2019).

**BOX 2:**

**Outline of the IFC's Country Private Sector Diagnostic**

Source: International Financial Corporation (2020 forthcoming)

The Country Private Sector Diagnostic (CPSD) for Albania will assess the barriers and opportunities for a more forceful development of the private sector in the country. Higher, more sustainable and equitable economic growth can only be achieved through a thriving private sector. More than 50,000 firms were created between 2013 and 2017, generating more than 60,000 jobs. Firms have also become more likely to export and innovate, but they still face many constraints. The CPSD will identify policy reforms to increase private investment and create market opportunities in specific sectors key growth and poverty reduction (proposed sectors include agriculture/agribusiness, tourism, ICT, garments, and auto-parts manufacturing). The selection of sectors will be based on a combination of criteria including the government medium term development strategy, recent sector growth performance, contribution to GDP growth, exports and employment generation, as well as ability to support the IFC 3.0 agenda of Creating Markets and the IFC investment pipeline in Albania. The CPSD will seek to identify: (i) opportunities for achieving development objectives through an expansion of the private sector; (ii) constraints to achieving that expansion; and (iii) the actions needed to remove those constraints, be it sector-specific or economy-wide, and realize the opportunities.





**If managed well, economic integration, productivity growth and rising incomes can set in motion mutually reinforcing feedback loops.**

Economic integration can allow Albanian firms to grow and upgrade their capabilities. At the same time, economies of scale and innovation can enable Albanian firms to better compete on international markets. For that shift in the development model to work better, it is necessary to remove constraints that (a) reduce the exchange of goods, services, factors and ideas with the rest of the

world, (b) impede the flow of resources towards the most productive uses domestically, and (c) create disincentives to invest in innovation, entrepreneurship and know-how. An improved allocation of resources within the economy will create rapid gains in productivity that generate momentum. Greater entrepreneurial spirit, technological awareness, innovation and know-how, and increased availability of skills and finance create more incentives to take the risks needed to join global markets. The shift to a more open economy and a competitive private sector also requires eliminating ambiguities in the law and excessive discretion in its application. While further opening the economy is critical for Albania's future, there will be winners and losers, so this process must be managed to minimize the social losses and ensure that a maximum number of people benefit from it (Box 3).

**BOX 3:**

**Managing the process of integrating into the global economy**

While further integration into the global economy is a key opportunity for Albania, risks from this process need to be managed: **(1) Displacement from trade:** domestic industries exposed to imports from higher-quality or lower-cost foreign competition will face disruption. Some firms will become more competitive, while others will fail. Yet, Albanian consumers will gain from increased access to better products. In the short term, this process will also create losers among employers and workers. To facilitate this transition, it is crucial to enhance the training and social assistance systems to support displaced workers and enable them to access new job opportunities. **(2) Dual labor markets:** FDI can spur the emergence of a dual labor market where firms compete for high-skilled workers and raise their wages while most workers continue to earn low wages. To counteract this polarization, it is important to encourage backward linkages between foreign and domestic firms, so that more domestic workers benefit indirectly from FDI; and foreign firms need to contribute to public revenues on the same footing as domestic firms. **(3) Increased out-migration:** stronger trade and investment linkages with the rest of the world will increase opportunities for Albanian workers to move to foreign labor markets and exacerbate brain drain. To reduce the loss of human capital the country needs to maintain strong ties with its large diaspora, encouraging investment by Albanians abroad and return migration. The transition towards a fully open and globally integrated economy will unleash many new opportunities for growth but it will also create winners and losers. Harnessing Albanians' support for this process will need policies to mitigate the losses to affected groups and alleviate their plight to the extent possible.

**Macroeconomic sustainability is a crucial pre-condition for private sector development.**

Albania's emergence has been marked by a series of crisis setbacks – including a macro-fiscal crisis 2008-14. In each case, it has taken years to recover lost ground in terms of private sector development. Equally, Albania's policy environment remains subject to frequent changes – leaving entrepreneurs uncertain over future business conditions and deterring long-term investment. Today, a key challenge to economic stability is Albania's high public debt. The World Economic Forum Global Competitiveness Index 2019 ranks Albania at rank 114 out of 140 countries in terms of debt dynamics. Raising public revenues by broadening the tax base, strengthening spending efficiency and containing off-budget fiscal risks are all crucial pre-conditions for growth.

**Reliable and effective contract enforcement is needed for entrepreneurs to invest and upgrade firm capabilities.** The 2019 Albania enterprise survey finds that 43 percent of firms identify corruption and 40 percent identify the court system as major constraints for their business. To strengthen investor protection, a formal and effective grievance redress mechanism needs to be implemented. The current temporary strategic investments law needs to be replaced by a permanent unified investment law which creates long-term planning certainty for both domestic and foreign investors. A particular constraint in Albania is lack of legal certainty on land rights, with many land titles in the property registry contested in court and not matching reality on the ground. In the 2019 International Property Rights Index, Albania ranks 122 out of 129 countries. Finally, the cost of doing business in Albania needs to be further lowered. Albania remains at 82nd position

(out of 190 countries) in the 2020 World Bank Doing Business ranking. Key drags are longwinded procedures to get construction permits, paying taxes, as well as the cost of enforcing contracts.<sup>31</sup>

**Nurturing market competition is needed to drive change.** For the adoption of some innovations, new entry by a firm unencumbered by the old ways of doing business is key. Sometimes, the threat of competition can shake up an incumbent firm to reorganize its business. Albania has done much to shift to a market economy; but that shift has been accompanied by the emergence of anti-competitive practices that limit entry and the mobility of resources within the economy. According to the 2019 Global Competitiveness Report, Albania ranks 120th in domestic competition, including 113th in the extent to which taxes distorts incentives and 130th in the extend of market dominance. The principle of open and fair market competition needs to be protected at all times, enshrined in the legal framework and reinforced through practice.

**Access to finance is needed to fund investment.** Albania's financial sector ranks at 102<sup>nd</sup> place out of 141 countries in the World Economic Forum 2019 Global Competitiveness Report. Credit to the domestic private sector represents only 35 percent of GDP compared to above 50 percent in regional peers, reflecting very low credit-to-deposit ratios at Albania's banks. Micro, small and medium sized enterprises (MSMEs) – the backbone of the Albanian economy – face significant constraints in accessing finance. 21.2 percent of firms report access to finance as a major constraint in Albania.<sup>32</sup> The financial sector is dominated by banks which are characterized by high levels of liquidity, strong risk aversion af-

31 These issues are developed in detail in the Country Private Sector Diagnostics International Financial Corporation (2020 forthcoming).

32 This is up from 8.4 percent of firms reporting access to finance as a major constraint in 2013, potentially reflecting increased needs for access to finance as the economy develops. World Bank Enterprise Surveys (2019).

ter the financial crisis and lack of proper incentives or capacity to explore new and innovative approaches to finance. Although on a declining trend NPLs remain high at around 11 percent burdening banks' balance sheets and their ability to lend. At the same time the MSME sector is generally characterized by informality (especially in agriculture), limited availability of collateral, low quality of financial statements and limited financial capability. Finally, improvements in the enabling regulatory framework and a supportive financial infrastructure are essential to encourage sustainable, viable, and significant improvements in access to finance. Beyond banks, the financial sector remains shallow and undiversified. According to the Global Competitiveness Report 2019, Albania ranks 81<sup>st</sup> out of 141 countries in terms of venture capital availability.

**Upgrading workforce skills is a pre-requisite for more sophisticated industries.** The Human Capital Index (HCI) ranks Albania at 56 of 157 countries in 2018, placing it at the bottom of the top tier. However, years of education are significantly below Western Europe: at age 15-19 Albanians and Western Europeans have similar years of education (about 9.5) but at ages 20-24 the gap widens to 1.4 years and grows by a year at ages 25-29.<sup>33</sup> Moreover, the quality of basic education is below EU comparators; the 2018 Programme for International Student Assessment (PISA) shows that on average, Albanian 15-year-olds perform at a level equivalent to having about 1.5 fewer years of schooling than the EU average in reading and math.<sup>34</sup> Learning outcomes are also unequal, as students from low socio-economic background score at a level equivalent to having about 1.5

fewer years of schooling than those from high backgrounds, and students in rural areas score at a level equivalent to having one year less of schooling than their urban peers. Low relevance of education for the labor market is another issue. For instance, the 2019 Albania Enterprise Survey reports that an inadequately educated workforce is among the top 3 constraints to business development for a significant share of medium and large firms. Indeed, low-quality education leads to lower productivity later in life: the productivity of a child born today will reach about 62 percent, at age 18, of what it could be with a complete education and full health. Finally, higher education enrollment doubled in the last decade to 61 percent, bringing Albania closer to the OECD average (68 percent), but quality and relevance have not kept up. In 2014, the inspection of Higher Education Institutions found a large share of non-compliance with the Ministry of Education's standards. Moreover, fewer than 10 percent of tertiary graduates come from engineering, manufacturing and construction programs (half the rate of EU comparators), and they have strong incentives to migrate to EU countries where demand for skills and salaries are high.<sup>35</sup>

**Investment in Albania's connectivity infrastructure can unlock positive feedback loops between greater firm capability and greater integration with the global economy.** The World Bank's 2018 Global Logistic Performance Index places Albania in 88<sup>th</sup> position, compared to 123<sup>rd</sup> in 2016, albeit behind peers. Still, fundamental infrastructure bottlenecks remain. A [2018 IMF report](#) estimates that Albania has the largest infrastructure gap in the Western Balkans.<sup>36</sup> The 2019

33 Wittgenstein Centre for Demography (2018).

34 PISA is the OECD's benchmarking tool to assess achievement and application of key knowledge and skills of 15-year-olds. In 2018, over half a million 15-year-olds from 79 countries and economies took the PISA test in reading, mathematics and science with a focus on reading.

35 See Country Private Sector Diagnostics International Financial Corporation (2020 forthcoming).

36 Atoyán, et al. (2018).

World Global Competitiveness Report ranks Albania 120 out of 141 countries regarding transport infrastructure, reflecting an underdeveloped road network, very limited railroad activity and low airport connectivity. Moreover, ICT adoption is the third-worst performing indicator, after capacity for innovation and financial markets.<sup>37</sup> A recent World Bank report on “critical connectivity” report ranks Albania at the bottom of the ECA region in a broad connectivity index. Better physical and digital connectivity is needed as basis for the flow of goods, people and information.<sup>38</sup> Public investment in key transport assets (first maintenance and then new construction) is needed, as long as public financial management arrangements can be strengthened to ensure value-for-money.

Beyond physical connectivity, digital connectivity can connect Albania with ideas and business partners abroad and is essential to drive firms’ digitalization process. The Digital Economy and Society Index (DESI) 2019 report finds that the digital transformation of European businesses is driven by fast broadband connectivity, social media and mobile application.<sup>39</sup> These connectivity upgrades will enable trade, FDI and return migration that can bring in foreign knowhow and catalyze economic growth. In turn, firms with greater capabilities have the potential to better compete on international markets. Firm upgrading and integration into the global economy therefore can unlock mutually reinforcing feedback loops that lead to higher incomes.

37 World Economic Forum, Albania Global Competitiveness Index 4 (2018)

38 Notably digitalization will be an important part to that process as research shows that companies adopting digital technologies are 26 percent more profitable than their industry peers (Gould 2018). See Caggemini Consulting; MIT Center for Digital Business (2013).

39 Index adopted by the European Commission to track the Digital Competitiveness of the EU Member States.



**The lack of economic opportunities and low quality of services have been pushing people out of rural areas for the last three decades.**

In the last 25 years, urban development in Albania has been propelled by migration to the central region (Tirana–Durrës) and to the Western Lowland, increasing urban sprawl over agricultural and vacant natural land. This process continues; in 2016, Tirana and Durrës’ population grew by about 14–16 percent, while Berat, Diber, Gjirokaster and Kukës had net out-migration of between 20 and 27 percent.<sup>40</sup> Unfortunately, this haphazard urbanization process has failed to create a connected network of cities that sustain both urban and rural sectors.<sup>41</sup> Population pressure in the Tirana–Durrës area has outpaced investment in infrastructure and primary services, and the resulting congestion has reduced the quality of life in these areas as well as the gains from urbanization and the capacity to compete and offer quality jobs. Indeed, Tirana, the largest, best connected and richest city, is growing below regional comparators.<sup>42</sup> This happens while the potential of the rural economy remains untapped and quality of life continues to deteriorate in small villages and

towns. As older and more vulnerable people are left behind, living conditions deteriorate, services become scarcer, and these regions become ever more dependent on remittances to survive (Box 4). Unless urbanization is better managed to accelerate improvements in competitiveness and quality of life in cities, basic services across regions are improved and the economic potential in rural areas is supported, spatial inequality will continue, and urban economic growth will wane.

**At the same time, the decentralization of government functions is still a work in progress.** While Albania has been undergoing a gradual decentralization process for the last two decades (Box 5); major reforms took place in 2015 and 2017. First, the government reduced the number of municipalities from 373 to 61 with the aim of achieving higher efficiency by creating larger, more connected municipalities. Second, the law on local government financing established a roadmap for fiscal and budgetary autonomy and discipline. Law no. 8652 of 2000 transferred many basic functions to municipal governments, and the recent administration reform extended the functions to fire departments and pre-school education.<sup>43</sup> However, in many cases, overlaps between the functions at the national and local levels remain, as well as an unclear division of responsibilities both of which create uncertainty and undermine the quality of the services.

**To reduce spatial disparities, Albania needs to offer equitable access to opportunities and**

40 See INSTAT, *Regional Statistical Yearbook 2017 (2018)*.

41 According to the administrative structure of 2011, Albania had 74 municipalities considered “urban”, but population-based classifications show fewer than 37 urban settlements (defined as continuous groups of cells including at least 5,000 inhabitants), and only 5 of those would have a status of “city” by OECD criteria (Tirana, Durrës, Shkodra, Elbasan and Vlora). This reflects the fact that many small municipalities lack the basic functions of a city that connects people and facilitates exchanges of goods and services, and that aggregates centers of production and knowledge to generate synergies and spillovers.

42 See World Bank, *Boosting the Competitiveness of Tirana, Policy Note (2019)*.

43 Functions that were transferred to municipalities include social services; preschool education staff and support staff for the pre-university system; forest and pasture management; management of the secondary and tertiary sewerage system for irrigation and drainage; fire rescue centers; and rural road management.

**BOX 4:**

**Quality of life and migration in lagging regions of Albania, and the “100 Villages” program**

Source: CoPLAN Institute for Habitat Development; MetroPOLIS shpk (2019); World Bank, Albania, location specific notes, Western Balkans Urbanization Review (2019)

Case studies of poor villages in the lagging regions of Kukës and Dibër highlight the dynamics of isolation, lack of opportunities, and poverty. Household dependence on remittances and social assistance is common, though in many villages, remittances had declined in recent years as previous migrants became settled into their destinations and established their own families. In most villages, over half of residents had emigrated and villages had seen their populations dwindle with mostly the elderly remaining. Village residents reported that more people would migrate if they could afford it, indicating that the poorest were not the ones leaving. Life in the villages is difficult: agricultural productivity and large-scale farming are limited by small land plots and a lack of access to water and irrigation, and few people available to work the land. Most households who cultivate land do so for their own consumption. A lack of job opportunities meant that few residents were formally employed. Residents report lack of good water supply (their most pressing concern), irrigation, and sewage and solid waste management; limited health facilities (reportedly a factor influencing people’s decisions to migrate). Secondary education facilities were also limited as schools are closing due to population shrinkage. These livelihood and service delivery gaps feed a perception of being left out and village residents feel excluded from decisions about infrastructure investments. Coordination across villages is low, so that common infrastructure projects (e.g. irrigation) do not take place. Some villages have tourist potential, and half of them are participating in a government program to stimulate tourism and promote integrated rural development, but this potential is constrained by poor infrastructure and services.

The “100 Villages” program (piloted in 2018-2020) aims to promote rural economies by supporting the development of eco- and agro-tourism that revalues cultural heritage. The program encompasses three municipalities in Kukës and four municipalities in Dibër, and investments are focused on improving infrastructure and human capital. A flagship government program led by the Prime Minister’s office, it requires an inter-sectoral effort involving municipalities, line ministries and public agencies such as the Albanian Development Fund. So far, funding has been limited (by end 2018, around 7.5 million Euro had been committed) so that the government is trying to in close coordination within government institutions and with donors to maximize its impact.

**BOX 5:****Albania has undergone a two-decade decentralization process**

The transition to a market-based democracy in Albania has been accompanied by a gradual process of political, economic, fiscal and administrative decentralization. By 1998 local government units had been created and the Constitution of 1998 established three levels of government: national, regional (qarks) and local (municipalities and communes). In 2000, Albania ratified the European Charter of Local Self-Government, which was followed by the National Strategy for Decentralization and Local Autonomy and the Organic Law No. 8652 “On the Organization and Functioning of Local Government,” which institutionalized and created 12 regions as the second level of local government. Law no. 8652 granted regions the role to design policies and strategies locally and coordinate with the central government, and to provide services delegated by the central government and region’s constituent local units. In 2014 Parliament amended this law with the New Administrative Territorial Reform (Law no. 30/2015 “On the Organization and Functioning of Local Government”), which defines the municipality as the basic level of governmental unit, strengthens the consultation process and creates an administrator figure to increase efficiency in local government management. A National Crosscutting Strategy on Decentralization and Local Governance (Council of Ministers’ Decision No. 691) also outlines a vision on decentralization, where fiscal decentralization played an important role to increase the autonomy of local government units in decision-making and enable them to respond to citizen’s needs. The Law “On the finances of the local self-government,” approved in 2017, establishes foundations for a fiscal and budgetary autonomy and discipline in small local units. The main objectives of the Law are: i) Strengthening financial autonomy, ii) Strengthening fiscal discipline; iii) Strengthening intergovernmental dialogue; iv) Increasing transparency and v) Unification.

**services for people, regardless of where they live.** While the population shift towards urban centers is inevitable and desirable to some extent, a more balanced approach to territorial development can correct the spatial disparities in outcomes and unleash the potential for growth in lagging areas.<sup>44</sup> Equitable basic services (security, education, sanitation, etc.) and connectivity, both physical and digital, increase the ability for people to benefit from growth. Rural areas with potential to grow from agrobusiness and fishing

exports, or tourism can benefit from targeted policies (e.g., well-functioning land markets are critical), while areas with lesser potential will need direct support to ensure basic needs are covered, and to facilitate mobility by investing in human capital. Urban centers can increase their growth potential by implementing better territorial planning policies to manage population growth, improve services, reduce congestion, and increase connectivity within and beyond the country.

44 The World Development Report 2009 provides a framework to think about how to rebalance territorial development in Albania (World Bank, 2008).



**Fiscal revenues for local governments are limited.** Although there has been some progress with the introduction of the unconditional transfer (no less than 1 per cent of GDP), there are still gaps related to allocation criteria (such as the dated population density statistics). Own-generated revenues only amount to about 14 percent of total local revenues, a growing trend but still well below the 24 percent in EU countries.<sup>45</sup> Some recent changes might improve own revenue generation, such as a 2-percent allocation of the Personal Income Tax revenue, and the new methodology for calculating the tax on buildings based on market value. However, rents from mining revenues allocated to the local government are low at 5 percent of the revenues from the activity, against 25 percent before 2013.

**At the same time, local governments show systemic weaknesses in budget planning, execution, and transparency.** The first PEFA assessment of public financial management (PFM) at the municipal level (Tirana, Berat, Fier, Kuçova and Tropoja) in 2016 found that municipal PFM systems are systematically weaker than national systems. In over 30 categories of PFM all but one municipalities (Fier) scored significantly below the national government. In many municipalities, actual revenues fall consistently short of budget-

ed ones (especially for own source revenues), in part due to weak fiscal forecasting capacity, but also because of incentives of local government officials to present ambitious expenditure programs ex-ante.<sup>46</sup> In addition, public investment management is deficient, leading to commitment for projects without assured funding, little monitoring of project implementation, and failure to include recurrent costs in outer year budgets. This has resulted in an accumulation of municipal government arrears amounting to ALL 11.8 billion in 2015, when the territorial reform was implemented, and falling to about ALL 7.1 billion by 2017 (38 percent from Tirana). Finally, transparency and accountability about local government financing and expenditures are low. For instance, between 2010-2015 capital project financing was on average 48 percent higher in politically affiliated local governments, especially during election years, and this trend has increased until 2017.<sup>47</sup> The [2017 PEFA report](#) notes that criteria for allocation of conditional transfers exist, but they are not transparent and verifiable, and less rule-based compared to the unconditional grants.<sup>48</sup> Annual budgets presented to the councils don't follow a standardized format, and public consultation is irregular. Audit reports are discussed, but there is no evidence of impact on subsequent decisions, and external audit reports are not available on municipality websites in an accessible format. Citizen engagement on budget is also limited.

**Local governments are increasingly responsible to ensure service delivery and manage natural resources, but they are ill-equipped to do so.** For instance, following the territorial reorganization, the control and responsibility of municipalities in water management increased, but

<sup>45</sup> Association of Albanian Municipalities (2019)

<sup>46</sup> World Bank, *Local government transparency, accountability, and capacity in allocating resources* (2018).

<sup>47</sup> Association of Albanian Municipalities (2019)

<sup>48</sup> PEFA Program (2017)



not the funding for investment in quality of water supply.<sup>49</sup> The 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. For example, of the amount of water produced during 2018 by all water utilities (262 million cubic m), only 55 percent was measured by utilities for lack of meters, a factor that directly affects the reliability of the data.<sup>50</sup> Only 36 percent of the amount produced was billed to consumers, and of this amount, only 68 percent was billed by metering (the rest is billed as a flat fee). Non-revenue water (NRW) reached 64 percent, slightly less than in 2017, but still at quite high levels, and total losses amount to 62 percent of the produced water, with half of these coming from administrative losses (meter tampering, double connections, meter by-pass, and overuse for irrigation by flat-fee billed customers). In contrast, NRW in the EU reaches on average 20 percent (although the variance is large). Illegal connections continue to be a problem as they represent about 25 percent of the amount of water produced. Continuity of service is low in most areas (only 7 of 58 utilities provide the service for 18 hours per day or more). Some utilities have managed to raise water tariffs, but one-third of them was denied a tariff increase by the regulator. The adoption of a holistic strategy to water resources (river basin administration, a water cadaster, and multi-sectoral support services) and the creation of a national agency to manage water resources are positive steps. However, the

newly created water utilities managed by municipalities (replacing water user associations) have low capacity and few resources. The irrigation and drainage service is also inadequate because of insufficient coordination between the municipality, line ministry and regional irrigation and drainage departments and low funding for investment. As farming transitions from subsistence to commercial agriculture, it will place greater demands on irrigation systems, and policies need to be in place to provide the services and recover sufficient revenues to maintain the resource.

**The Albanian coastline is under pressure from the impacts of unsustainable development and pollution, including untreated solid waste.** Albania's unplanned coastal development and intensive construction have led to unmanaged waste disposal and lack of proper wastewater treatment facilities.<sup>51</sup> Pollution of marine and coastal waters is increasing, especially in the lagoons, and around beaches plastic litter represents more than 90 percent of the total generated solid waste (half of it coming from land-based sources).<sup>52</sup> Quantities of marine litter including nano-plastics found in the Adriatic marine environment are one of the highest in the world, and plastic litter found in the Albanian part of the Adriatic accounts for 28.5 percent of the total. Albania has the highest percentage of untreated plastic waste (73 percent) followed by Montenegro, Egypt, and Libya.<sup>53</sup> The adoption of EU directives on waste management and other environmental regulations has progressed but enforcement re-

49 Albania contains 65 percent of the total surface of water basins of the Balkans (about 43,900 sq. km), with a large variety of water sources. The supply of drinking water mainly comes from natural springs (20 percent) and underground sources (80 percent). The energy sector is the largest consumer of water in Albania, using about 3 percent of all water provision (an almost equal amount to total water flowing in rivers).

50 Water Regulatory Authority (2019).

51 See World Bank, Wastewater treatment in Albania: finding the right balance to finance and operate WWTPs in the short and long term, Strategic Paper (2014).

52 Although some progress has been made with the closure of 89 non-sanitary landfills, institutional capacity remains weak World Bank, Realizing the Blue Economy Potential of Albania, (ID: P171389) (2019).

53 Invest in Albania (2019).

mains weak. Recycling shares decreased to 17.2 percent of total waste in 2016 from 25.3 percent in 2014, while the largest recycling companies work below 25 percent of installed capacity.

**The transfer of forest and pasture management to municipalities increases the risks for the sustainability of highly degraded and over-exploited forest areas.** The surface of protected areas in Albania occupies nearly 15 percent of the national territory and includes 15 national parks, 22 natural reserves, protected landscapes and natural monuments. Albania is also part of the European Green Corridor. However, the surface of forest cover has decreased in the last two decades. In 2018 it is estimated that only 6 percent of the surface of the country was covered by dense forest canopy (over 75 percent cover) and 17 percent was covered by light forest canopy (30 percent cover). Overbuilding, fragmentation, high firewood-use for cooking and heating have contributed to this loss.<sup>54</sup> The new function of forestry services established in 2016 defines the municipality as the owner of forests and pastures located within its administrative territory. Unfortunately, the legal framework regarding forestry has changed multiple times and local residents have raised concerns regarding the inventory of forests and pastures and the certification of the ownership of the municipality. Even to date, a considerable number of municipal forest offices are thinly resourced in terms of office facilities and staffing

with consequences on proper management of their activities. In addition, the reduced technical capacity and insufficient staffing affected the undertaking of several functions like the development of national forest policy and legislation, national reporting and monitoring. While municipalities own the forest and pasture resources, these functions are still required at the central level. Importantly, municipalities lack the authority to collect fines (a competency of the line Ministry). 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 implementation of disaster risk management is challenged by the division of responsibilities between the national and local governments.** Weather- and climate-related hazards have historically affected Albania. Floods frequently affect the north and southeast of the country, and climate change is expected to result in more intense and frequent rainfall events, exacerbating flood risk. Drought, heat waves and forest degradation—also expected to increase due to climate change—are increasing the frequency of wildfires, affecting the population's health especially in remote areas, while threatening agricultural and hydropower production.<sup>55</sup> Earthquakes are rarer but can have significant impacts, as seen during 2019 when two strong earthquakes hit the Durres area. The Post Disaster

54 At the same time, air pollution is also high due to high use of firewood; as well as in urban areas due to traffic congestion. A sustainable use of firewood is possible in Albania. For instance, reducing residues lost during harvesting to 12 percent (from 25-30 percent) of wood volume through improved methods to collect and transport residues during harvesting could reduce the amount of harvested wood needed to meet domestic demand by 500,000 m<sup>3</sup> per year. Reducing fuelwood moisture content to 30 percent could reduce the demand by 246,000 m<sup>3</sup> per year. Improving stove and boiler efficiency would reduce fuelwood demand: a 5 percent efficiency increase could result in a 200,000 m<sup>3</sup> reduction in the demand of fuelwood.

55 Damage from the 2002 floods exceeded US\$23 million, while the 2010 floods on the Drin River resulted in at least US\$30 million in damages. Urban flooding is another risk as urban storm water systems struggle to cope with more intense rainfall; Shkodra is at particularly high risk. It is estimated that a 100-year return period flood (1 percent annual probability of occurrence) would affect about 6 percent of GDP and 7 percent of the population, and that on average every year floods affect about 50,000 people and \$200 million of GDP. In addition to threatening people, property and agriculture, floods pose a significant risk to the transportation and trade network: average annual losses from floods along the two most critical road corridors (Tirana to Durres and Durres to Vlore) are estimated at about \$15 million, while bridges and culverts along the primary road network are estimated to suffer over US\$20 million annually (GFDRR, 2015).

Needs Assessment completed in February 2020 indicates that the total effects of the magnitude 6.4 November 26th earthquake in the 11 affected municipalities reached EUR 985.1 million in damages and losses and caused a reduction in GDP growth of 0.5 percentage points for 2019.<sup>56</sup> Despite Albania's high-risk exposure, the governance and capacity to manage these risks are still weak. In July 2019, Albania approved a new law on civil protection, which presents a modern and progressive approach to disaster risk management (DRM). Under the same law, the government created the National Agency for Civil Protection within the Ministry of Defense, while also trans-

ferring the main responsibilities for DRM to the municipalities. So far, the new National Agency for Civil Protection is under-resourced, and the municipalities lack the resources and capacity to implement a proactive policy, resulting in weak DRM implementation across the country. Lack of pro-active risk management and planning has led to dependence on external capacity and funding to respond to and recover from larger scale disasters. Considering the general unreliability of aid and increasing disaster risk due to climate change and urban development, Albania should pursue a more systematic approach to fiscal contingency planning and risk financing.

56 European Union; Government of Albania; UNDP; World Bank (2020)



**The government is investing to raise the PFM capacity of local governments.** The central government has made efforts to increase the capacity of local governments to produce accurate budgets and monitor and report their expenditures with transparency. The Ministry of Finance and Economy has produced guidance on the identification of local taxpayers, procedures for preparing and reporting on the Mid-Term Budget Plan (MTBP), monitoring implementation of the local budget, determining external-audit cases, deadlines, and standards; preparation of consolidated financial statements, procedures for managing financial difficulties and insolvency situations. The Ministry has also prepared a Financial Planning Tool for the preparation of the MTBP, it has set up a Help Desk to help municipalities implement it, and it has increased the transparency of local government public finances by updating the local government finance portal periodically. It also issued a simplified Citizen Budget (clear and simple summary guide) that is publicly available. Finally, the it has taken steps to reduce the risks of new local arrears by requesting local governments to report quarterly on accumulated arrears and their repayments. These efforts are supporting progress, but more needs to be done to generate the right incentives.

**Increased revenue generation and a more efficient planning could be stimulated by performance-based grants.** While it is clear that lo-

cal governments need increased resources, they also need more efficiency, transparency and accountability in the use of their current resources. Requirements for transparency combined with a system of performance grants linked to good governance conditions can create better incentives to generate results. The dissemination of audit reports can help citizens judge the performance of the local authorities and empower citizens in their political selection, and to demand accountability. Performance grants linked to the fulfillment of a set of governance conditions, quality of budget execution, and outputs can be an added incentive to enforce the law.

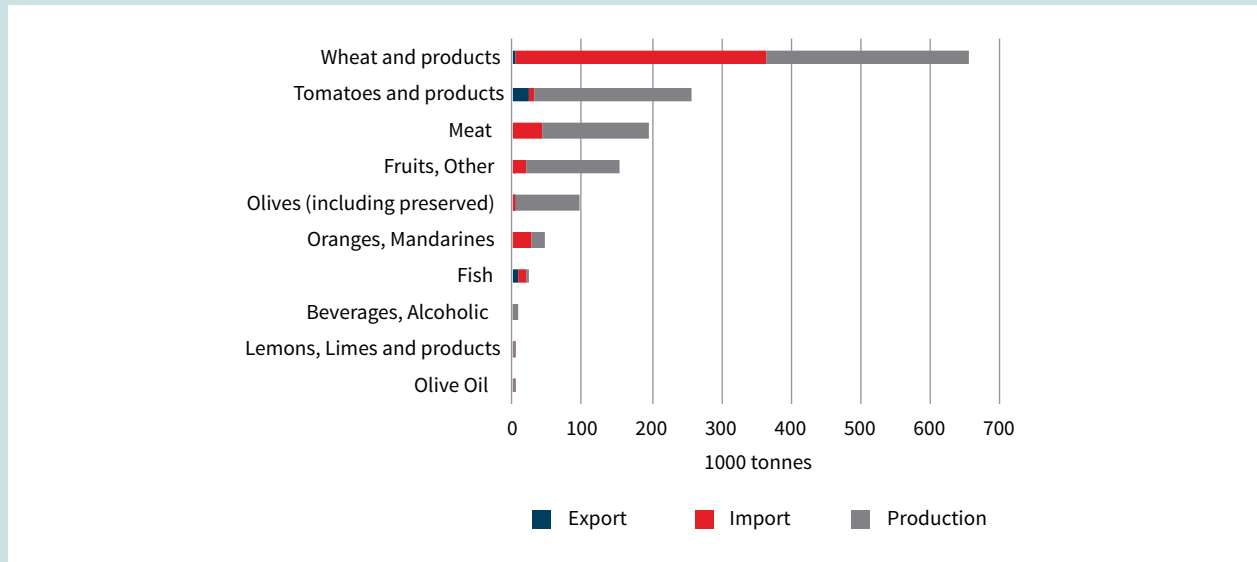
**Financing oriented to results can improve outcomes.** Municipalities are responsible for providing pre-university education (except vocational schools), but the financing and management of the system has traditionally been led by the Ministry of Education. Financing was historically allocated on the basis of the number of teachers, leading to an unbalanced student-teacher ratio across municipalities. Recently, the preschool finance system shifted to a per-student allocation, to bring the ratio of students per teacher to a maximum of 18, thus reducing overcrowding and increasing the quality of education for this group. In other areas of human development, however, low financing and incentives seriously limit the ability to deliver any services, especially to the most vulnerable. For instance, primary health service personnel in local health care centers does not consistently follow basic patient attention protocols, and there is little or no monitoring, training, and educating of patients.<sup>57</sup> Municipalities lack financial resources and data on basic welfare outcomes to design and deliver the appropriate social services. Social housing needs are unmet (about 30 percent of excess demand on average).

57 World Health Organization (WHO) (2018).

FIGURE 14:

Composition of domestic supply of agricultural products, 2013

Source: FAO Food Balance Sheets



Vulnerable groups such as victims of domestic violence have little support in terms of sheltering and access to health and legal services. People with disabilities rarely find municipal services for care and rehabilitation. Finally, young people receive little support for accessing job and training opportunities, which encourages them to migrate to larger urban areas. Strategic Objective 3 develops in more detail other policy options to reduce human development gaps in Albania.

**Rural earnings could significantly increase if agricultural productivity rises.** Albania’s agriculture sector consists of over 350 thousand farms with small and fragmented farming plots of 1 hectare on average, and with the lowest value added per agricultural worker in the Western Balkans. Over the past decade, agricultural labor productivity increased by 45 percent in Albania, a similar increase to the average EU country, but still ranks the lowest in the region (and it is mostly due to outmi-

gration of agricultural workers). As a result of low productivity, agriculture contributes 22 percent to GDP although its share in employment is about 40 percent. Most agricultural production is driven by own consumption needs, with excess production sold in local markets, and agricultural exports are marginal (Figure 14). Value chains are fragmented, and earnings are low. Farming is a source of both food and income security, with older people especially relying on it to complement pension or remittance income. A third of agricultural workers are above 65 years of age and most have low educational levels. Women represent half of agricultural employment in Albania, a larger share than in any Western Balkan country, and female workers represent 80 percent of all informal workers in agriculture. Capital availability is low, for instance, lending to agriculture makes up only 1.5 percent of total lending to the economy and farmers in the EU-28 use on average 710 tractors per 100 square

km of arable land, whereas Albanian farmers use 120.<sup>58</sup> Given these constraints, the capacity for innovation, scale production, processing and export are very limited.

**Albania can boost rural incomes by expanding agricultural production and exports.** Although Albanian agricultural exports are significantly below potential, Albania already has some competitive edge in vegetable exports, which it could expand further. It is a leading exporter of tomatoes (25 percent) and salad cucumber (11 percent) in the region, following North Macedonia (53 percent and 48 percent). It accounts for 5 percent of the regional paprika market and has experienced the fastest growth in the region. The Western Balkan regional market comprises more than 20 million consumers, with a large diaspora located in high-income countries. Albania could take more advantage of these two important markets by strengthening the trade links with them, using existing mechanisms such as the CEFTA agreement, and cultivating relations with merchants of Western Balkan products in the EU. Preferential access to the Turkish market is also an opportunity to expand exports. Investing in agricultural competitiveness has strong employment multiplier effects. An input/output analysis finds that the agri-food industry is responsible (directly and indirectly) for almost half the economy-wide jobs.<sup>59</sup>

**Investment in productive capital for farmers is key but needs to be accompanied by greater knowledge and coordination among producers.** To export successfully, Albanian farmers need to sustainably increase their production volume and quality by modernizing their practices. Ag-

riculture public expenditure is on the right track to increase the competitiveness of the sector with its focus on on-farm capital investments and rural development. Between 2010 and 2017, about 65 percent went to rural development, and around 10 percent to market support and direct payments. Positively, agricultural spending has shifted towards capital expenditures. Increased capital intensity needs to be accompanied by improvements in knowledge to increase productivity. It is estimated that closing  $\frac{1}{4}$  of the gap to EU-28 level of agricultural capital stock per worker would increase labor productivity by 76 percent in Albania.<sup>60</sup> However, agriculture public expenditure is low compared to regional peers. Between 2010 and 2017, public spending on agriculture averaged 0.27 percent of GDP. This compares to 0.72 percent in the EU, 1.27 percent in North Macedonia (the highest in the Western Balkan region), and 0.51 percent in Bosnia and Herzegovina (the second lowest in the region).<sup>61</sup> Closing this gap can help reverse the trend on investment in research.<sup>62</sup> Albania's increased focus on food safety and quality control is in line with the growing demand for processed food and agri-food exports. While the economic impacts of direct support to farmers are not negligible, support allocated under rural development programs (particularly farm modernization and food processing) has double effect on increases in employment. Building and/or strengthening farmer's associations and cooperatives could also help with rural transformation amidst the fragmentation of small land plots. Albania has few aggregation mechanisms, unlike many countries in the EU, where small pro-

58 World Bank, Albania, Agriculture for Jobs and Growth (2018).

59 World Bank, Albania, Agriculture for Jobs and Growth (2018).

60 See World Bank, Exploring the Potential of Agriculture in the Western Balkans (2018).

61 See World Bank, Albania Agriculture Public Expenditure Review (2019).

62 Estimates suggest that closing a quarter of the R&D gap relative to EU-28 levels could increase agricultural productivity by 15 percent in Albania.

ducer associations and cooperatives play a critical role in linking smallholder farmers to finance, inputs and output markets. Traders and off-takers provide aggregation services, but the lack of producer groups inclines bargaining power towards buyers, leaving smallholder farmers with the smaller percentage of value added.<sup>63</sup>

**Expanding fishing and tourism would contribute to sustainable and spatially inclusive growth.** The marine and coastal economy represents a combined 40 percent of GDP, of which 0.2 percent comes from the fisheries sector (IN-STAT, 2014) with an estimated value of the sector of US\$ 22 million, mainly from marine capture fishery, while aquaculture adds about US\$ 8 million and mussel production about US\$ 10 million. Both domestic and export demand can be expected to increase in the future, but the sector currently faces uncontrolled, over-exploitation of fish stock and low productivity.<sup>64</sup> Meanwhile forecasts from the World Travel and Tourism Council (WTTTC) estimate that by 2028 tourism in Albania could generate US\$ 2 billion, but this will depend on Albania's ability to maintain a pristine coast, to connect the country's coastal and maritime-based tourism with offerings inland, to attract more higher-spending environmentally and socially conscientious tourists and to further develop the tourism supply in a sustainable way.<sup>65</sup>

**Adopting a “blue economy” development plan would enhance the sustainability of coast-**

**al and marine activity and address environmental challenges.** The “blue economy” (a sustainable and integrated economic development in healthy oceans) is an approach that promotes inclusive economic activity while ensuring environmental sustainability and cultural acceptability.<sup>66</sup> Albania could adopt a blue economy approach to plan and implement policies to reduce pollution, preserve marine and coastal areas, improve their management framework to mitigate environmental risks, set boundaries for activity that respect the ecosystem's environmental limits, and ensure that the country's key tourism assets are most efficiently and sustainably used for the benefit of the local people. The EU has pointed to the current policy gaps in marine and coastal management and has called for policies to manage fisheries, solid and water waste, and to reduce marine pollution. Albania's preparations for reforming fisheries management to meet the EU Acquis are still at an early stage; although the Fisheries Strategy for Albania was adopted in 2016, only a small fraction has been implemented so far.<sup>67</sup>

**Connecting infrastructure between urban and rural sectors could support the development of agricultural exports and tourism.** Despite Albania's efforts to invest in public infrastructure and increase its capital stock, it still has the largest infrastructure gap in the Western Balkans.<sup>68</sup> A large swath of the country remains ill-connected with internal and external markets

63 World Bank, *Exploring the Potential of Agriculture in the Western Balkans* (2018).

64 See FAO (2015).

65 See Annex 3: Strategic sectors for Albania's export-oriented growth model for details on the tourism and agriculture sectors.

66 For example, reducing overfishing could potentially add more than US\$ 80 billion to the global economy each year, more than 30 times the current net contribution of the fisheries sector. See World Bank, *The Potential of the Blue Economy: Increasing Long-term Benefits of the Sustainable Use of Marine Resources for Small Island Developing States and Coastal Least Developed Countries* (2017).

67 European Commission (2018)– Chapter 13 – Fisheries.

68 For instance, in 2017, Albania spent 2.4 percent of GDP in the transport sector, but it ranked 115 of 140 countries in road connectivity in the 2018 Global Competitiveness Index, and 100 of 140 in overall infrastructure (Atoyan, et al., 2018). Still, between 2014-2018, spending on roads focused on network expansion and upgrade investments. The road quality improved; shares of km in “good” and “very good” condition increased from 35 percent in 2014 to 60 percent in 2018.

(Figure 15).<sup>69</sup> Responding to the EU accession process, the government has prioritized connecting the main economic poles in Albania with each other and with neighbor countries. For instance, a joint railway station between Albania and Montenegro was inaugurated in Tuzi, and Albania approved the Transport Community Treat to establish an integrated market in the transport sector and enhance transport operations within the region and with the EU.<sup>70</sup> Regarding roads, the “core transport network” has been prioritized. Roads are safer and the country has almost achieved its target to reduce fatalities by 20 percent compared to 2014 by improving the effectiveness of road safety inspectors.<sup>71</sup> Still, investment and maintenance of the rural road infrastructure is uncoordinated and inefficient, as municipalities lack an integrated management strategy. Standards for design, construction and maintenance which are used at the national level are not systematically adopted by municipalities, affecting quality. In terms of digital connectivity, Albania has made significant effort to include digital infrastructure as part of the Western Balkans Investment Framework (WBIF) facility and is the first country to take advantage of the available funding to design its first rural broadband program.<sup>72</sup> Albania is now part of the Balkans Digital Highway initiative that aims to strengthen digital connectivity through commercialization of fiber assets on the

regional level.<sup>73</sup> Still, more than half of the country’s households lack access to commercial fixed broadband connectivity, and high-speed broadband ( $\geq 30$  Mbps) is available to fewer than 10 percent of households.<sup>74</sup> Broadband household penetration varies widely across regions; while in Tirana penetration exceeds 70 percent, it drops to 30 percent in all eastern counties and in the south. Improving connectivity between rural areas (agricultural and natural) and the “core network” would reduce time and costs of transportation for agricultural produce for export, and it would also allow other non-agricultural activities to develop further (such as tourism). Supporting the capacity of municipal governments to better plan, coordinate, and invest in maintenance of rural roads would be an important step as these are local government functions. In the long term, expanding the rail network towards the southern and central parts of the country will also enable alternative transportation options for people and merchandise, reducing congestion. Finally, expanding access to digital connectivity will be critical to allow all sectors operating in rural areas to modernize, experience efficiency gains and create jobs.

**Albania needs to implement more proactive urban planning policies that support the creation and strengthening of dynamic, attractive and competitive cities.** Local governments have low capacity to conduct and implement territorial

69 The connectivity index shown in the figure is the sum of the road density and market accessibility indices (World Bank, Albania Vulnerability Index, unpublished, 2019).

70 The government is also implementing measures such as aligning and simplifying border crossing procedures, railway expansion and reform, information systems, road safety, and maintenance schemes.

71 That said, roads are still vulnerable to weather events and natural hazard.

72 The WBIF is a regional blending facility to support EU enlargement and socio-economic development in the Western Balkans by providing financing and technical assistance for strategic investments in the energy, environment, social, transport, private sector development and digital infrastructure sectors. In 2020 Albania aims to upgrade its major sectorial policies such a Broadband strategy and 5G strategy that should pave the way for the further advancement of its infrastructure. In November 2019 Albania’s energy regulator (ERE) has authorized the electricity transmission operator to commercialize its underutilized fiber optic assets thus providing important input into diversification, robustness and security of the national digital connectivity routes.

73 Gelvanovska-Garcia (2019).

74 AKEP (2018).

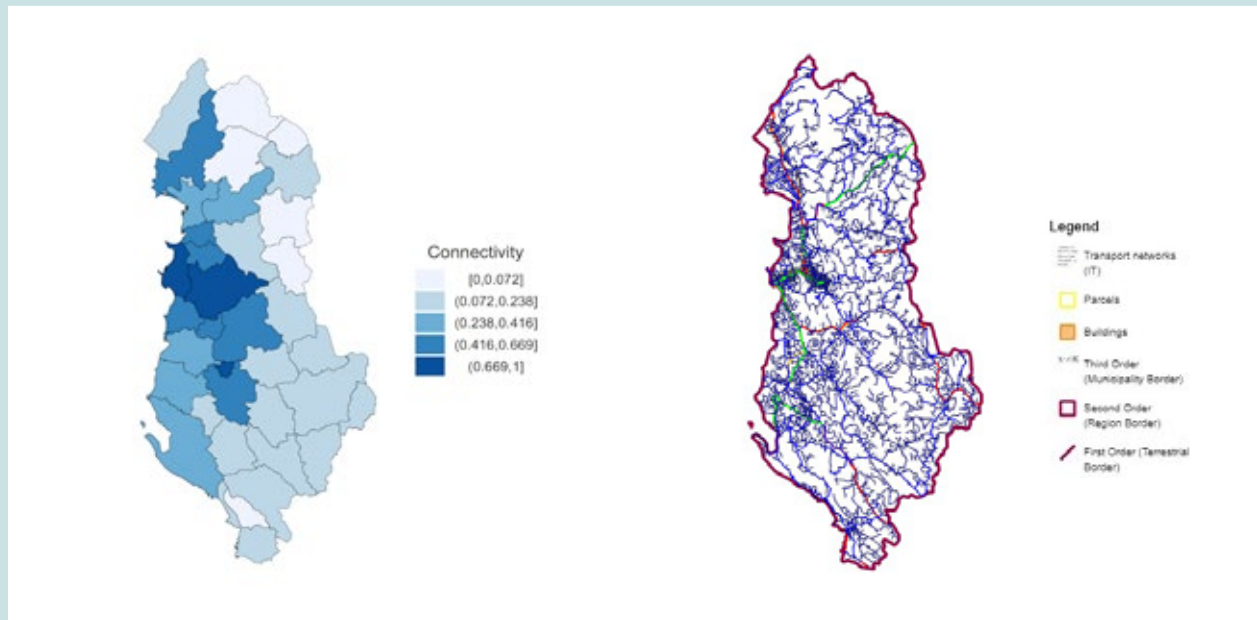


FIGURE 15:

### Connectivity index and road network

Source: World Bank, Albania Vulnerability Index, unpublished (2019)

Source: ASIG



planning. Only 34 municipalities have approved territorial development plans. Most municipalities experience difficulties due to their inexperience, lack of technical expertise and limited access to immovable property registration data. In some cases, borders with other administrative units is unclear, generating further problems. As the General National Plan “Shqipëria 2030” states, government at all levels need to strengthen a larger system of interconnected cities and rural areas with dynamic activity and good quality of life by gradually and strategically investing in improving key infrastructure and in primary healthcare, education, public transportation, and housing.<sup>75</sup> These investments would enhance economic ac-

tivity and attract investment in the different urban centers, creating better job opportunities and improving the quality of life in smaller cities.

**The under-performance of the land administration sector remains a critical constraint to economic and territorial development.** Since the privatization process began at the start of the transition, the land management sector has suffered a lack of cohesive leadership, fragmented institutional arrangements, and an inconsistent policy, legal and regulatory framework. This has created disincentives to invest in land, restricted the development of a land market, and prevented the transition to a modern economy.<sup>76</sup> During

<sup>75</sup> Government of Albania (2016).

<sup>76</sup> In 1991, the Law on the Land (No. 7501/1991) was passed to manage the privatization of ex-cooperative farmland. It established that land should be distributed to families that resided on the cooperatives. The ownership certificates (“tapis”) issued to each family, indicated the name of the household head, a list of parcels assigned to the household, their characteristics and the local names of the bordering

this time the laws on the property privatization processes have been amended continuously to address problems as they were identified; often times with lack of clarity, leading to further implementation challenges. Frequently, privatization commissions issued various acts for the same plot of land. Agencies in charge of the privatization process were constantly restructured, decisions were not documented creating scope for errors and malpractice. In short, the mismanaged privatization process led to many legal disputes that continue to the present day. Moreover, the quality of immovable property data is low, which weakens property rights and the development of healthy and transparent real estate markets. Approximately 80 percent of private properties in Albania are registered, but their records exist only in paper format. The mapping records are often in poor physical condition, complicating maintenance. The share of properties registered and held in digital format is still very low. Registrations have continued largely in analogue form until 2019. The shallow markets for agricultural land sales and rentals have obstructed the process of land consolidation especially in remote areas with higher land fragmentation and high orientation to livestock activities, where rented land is used almost exclusively for short-turnover

uses such as producing animal feed. A significant portion of agricultural land is thus not being used productively due to an ill-functioning land market and lack of access to capital.<sup>77</sup>

**Completing the implementation of a comprehensive land administration system is critical to secure land property rights and conduct proper urban planning.** To address the capacity problems and the lack of a coordinated approach between agencies, the new Cadaster Law defines the rules for the establishment, organization and functioning of the new State Agency of Cadaster, as the state institution responsible for the administration of the immovable property register as well as for the completion of the outstanding land privatization processes. In addition, an e-Gateway, managed by the National Agency for Information Society (AKSHI), operates as a single point of access to various government datasets and services. Positively, during 2017, the immovable property registry (IPRO) accepted approximately 300,000 applications for transactions. Approximately 50 percent of the applications concerned a group of nine services. A pilot in Tirana began to complete all applications that fell into these categories within 24 hours, a system known as “Fast Track.”

parcels. The local cadaster offices then archived the “tapi”. This led to over 300 thousand new properties which resulted in high land fragmentation. However, the Land Law did not recognize the land ownership rights as they existed prior to collectivization. This caused resentment on the part of pre-1945 owners and eventually led to a Law on the Restitution and Compensation of Properties of Ex-Owners (Law No. 7698/1993), which allowed recognition in some areas for ex-owners or compensation with alternative parcels of land. The trust on the validity of the new titles was low because of frequent overlaps with titles issued before WWII (pre-collectivization) and the slow process of addressing disputes. See Zhllima, Imami, & Rama (2019) and World Bank, Albania: Status Review of the Immovable Property Registration Office now superseded by the State Cadaster Agency (ASHK) Services and Data Quality (2019).

77 Deininger et al. (2012).



**The Albanian social contract needs to be reinforced to ensure that the poor and vulnerable have more opportunities to prosper.** At 38 percent of the population in 2017, Albania’s absolute poverty (measured at US\$5.5 per person per day, in PPP) is still high by UMIC and ECA standards. Despite the decline in poverty between 2014 and 2015, the headcount in 2017 is comparable to that from a decade earlier. The modest progress observed between 2014 and 2015 resulted mainly from job creation and to a lesser extent by higher

earnings, but the overall quality of jobs remains low. Over 30 percent of jobs are informal, preventing workers from joining the pensions system and benefiting from the protection of formal jobs. The share of self-employed (34.9 percent of total employment) is the highest in the region.<sup>78</sup> These labor market outcomes partly reflect the structure of Albania’s economy – low-productivity agriculture continues to absorb close to 40 percent of total employment, while manufacturing and services are underdeveloped.<sup>79</sup> Moreover, the social contract—that is, the institutional arrangements to protect the most vulnerable and to foster equal opportunities—is not sufficiently strong and efficient to ensure that people fulfill their potential while providing sufficient protection to those that cannot participate in the labor market, including the growing aging population.

78 World Bank & WiiV, SEE Jobs Gateway Database (2020).

79 INSTAT, Employment by administrative source and agriculture sector (2017).



**Low wages and low real wage growth limit the potential of jobs to improve living standards.**

In 2018, the average remuneration rate of Albanian workers in the formal sector was EUR 853 per month, adjusted for purchasing power parity (PPP). Despite a real growth rate of 2.1 percent per year between 2014-2018, it remains the lowest in the Western Balkans (where the average was EUR 1,167). Consequently, labor earnings have now less impact on poverty reduction compared to the period before 2008, when real wages grew at close to 10 percent per year on average, which contributed to a faster poverty reduction. A new law to promote the employment of unemployed job-seekers was adopted in April 2019 to provide specialized services, including counselling and career guidance, intermediation services and training, with priority given to vulnerable groups. However, the budget for employment services and promotion is only 2.6 percent of total social protection spending (including social security).<sup>80</sup>

**Women face significant gaps in access to economic opportunity.** The employment gender gap in 2018 was 14 percentage points in favor of men for ages 15–64, and 17 percentage points for labor force participation. In 2018, 60 percent of Albanian women were economically active, the highest participation rate since 2011 but still 9

percentage points below the EU28 average. The drivers of inactivity are different among men and women: nearly one-third (31.6 percent) of economically inactive women carry out domestic responsibilities, compared with only 2.1 percent of men, and over half (53.1 percent) of the men who are economically inactive are students (against 29 percent of women).<sup>81</sup> As a result, elderly women are at risk of vulnerability because they have less pension income and assets and have higher rates of becoming widowed (48 percent) compared to men (11 percent). Among those who work, women are overrepresented in unpaid family work (23 percent, compared with 12 percent among men) and concentrate in opposite ends of the occupational spectrum: either formal, professional occupations, or in agriculture, informal, and low-skill jobs. A gender wage gap of roughly 15.2 percent exists in favor of men, even after one controls for education, experience, and other characteristics. Occupational segregation, dependent children, and missed work experience are among the factors that increase the gender wage gap. There are gaps in entrepreneurship as well. Only 11.7 percent of Albanian firms have women managers, and only 12.5 percent are owned or co-owned by women. These shares are well below regional averages.

**Other groups also suffer from economic and social exclusion.** Youth and minorities are disproportionately excluded from the labor market. For instance, 27 percent of youth are not in education, employment or training (NEET), and unemployment among youth is 2-3 times higher than for the adult workforce. Exclusion from the labor market may lead to social exclusion, as suggested by international evidence.<sup>82</sup> In Albania, a high share of

80 Fostering stronger labor demand is a crucial endeavor, and the country needs to expand job creation in non-traditional sectors, for instance E-commerce (which has spillovers in areas such as digital marketing and logistics).

81 This difference also reflects the fact that most inactive men are below 25 years old. In contrast, inactivity is only about 10 percent among men 25 to 54, against 25 percent for women in the same group.

82 See OECD (2016) and Henderson, Hawke, & Chaim (2017).

the prison population are youth (37 percent) and there is high fertility among young women 15-19 (14.5 births per 1,000 women, compared to 10 in EU). Despite significant progress in the protection of rights of LGBTI people, a large majority of them are systematically discriminated from access to work opportunities, health services, housing, and obtaining police and justice services.<sup>83</sup> For example, 10 percent of LGBTI people have forgone necessary medical treatments because of fear of discrimination. Almost one third (29 percent) of LGBTI people in Albania have been a victim of violence, with 25 percent of that violence originating within the family/household. Only 11 percent of the victims reported their case to the police, mostly stating fear of homophobic and/or transphobic reaction from the police.<sup>84</sup> Disabled people (who represent about 2.5 percent of the adult population) face barriers to access education, and have a low labor force participation (34 percent, against 55 percent in total population), while disability benefits—which take a large share of social assistance spending—do not reach the most needed beneficiaries.<sup>85</sup> Roma and Egyptians (who represent around 3 percent of the population) have very low enrollment in basic education (66 percent of children 7-to-15, compared to 96 percent of non-Roma), only 18 percent are employed (against 56 percent nationally), and only 27 percent have health insurance (45 percent for non-Roma).<sup>86</sup> They also suffer exclusion from social programs because of inflexible eligibility rules.

**Despite the large Albanian diaspora and current level of remittances, these private transfers could decline in the future.** Although the massive out-migration seen during the 1990s and early 2000s has decreased significantly and continues to fall (in 2018, 39 thousand people emigrated, against 46 thousand in 2014), the Albanian diaspora living abroad represents close to a third of all Albanians and 40 percent of those still living in the country (Figure 16). For years, the Albanian diaspora has maintained strong links to the country, and remittances represent an important source of income support for many households in Albania. Thus, many households have come to rely on private transfers from relatives home or abroad rather than from public redistribution of resources via taxation and social spending. However, the diaspora's links to Albania will become weaker as family ties diminish, and private transfers will contribute less to household income, which could put more pressure on public social programs.

**Moreover, demographic change will increase the pressure to shift resources towards older generations.** Once considered a young country, Albania has seen its population growth fall into negative territory and the composition of families change since the second half of the 1990s when massive out-migration took place as a response to economic hardship. During the 2000s, despite better economic performance, population growth has been consistently below zero. This is the combined result of net out-migration

83 In the last decade, the Albanian government has passed some of the most progressive LGBTI protections in the Western Balkans. In 2013, Albania reformed its criminal code to incorporate SOGI into existing hate crime and hate-speech laws. In 2015 the government of Albania held the biggest consultative meeting on LGBTI rights for the action plan for non-discrimination of LGBTI people 2015-2020. A Commissioner for Protection from Discrimination was appointed for a 5-year term to examine complaints, monitor the status of discrimination, and issue recommendations. However, LGBT progress goes beyond legal reforms. Discrimination and marginalization of LGBTI or ethnic minorities also reflect insufficient access to social and legal services, and insufficient efforts to encourage the public visibility of LGBTI individuals (UK Home Office, 2019) and (Bertelsmann Stiftung, 2018).

84 World Bank Group. 2018. *Life on the Margins: Survey Results of the Experiences of LGBTI People in Southeastern Europe*. World Bank, Washington, DC.

85 See World Bank, *Albania Social Assistance Modernization Project additional financing* (2018).

86 Robayo-Abril & Millán (2019)

FIGURE 16:

Stock of emigrants by destination, 2017

Source: Authors with data from UN Population Division (2017)

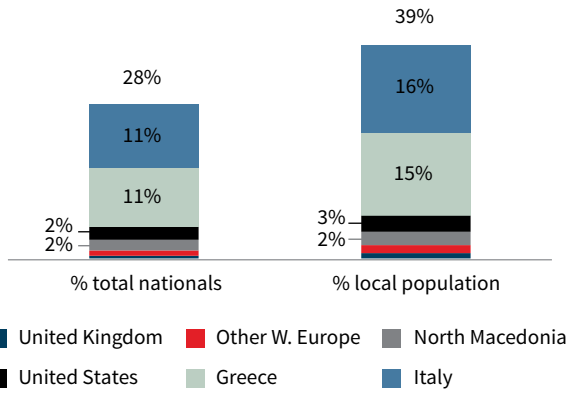


FIGURE 17:

Population pyramid by gender, 2020-2050

Source: Authors with data from UN Population Division (2019)

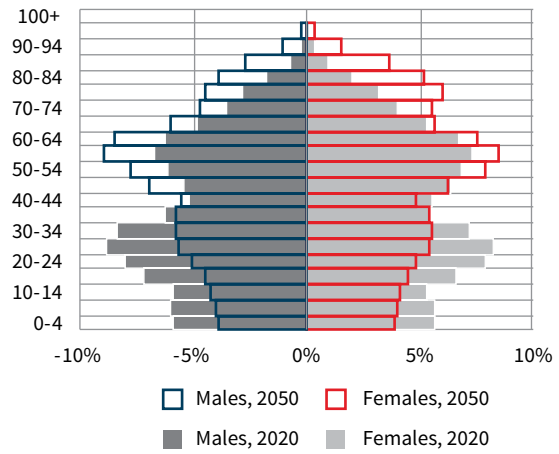


FIGURE 18:

Share of Albanians saving money regularly

Source: Authors with Global Financial Inclusion Database (2019).

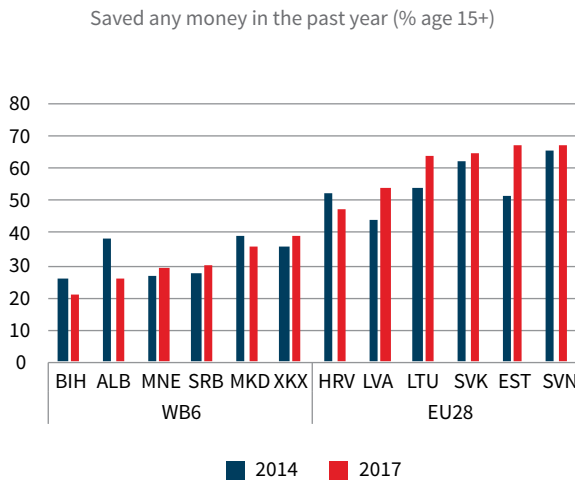
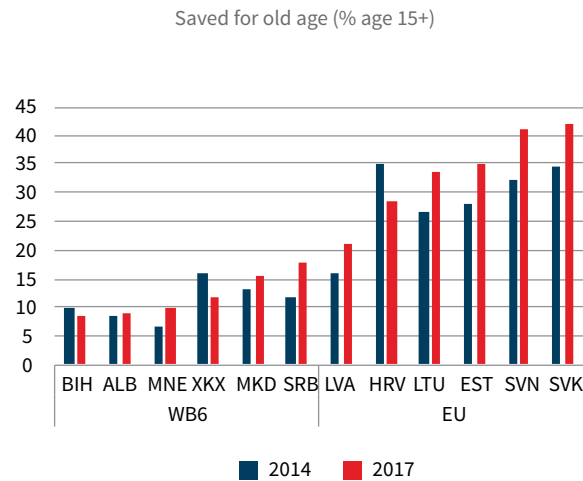


FIGURE 19:

Share of Albanians saving for old age

Source: Authors with Global Financial Inclusion Database (2019).



and a below-replacement birth rate of 1.71 children per woman. In 2014, close to 36 thousand babies were born, but this number had declined to 29 thousand by 2019 (INSTAT), and this trend is more pronounced outside of the Tirana-Durres prefectures. Population projections show that by 2050 half of Albania's population will be over 50 years old (Figure 17). Internal migration within Albania is also changing the demographic landscape and making the areas outside of Tirana and Durres older as a result of the low birth rates and the migration of working age adults. Inevitably, this demographic change will shift public and private resources from the young to the old, as these become more numerous. It is then important to understand how Albania can renew its social contract to reduce poverty faster and to ensure that higher living standards for the future Albanian population are sustainable.

**Despite the aging trend, too few Albanians are saving for old age.** According to the Global Fi-

nancial Inclusion Database, in 2017 only around one in four adults in Albania saved any money in the year prior, and this share had decreased since 2014 (Figure 18). The share is also the lowest in the region after Bosnia and Herzegovina, and less than half of the share in countries like Estonia, Lithuania, Slovakia or Slovenia, where over 60 percent of adults saved in the last year. Even fewer people use bank accounts actively. More importantly, only around 9 percent of adults save any money for old age (Figure 19), again the lowest after Bosnia and Herzegovina and about four times below the countries above. In a context of aging, this means that as adults reach old age, their savings base will be insufficient to generate retirement income, and younger generations will have to bear the burden of supporting the old through non-contributory pensions. However, as the working-age population declines, it will become harder to finance such schemes and they will take place at the detriment of other investments.



**Investing efficiently in education is critical to enhance economic inclusion.** The fact that 70 percent of the poor live in households where the head has lower secondary education or less indicates that insufficient investment in skills reduces the probability to exit poverty. Low skill accumulation is in part the result of underinvestment in early childhood development (including nutrition and education) that decreases the ability, especially among the poor, to fully develop their productive potential in adult life. Overall public spending for education is low. It reached 3.1 percent of GDP in 2017 (compared to 5 percent on average in the OECD), still far from the 5 percent target, and pre-university education spending was only 2.31 percent of GDP.<sup>87</sup> Per-student expenditure is among the lowest in Europe across all levels of education. In 2017, per student expenditure as a percentage of GDP per capita was 12.5 percent for preschool and basic education (Grade 1-9) combined, against the EU28 average of 20.2 percent for pre-school, 21.5 percent for primary and 25.7 percent for lower-secondary. Expenditure per student in upper-secondary (general and vocational) reaches 14.9 percent of GDP per capita, against the EU28 average of 25.2 percent, while per student spending in tertiary is 13.6 percent, less than half the EU28 and OECD averages of 28 percent. More importantly, education financing is still largely input-based, with no national bench-

marks and goals to drive system improvement and efficiency in light of declining school-age population. Recently, the preschool finance system shifted to a per-student allocation, to bring the ratio of students per teacher to a maximum of 18, which should reduce overcrowding and increase the quality of education for this group.

**Greater access to quality primary health care is needed to reduce health risks diminishing the quality of human capital, especially among the poor.** As discussed above, child malnutrition and anemia are relatively high nationally and also more prevalent in poorer prefectures, and the quality of health services is also lower there, where people report making frequent informal payments, especially among the poor and ethnic minorities. The risk of premature death from four major noncommunicable diseases (NCD) for ages 30-70 was 20.7 percent for men and 13.1 percent for women in 2016.<sup>88</sup> Morbidity and disability risks from NCDs have strong negative impacts on productivity. To improve adult survival and ensure a healthy and productive aging, Albania needs to invest in prevention, emergency services and specialized care. The government's national health strategy, adopted in 2017, aims to establish universal healthcare coverage.<sup>89</sup>

**For women, expanding childcare services would facilitate labor market participation.** Low availability of early childhood education and care among children aged 0-3 in Albania reflect the limited working time available among parents, particularly women. Only 10 percent of children ages 0-3 have access to organized day-care or crèche services, and preschool enrollment, although it has increased, is lower in rural areas. Furthermore, although the enrollment rate in pre-

<sup>87</sup> UNICEF (2019)

<sup>88</sup> World Health Organization (WHO) (2018).

<sup>89</sup> European Commission (2019), p. 92.



FIGURE 20:

Incidence of Ndihma Ekonomike by welfare decile

Source: Authors based on HBS data

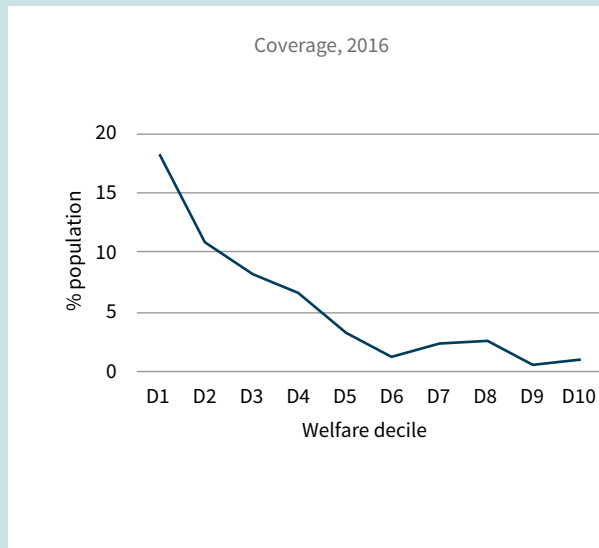
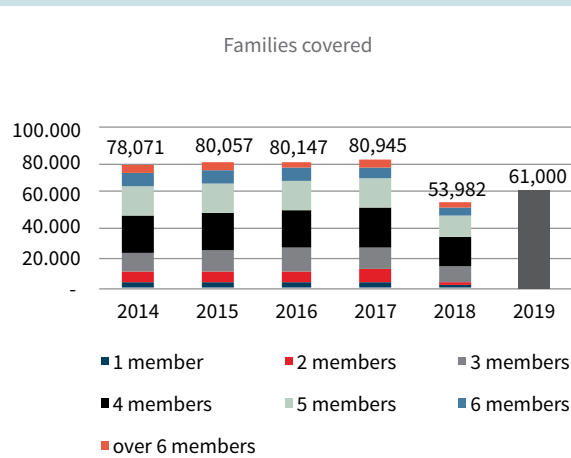


FIGURE 21:

Overall coverage of Ndihma Ekonomike

Source: INSTAT



school education of children ages 3-5 is high in Albania (86 percent), participation is significantly higher among households from higher socio-economic status and in urban areas. In Albania, most childcare needs are covered by household members, particularly women. These barriers affect not only the supply of labor, but also the demand for women’s labor: evidence from a survey of employers in several countries of the Western Balkans shows that a large share view women’s competing family obligations as an issue in hiring women (48 percent of employers in Albania and 27 percent in Serbia). The limited access to childcare generates a vicious circle of low labor market attachment and the prominence of the care provider role that leads to increased vulnerability and gender-based inequalities.

**Social assistance is important to complement the income of poor households, but its coverage and efficiency to reach the most vulnerable could improve.** Social assistance spending increased steadily until 2014 and has remained roughly constant, but it remains the lowest (as a share of GDP) in the Western Balkans after North Macedonia. Social assistance transfers (poverty and disability benefits) accounted for only 12 percent of poor households’ income in 2017, below the average for upper-middle income countries and below all Western Balkan neighbors and Croatia.<sup>90</sup> Among the components of social assistance, disability benefits drove the increase, peaking in 2014, when 16.7 billion lek were spent on disability (79 percent of the total social assistance budget), with a slight decrease in 2015 and 2016. An increasing share of disability benefits

90 See ASPIRE (2019).

went to work invalids, who in 2015 received close to half of the benefits, whereas the disabled and their caregivers have seen their share decline. The government is planning to implement a social model for disability assessment.<sup>91</sup> It has conducted a pilot of the new assessment methodology, developed a monitoring system and approved legislation for scaling the reform. However, the model still needs to be strengthened before it can effectively cover the most vulnerable disabled people. The coverage of the main poverty alleviation program, Ndhima Ekonomike, should also increase. Only 18 percent of households in the poorest decile were covered in 2016 (Figure 20) and spending remained at around 4.4 billion lek between 2011 and 2016.<sup>92</sup> Recent reforms to targeting of Ndhima Ekonomike to improve eligibility criteria and deliver the cash transfer to women in the household, resulted in lower coverage in 2018, although it has increased more recently (Figure 21). Because of the reform, the generosity of the program increased by 17 percent between 2017 and August 2019. The government is working to strengthen economic assistance, although more analysis is needed to determine if recent reforms are reaching those most in need.<sup>93</sup>

**The provision of activation and social care services needs to be strengthened.** Active labor market programs are starting to connect beneficiaries of social assistance with the labor market. In 2018, close to 4,000 beneficiaries of social were employed through the National Em-

ployment Services, and additional 648 people enrolled in vocational training courses through the newly approved Employment Promotion Program. Activation support coverage is still very low, but the government plans to expand it, including providing more attention to women. At the same time, at the local level social care services are undeveloped and insufficient to connect the poor with the services available. Although local governments have the responsibility to assess needs, plan and provide social care services, almost half of them lack the capacity and experience to implement them.<sup>94</sup> For instance, municipalities lack data on basic welfare outcomes to design and deliver the appropriate social services. Social housing needs are unmet (about 30 percent of excess demand on average). Vulnerable groups such as victims of domestic violence have little support in terms of sheltering and access to health and legal services. Similarly, the country has only one shelter for LGBTI people which begun recently receiving financial support for the government.<sup>95</sup> People with disabilities rarely find municipal services for care and rehabilitation. Finally, young people receive little support for accessing job and training opportunities, which encourages them to migrate to larger urban areas.

**Fiscal policy and administration, particularly taxation, could have more ample redistributive effects.** Few Western Balkan countries apply progressive personal income taxation,

91 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.

92 A caveat is in order, as the HBS, is not designed to be representative of NE beneficiary population. In 2016, the HBS captures even a lower NE coverage than previous years. According to HBS 2016 the overall NE coverage is 5.4 percent compared to the actual coverage measured based on administrative program data of 10.5 percent in the same year, about half of the actual coverage. Hence any statistics derived from the HBS have limited reliability. The simulations on matching program MIS administrative data with the national distribution of consumption based on HBS 2016.

93 Council of Ministers (2019), p. 121-123.

94 European Commission (2019).

95 <http://strehalgbt.al/>

among them Albania (with a top marginal rate of 23 percent), North Macedonia (top rate of 18 percent), and Kosovo (top rate of 10 percent). Because most revenue collection relies on indirect taxes, fiscal policy—both taxation structure and government transfers—tends to have relatively limited redistributive effects in Albania.<sup>96</sup> Direct taxation reduces inequality only at the margin: the Gini coefficient falls from 0.37, measured at income plus pensions, to 0.35 for consumable income (subtracting all taxes and contributions and adding direct transfers). But taxation as a whole, especially the VAT, has a small poverty-increasing effect that is not sufficiently offset by direct social transfers. Moreover, the redistribution

system is undermined by the weak tax collection of the state due to significant informality and income under-reporting. For instance, less than 18 percent of adults have formal wage employment, which means that the base for personal income taxation is very small. Likewise, VAT collection is about 10.4 percent of final consumption (2017), half of the potential revenue. And a system of private transfers (remittances included) represents about half of the income share of public transfers for the bottom 40 percent, suggesting that private transfers are also an important redistributive mechanism, although they are not targeted to the most vulnerable.

96 Davalos, Robayo, Shehaj, & Gjika (2018).



**The evidence presented in the Update, combined with internal and external consultations, resulted in the identification of five key policy priorities to achieve the Strategic Objectives for Albania's development outlined above.<sup>97</sup>**

The country has undoubtedly seen positive institutional, economic and social developments since the SCD was presented in 2015. At the same time, while legal frameworks have moved forward to address key constraints to achieve poverty eradication, shared prosperity, and accelerate progress to reach high-income status, in practice most still need to be fully implemented. The Update revisits the policy priorities presented by the SCD and organizes them with the lens of the three Strategic Objectives described above, based on the most recent evidence available, on internal and external consultations, and in alignment with the EU accession process. Similar to the SCD, the Update also considers as pre-conditions for development the consolidation of institutional quality, economic stability, and a sustainable use of natural resources.

**The SCD identified 12 sectoral priorities of which five were fundamental.** The five policy areas **fundamental** for reaching the twin goals in Albania and having direct impact both on competitiveness and inclusion were: (1) *restoring fiscal sustainability and financial stability*; (2) *establishing a high-quality business environment that promotes firm growth and job creation*; (3) *providing*

*clean energy efficiently, equitably, and in a sustainable manner*; (4) *formalizing and enhancing the inclusiveness and sustainability of the land market*; and (5) *enhancing governance, transparency, and the accountability of government toward citizens*). Four priorities were grouped as **supporting** or amplifying the impact of the top five priorities over the longer run (*increasing the quality of labor market engagement*; *improving the quality and relevance of the education system and skills training*; *improving efficiency, access and quality of public services delivery*; and *ensuring more inclusive access to financial markets*). Finally, three priorities were considered critical to **enhancing** the economic, social, and environmental sustainability of the top five priorities and the overall reform agenda (*enhancing the effectiveness and efficiency of social protection systems for the benefit of vulnerable groups*; *ensuring the sustainable use of natural resources and the stewardship of the environment*; and *improving the quality and equity of health services and reducing health-related financial risks*).

**This SCD Update revisits these priorities and organizes them around 5 policy areas consistent with the 3 Strategic Objectives.** The insights from recent evidence analysis and internal and external consultations helped to re-examine the SCD's proposed priorities in light of the current trends undergoing in the country and the EU accession process. For the most part, given the slow progress in the implementation of reforms (despite more favorable external conditions) the priorities put forth by the SCD remain valid. In line with the organization of the Update's analysis around the 3 Strategic Objectives, the Update proposes to reorganize these priorities by grouping them around specific outcomes that would contribute to reaching the Strategic Objectives. In doing so, the Update highlights the cross-cutting

<sup>97</sup> See Annex 6: SCD Update consultations.

nature of the policy outcomes needed to achieve the Strategic Objectives, and the importance of policy coordination both horizontally and vertically across government levels. These goals are also in line with the EU acquis chapters. The Update identifies 5 policy areas that directly contribute to growth and inclusion (the first three critical to increase competitiveness, while the last two

contribute the most to inclusion). Additionally, three policy areas address the pre-conditions for development of institutional quality, economic stability, and a sustainable use of natural resources, also identified as fundamental by the SCD. The relation between the SCD and the Update's proposed priorities is presented in Table 1.

**TABLE 1:**  
Relation between priorities, pillars and foundations

Priority policy areas in the 2019 SCD Update	Priorities from the 2015 SCD (F=Fundamental; S=Supporting; E=Enhancing)
Fostering <b>competitive markets</b> .	Establishing a high-quality business environment (F) Enhancing governance, transparency and accountability of government (F) Improving inclusiveness of access to financial markets (S) Improving efficiency, access and quality of public services delivery (S)
Enhancing efficient investment in <b>human capital</b> .	Improving quality, access and relevance of education and training systems (S) Improving quality, efficiency and equity of health services (E)
Upgrading <b>infrastructure</b> , improving <b>disaster resilience</b> and <b>energy diversification</b> .	Providing clean, efficient, equitable and financially sustainable energy sector (F) Improving efficiency, access and quality of public services delivery (S) Ensuring sustainable use of natural resources and stewardship of the environment (E)
Strengthening the capacity of <b>local government to raise revenues and deliver services</b> .	Improving efficiency, access and quality of public services delivery (S) Restoring fiscal sustainability and maintaining financial stability (F) Enhancing governance, transparency and accountability of government (F)
Strengthen the <b>redistributive efficiency</b> of the state.	Enhancing effectiveness and efficiency of social protection systems (E) Increasing the quality and inclusiveness of labor market engagement (S)
<b>PRE-CONDITIONS</b>	
Strengthening <b>rules-based government</b> .	Enhancing governance, transparency and accountability of government (F) Establishing a high-quality business environment (F) Formalizing and enhancing inclusiveness and sustainability of land markets (F)
Achieving a <b>stable and transparent macroeconomic environment</b> .	Restoring fiscal sustainability and maintaining financial stability (F)
Strengthening <b>protection of natural resources</b> .	Ensuring sustainable use of natural resources and stewardship of the environment (E)

**Fostering competitive markets.** A competitive and high-quality private sector is the economic basis for integrating into the global economy, creating job opportunities across the territory of Albania and generating broad-based development that benefits all. This calls for removing unnecessary barriers to entry, exit, and operation of companies, and maintaining a level playing field for all companies. A business-friendly and predictable legal environment that encourages long-term investment decisions is critical. Firms need broader access to production inputs, including a skilled workforce, finance as well as a high-quality infrastructure connecting businesses with markets. A deeper and more diversified financial sector is needed to meet the varying needs of businesses and the population. By developing and implementing a sound innovation and digitalization policies through providing access to funds, technical assistance and knowledge, the government can encourage firms to remove inefficiencies in downstream value chains, encourage new business models such as e-commerce to integrate better with regional and global value chains and upgrade managerial skills and processes.<sup>98</sup> A more developed digital economy would offer new opportunities for women's labor force participation, with a flexible work model that allows for more balance between professional and family engagement. In the agricultural sector, investing in capital upgrading and knowledge should be accompanied by introducing aggregation mechanisms to link producers to finance, inputs and output markets.<sup>99</sup>

**Enhancing efficient investment in human capital.** Upgrading the quality of health and edu-

cation services is critical to increase human capital of the workforce to access better jobs and improve quality of life. The first major challenge is to secure the nutritional and cognitive development of all children before they reach school-age. The attention to basic education needs to be complemented with a push to increase completion of upper secondary and build market-relevant skills that accompany the transformation of the economy. In education, higher investment must be accompanied by measures to increase efficiency, including introducing assessment of primary school readiness, scaling-up and increasing the relevance of teachers' pre-service teacher training and professional development, introducing modern methods to evaluate teachers, and expanding the shift to per-student funding to all pre-university education. Encouraging the development of entrepreneurial mindset, especially among women, technological awareness and knowledge of foreign languages would help raise the potential of the domestic private sector to modernize, increase productivity and compete globally. Additionally, expanding access to lifelong training would ensure that all workers maintain marketable skills as the economy changes. A strong primary health care is necessary to ensure that children grow healthy, that adults have easy access to preventive care and that people with chronic conditions receive services that require strong coordination and continuity. Shifting some services to day and outpatient care and implementing the hospital master plan will improve efficiency, quality and outcomes for patients. Recruitment, training and retainment practices for health staff with critical skills, especially for areas where shortages are more severe require a joint effort with the ed-

98 Digitalization defined as the use of digital technologies to change a business model and provide new revenue and value-producing opportunities.

99 For instance, in the United States, broadband has been associated with a 4.1 percentage point increase in employment among married women, as a result of Internet use for teleworking, which facilitates the work-family balance. (Dettling, 2017).

ucation sector.<sup>100</sup> Strengthening the capacity of local governments would be part of the strategy to provide quality services, and the government can also use social assistance programs to promote demand for human capital services among the most vulnerable.

**Upgrading infrastructure, improving disaster resilience and energy diversification.** Electricity access has become more reliable and power losses in the distribution network have declined. Yet, the system remains vulnerable to years of low rainfall, leading to hydropower production falling short of domestic demand and the need to resort to expensive energy imports. Continued infrastructure upgrading to reduce distribution losses, diversification of the energy base towards solar and gas, as well as the use of financial instruments to buffer financial shocks from hydropower, all need to be further developed. Energy diversification in Albania would support the EU's energy transition project and attract investments in low-carbon industries.<sup>101</sup> Improving connecting infrastructure is also critical, particularly, supporting the capacity of municipal governments to better plan, coordinate, and invest in maintenance of rural roads. In the long term, expanding the rail network towards the southern and central parts of the country will also enable alternative transportation options for people and merchandise, reducing congestion. Expanding access to digital connectivity is also critical to allow all sectors operating in rural areas to modernize and create jobs. Increasing the capacity of municipal governments to improve water management and delivery infrastructure is key to ensure the sustainability of the resource. This

involves a closer coordination between the national water agency and the water utilities managed by municipalities. Upgrading and integrating the network and making utilities financially viable is a first step to reducing revenue losses. Upgrading the irrigation and drainage system is crucial to support sustainable agricultural productivity growth. Finally, ensuring climate and disaster resilience of Albania's infrastructure is a priority.<sup>102</sup> The first step is to clarify the roles and responsibilities of the National Agency for Civil Protection and the municipalities in accordance to their capacity to plan, finance, and implement response plans. Further, fiscal resources should be available to be deployed for disaster risk management and response, given that the frequency of climate-related events is estimated to increase.

**Strengthening the capacity of local government to raise revenues and deliver services.** To reduce spatial inequality of services and opportunities it is critical to enhance the capacity of the local governments at all levels, including their accountability towards communities. National and local governments also need to implement more proactive urban planning policies that support growth of dynamic and connected cities. However, local governments have low capacity to conduct and implement territorial planning and only 34 municipalities have approved territorial development plans. Most municipalities struggle to implement territorial plans due to their inexperience and limited access to immovable property registration data. The challenge in larger urban centers like Tirana is to work towards development of a competitive platform that benefits from

100 Adhami A., Çela D., Rrumbullaku L. (2013) (Grobler, et al., 2009)

101 The European Green Deal plans to take EU countries to produce net zero CO<sub>2</sub>-equivalent emissions and achieve climate neutrality by 2050. To this end, EU countries need to transform energy, transport, agriculture and environmental services. Albania will be drawn into this policy given it is negotiating EU accession. The country is in a relatively strong position regarding energy but there will be a need for fundamental change in approach for many other sectors of the economy.

102 See Xiong & Xavier (2019).

the economies of agglomeration, reduces congestion, and provides adequate services for households and business, including public transportation, housing, connectivity, etc. Government at all levels needs to strengthen a “polycentric” urban development model by gradually and strategically investing in improving key infrastructure and in primary healthcare, education, public transportation, and housing. These investments would enhance economic activity and attract investment in the different urban centers, creating better job opportunities and improving the quality of life in smaller cities. A variety of tools can be developed and implemented to foster an improved local government capacity. These can include: greater taxation powers, transfers from the center conditional on results, collaboration among local authorities to develop and adopt best practices, etc. A review and adjustment of the competencies of local administrations in view of the available resources is in order.

***Strengthening the redistributive efficiency of the state.*** Albania needs to strengthen an inclusive growth model by increasing the efficiency in the use of public funds, especially to address inequality. This implies attention to several areas, including (a) increasing the progressivity of the tax system and fighting tax evasion; (b) improving targeting and adequacy of social assistance and disability benefits; (c) reducing barriers for women to participate in labor markets, for instance by providing child- and elder-care services; and (e) proactively reducing discrimination of marginalized groups such as Roma and Egyptians, and LGBTI people. The integration of social assistance and activation services is crucial to ensure that people have a chance to access income generating options that can sustainably lift them out of poverty. Additional efforts are needed to ensure a smoother transition from school to work for young people, to reduce high youth unemployment and

inactivity. Finally, reducing informality by bringing more people and businesses to contribute to public redistribution is the only sustainable way to ensure a more equitable society, but this can only happen if the taxation and redistribution systems are transparent and accountable.

**Finally, the Update also proposes three policy areas to address the pre-conditions and the sustainability of economic and social gains.**

First, a predictable and transparent exercise of the rule of law lies at the heart of modern market economies and inclusive societies. Government institutions should have clearly defined and complementary—not overlapping—functions; and checks and balances need to be in place at all levels. Second, the gains that have been made in restoring fiscal sustainability since 2014 need to be protected and enhanced to enable the government to devote the resources needed to invest in enhancing competitiveness and boosting opportunities for the most vulnerable, while avoiding new crises that can set development back. Third, Albania’s natural resources, including water, forests, and the precious coastlines need a more proactive management to directly increase the sustainability of the sectors that rely on them, among others energy, agriculture, fishing, tourism, and mining. They also affect overall productivity—think for instance of air quality—and are key to mitigate the risks caused by climate change.

***Strengthening rules-based government.*** Albania’s policies and regulations need to be designed and implemented more consistently and transparently across all government institutions. This requires a more efficient and transparent courts’ system, which can improve the business environment and can facilitate resolution of civil and administrative disputes. The government needs to continue to pursue justice reform by strengthening monitoring and reporting mechanisms, ac-



celerating the pace and enforcement of case resolutions, and investing more in training and court infrastructure. This also includes the need to improve the transparency and reliability of land markets by increasing the certainty of land titles, which requires an acceleration in the digitalization of national property registry, the finalization of the legalization and privatization process, and the resolution of disputes related to the privatization process. Finally, this includes reinforcing the fight against corruption and organized crime, reducing transactions costs by increasing trust and increasing the effectiveness of public policies at all levels of government. The capacity of institutions and to formulate and implement policies and regulations consistent with the principle of a rules-based government depends strongly on the quality of public sector officials. Albania needs to continue the process of professionalization of public sector workers, by strengthening the application of selection and evaluation rules and by expanding access to training for public sector workers.

***Achieving a stable macroeconomic environment.*** Namely, there is further scope for increasing the domestic mobilization of revenues, strengthening the effectiveness of budget spending and tackling off-budget fiscal risks. Financial sector stability needs to be strengthened, including through continued winding down of the still

high NPLs that plague the banking sector. The still significant external imbalances need to be tackled by growing the domestic export base, while continuing to improve Albania's attractiveness for foreign financing.

***Strengthening protection of natural resources.*** Critical challenges today include high coastline pollution, an inefficient use water resources, and the loss of forest cover, in part as a result of energy needs. Mismanagement of these resources undermines the development of the country in the short-and long-term. Current challenges emerge from inadequate, incomplete regulations and weak enforcement. A successful strategy to address these issues requires strengthening local government capacity, as most of these functions are now municipal responsibility. This effort needs to be led by the national government in partnership with local governments and key stakeholders in the private sector and the communities. Addressing these gaps is urgent as pressure on these resources will only grow. For coastal development, adopting a "blue economy" development plan would ensure the sustainability of coastal and marine activity and address environmental challenges, to avoid a rapid resource degradation from pollution, overfishing, and over-construction on the seashore. The "blue economy" strategy is consistent with the EU Acquis in the fisheries sector, which Albania has not yet developed.



## MAIN FINDINGS AND PRIORITIES IDENTIFIED BY THE FIRST-GENERATION SCD “NEXT GENERATION ALBANIA”

The SCD analyzes the evolution of Albania’s economy since it opened up in 1991 up to the years following the global financial crisis of 2008. The economic liberalization and early reforms of the 1990s produced a per capita GDP growth of 6 percent on average in real terms—the best performance of any non-oil rich European country—and transformed Albania from the poorest country in Europe to middle-income status by 2008. The global crisis and its aftermath slammed the brakes on the pace of progress and raised questions about the ability of the economy to recover and continue on this path sustainably. To identify how Albania could generate sustainable and inclusive growth and significantly reduce poverty, the SCD proposed a conceptual framework based on the ‘assets model’ that analyzes the interplay between asset accumulation, utilization, and returns for households, firms and the government. The SCD then divides this framework into four blocks: (I) Pattern and inclusiveness of growth; (II) Accumulation and efficiency of assets’ use; (III) The enabling environment; and (IV) Sustainability.

### I. Pattern and inclusiveness of growth

Up to the crisis, growth was fueled by foreign capital flows—including remittances from the massive Albanian diaspora—and foreign aid, which

boosted domestic consumption and capital accumulation, creating large employment gains in construction and services, but generating little productivity growth. Poverty fell during the period thanks to strong real wage increases, and to a lesser extent pensions, remittances and social transfers. At the same time, domestic demand caused the trade deficit to grow. As the global crisis unfolded, Albania’s export volumes, remittances, and financial flows diminished sharply, and the country avoided a recession by resorting to fiscal policy. Public sector debt grew up to 70 percent in 2014, generating high interest costs, rollover risks, and crowding out private sector activity. Payment arrears to businesses reached 5.2 percent of GDP in 2013, which in turn increased the ratio of nonperforming loans (NPLs) from 6.5 percent in 2008 to almost 25 percent in late 2014, and restrained banks’ supply of credit to the private sector. As a result, around 123,000 jobs were lost in 2008–09 and poverty increased. The global crisis thus exposed the vulnerability of Albania’s domestic-oriented-growth model supported by foreign flows financing consumption and investment. The large macroeconomic imbalances generated at the time eroded the economic gains of households and created disincentives for the accumulation and productive use of factors of production. The SCD concluded that pre-crisis drivers of growth were exhausted and suggested that a different model was needed.

### II. Accumulation and efficiency of assets’ use

Despite being relatively young and healthy, Albanians lack the skills and the opportunities to make the most of their human capital. As GDP grew strongly over the years, the labor market remained structurally weak, characterized by low labor force participation and employment rates, significant informality—including a substantial

share of unpaid family workers—and extremely high outmigration. For youth, women, minorities, and the bottom 40, the barriers were greater. These structural deficiencies worsened after 2008–09. For example, unemployment among youth (15–29) increased to 29 percent in 2013. Sustained outmigration since the early 1990s also undermined the stock of human capital and the potential for job creation in the economy. Skills of young Albanians are also low: despite students’ progress in scores in international assessments, they show a learning gap equivalent to 2.5 years of schooling relative to the OECD average. Moreover, inequities in human capital accumulation were large, with much lower enrollment and educational attainment among children in the bottom 40 percent. In preprimary education, for example, net enrollment was two times higher among the wealthiest quintile than the poorest quintile, and in 2011, only a third of Roma children were enrolled in preschool. And in spite of being healthy on average, disparities in outcomes were significant. For example, infants in rural areas were twice as likely to die before age 1 as those in urban areas, and over a quarter of children in the poorest quintile suffered from chronic malnutrition in 2009, compared with 13 percent in the wealthiest quintile.

Albania has also a large endowment of land, which it cannot efficiently use due to insecurity of property rights. The lack of a well-functioning land market has resulted in farm fragmentation (in 2012, there were over 350,000 farms of below one hectare) and uncontrolled growth of urban settlements. The lack of urban planning and uncontrolled construction has distorted land use and density, reducing the growth potential of Albanian cities. Poor enforcement of property rights is a key obstacle for firms, farms and households to enter the land market, and for poor landowners to reap the benefits from their assets. Moreover, women have a much lower rate of ownership of

immovable property. Sustainability of land management is also critical given the importance of nature-based tourism and abundance of environmental hotspots.

While physical capital accumulation was an important driver of growth prior to the crisis, returns on capital were low and further declined by about 30 percent between 2000 and 2012. Total investment expanded on average by 13.3 percent in 2000–08, driven mostly by private investment. However, capital investment both on the private and public side did not prioritize high return investment (for example maintenance over new roads). Moreover, weaknesses in financial intermediation limit the accumulation and use of financial assets. For example, Albania had 22 branches per 100,000 adults in 2012 against 36 in the EU, and only 280 deposit accounts per 1,000 adults, compared with 2,245 in the EU.

The SCD concluded that inefficient use and inequitable accumulation of Albania’s assets had undermined growth and economic inclusion.

### III. The enabling environment

Low institutional quality in Albania hampers economic and social progress. An ineffective judicial system prone to corruption and an inconsistent application of the rule of law have generated mistrust in the government as well as significant informality. Dealing with construction permits, trade logistics, inspections, and property and land registration is more burdensome than in neighboring countries. Public services are also constrained by low capacity, limited accountability, territorial fragmentation, and spatial inequalities in access. Moreover, an unreliable energy supply overtime creates added costs for businesses and the government. High dependence on hydropower (98 percent of supply) combined with high distribu-

tion and collection losses have made the electricity sector a less-efficient and costly supplier.

Finally, the main safety net program was poorly targeted and had low coverage. As of 2012, the share of the poor covered by the program was only 24 percent, but the share of non-poor receiving benefits had risen from 5.2 percent in 2008 to 7.4 percent of the total in 2012. The benefits received by the poorest quintile were among the lowest in Europe. Meanwhile, spending on disability assistance increased because of growth in the number of beneficiaries and the overly generous indexation and ad hoc expansion in benefits. From 2007 to 2013, the number of beneficiaries rose by 50 percent to reach 165,000. The disability assistance program did not effectively target and support the truly disabled. As a result, social safety nets failed to cover the needs of most poor households.

The SCD concluded that the quality of the institutional and business environment as well as the provision of and access to public services were ineffective in supporting the buildup, productivity, and use of Albania's endowments.

#### IV. Sustainability

Following the global crisis, the domestic-demand, foreign-financed growth model proved unsustainable and caused severe increases in public debt, fiscal deficits, public sector arrears and nonperforming loans. While the financial sector remained largely resilient to the global crisis, vulnerability increased because of the decline in banks' profitability and potential deleveraging in a system of mostly European banks' subsidiaries. The SCD concluded that Albania was highly exposed to external macroeconomic risk from the weak European recovery and its impact on demand for Albanian exports and workers abroad.

On the environmental front, Albania is exposed to hydrometeorological and geological hazards,

which are exacerbated by climate change, the overexploitation of natural resources and growing pollution. In turn, this increases the vulnerability of households and the overall economy to climate shocks, which, if materialized, can reverse the progress toward the twin goals. The SCD concluded that Albania needed to better manage its natural resources, which are key for competitiveness and to secure the livelihoods of those relying on agriculture, energy, water, tourism, and extractive industries.

Albania also faces social risks fueled by perceptions of inequality and corruption, as well as barriers to equitable economic participation, especially among vulnerable groups and minorities. The SCD concluded that exclusion was undermining social progress by reducing gains from the growth process for some groups and eroding trust in institutions.

#### Prioritization

The SCD identifies the policy priorities to restore a sustained and inclusive growth process in Albania. The SCD follows a two-stage approach: first, it identified twelve major constraints for progress towards the Twin Goals and formulated a policy priority to address each constraint. In the second stage, the SCD clusters the priorities according to their direct impact on advancing the Twin Goals. Three mutually reinforcing categories of priorities resulted from this process:

1. **Fundamental Priorities:** considered fundamental, as they constitute a prerequisite for the success of all other policy priorities. They include: (1) *restoring fiscal sustainability and financial stability*; (2) *establishing a high-quality business environment that promotes firm growth and job creation*; (3) *providing clean energy efficiently, equitably, and in a sustainable manner*; (4) *formalizing and enhancing the inclusi-*

veness and sustainability of the land market; and (5) enhancing governance, transparency, and the accountability of government toward citizens.

2. Supporting Priorities: they amplify the impact of the Fundamental Priorities over the longer run. They include: (1) increasing the quality of labor market engagement among the bottom 40, youth, women, and minorities; (2) improving the quality and relevance of the education system and skills training programs; (3) improving the efficiency and equity of public resource ma-

agement; and (4) ensuring more inclusive access to financial markets.

3. Sustaining Priorities: considered critical to enhancing the economic, social, and environmental sustainability of the Fundamental Priorities. The group includes: (1) enhancing the effectiveness and efficiency of social protection systems for the benefit of vulnerable groups, (2) ensuring the sustainable use of natural resources and the stewardship of the environment, (3) improving the quality and equity of health services and reducing health-related financial risks.



## POVERTY PROFILE

### Socio-demographic characteristics by poverty status (% population), 2017

Source: Authors with data from Household Budget Survey 2017

		Poor	Non-poor
Gender	Male	50	51
	Female	50	49
Age group	[0-14]	24	15
	[15-24]	18	15
	[25-34]	13	13
	[35-44]	13	11
	[45-54]	13	15
	[55-64]	10	16
	[65+]	10	15
Education level	Primary or less	12	7
	Incomplete secondary	51	35
	Complete secondary	30	37
	Tertiary	7	21
Education of the household head	Primary or less	14	8
	Incomplete secondary	53	35
	Complete secondary	28	39
	Tertiary	4	18
Household size (# members)	<=2	3	18
	3	7	19
	4	23	30
	5	26	18
	6	20	10
	7+	20	5

		Poor	Non-poor
Household type	No children	31	56
	With one child	25	21
	With two children	27	18
	With 3+ children	16	5
Labor force status	Employed	37	45
	Unemployed	14	8
	Inactive	49	47
Sources of income	Labor earnings	60	63
	Pensions	17	23
	Remittances	7	6
	Public transfers	12	5
	Property income	1	1
	Other income	3	2



## STRATEGIC SECTORS FOR ALBANIA'S EXPORT-ORIENTED GROWTH MODEL

Building on a three-dimensional analysis,\* four sectors/sub-sectors emerge with high potential for a shift toward a higher value-added, high productivity, export-oriented growth model:

Agriculture, Textile/Apparel, Tourism and ICT as export locomotives

	Agriculture	Mining	Construction	Utilities	Textile & Apparel	Other Manufacturing	Trade	Tourism	Transport	ICT	Public Adm. & Education & Health
I. Share in GDP	●	●	●	●	●	●	●	●	●	●	●
Value Added Growth	●	●	●	●	●	High ●	●	●	●	●	●
Share of Employment	●	●	●	●	●	Med ●	●	●	●	●	●
TFP Growth	●	●	●	●	●	Low ●	●	●	●	●	●
Share of Gross Exports	●	●	●	●	●	●	●	●	●	●	●
Share of GVC Links in Exports	●	●	●	●	●	●	●	●	●	●	●

**Agriculture is the largest contributor to GDP and the biggest employer.** With higher productivity, agriculture and agri-business can play a much larger role in boosting exports. The sector can open up opportunities for factor relocation (e.g., labor) to higher value-added manufacturing and services. Yet, it currently accounts for only 15 percent of exports, with low GVC linkages at 30

percent of exports. Challenges include unreliable land titles; lack of scale; low take-up of new technologies; deficient quality and compliance with standards, and higher input costs than in peers. A functioning land market is critical for farmers to access financing sources, increase in scale, and invest in competitive technologies.



**Albania's manufacturing sector stands out as a fast-growing, large sector.** It accounts for about 10 percent of total employment but has seen negative TFP growth (-2 percent) over the past 4-5 years. The *automotive parts and apparel manufacturing* industries are significantly integrated into GVCs, with the latter accounting for nearly ¼ of total goods' exports. Upside potential to climb up the value chain is significant, given the size and knowhow accumulated in the sector. Yet, the sector remains highly dependent on Italian companies and faces growing competition and risk of relocation to cheaper countries. The auto parts industry is a recently emerging sector, with some FDI attraction based on low labor costs, including from Germany, France, and South Korea in the production of cabling and electromechanical systems and rubber-metal, sealing and anti-vibration parts subsectors.

**Tourism emerges as relatively high-productivity sector at 2 percent TFP growth.** According to the 2019 World Travel and Tourism Council Report, tourism contributes 27.3 percent of GDP (directly and indirectly), 56 percent of total exports and 25 percent of total employment. Tourist arrivals have increased in recent years, reaching nearly 6 million in 2018—a 15 percent increase over 2017. However, the sector suffers high seasonal and geographical concentration leading to uncontrolled development with growing environmental impacts. The sector's value-added is low, with in-

coming tourists mostly being Albanian expats and low-spending tourists. Poor infrastructure, lack of quality standards, weak branding and marketing and low institutional capacity are among the major challenges hindering the sector's move up in the value chain.

**Although a nascent sector, ICT is among Albania's fastest-growing sectors (avg. growth 6 percent in 2015-17).** It is also the fastest TFP growth sector. Although starting from a low base, ICT is poised to become a larger share of GDP. ICT has significant GVC linkages and, therefore, carries potential for greater knowledge and skills flow, as well as for more private sector investment. There has recently been a considerable increase in new joint-venture activities between domestic and foreign firms, signaling a growing interest. Cheap labor with relevant skills is the cost arbitrage opportunity creating a comparative advantage for Albania. "Digital Agenda 2015-2020" and "National Strategy for Science, Technology and Innovation 2017-2022" place ICT at the center of government focus. Major challenges faced by the sector include inadequate infrastructure, particularly low and poor coverage of fiber optical network in rural and inter-urban areas, and a limited technical skills base.

\* Dimension 1: Output vs Growth; Dimension 2: Employment vs Productivity; and Dimension 3: Exports vs GVP Participation



## KNOWLEDGE GAPS

**The SCD identified one key knowledge gap regarding Albanian labor market dynamics and distortions.** There was insufficient evidence on existing disincentives and barriers to employment, particularly across some population groups. The SCD recommended to (a) conduct in-depth labor market analysis to identify and propose policies to address the disincentives and barriers to formal work (labor regulations, labor taxation, social protection, additional barriers), especially those affecting specific population groups disproportionately, and (b) collect timely, accurate data on labor market supply and demand that can also feed into education and training system policies and reforms and active labor market policies.

Since then, the World Bank has contributed substantially to close this gap through the following studies:

- **Key Challenges and Trends in Albania's Labor Markets: Possible Policy Solutions** (World Bank, 2017). The note highlights important areas to improve labor market conditions. The note deliberately focuses on labor supply and intermediation functions, and on the areas where the World Bank is engaged to support the jobs agenda.
- **Training Assessment Project (TAP)** (World Bank, 2017). The World Bank launched the Training Assessment Project (TAP) initiative to identify the current conditions and common

practices under which training providers (with a focus on technical and vocational education and training [TVET] institutions) operate, as well as those conditions and practices that contribute to good performance. TAP aims to help the World Bank Group's (WBG) partner countries fill an information gap regarding two questions. First, it seeks to determine the conditions and practices that make a training provider successful, measured in terms of the percentage of graduates who find employment after graduation or who enroll in further education or training activities. Second, it aims to find the most common constraints faced by training providers and how successful institutions address them.

- **Job Dynamics in Albania: A note profiling Albania's labor market** (Honorati, Johansson De Silva, Kupets, & Berger, 2018). Using the most recent data available on Albanian labor markets from the perspectives of labor demand (firms) and labor supply (individuals), this note provides some key insights into the current situation and important dynamics over time and across firms and workers with different characteristics. The note is complemented by two other reports that look at (i) skills development challenges from the demand (employer) side, and (ii) the role and effectiveness of the National Employment Service (NES) in reducing unemployment.
- **Demand for skills in Albania: an analysis of the skills towards employment and productivity survey** (Honorati, et al., 2018). The report presents findings from the Albania STEP Employer Survey, a nationally representative survey conducted between April and October 2017 on a sample of 600 registered firms drawn on the 2016 business register in Albania. The STEP Employer Survey provides new and

important insights into the mix of cognitive, socioemotional, and technical skills valued by employers, the extent of skills gaps among employers, the skills constraints among job applicants, the extent to which skills gaps affect firms' hiring decisions, and what firms are doing to address possible skills gaps; it also examines the functioning of the education and training systems based on employers' perceptions.

- **Albania - A series of summary policy notes: Towards more, better and sustainable jobs for Albania** (Ungerer & Shijaku, 2018). This series of policy notes looks at 5 interlinked aspects of the issue. The first note addresses the question of What is Albania's labor market performance today? This overview note takes stock of Albania's labor market indicators, benchmarking against regional peers and identifying segments of the population that have so far been left behind. The second note asks How can Albania's labor market institutions and regulations be strengthened to facilitate job creation? The theme of the third note is How can Albania create the right business environment to enable job creation? The fourth note addresses the question of How can Albania equip its citizens today with the right skills for the jobs of tomorrow? A final note proposes recommendations to strengthen labor market statistics to better monitor progress on Albania's jobs and growth agenda going forward.

**During the preparation of the SCD Update, the team has identified additional key gaps in the knowledge base in Albania.** Additional information to fill these gaps would enable a more precise identification of policy actions to address the priorities identified by the SCD Update. They include:

- **Informal economy, including tax compliance.** Assessing the extent (in terms of GDP or

employment, for instance) and nature of informality (business registration, tax or social security compliance, health and safety regulations, etc.) is key to understanding the "pressure points" that generate non-compliance among firms and individuals and the appropriate policy solutions. To identify the nature of informality, specific data collection efforts are needed, in combination with further analysis of existing administrative and survey data sources.

- **Corruption and organized crime.** While up-to-date measures of perceptions of corruption and the quality of the rule of law are widely available, detailed case studies of how corruption affects the effectiveness of markets and government functions would shed light on the weaknesses in accountability and transparency within the government and could inform policy solutions. Moreover, the weight of organized crime activities in the economy is unknown, but it is potentially large and with many ramifications into legal sectors of activity. A better understanding of this phenomenon would be informative for macroeconomic monitoring purposes as well as for policy advice.
- **Monetary poverty.** The last official poverty headcount for Albania was estimated using consumption data from the Living Standards Measurement Survey (LSMS) collected in 2012. Starting in 2016, Albania has collected the Survey of Income and Living Conditions, which only measures income but can be used to estimate absolute (income) poverty. Since Albania will only monitor relative poverty going forward (that is, the percentage of the population living with less than 60 percent of the median income per capita), it will be important to continue to produce measures of absolute poverty that can be compared internationally

and over time, as well as detailed poverty diagnostics.

- **Discrimination in access to services:** While gender, ethnicity and SOGI -based gaps in outcomes have been documented, discrimination in access to services is less well understood. Addressing public policy biases is key to formulating policies that will effectively close the outcome gaps for these groups.
- **Demographic change.** There is a gap in understanding the impact of demographic trends, including aging and migration. on economic performance, fiscal sustainability of social systems as well as welfare outcomes. A better insight into these trends could help inform fiscal policy, including reform of social welfare systems, economic policy, including labor market activation measures and social policy,

including expansion of elderly care.

- **Firm productivity and management practices.** While diagnostics of firm-level productivity indicate large differences across Albanian firms and relative to EU firms, the reason for these gaps needs to be further explored. One important avenue would be to use a survey to study the management practices of Albanian firms, combined with an analysis of key channels through which these management practices can be improved going forward.
- **Public Investment Management (PIM).** A comprehensive analysis of the quality of PIM, detailing the process for selecting, designing, and implementing public investment projects, would provide insights into the weaknesses of the system and help identify concrete policy solutions.

## MAIN MACROECONOMIC INDICATORS

Description	2017	2018	2019 <sup>e</sup>	2020 <sup>f</sup>	2021 <sup>f</sup>	2022 <sup>f</sup>
Real GDP growth (percent)	3.8	4.1	2.2	-1.4	6.5	3.4
Composition (percentage points):						
Consumption	3.7	3.9	2.6	-1.4	4.3	2.9
Investment	-0.2	1.0	-1.1	0.9	1.5	0.5
Net exports	0.3	-0.8	-0.9	-3.1	-4.6	-1.7
Exports	4.0	1.0	2.0	-5.5	2.7	1.7
Imports (-)	3.7	1.8	1.3	-4.5	1.9	1.7
Consumer price inflation (percent, period average)	2.0	2.1	1.4	2.1	2.4	2.9
Public revenues (percent of GDP)	27.7	27.6	27.8	26.4	26.9	26.9
Public expenditures (percent of GDP)	29.8	29.4	29.7	30.5	29.3	29.0
<i>Of which:</i>						
Wage bill (percent of GDP)	4.7	4.5	4.6	4.4	4.4	4.5
Social benefits (percent of GDP)	15.1	15.0	15.6	15.7	15.2	15.1
Capital expenditures (percent of GDP)	4.4	4.8	4.5	5.6	5.0	4.7
Fiscal balance (percent of GDP)	-2.0	-1.8	-1.9	-4.1	-2.4	-2.2
Primary fiscal balance (percent of GDP)	0.0	0.4	0.2	-2.0	-0.1	0.0
Public debt (percent of GDP)	67.8	64.6	64.4	68.4	65.1	63.3
Public and publicly guaranteed debt (percent of GDP)	71.9	69.7	68.0	71.8	68.1	66.3
<i>Of which: External (percent of GDP)</i>	32.6	32.9	31.5	32.5	28.8	28.9
Goods exports (percent of GDP)	6.9	7.7	6.6	6.0	5.8	5.7
Goods imports (percent of GDP)	31.3	30.2	29.7	29.2	28.3	27.8
Net services exports (percent of GDP)	9.4	8.6	9.3	7.1	7.9	8.4
Trade balance (percent of GDP)	-15.1	-13.8	-13.7	-16.1	-14.5	-13.7

Description	2017	2018	2019 <sup>e</sup>	2020 <sup>f</sup>	2021 <sup>f</sup>	2022 <sup>f</sup>
Remittance inflows (percent of GDP)	5.5	5.2	5.1	5.1	5.0	4.8
Current account balance (percent of GDP)	-7.5	-6.7	-7.6	-8.1	-7.0	-6.2
Net foreign direct investment inflows (percent of GDP)	8.6	8.0	7.6	6.4	7.4	7.3
External debt (percent of GDP)	68.7	62.9	60.6	61.7	60.6	60.7
Real private credit growth (percent, period average)	-2.3	-3.0	n.a.	n.a.	n.a.	n.a.
Nonperforming loans (percent of gross loans, end of period)	13.2	11.1	n.a.	n.a.	n.a.	n.a.
Unemployment rate (percent, period average)	13.7	12.3	11.5	n.a.	n.a.	n.a.
Youth unemployment rate (percent, period average)	25.9	23.1	n.a.	n.a.	n.a.	n.a.
Labor force participation rate (percent, period average)	58.3	59.4	n.a.	n.a.	n.a.	n.a.
GDP per capita, PPP (current international \$)	11,693	15,101	n.a.	n.a.	n.a.	n.a.

Sources: Country authorities, World Bank estimates and projections.

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

Change in inventories is included in Investments



## SCD UPDATE CONSULTATIONS

Internal and external consultations were held for the SCD Update between May and December 2019.

### Internal consultations:

Country team meetings with IBRD, IFC and MIGA were held throughout the SCD drafting process. A first meeting took place in May 2019 to take stock of the country team's views on the developments in each sector since the first SCD and the main priorities going forward. Bilateral consultations with GPs, IFC and MIGA followed during June-October. A second meeting took place in November 2019 to discuss the main findings of the analysis and the emerging messages. A final team meeting took place in early December to discuss and validate the proposed priorities.

### External consultations:

External SCD consultations were held during September 18-19, 2019 in separate sessions with more than 80 representatives from government and its main institutions, Bank of Albania, private sector, civil society and development partners. In their discussions, they welcome the consultative process with local and international stakeholders, validating most of the findings and messages of the SCD presentation.

## List of institutions consulted:

### Government and governmental institutions

- Prime Minister office
- Ministry of Finance
- Ministry of Infrastructure and Energy
- Ministry of Health and Social Welfare
- Ministry of Interior
- Ministry of Culture
- Bank of Albania (BoA)
- Albanian Investment Development Agency (AIDA)
- Albanian Rural Development Agency (ARDA)
- Albanian Development Fund
- Albanian Electro-energetic Corporation (KESH)
- Institute of Statistics (INSTAT)
- Albanian Financial Supervisory Authority (AFSA)
- State Cadaster Agency (SCA)
- Albanian Development Fund (ADF)
- Health Insurance Fund (HID)
- Institute of State Social Services
- Water Resources Management Agency (WRMA)

### Development Partners

- Swiss Embassy
- Dutch Embassy
- UNDP
- AICS-Italian Cooperation
- OSCE
- German Embassy
- US Embassy

- USAID
- EBRD
- UNICEF
- EU

#### **Private Sector**

- American Chamber of Commerce
- DM Consulting Services
- Statkraft Albania
- Foreign Investors Association of Albania

#### **Civil Society Organizations**

- Junior Achievement Albania
- Gender Alliance for Development Centre (GADC)

- Co-PLAN
- Albanian Center for Economic Research (ACER)
- Center for Economic and Social Studies (CESS)
- Regional Environmental Center (REC)
- Institute of Roman Culture in Albania (IRCA)
- Cooperation Development Institute (CDI)

Following on the consultation feedback and the inputs provided by the different stakeholders, the team has shared versions of the SCD draft with the different stakeholders as requested, for additional feedback. The team will also follow up on a second level of consultations in the context of the **CPF** to ensure to capture the most important insights and priorities for them.



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