



Brussels, 22.4.2021  
SWD(2021) 89 final

**COMMISSION STAFF WORKING DOCUMENT**

**ECONOMIC REFORM PROGRAMME**

**OF**

**ALBANIA**  
**(2021-2023)**

**COMMISSION ASSESSMENT**

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## 1. EXECUTIVE SUMMARY

**The economic reform programme (ERP) estimates that in 2020, the economy contracted by less than initially projected.** Hit by the double shock from the earthquake of November 2019 and the COVID-19 pandemic, real GDP decreased 3.3% in 2020. Pandemic-related domestic and international restrictions caused substantial losses in tourism and manufacturing, but economic conditions started to improve in the second half of the year. Within the limited fiscal and monetary policy space, the government and the central bank took swift and appropriate action to support businesses, households and the healthcare sector; this cushioned the impact on the labour market and preserved macroeconomic and financial-sector stability.

**The ERP projects the economy to rebound to an average of 5% growth in 2021-2023, driven by strong recovery in private consumption, exports and investment.** In 2021, the ERP expects growth to increase to 5.5% due to moderate recovery in private consumption and investment, a strong resurgence of services exports (including tourism) and an exceptionally high level of public investment. Real growth is expected to moderate to 4.5% by 2023 and be driven increasingly by private consumption and investment. This should help to create conditions for a gradual fall in the unemployment rate to 9.4%.

**Ambitious capital spending plans are expected to keep the fiscal deficit above 6% of GDP in 2021, followed in 2022 by expenditure cuts to halve the deficit and a gradual reduction of the public debt ratio.** In 2020, the fiscal deficit reached 6.9% of GDP owing to a stark drop in tax revenues coupled with unforeseen expenditure needs and post-earthquake reconstruction. In 2021, the deficit is set to remain above 6% of GDP despite an expected rebound in revenue. This is because public investment will increase significantly to complete post-earthquake reconstruction and stimulate economic recovery, while pandemic-related expenditure needs will remain high. In 2022 and 2023, lower capital expenditure is expected to bring the fiscal deficit below 3% and move the primary balance into positive territory by 2023 in line with the new fiscal rule. The ERP expects the public-debt ratio to decrease gradually, by some 4.3 pps. over three years. It is projected to reach 75.6% of GDP in 2023, when the pace of debt reduction is set to accelerate.

The main challenges Albania faces are as follows:

- **The commitment to fiscal consolidation needs to be supported by increased revenue mobilisation and improved management of liabilities.** Spending on earthquake-related reconstruction and recovery support must be accommodated in the short term, but will keep the budget deficit high. Medium-term fiscal plans are rightly geared towards fiscal consolidation in view of the elevated level of debt, but are contingent on economic recovery becoming well entrenched. The new positive primary balance rule, applicable from 2023, will help anchor stability-oriented fiscal policy. Completing and implementing the medium-term revenue strategy should be a priority with a view to meeting the ambitious revenue targets on which the fiscal plans largely depend. Improving and expanding the monitoring of fiscal risks, including those stemming from public-private partnerships, concessions and state-owned enterprises, by developing additional capacity would contribute further to debt sustainability.

- **There is considerable scope to make public expenditure more growth-friendly and efficient.** The implementation rate of capital expenditure has improved since 2019, but some investment projects are still not subject to stringent public financial management practices. High-budgeted public investment must be managed more efficiently. The transparency and control of payment arrears improved, but efforts to eliminate arrears need to be stepped up, especially at a time when stressed businesses need liquidity. Increased public investment in infrastructure is not matched by a similar increase in investment in human capital, which is a crucial factor for future growth. Spending on health, social protection, education, and research and development remains significantly below needs and below the levels of EU and regional peers; a continuous gradual increase in public spending on these areas would make the composition of public expenditure more growth-friendly.

- **Albania's business environment remains hampered by structural weaknesses.** Private sector development remains below its potential, as action to improve the business environment lacks effective policy instruments and a more strategic approach. The lack of business know-how, low financial literacy and the high degree of informality are obstacles to access to finance for the private sector, which consists mainly of micro and small businesses. Business support services remain inadequate, notably as regards export facilitation, and assistance with access to finance and entrepreneurial know-how. Transparency in the adoption and implementation of legislation is still insufficient, particularly regarding the effective and timely consultation of businesses and social partners on new legislation affecting their operations.

The high level of informality is a key challenge for the economy. Informal economic activity and employment are cross-cutting challenges that distorts competition and constitutes a serious barrier to the development of the private sector, and also on the quality of jobs and on the sustainability of social protection. Informality also has an impact on fiscal revenues, affecting the capacity of the state to provide high-quality public services. Albania lacks a comprehensive strategy for the tackling and monitoring of all aspects of the informal economy. Such a strategy would need to be accompanied by an action plan with baselines, including clear and measurable targets and establish the regular a performance-based monitoring of the plan's implementation and results.

- **Although the number of university graduates is increasing, the share of the adult population with low skills and the percentage of young people not in employment, education or training remain high.** The impact of the crisis on the labour market was partially mitigated by labour preservation measures. Employment rebounded seasonally in the third quarter, but it contracted again in the fourth quarter of 2020. Vocational education and training attracts few young people and the operationalisation of its new legal framework has been delayed. Albania lacks tools for regular monitoring and forecasting of skills needs in the labour market. Also, while a measure is foreseen on innovation, the link between innovative businesses and academia is weak, with insufficient science and research funding and unfavourable conditions for the development of business incubators.

- **Poverty and social exclusion are widespread and spending on social protection and healthcare is insufficient to decrease poverty and increase healthcare coverage.** The government adopted income support measures during COVID-19 pandemic, but more structural measures to increase benefit adequacy are still pending. Moreover, the availability of social services is insufficient to support the active inclusion of people in

vulnerable situations. The government took steps to increase healthcare coverage for Albania's significant number of uninsured people, but access to healthcare is still limited due to high out-of-pocket payments, the remoteness of healthcare facilities and a critical shortage of doctors.

**The policy guidance set out in the conclusions of the economic and financial dialogue held with Albania in May 2020 has been partially implemented.** The medium-term fiscal framework plans for gradual fiscal consolidation, and the fiscal rule was strengthened. The government provided financial support to affected households and businesses in a generally transparent and cost-effective manner (though this cannot be confirmed for the implementation of post-earthquake reconstruction). Tax relief measures were temporary, substantial progress was made on VAT refunds and reporting on arrears, and work on tax expenditure continued. The adoption of the medium-term revenue strategy was postponed and limited progress was made on increasing capacity for monitoring fiscal risks and improving management of public investments. Effective measures and close supervision preserved the stability of the financial sector, and the development of hedging instruments advanced.

While Albania approved a COVID-19 package to support businesses, SMEs and self-employed people, there was not an adequate stakeholder consultation of its preparation, adoption and implementation. There was progress on energy efficiency legislation and bylaws, but insufficient progress on implementation. Little of the current National Energy Efficiency Action Plan (NEEPA) plan was implemented, and the energy efficiency agency is still not yet fully staffed and operational. The creation of the energy efficiency fund has been abandoned, but it seems that no alternative mechanisms seem defined to provide the required incentives for energy efficiency measures targeting the private sector, households, and local authorities. The draft amended Energy Efficiency Law has been prepared but parliament has not been adopted it. Albania adopted swift measures to preserve employment and implement new active labour market measures to help some laid-off workers, including workers formerly employed in the informal economy, back into employment. Temporary increases in social assistance benefits improved their adequacy, but an adequacy assessment and a subsequent systemic adjustment of benefits are still pending. Municipalities' capacity to identify needs and prepare social plans improved somewhat, but more work must be done in this area. Further structural action is needed to reduce out-of-pocket payments and decrease the unmet need for medical care. Albania took positive steps to increase access to healthcare during the COVID-19 pandemic. The Government is trying to strengthen the so far weak response to the health emergency in regional hospitals.

**The analysis of key challenges in the ERP is incomplete. Although some reform measures are in line with the priorities identified by the Commission, some challenges are not adequately addressed.** The programme's macro-fiscal framework is optimistic, in particular the revenue forecast. The fiscal deficit is reasonable in view of the pandemic and the delayed reconstruction needs. The commitment to continue reducing public debt is better anchored with the new primary balance rule applicable as of 2023. The analysis of structural obstacles fails to examine key sectors of the economy, notably agriculture, industry and services (except tourism). The budget of education measures does not allocate sufficient resources for teacher and assistant teacher training and fails addressing inclusiveness in kindergartens. The measures on employment, vocational education, social protection and healthcare propose relevant activities. However, the measure on social protection measure does not address the sustainability of

social services after support from the Social Fund is phased out, and the healthcare measure does not do enough to tackle high out-of-pocket expenditure, low public spending on healthcare or the emigration of healthcare professionals. A new measure has been introduced to address informality, complementing the ongoing fiscalisation efforts, but these are mainly focused on taxation, and more comprehensive steps need to be taken to fully address this challenge.

## 2. ECONOMIC OUTLOOK AND RISKS

**Albania's economic reform programme (ERP) estimates economic contraction in 2020 at 4.4%, only half as much as previously forecast, while recent data confirmed an even lower contraction of 3.3%.** Economic momentum was weak at the start of the year following the earthquake of November 2019. When the first COVID-19 infections were identified in early March 2020, the authorities immediately responded with a temporary strict lockdown and adopted the first set of support measures in April 2020. In the second quarter of 2020, the pandemic-induced sharp drop in private consumption and investment caused a deep recession, while in the third quarter, the easing of restrictions and the resumption of regional and domestic tourism limited the year-on-year contraction. Increasing exports and retail activity indicate further recovery in the last quarter of the year. Overall, pandemic-related domestic and international restrictions caused substantial losses in tourism and manufacturing, while good performance by Albania's large agricultural sector and the electricity generation and construction industries buffered the downturn. The economic improvement in the second half of 2020, combined with wage subsidies and an employment promotion programme, limited the increase of the unemployment rate<sup>1</sup>, which stood at 12.3% at the end of 2020. The labour market participation rate decreased to 68.7% in 2020, with women more negatively affected than men.

**The ERP projects the economy to rebound to an average of 5% growth between 2021 and 2023, driven by a broad-based recovery of private consumption, exports and investment.** In 2021, the ERP expects growth to increase to 5.5% due to moderate recovery in private consumption and investment, a strong resurgence of services exports (including tourism) and an exceptionally high level of public investment. The ERP assumes that net external demand will contribute 1.1 pps. to growth in 2021, though this is set to moderate in subsequent years because of rising imports. Private consumption and investment are expected to be the main drivers of growth once more; their contribution will increase significantly to reach 3.1 pps. in 2022, when the contributions made by public consumption and investment are projected to flatten. Agriculture, manufacturing, construction and services are expected to make the biggest contributions to the growth of production value between 2021 and 2023, supported by strongly rebounding growth rates in trade, transport and hospitality services. The labour market participation rate is expected to recover to 69.9% in 2021, above the pre-crisis level. While the employment growth rate is expected to be moderate, progressively decreasing from 1.7% to 1.3% between 2021 and 2023, the unemployment rate is forecast to fall gradually to 9.4% in 2023.

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<sup>1</sup> Data and ratios on the labour market refer to the age group of the 15-65 year old.

**The economic outlook, which relies on optimistic projections for public investment, is subject to downward risks stemming from the COVID-19 pandemic and the political cycle.** In early 2021, the restrictions introduced in response to surging infection rates had only a limited impact on economic activity in Albania. However, the manufacturing and business service sectors continue to feel negative effects from the continuing pandemic in Europe. In addition, disruptions resulting from the national elections, which are scheduled for 25 April 2021, could delay the implementation of the ambitious public investment plans on which the recovery of growth partly relies. The ERP revises upwards last year's projections (which were made before the COVID-19 pandemic began) not only for 2021, but also for 2022; expected real GDP growth for 2022 was upgraded from 4.0% to 4.8%. The ERP provides an optimistic and a pessimistic scenario for real GDP growth rates. These deviate from the baseline growth scenario by +0.5 pps. and -1.5 pps., respectively. However, the assumption of a revenue-to-GDP ratio 1 pp higher than the 2020 pre-crisis estimate is not supported by any explanation in the ERP and seems unrealistic.

Table 1:

**Albania - Comparison of macroeconomic developments and forecasts**

	2019		2020		2021		2022		2023	
	COM	ERP	COM	ERP	COM	ERP	COM	ERP	COM	ERP
<b>Real GDP (% change)</b>	2.2	<b>2.2</b>	-6.8	<b>-4.4</b>	3.7	<b>5.5</b>	4.6	<b>4.8</b>	n.a.	<b>4.5</b>
<i>Contributions:</i>										
- Final domestic demand	2.3	<b>2.3</b>	-4.9	<b>-4.6</b>	3.9	<b>4.3</b>	4.1	<b>4.6</b>	n.a.	<b>4.1</b>
- Change in inventories	-0.6	<b>-0.6</b>	-0.7	:	0.0	:	0.0	:	n.a.	:
- External balance of goods and services	0.6	<b>0.5</b>	-1.2	<b>0.2</b>	-0.2	<b>1.1</b>	0.5	<b>0.2</b>	n.a.	<b>0.3</b>
<b>Employment (% change)</b>	0.8	<b>2.4</b>	-2.7	<b>-0.6</b>	1.0	<b>1.7</b>	2.0	<b>1.4</b>	n.a.	<b>1.3</b>
<b>Unemployment rate (%)</b>	12.2	<b>12.0</b>	14.5	<b>12.0</b>	13.9	<b>11.1</b>	12.8	<b>10.3</b>	n.a.	<b>9.4</b>
<b>GDP deflator (% change)</b>	0.7	<b>0.5</b>	0.9	<b>-2.1</b>	1.1	<b>1.5</b>	1.6	<b>2.2</b>	n.a.	<b>2.4</b>
<b>CPI inflation (%)</b>	1.4	<b>1.4</b>	1.9	<b>1.7</b>	2.1	<b>2.4</b>	2.3	<b>2.8</b>	n.a.	<b>3.0</b>
<b>Current account balance (% of GDP)</b>	-7.6	<b>-8.0</b>	-10.9	<b>-9.2</b>	-9.0	<b>-7.1</b>	-7.3	<b>-7.2</b>	n.a.	<b>-7.1</b>
<b>General government balance (% of GDP)</b>	-1.8	<b>-1.9</b>	-6.3	<b>-6.7</b>	-5.3	<b>-6.5</b>	-3.2	<b>-2.9</b>	n.a.	<b>-2.3</b>
<b>Government gross debt (% of GDP)</b>	66.3	<b>66.3</b>	78.8	<b>79.9</b>	77.4	<b>78.6</b>	75.4	<b>77.7</b>	n.a.	<b>75.6</b>

Sources: Economic Reform Programme (ERP) 2021, Commission Autumn 2020 forecast (COM).

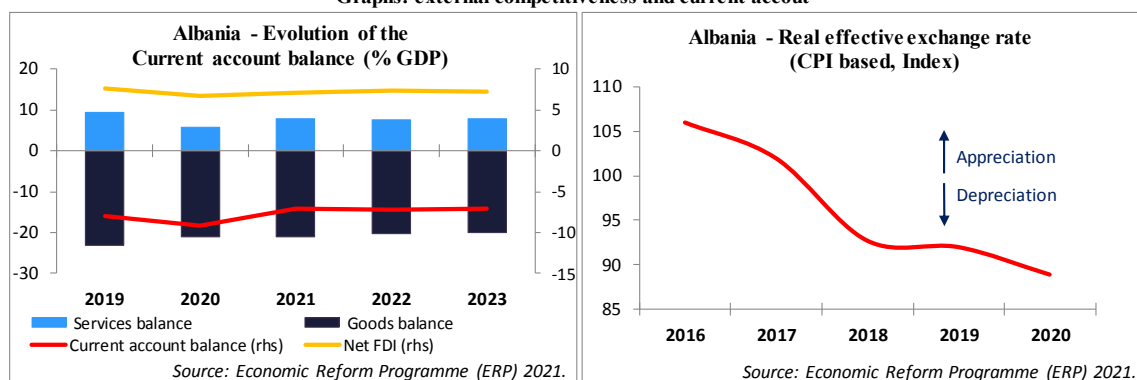
**Inflation is expected to rise to 2.4% in 2021 before converging to the 3% target in 2023 in line with the assumed closing of the output gap.** In response to the economic downturn that is expected to result from the pandemic, the Bank of Albania (BoA) lowered the policy rate to 0.5% in March and does not expect to change its loose monetary stance given the expected recovery. However, the very low policy rate limits the monetary policy space for responding to future shocks. The ERP assumes that the output gap will gradually narrow from 2021 and turn positive in 2023. Accordingly, the BoA expects the inflation rate to converge to its 3% inflation target in 2023. The macro scenario does not include assumptions for the exchange rate of the Albanian lek and the inflation rate in the EU. The expected strong increase in domestic consumption and the expected recovery of commodity prices could generate push up prices in 2022 and 2023, but the ERP does not provide any additional explanation or project wage growth.

**After temporarily widening to 9.2% in 2020, the current account deficit is expected to stabilise at 7.1% of GDP from 2021 on, financed almost entirely by foreign direct investment (FDI) inflows.** In 2020, the sharp decrease in tourism exports and the fall in remittance inflows drove the cyclical widening of the current account deficit. Following the recovery of the host countries of Albanians working abroad, remittances are expected

to rebound to their pre-crisis level in 2021. For 2021-2023, the ERP expects improving services and goods balances to stabilise the current account deficit. A lasting lower level of imports and a higher export ratio than before the crisis are projected to drive the reduction of the goods trade deficit to below 20% of GDP. Services exports are expected to recover more gradually and the surplus of the services balance, in terms of GDP, is forecast to stabilise slightly below pre-crisis levels in the medium term. The more cautious projection for services is supported by the muted recovery observed in manufacturing services in the clothing industry and the expected lasting structural changes in tourism. The composition of goods exports is projected to shift towards agricultural and metal exports, while imports are set to remain low because of the lower level of FDI inflows, continuing a trend that began in 2019 with the completion of some exceptionally large energy projects. FDI inflows are expected to catch up in 2021 and 2022 before stabilising at about 7% of GDP. In 2020, the temporary drop of FDI inflows increased the share of debt-creating inflows in the financing of the current account deficit to about 20%, mainly in form of a large Eurobond issued by the government. In 2021-2023, the sustained inflow of FDI is expected to fully finance the decreasing current account deficit again.

**Albania’s vulnerability from its increasing external debt ratio is mitigated by solid foreign exchange (forex) reserves and the dominance of concessional debt.** Gross external debt is estimated to have reached 70% of GDP in 2020, up from 60.4% at the end of 2019. About 90% of the external debt stock is long-term and more than half of that is owed by the government, mostly on concessional terms. Although the ratio of the government’s external debt stock over fiscal revenue deteriorated in 2020, this is expected to be temporary, due to the exceptional revenue loss in 2020. The BoA’s risk analysis shows that the external debt ratio is more sensitive to currency depreciation than to increasing interest rates. Considering the very moderate reaction of the lek’s exchange rate during the crisis, a depreciation shock does not seem likely and is adequately cushioned by forex reserves. Forex reserves have consistently increased in recent years and totalled EUR 3.9 billion at the end of 2020, corresponding to about 30.6% of GDP and covering over eight months of imports of goods and services (reflecting the temporary import drop) and around 46% of external debt.

Graphs: external competitiveness and current account



**Timely and effective regulatory interventions contributed to the stability of the financial sector, under the close supervision of the Bank of Albania.** As well as lowering the policy rate to 0.5% in March 2020, the BoA provided liquidity to the market and suspended banks’ dividend payments until the end of 2021. Between March and August 2020, the BoA temporarily facilitated the deferral of loan instalments to help crisis-hit borrowers and allowed banks to restructure loans without additional



provisioning. There were concerns that financial soundness indicators would deteriorate once these temporary regulatory measures were lifted, but these fears have proved unfounded so far. Even after the moratorium on loan repayments ended in August (at which point it covered 38.5% of the loan portfolio), the ratio of non-performing loans continued to decrease, reaching 8.1% by the end of 2020. Banks can still make use of relaxed loan provisioning rules until the end of 2021, but many foreign-owned banks are applying the rules of their foreign (mostly EU) parent companies. Despite the pressure on profits – return on equity fell to 10.7% in 2020 – banks remained profitable and well capitalised. Credit growth slowed from 7.1% to 6.7% in 2020. However, deposit growth accelerated to 8.3%. This resulted in a slight reduction of the loan-to-deposit ratio, which was already very low. Although exposure to unhedged foreign exchange risks decreased and the BoA is developing more hedging instruments, some vulnerability remains; this is also connected to banks' exposure to sovereign risks and the dominance of variable-rate loans in the overall loan portfolio. The BoA's stress test confirmed that banks were solvent without requiring capital injections in 2021.

**An impressive number of financial reforms inspired by EU law will contribute to the stability and development of the sector beyond 2021.** The BoA has begun to update resolution plans for systemic banks and intends to have a complete regulatory framework for banking sector resolution in place by 2023. Work continues on alignment with EU directives on financial instruments, payment systems and money laundering. The new capital market law will contribute to the development and integrity of the capital market. Financial inclusion has improved, due in part to the modernisation of payment systems and the promotion of electronic financial transactions and banking services in view of reduced mobility during the pandemic. This trend is expected to continue as banks are beginning to offer accounts to the unbanked, while a modernised credit registry will increase the transparency of credit data and help to improve access to finance in future.

Table 2:

**Albania - Financial sector indicators**

	2016	2017	2018	2019	2020
<b>Total assets of the banking system (EUR million)</b>	10248	10768	11 398	12 380	13 156
<b>Foreign ownership of banking system (%)*</b>	82.6	81.4	80.8	78.4	69.4
<b>Credit growth (%)</b>	0.1	0.6	-3.2	7.1	6.6
<b>Deposit growth</b>	2.9	-1.2	-1.3	3.9	8.3
<b>Loan-to-deposit ratio</b>	54.0	54.9	53.9	55.6	54.7
<b>Financial soundness indicators (end of period)</b>					
- non-performing loans	18.3	13.2	11.1	8.4	8.1
- net capital to risk-weighted assets	15.7	16.6	18.2	18.3	18.3
- liquid assets to total assets	12.8	13.0	14.8	15.1	13.6
- return on equity	7.1	15.7	13.0	13.5	10.7
- forex loans to total loans (%)	57.8	55.7	55.1	50.1	48.5

\* of total sector assets

Sources: *Economic Reform Programme (ERP) 2021, IMF, Bank of Albania.*

### 3. PUBLIC FINANCE

**The government revised the 2020 budget four times to accommodate the revenue losses and expenditure needs resulting from the pandemic.** As the development of the

pandemic was unforeseeable and growth projections changed, the government adjusted revenue and expenditure plans several times, most recently in December 2020, to accommodate support for the economy and the healthcare sector. Earthquake-related reconstruction projects stalled in the second quarter before their implementation could actually get up to speed. The revenue ratio decreased from 27.4% of GDP in 2019 to 27.1%, mainly due to an 8.5% year-on-year drop in tax revenue. Expenditure increased 9.1% year-on-year, which, coupled with the lower GDP denominator, pushed the expenditure ratio from 29.3% of GDP in 2019 to 34.1%. Capital expenditure increased most strongly, including spending on reconstruction (which amounted to 5.4% of GDP). Expenditure on social assistance and healthcare was also higher.

**Within the limited fiscal space, households and businesses received effective and targeted support through established channels.** To address the impact of COVID-19, the government disbursed 1% of GDP on two support packages for businesses and households and on measures for the healthcare sector. Direct support subsidised wages at minimum-wage level, especially in the sectors most affected by the mobility restrictions applying from March to May. Direct support was also used to pay grants directly to self-employed people and micro businesses. Informally employed people were encouraged to register to receive support under the Economic Aid scheme (*“Ndihma Ekonomike”*) and for those registered unemployed before the start of the lockdown the usually very low unemployment benefits were doubled. In addition, the government provided liquidity to businesses in the form of sovereign guarantees equivalent to 1.65% of GDP (two schemes totalling ALL 11 billion with interest subsidy and ALL 15 billion without subsidy). About 40% of these guarantees were used by the end of 2020. Additionally, the government allowed profit and corporate income tax payments for 2019 and 2020 to be postponed and waived the related penalties and interest. SMEs and businesses directly affected by the drop in external demand (tourism, textile processing and business services/call centres) were relieved from profit tax and income tax for April to December 2020 and payments of small business tax (levied by local governments) were suspended.

**While the fiscal stance is still expansionary in the short term to accommodate spending on post-earthquake reconstruction, in the medium term the ERP aims to consolidate public finances and comply with the fiscal rules.** Ambitious expenditure plans are expected to keep the fiscal deficit above 6% of GDP in 2021, slightly below the actual deficit of 6.9% in 2020<sup>2</sup>. The first budget amendment of 5 February 2021 increased expenditure by 1.5% to provide additional funding for contingencies, social assistance, health insurance and capital expenditure, but does not foresee an increase of the deficit. Overall, expenditure is to increase by 12% to 35.7% of GDP in 2021 (compared with 29.3% in 2019), temporarily boosted by capital spending on earthquake-related reconstruction. From 2022, though, a sharp reduction in capital expenditure is set to bring the fiscal deficit to below 3% of GDP. The expenditure ratio is expected to decrease from its peak of 35.2% of GDP in 2021 to 31.1% in 2023. Capital expenditure is expected to fall by 2.5 pps. in 2022 to slightly above its pre-crisis level, while current expenditure is set to remain about 1.5 to 2 pps. above its earlier level to accommodate

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<sup>2</sup> There are differences between the data presented in the text of the ERP and the programme’s data annex. The latter does not reflect the actual outturn of 2020. In addition, the macro-fiscal framework, on which the ERP and the budgets 2021-2023 are based, does not distinguish between the current and capital expenditure of local governments. Consequently, the ERP table shows higher overall gross fixed investment by the public sector than the budget plan.

increased interest costs and slightly higher allocations for spending on healthcare and social security. The primary balance is expected to improve from -3.9% of GDP in 2021 to -0.1% in 2022 and turn positive in 2023, in line with the new fiscal rule.

**The fiscal consolidation strategy is not supported by concrete proposals to increase revenue mobilisation.** The revenue ratio is projected to rebound strongly to 28.9% in 2023 and exceed its pre-crisis level by 1.5 pps. This is partly because higher grants are expected from budget support programmes and for earthquake reconstruction, but it is mainly due to the assumed strong growth in tax revenue, such as the additional 6% increase in budgeted VAT revenue, which is to finance additional expenditure included in the first budget amendment. Overall, revenue is expected to grow by 15% and reach 29% of GDP in 2021, but the ERP does not present concrete policy proposals for revenue mobilisation. The tax revenue forecast seems overly optimistic given the performance in pre-crisis years, the narrowing of the tax base and the postponement of the medium-term revenue strategy.

Table 3:

**Albania - Composition of the budgetary adjustment (% of GDP)**

	2019	2020	2021	2022	2023	Change: 2020-23
<b>Revenues</b>	27.4	27.0	28.8	28.7	28.9	1.9
- Taxes and social security contributions	22.1	21.6	22.8	23.1	23.3	1.7
- Other (residual)	5.3	5.3	6.0	5.6	5.5	0.2
<b>Expenditure</b>	29.3	33.7	35.2	31.6	31.1	-2.6
- Primary expenditure*	27.2	31.5	32.6	28.8	28.2	-3.2
of which:						
Gross fixed capital formation	5.5	7.3	8.3	5.8	5.8	-1.5
Consumption	9.6	10.9	10.6	10.0	9.8	-1.1
Transfers & subsidies	12.0	13.2	13.4	12.8	12.4	-0.8
Other (residual)	0.1	0.1	0.3	0.2	0.3	0.2
- Interest payments	2.1	2.2	2.6	2.7	2.9	0.7
<b>Budget balance</b>	-1.9	-6.7	-6.5	-2.9	-2.3	4.4
- Cyclically adjusted	-1.8	-4.5	-7.3	-3.4	-2.6	1.9
<b>Primary balance</b>	0.2	-4.5	-3.9	-0.1	0.6	5.1
- Cyclically adjusted	0.3	-2.3	-4.7	-0.6	0.3	2.6
<b>Gross debt level</b>	66.3	79.9	78.6	77.7	75.6	-4.3

\* Excluding arrears clearance

Sources: Economic Reform Programme (ERP) 2021 and preliminary fiscal results 2020.

**The ERP focuses on stimulating economic recovery by increasing capital expenditure and includes only limited support for households and businesses affected by the pandemic.** The 2021 budget includes ALL 11.6 billion (0.7% of GDP) to fund COVID-19-related measures including the vaccination campaign, additional social assistance, the digitalisation of schools, business support and labour market measures. However, the ERP provides only some details of the employment promotion programme. The budgeted salary increase for teachers and healthcare workers does not address the problems caused by the pandemic but will help to keep staff in these critical sectors. The additional budgets for social assistance, labour market policies and business support are dwarfed by the very ambitious investment and reconstruction plans, which are supposed to stimulate economic recovery. The investment priorities have not been reviewed in the light of the pandemic and are set to continue projects initiated under the

2017-2021 government programme, which focus on road construction. The public investment drive will certainly stimulate construction activity, as it did in 2020, but might have limited effects on other sectors, like manufacturing and tourism. More targeted support for recovery, tailored to the needs of sectors including services, would require a more in-depth analysis of the pandemic's effect on business and employment than is presented in the ERP. The allocation for human development is increasing in nominal terms but not as strongly as capital investment, while spending on education is set to decrease both in GDP terms and as a share of total expenditure.

***Box: Recovery measures in the 2021 budget***

The ERP describes few discretionary and targeted fiscal measures to support the recovery and strengthen resilience. Overall, expenditure on health care services and social protections are planned to remain elevated, but the specific COVID-19-related support measures of 2020 are not planned to continue. A number of ongoing initiatives are very pertinent in the new context, like the expansion of digitalisation, promoting e-commerce, legislative framework for start-ups, and some of these may have been front-loaded. On the other hand, the ERP does not describe any specific support to the tourism sector in view of the pandemic, which leaves a heavily affected major growth-relevant sector at risk of a delayed recovery and of a diminished service structure.

*a. Incentives to increase employment*

Overall, the budget for additional labour market support is ALL 150 million (0.01% of GDP). The COVID-19-related employment promotion programme is costed with about ALL 30 million for 2021 and 2022. The employment promotion programme, targeting persons who lost their employment due to the pandemic, includes 3 targeted schemes to subsidise wages (at minimum wage level) and/or compulsory social insurance to variable degrees depending on the length of employment and the type of jobseekers (formal or informal).

*b. Support public and private investment, and the green and digital transition*

Investment priorities have not been reoriented in view of the pandemic, except of an allocation of ALL 1.1 billion (0.06% of GDP) for digital competencies and the school's digital infrastructure, but public investment is planned to increase to 7.3% of GDP including 1.7% of GDP for reconstruction. The reconstruction projects mainly consist in construction of housing and schools, while the regular capital expenditure budget will continue to finance ongoing investment projects, mainly roads.

*d.) Support solvent businesses*

The budget includes additional business support of ALL 250 million (0.02% of GDP) in the context of the pandemic, but the ERP does not provide details on this support. The ERP mentions the budget provision of ALL 1 billion (0.06% of GDP) to subsidise farmers' use of diesel, which is neither targeted to solvent farmers nor limited in time, and subsidises use of fossil fuel instead of its reduction. Considering that the agricultural sector recorded exceptional growth in 2020, this initiative cannot be seen in relation with the pandemic. However, it is positive that this support takes the form of a subsidy instead of a tax exemption that would add to complicating the tax system.

*e.) Liquidity measures*

In the 2021 budget about ALL 100 million (0.01% of GDP) have been included for the expenditure of interest subsidies offered in the first sovereign guarantee scheme. Possible payments of principal in case guarantees are called, have been provisioned with ALL 2 billion in 2021 (0.13% of GDP, below the line). In January, the government extended the application time for its 2<sup>nd</sup> sovereign guarantee scheme, of which ALL 10 billion (0.6% of GDP) have not been used, to June 2021. It guarantees 60% of the loan principal, but doesn't provide for interest rate subsidies.

**The key fiscal policies in 2021 will further narrow the tax base and do not support the expected revenue mobilisation, even though the introduction of automated electronic VAT invoicing will help to narrow the VAT gap.** From 2021, businesses with a turnover below ALL 14 million (about EUR 120 000) will be exempt from paying profit tax and those with a turnover below ALL 10 million (about EUR 80 000; a higher threshold than common in the EU) will be exempt from registering for VAT. These tax measures for 2021, which were announced in the second quarter of 2020, were not intended as support for SMEs in the context of the COVID-19 crisis but as a means of relieving small businesses from the burden of tax administration. The ERP does not assess the possible impact of these exemptions on business development, investment and tax compliance. At the same time, the government postponed the adoption of the medium-term revenue strategy, which is crucial for a realistic and reliable increase of public revenue and for financing a growth-friendly fiscal policy, even though its supporting international partners (EU, IMF) asked it to reconsider or present a preliminary draft. The roll-out of the “fiscalisation” scheme, consisting of obligatory, electronic VAT invoicing, is an important step towards increased VAT-efficiency and will help to reduce informal sales. The ERP assumes that this will lead to an increase in VAT revenue, but does not provide concrete estimates.

**Box: The budget for 2021**

\* The draft budget for 2021 was presented to parliament on 16 November 2020 and adopted on 6 December 2020 targeting a 6.5% of GDP deficit. Parliament adopted its first amendment on 5 February 2021, which increased expenditure from 34.9% to 35.4% of GDP and revenue from 28.5% to 29% of GDP.

\* Key fiscal policies are the permanent exemptions of small business from profit tax and VAT and the increase of wages in the health and education sector and of the minimum wage. The increase of the social contributions due to the higher minimum wage compensated some of the tax expenditure due to the new tax exemptions and result in an overall decrease of revenue by 0.1% of GDP, while expenditure increased by 2.9% of GDP.

Table: Main discretionary measures in the budget for 2021

<b>Permanent revenue measures*</b>	<b>Temporary/permanent measures**</b>	<b>Expenditure</b>
<ul style="list-style-type: none"> <li>• ALL 3-4 billion raising VAT registration threshold to turnover of ALL 10 million, about EUR 80 000 (-0.2% of GDP)</li> <li>• ALL 0.7 billion exemption of businesses with turnover below ALL 14 million (EUR 120 000) from profit tax (-0.05% of GDP)</li> <li>• ALL 3 billion increase to social contributions due to increase of minimum wage (0.15% of GDP)</li> </ul>	<ul style="list-style-type: none"> <li>• ALL 28 billion post-earthquake reconstruction (1.7% of GDP)</li> <li>• ALL 8 billion to increase salaries of health workers by 40% and of teachers by 15% (0.5% of GDP)</li> <li>• ALL 7.5 billion directly related to needs from the COVID-19 pandemic including vaccines (0.4% of GDP)</li> <li>• ALL 5 billion reserve fund for elections, project studies, contingency (0.2% of GDP)</li> <li>• ALL 1 billion diesel subsidy to agricultural business (0.06% of GDP)</li> </ul>	

\* Estimated impact on general government revenues.

\*\* Estimated impact on general government expenditure.

Source: ERP

**The public debt ratio peaked at 76.1% of GDP in 2020, lower than expected, because contracted public guarantees undershot initial projections<sup>3</sup>.** Despite the deficit outcome of 6.9% of GDP turning out 0.4 pps. higher than expected, public debt turned out lower than initially forecast both in nominal terms (-ALL 30 billion) and, due to the higher than expected GDP, as a share of GDP (-3.7 pps.). This is partly because the amount of public guarantees included in the debt stock was adjusted after the year ended on the basis of the guarantees actually contracted<sup>4</sup>. In addition, the energy sector needed a lower amount of guarantees than expected. Public guaranteed debt is expected to decrease gradually to its average pre-crisis level by 2023.

**The ERP plans to gradually reduce the public-debt ratio starting in 2021, even though the deficit remains high.** The medium-term fiscal plan sets out a 1 pp. reduction of the debt ratio in 2021 and 2022, accelerating to 2 pps. per year from 2023. At the end of the period covered by the ERP, the debt ratio could drop below 73% based on the revised debt figures. This is expected to be supported by strong improvement in the primary balance, which is required to be zero or positive from 2023 according to a recent amendment to the organic budget law. The proposed halving of the fiscal deficit from 6.5% in 2021 to 2.9% in 2022 appears drastic, but the transition will likely be smoother if the very ambitious capital expenditure plans for 2021 prove difficult to implement fully. The share of foreign-financed debt increased from 45.6% in 2019 to 46.5% in 2020 and is set to continue increasing to 48.5% in 2024. It will nevertheless remain below 55%, in line with the debt management strategy to limit exchange rate risks. Albania's debt management strategy aims to continue extending the maturity of domestic debt and limit the share of securities with variable interest rates in order to lower roll-over and interest rate risks.

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<sup>3</sup> The data in the tables refer to the ERP submission, which did not reflect the latest updates on debt and fiscal outturns.

<sup>4</sup> Public guarantees were expected to increase from 2.5% of GDP in 2019 to 4.7% of GDP in 2020, partly because of the crisis-related guarantee schemes worth 1.6% of GDP, which the government set up to provide liquidity to business. The organic budget law requires 100% of public guarantees to be accounted to the public debt. In this respect, it is stricter than the EDP calculation method, which requires guarantees to be included in public debt based on the risk that the guarantee will be drawn.

### Box: Debt dynamics

Albania					
Composition of changes in the debt ratio (% of GDP)					
	2019	2020	2021	2022	2023
<b>Gross debt ratio [1]</b>	<b>66.3</b>	<b>79.9</b>	<b>78.6</b>	<b>77.7</b>	<b>75.6</b>
Change in the ratio	-1.4	13.6	-1.3	-0.9	-2.1
<i>Contributions [2]:</i>					
<b>1. Primary balance</b>	<b>-0.2</b>	<b>4.5</b>	<b>3.9</b>	<b>0.1</b>	<b>-0.6</b>
<b>2. "Snowball" effect</b>	<b>0.3</b>	<b>6.7</b>	<b>-2.7</b>	<b>-2.6</b>	<b>-2.3</b>
<i>Of which:</i>					
Interest expenditure	2.1	2.2	2.6	2.7	2.9
Growth effect	-1.4	3.1	-4.1	-3.6	-3.3
Inflation effect	-0.3	1.4	-1.2	-1.7	-1.8
<b>3. Stock-flow adjustment</b>	<b>-1.6</b>	<b>2.4</b>	<b>-2.5</b>	<b>1.6</b>	<b>0.8</b>

[1] End of period.

[2] The snowball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator).

The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other effects.

Source: *Economic Reform Programme (ERP) 2021, ECFIN calculations.*

The debt dynamics are based on rather optimistic growth expectations and assume a stable exchange rate. Debt reduction is expected to be driven by the favourable snowball effect despite a projected increase in interest expenditure. The improving primary balance, based on a planned decrease in capital expenditure coupled with strong revenue growth, is set to contribute to debt reduction from 2023. Achieving the projected high growth rates and the planned fiscal consolidation are key for debt reduction. The level of public debt is likely to be lower than shown in the table, as the actual outcome was lower in 2020 (estimated at 77.9% of GDP)

and public guarantees continue to be overestimated in 2021.

The projected debt reduction in 2021, despite the still high primary deficit, relies on a significant favourable impact from stock-flow adjustments. Fluctuations in stock flow adjustments in the table above reflect the issuance and use of Eurobonds. In addition, the projected recovery could well lead to a strengthening of the Albanian currency, which would have debt-reducing valuation effects.

**Contingent liabilities from public-private-partnerships (PPPs) and state-owned enterprises (SOEs) remain high with rising out-of-budget payments, while efforts to improve their monitoring need to continue.** The results of the improved monitoring and assessment of PPPs and concessions are reported in annual PPP monitoring reports and are integrated into the fiscal risk statements, which regularly accompany the budgets. In 2020, the fiscal risk analysis started to include the water utility sector, whereas enhanced monitoring of SOEs like Albpetrol and Albgas is planned for 2021. Plans have been made to monitor the natural-disaster risks to which Albania is prone. However, institutional capacity for meeting risk-assessment needs is still limited, with a heavy reliance on external help from International Financing Institutions (IFIs). Payments to 13 PPPs and concessions are expected to reach ALL 14.46 billion in 2021, equivalent to 3.6% of the 2020 tax revenue<sup>5</sup>; this is a sharp increase from the ALL 9.6 billion in 2020 (2.5% of 2019 tax revenue) and is due to increased payments on maturing PPPs. If new PPPs<sup>6</sup> are concluded and tax revenue does not perform as well as expected, the related payments could approach the 5% limit set by the fiscal rule. In addition, the contingent risks stemming from PPPs without budgetary payment obligations, which are not reported in the ERP, remain unevaluated and the state budget remains exposed to liabilities in the energy sector, which receives 70-80% of state guarantees.

<sup>5</sup> Under the organic budget law, payments to PPPs and concessions from the budget are not to exceed 5% of the actual tax revenue of the preceding year.

<sup>6</sup> The list presented in the ERP only reflects those PPPs and concessions that are explicitly intended to receive payments from the budget during their implementation; they mainly relate to road construction and hospital services.



***Box: Sensitivity analysis***

The sensitivity analysis of this year's ERP extends to 2025 and provides more detail on the expenditure and financing categories to reflect the impact of the scenarios on the financing composition. The ERP provides both an optimistic and pessimistic scenario for real GDP growth rates, which deviate from the 5.5% baseline growth scenario, which assumes no shock in 2021, by +0.5 pps. and -1.5 pps. respectively. In the pessimistic scenario, the revenue ratio is set 0.5 pps. lower than in the baseline, however, assuming that it will exceed all revenue ratios realised since 2015 does not seem adequate for a pessimistic scenario.

Adjustment under the pessimistic scenario is set to avoid increasing the debt ratio, mainly by reducing domestically financed investment and lowering operational & maintenance expenditure without adjusting reconstruction-related and foreign financed investments. In 2021, cutting domestically financed capital expenditure would carry the adjustment alone with a very limited increase in the fiscal deficit. From 2022 on, annual issuances of EUR 500 million Eurobonds will complement domestic borrowing, which will be about 0.5 pps. of GDP higher than under the baseline scenario from 2023 on. Compared with the optimistic scenario, the reduction public debt to GDP ratio would be only incremental in the pessimistic scenario and about 5 pps. higher by 2023, while interest expenditures would only differ slightly between 2.8% and 3% of GDP. In all scenarios, the primary balance would turn positive in 2023, as legally required.

**Implementation of the comprehensive public finance management (PFM) reform strategy progressed but the reform pace slowed, hampered by the pandemic and a lack of capacity.** The updated PFM reform strategy for 2019-2022 addresses key weaknesses and includes targets to improve public investment management, budget comprehensiveness, expenditure and arrears control, fiscal risk monitoring and revenue mobilisation. However, speedier implementation is prevented by continuing capacity limitations across the administration. The reporting and publication of arrears have substantially improved. VAT refunds reached most small businesses promptly but new agreements had to be arranged for delayed VAT refunds to some large firms and local government arrears increased. Budget execution improved and capital expenditure increased by 13.7% in 2020, although only 50% of planned reconstruction expenditure was implemented. Public reconstruction funds and concessions and PPPs remain outside the established processes for approving, managing and reporting on public investment; this reduces their transparency and efficiency. The postponement of previously agreed reforms like the medium-term revenue strategy could indicate reform obstacles beyond technical capacity limitations, which also lead to overestimated tax revenue targets and ad hoc changes of taxation policy. Potential election-related disruptions and reorganisations could further delay reform implementation.

**The expenditure composition could more clearly prioritise education and innovation and accelerate the increase of spending on social security and healthcare.** Higher public investment in infrastructure projects is not matched by a similar increase in investment in human capital, which is a crucial factor for future growth, foreign direct investments and technology transfer. Allocations for healthcare and social protection have increased gradually since 2015, particularly in response to the crisis. However, they remain significantly below EU and regional averages and contribute too little to poverty reduction. The allocation for education is declining and public expenditure on research



and development (R&D) remains negligible. In 2021, the government does not plan to further increase the ratio of expenditure allocated to healthcare and social security. Moreover, expenditure on education has been scaled back (both in GDP terms and as a share of total expenditure) and the ERP does mention when public research funding (0.06% of GDP in 2019) will reach the government's 0.1% target.

**Albania activated the escape clause of its fiscal framework in 2020, but plans to comply with a strengthened set of fiscal rules from 2021.** Albania's organic budget law allows for an exemption from fiscal rules in the event of a natural disaster. The government used this exemption in 2020 when the state of emergency was announced following the November 2019 earthquake and when it was extended due to the COVID-19 pandemic. The exemption clause for states of emergency therefore covered both the increase in the public-debt ratio<sup>7</sup> in 2020 and the fact that net borrowing was higher than the planned capital expenditure. At the same time, budget payments to PPPs remained below 5% of 2019 tax revenue. In July 2020, the Albanian parliament adopted a proposal to introduce into the organic budget law a requirement that the primary balance must be neutral or positive from 2023. In 2021, the government does not plan to apply the exemption clause and the budget includes a reduction of the public-debt ratio. Capital expenditure is planned to be higher than net borrowing ('golden rule'). The PFM strategy aims to gradually align fiscal data with ESA 2010 requirements.

#### **4. KEY STRUCTURAL CHALLENGES AND REFORM PRIORITIES**

**Albania's private sector development remains below its potential, as efforts to improve the business environment lack sufficient policy instruments and a more strategic approach.** Exports are concentrated in few low-value added products, due to the narrow industrial base. There is widespread informality, businesses have difficulties to employ skilled staff, and support to innovation remains limited.

The Commission has conducted an independent analysis of the Albanian economy to identify the key structural challenges to mitigate the impact of the pandemic, to boost competitiveness and inclusive growth, drawing from Albania's ERP itself but also using other sources. This analysis of the economy shows that Albania experiences several structural weaknesses across many sectors. However, the main challenges to mitigate the impact of the COVID-19 pandemic and to support the recovery in terms of boosting competitiveness and long-term and of sustained and inclusive growth are: (i) increasing innovation and skills of young people and adults to enhance employment; (ii) increasing coverage and adequacy of social protection and health insurance to reduce the share of population at risk of poverty and (iii) improving the business environment and investment climate by increasing government support and tackling informality.

Albania also needs to tackle corruption, improve the rule of law and strengthen institutions in order to promote competitiveness. Addressing these fundamental challenges is a prerequisite for a successful transformation of the economy. The

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<sup>7</sup> The fiscal rules in Albania set a debt-to-GDP ceiling of 45%, with the obligation to decrease the ratio each year until the target is reached. In addition, targeted net borrowing should be lower than planned capital expenditure plans and payments to PPPs limited to 5% of the previous year's tax revenue.

Commission is closely following the issues of strengthening the rule of law, including the ongoing justice reform as well as those related to corruption in the annual Albania report.

***Key challenge #1: Increasing innovation and skills of young people and adults to enhance employment***

**Albania's labour market contracted slightly due to the COVID-19 pandemic with informal workers hit harder.** The employment rate (20-64) improved by 10.5 pps. between 2014 and 2019 to reach a record high of 67.1%. Despite lagging behind the EU-27 average by 6 pps., this was the highest level among the Western Balkan countries. Although female employment has increased at a swifter pace than male employment in recent years, the gender employment gap still stood at 15 pps. Following a decrease to 65.3% in the second quarter of 2020 due to lockdown measures and an increase to 67.1% in the third quarter, the employment rate fell back to 65.8% in the fourth quarter, i.e. a decrease by 1.2 pps. y-o-y. Data from the tax authority show that by December 2020, the number of formally employed people exceeded the 2019 level. Unemployment (15-64) grew slightly and reached 12.3% in the fourth quarter of 2020, i.e. an increase by 0.7 pps. y-o-y. Even as formal employment rebounded, between January and December 2020 the number of registered unemployed increased by 25 955 (or 39%) to 92 326 between January and December 2020, the highest level since 2017. Only 16% of those newly registered as unemployed between the first and the third quarter were eligible for unemployment benefits. This suggests that informal workers and people in non-standard forms of employment represented a significant share of the newly registered unemployed and that these groups were left on the fringes of government support, thus increasing their risk of poverty and social exclusion.

**Ever more young people are graduating from higher education, but the share of young people not in employment, education or training (NEET) is high.** Albania saw a remarkable shift in higher education levels between 2010 and 2019 as the share of university graduates in the age group 30-34 rose from 11.4% to 31.3% and reached 40.8% for the age group 25-29. In 2019, one in four young people aged 15-29 were NEETs (26.6%); this is more than double the EU-27 average (12.6%). Within this age group, the share of NEETs was highest among upper secondary graduates (28.9%), followed by university graduates (26.5%), while young people with no more than lower secondary education fared the best (24.4%). This indicates a very challenging labour market transition for young people and problems with the quality of education. This is linked to the structure of enterprises that are not yet able to absorb the increased number of graduates with higher education coupled with currently low attraction of foreign direct investment into the country and limited or inexistent career guidance, whereby students make choices that may not always correspond to the demand in the labour market. The situation also highlights a potential need for additional actions to channel the increasingly skilled young workforce into entrepreneurship and social economy.

**The government increased its support for active labour market policies (ALMPs) to tackle the crisis.** In 2020, the ALMP budget was increased by 50% and two new employment promotion programmes (EPPs) were approved for people who lost their jobs due to the crisis, one of which specifically targets people who were informally employed. However, due to the difficult situation in 2020, the budget allocation was not used in full and the increase was carried over to 2021. Implementation of the new EPPs is prioritised in 2021 under the *reform measure 16* (“*Improving the employability of the most vulnerable unemployed*”) to help those who lost their jobs due to the crisis to get back to

work. Albania intends to finalise the public employment service's information system, implement jobseeker profiling and develop individual employment plans in 2021; these measures are necessary to boost the effectiveness and efficiency of active employment policies. The reform measure provides for the creation of a Youth Guarantee programme. Given the high number of NEETs and an increased risk of school drop outs due to the pandemic, these plans are very relevant to increase the labour market integration of young people. However, the proposed approach, which makes reference to a pilot with 200 young people in 2022 and a deployment countrywide in 2023, is not sufficiently close to the principles of the EU Youth Guarantee, such as universality, close coordination among multiple ministries and agencies, the establishment of an adequate legal framework, and covers not only employment and internships, but also apprenticeships and further education opportunities.

**The share of the active population with low educational attainment remains high and progress is limited by insufficient provision of and participation in learning.** In 2019, almost half of the population aged 25 to 64 had low educational attainment (44.7%), meaning primary education or less. This is double the EU-27 average (21.6%). Among registered unemployed, the share exceeds 55%. However, the system lacks any form of remedial education for the young and middle-aged workforce. Participation of adults (people aged 25 to 64) in formal or non-formal education and training is extremely low (0.8%) compared to the EU-27 average (10.8%). Vocational training courses are mainly provided by public vocational training centres (VTCs) but are insufficient in scale, with only 15 154 participants in 2019. Only 12.4% of registered jobseekers (8 818) were upskilled or reskilled in VTCs in 2019. The geographical coverage by ten VTCs is limited, with one of them being mobile and covering the north-east of the country. The courses on offer cater for low-skilled people. Albania is developing a bylaw on outsourcing training to private providers to increase the offer for mid- and high-skilled people. Another 6 814 adults were certified after attending vocational training delivered by 136 private training providers. The system of recognition of prior learning is underdeveloped, thereby limiting access to formal qualifications for those who may have earned relevant competences in informal settings.

**Albania lacks tools for regular monitoring and forecasting of skills needs in the labour market.** This makes it difficult to set the right priorities for secondary vocational education and tertiary education and provide relevant career guidance and upskilling and reskilling programmes for unemployed and low-skilled people. An inadequately educated workforce is the third of the top three business obstacles for medium and large enterprises in Albania (World Bank 2019). The challenge is recognised in the ERP and *reform measure 16* plans to conduct a skills needs analysis in 2021. The Ministry of Education, Youth and Sports has started using administrative data to assess the labour market transitions of university graduates and collect information on their sector of employment and earnings. This exercise can provide first insights into the quality and relevance of curricula and lead to the prioritisation of programmes whose graduates are in demand on the labour market.

**Vocational education and training (VET) attracts only a low number of young people, is under-financed, lacks stronger involvement of the private sector and its modernised legal framework still lacks full operationalisation.** Only 17% of upper-secondary students attend VET, far below the regional average of 62%. VET is a second-choice form of secondary education attracting mainly boys (who account for 83.6% of all VET students) from vulnerable socio-economic backgrounds, which raises questions

regarding equal opportunities in student sorting. The system is dependent on donors' funds, which exceed state allocations. State funding does not take into account the real costs of different VET providers. The National VET Council is not yet operational and sectoral skills committees are not established yet, resulting in limited opportunities for the private sector to shape the VET policy design (SDC and UNDP 2020). A comprehensive set of laws has been adopted since 2014 to modernise VET provision, but there are still difficulties with making the legal framework operational through secondary legislation. A bylaw on work-based learning was adopted in 2020, but other important bylaws are still pending (on financial autonomy, opening/closing of VET providers and on inspection). The Ministry of Finance and Economy has very limited human resources to advance with the reform while both agencies, the National Agency for Employment and Skills (NAES) and the National Agency for VET and Qualifications, are not fully staffed yet. NAES has to handle new responsibilities and is in an early stage of operationalisation of its new functions.

*Reform measure 15 (“Increasing the quality and access to VET”)* aims to address some of the existing challenges. It plans the completion of the legal framework as regards financial autonomy and income generation by VET providers. The planned establishment of two sectoral skills committees is a positive step towards increasing business involvement, but the number of committees could be higher and the schedule for their establishment could be linked with the implementation of the optimisation plan for VET providers, which is expected to be completed by September 2022. The plan on which businesses were not consulted rearranges 46 existing VET providers into 27 institutions, most (22) of which will perform both initial and continuous VET, thus increasing the financial efficiency of the system and expanding the offer of continuous training. The optimisation plan provides for capacity building for VET providers to prepare them for new responsibilities entrusted to them by the VET law.

**Albania also ranked particularly low in the 2019 Global Competitiveness Index (World Economic Forum, 2019) for innovation capability (110th of 141) and R&D (126th) and spends less than 0.5% of GDP on the latter.** It has few innovation support or development policies in place, even though these could stimulate private investments, increase competitiveness and help to diversify the economy. A clear methodology to establish research or science funding is also missing. There are no operational science or technology parks and no funds to support the establishment of new business incubators (SME Policy Index, 2019). At the same time, university graduates face higher unemployment than in the EU (12.3% compared to 5.3% for the age group 15-64). Moreover, the collection of statistics about research and innovation is insufficiently developed to support the policies.

Despite some progress on the digital agenda strategy and e-government, fixed broadband penetration is still low, notably in rural areas (40% of the population) where only 5% of people are connected to the internet. The limited digital infrastructure and the lack of digital skills negatively impact the supply and demand for digital products and the limit the digital sector's potential to create employment and positive effects, especially in services. E-commerce remains underdeveloped, though the COVID-19 crisis requires from enterprises and consumers to adjust themselves to distance marketing and trade.

*Reform measure 10 (“Improving institutional, financial and human capacities for research and innovation”)* is very relevant and if implemented, it has the potential to foster Albania's innovation and research capacities. The measure is ambitious, providing

for R&D to be doubled as a percentage of GDP in three years. It also includes the completion and implementation of the Smart Specialisation Strategy (S3). However, efforts for the implementation of these measures will need to be clearly steered and strongly supported, for their timely adoption.

The recent establishment of the Council for Higher Education and Research should foster the implementation of measures to strengthen research and innovation capabilities at the national level. However, efforts need to be stepped up for the introduction of indicators in the statistical programme for the production of statistics and reliable data on science and technology as well as of a methodology to assess expenses / funding on R&D in both public and private sector.

***Key challenge 2: Increasing the coverage and adequacy of social protection and health insurance to reduce the share of the population at risk of poverty***

**Spending on social protection is low.** Between 2015 and 2019, Albania spent 9.3% of its GDP on social protection, excluding healthcare; this was half the EU-27 average of 18.6%. Most social protection spending was on pensions (82.4%), followed by non-contributory cash assistance programmes to people with disabilities and people at risk of poverty (13.7%, equivalent to 1.27% of GDP) and by the baby bonus scheme (accounting for 1.5% of social protection spending). In 2019, only 1.1% (0.1% of GDP) of the social protection budget was spent on passive and active employment policies and around 1.3% (0.12% of GDP) on social services and administration costs for social protection at central and municipal level.

**Poverty and social exclusion are widespread and the capacity of social transfers to decrease poverty is very low.** Almost half of Albania's population (49%) was at risk of poverty or social exclusion in 2018, more than double the EU-27 average (21.6%). In 2020, 63 510 families (around 9% of Albanian population) received means-tested income support through the Economic Aid scheme (*Ndihma Ekonomike*). The adjusted means-test was deployed countrywide in 2019, but no assessment is available to show whether targeting of poor households has improved. People with disabilities (147 102 in December 2020) receive monthly benefits to cover their medical and care costs and compensate them for their inability to work. Despite this, 56.1% of them live at risk of poverty or social exclusion<sup>8</sup>. Before the crisis (fourth quarter of 2019), only 3.8% of people registered as unemployed received unemployment benefits while another 31.2% received support through the Economic Aid, leaving 65% without material support. Unemployment benefit coverage and the level of social benefits are structurally too low to maintain private consumption and support the economic recovery. The capacity of social transfers (excluding old age and family pensions) to reduce the at-risk-of-poverty rate stands at only 11.3%, below regional peers and significantly below the EU-27 average reduction of 32.38%.

**The allowances paid under the Economic Aid scheme are too low to combat poverty.** Based on Statistics on Income and Living Conditions (EU-SILC) 2018 data, the annual allowances for a four-member household of two parents and two children under

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<sup>8</sup> As measured for people aged 16 and above strongly limited or limited in activities due to health problems.

14, including monthly energy compensation and an allowance for both children attending school (ALL 80 976), stand at 14.4% of the median equivalised annual income for a household of this composition (ALL 562 668), far below the poverty threshold.

**The government took temporary measures to increase the adequacy of social assistance benefits and extend income support during the pandemic.** From April to June, people working in businesses that had limited annual turnover and closed due to the lockdown received monthly payments equal to the minimum wage. Importantly, this measure included self-employed people and unpaid family members. A one-off lump-sum payment of ALL 40 000 was made to employees in most of other businesses that closed or were impacted by the economic slowdown, thus boosting their income. Unemployment benefits were doubled, but only for people who were registered as unemployed before the lockdown, while eligibility criteria for unemployment benefits were not eased. Of the 21 273 people newly registered as unemployed between the first and the third quarter of 2020, only 3 330 (15.7%) were granted unemployment insurance, while 5 850 received assistance under the Economic Aid scheme (27.5%). Ineligible formal workers who were laid off due to the lockdown or the economic slowdown benefitted from a lump-sum of ALL 40 000, while informal workers who were laid off did not receive any material support. Economic Aid benefits were doubled for three months (April to June 2020) and the budget of the scheme for 2021 was increased from ALL 4.6 billion to 7.1 billion. As a result, benefits doubled in the first six months of 2021; however no assessment was performed to gauge benefit adequacy. In an effort to address the policy guidance of May 2020 and the relevant conditionality attached in the European Commission's Macro-Financial Assistance (MFA) to Albania, *reform measure 17* ("*Strengthen and expand health and social protection coverage*") foresees to assess the adequacy of Economic Aid benefits in 2021. This assessment will take into account the data from the EU-SILC and establish a transparent mechanism for their annual review. A subsequent adjustment of benefits is planned for 2022. During the lockdown of 2020, a lump-sum of ALL 16 000 (EUR 130) was paid to 4 524 families that had unsuccessfully applied for Economic Aid benefits between July 2019 and April 2020. In addition, a total of 88 671 families received food packages, hygiene kits and emergency support services. The recipients included 18 144 Roma/Egyptian families and 54 980 elderly people.

**The scarcity of social care services is a major obstacle to the active inclusion of vulnerable people.** Only 10 065 people, or 0.35% of the population, received social care services in 2019 (State Social Services data). Social care services are distributed unevenly across the country and are completely lacking in one third of municipalities (21 out of 61). Albania only provides five of the seven types of services defined by law. Para-social services and specialised services are not available yet. *Reform measure 17* only sets the very modest goal of employing 150 socially vulnerable people and people with disabilities in social enterprises by 2023.

**Although the number of local social plans is increasing, very limited resources are available to establish new social services and the capacities of local governments are insufficient.** In 2020, the number of municipalities with an approved social plan increased substantially from 24 to 50 (of 61) with the help of donors and NGOs. Efforts to build capacity in 2020 focused on 21 municipalities that did not provide any social services. Despite this, local governments' capacity to assess needs, apply for government funds and manage social services remains weak. Municipalities must have a social plan to apply to the Social Fund, which was put in place in 2019 to help roll out new social

care services. The mid-term budget for 2021 to 2023 foresees that annual allocation will stagnate at ALL 200 million (approx. EUR 1.61 million), despite an increase in the number of eligible municipalities and thus in the resources required. The target under *reform measure 17* of developing 45 new services with support from the Social Fund is realistic given the limited funding provided. However, it is insufficient to markedly improve the availability of social services in the country. The question of whether the newly established social services will be sustainable once support from the Social Fund is phased out, has not been addressed yet.

**The Albanian healthcare system is underfinanced and the share of uninsured people is significant.** The budget allocation to healthcare has been steadily increasing as a share of GDP, from a low of 2.5% of GDP in 2008 to 3% in 2018, 3.05% in 2019, 3.36% in 2020 and 3.41% in 2021, the latest marked increases being linked to the COVID-19 pandemic. This is still below the allocation levels of regional peers (with the exception of Kosovo) and significantly below the EU-27 average of 7.0% (2019 data). Public spending on healthcare as a share of total government spending has also been consistently low at 10% or below, thus not reaching the 12% share recommended by the World Health Organisation (WHO). This signals that healthcare has low priority in the allocation of the government budget. Health services within primary and hospital care are financed through the Compulsory Health Care Insurance Fund (CHCIF). Insurance contributions for formally employed people only covered about a third of CHCIF expenditure in 2019 (32.7%), with the state budget financing the remaining 67.3%. The state budget covers investments, other capital expenditure, as well as health insurance for economically inactive people<sup>9</sup>. Other economically active people (self-employed, small family businesses, farmers) can enrol voluntarily in the health insurance scheme. There are around 600 000 uninsured citizens (21% of the population); they are principally informal workers<sup>10</sup>, low-income groups, minorities (Roma/Egyptians), and people living in rural and peri-urban deprived areas (WHO 2020a). The 2020–2025 Strategy on the development of primary health care services calls for the status and funding of primary healthcare to be strengthened and increased.

**The government took steps to increase the healthcare coverage for uninsured people.** Uninsured people are entitled to free emergency care and the government put in place additional free entitlements irrespective of insurance status under the 2016-2020 Albanian National Health Strategy (ANHS). These entitlements are annual health check-ups for people aged 35 to 70 years (2016)<sup>11</sup> to detect non-communicable diseases, visits to general practitioners (2017) and national breast and cervical cancer screening programmes (2018). As a result, annual check-up visits and the use of primary healthcare increased in recent years. However, the coverage of annual check-up visits falls short of objectives announced in ANHS. If admitted to hospital, the care and medications for uninsured patients are covered and, similar to insured patients, they only have to pay entry fees (ALL 2 000 to 4 000). However, further outpatient care and medicines are not covered for uninsured people. The chronically-ill benefit from reimbursement of drugs on the government list. Additional 12 health care packages cover specific intensive therapies in private facilities, but uninsured people face fixed tariffs. Children below 18,

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<sup>9</sup> Children, students under 25 years, pensioners, beneficiaries of Ndhima Ekonomike and disability benefits, registered unemployed, asylum seekers and other categories.

<sup>10</sup> 30% of all employment in non-agricultural sector in 2019 was informal.

<sup>11</sup> The programme was introduced already in 2015 for a more restrained age group of 40-65.

students under 24 and recipients of Economic Aid benefits are entitled to free, mainly preventive, dental care in public facilities. In practice, most dental treatment is provided in private facilities and people, even if insured, must pay the full cost of care (WHO 2020b). Although the number of medicines on the government list has grown and state financing has increased, co-payments for outpatient medicines continue to drive financial hardship (WHO 2020a). As a result of legal changes introduced in November 2020 (Decision of the Council of Ministers No 908), all people infected with COVID-19 are considered to have health insurance.

**Access to health care is limited mainly due to high out-of-pocket payments and remoteness of healthcare facilities.** The limited public spending has resulted in an increased reliance on out-of-pocket spending of Albanian households that represented 45% of current health expenditure in 2018, significantly above the EU-27 average of 22% and above regional peers. However, it has been decreasing since 2014, when it was 52% (WHO Global Health Expenditure Database). Heavy reliance on out-of-pocket payments, a part of which is informal, results in significant financial hardship for households and may contribute to increased inequalities and also to barriers in access to healthcare (Tomini et al 2015). In Albania in 2015, 12.4% of households experienced catastrophic health spending (WHO 2020b). In 2018, 21.5% of the population reported an unmet need for medical care (EU-SILC); this was 12 times higher than the EU-27 average (1.7%) and significantly above regional peers for which data are available. Almost two thirds (63.9%) of respondents reported the cost as the reason. The main groups affected include persons with disabilities and chronic diseases, poor households, people aged 65 and over, and minorities. Additional reasons for low access are long waiting times due to the limited number of medical professionals and large distances to primary health care centres in rural areas and low density municipalities (WHO 2018), posing a particular accessibility challenge to persons in need of long-term care and elderly people. While not resolving the issue of distance to care facilities, the budgetary programme launched in 2018 for the reconstruction of 300 primary health care centres has improved service provision in urban and rural areas.

**Albania is facing a critical shortage of doctors that could jeopardise access to medical care in the coming years.** In 2016, the per capita ratio of medical doctors was 1.216 per 1 000 inhabitants, significantly below the averages for the EU, regional peers and upper-middle-income countries (Eurostat, World Bank DataBank). In the beginning of 2020, there were 330 vacancies for general practitioners and 250 for specialists, representing about 21% and 12% respectively of those currently employed. The current number of physicians being trained in the country (around 300 per year) is lower than the number of vacancies and retirements. The geographical coverage of healthcare personnel is skewed towards central and larger urban areas, as opposed to remote and small districts. The emigration of doctors is increasing due to low salaries, unfavourable working conditions, job and social insecurity (including a high number of lawsuits) and a lack of professional development opportunities (SDC 2020). A survey from 2018 contains alarming figures showing that 24% of doctors are prepared to leave Albania immediately and another 54% would do so if given a chance (FES and TFL 2018). The 40% salary increase given to medical workers in 2021 is a step in the right direction, but it does not address the other factors driving doctors out of the country.

*Reform measure 18 (“Increasing access to health care”)*, envisages to tackle some of the challenges described above, especially in terms of expanding the coverage of free healthcare packages and screening and prevention programmes as well as increasing the



list of reimbursed medicines. However, it does not do enough to tackle high out-of-pocket expenditure, low public spending on healthcare or the emigration of healthcare professionals.

***Key challenge #3: Improve the business environment and investment climate by increasing government support and tackling informality.***

**Albania's business environment remains prone to structural weaknesses.** Albania's private-sector development remains below its potential, and efforts to improve the business environment need more effective policy instruments. The COVID-19 pandemic has exacerbated certain weaknesses, notably the low level of product diversification: tourism, for instance, accounts for over 20% of GDP (EBRD Regional Economic Prospects, April 2020). The private sector mainly consists of micro and small businesses, which face obstacles to access financing due to their lack of business know-how, low financial literacy and high degree of informality. The reforms to improve the economy's competitiveness have stagnated, and Albania has dropped further in the ranking of the Global Competitiveness Report, sliding from 76th to 81st (World Economic Forum, 2019).

The main business environment obstacles identified by Albanian firms were multiple and complex tax rates, competitors' practices in the informal economy, an inadequately educated work force, transportation and corruption (Enterprise survey, Albania, 2019). Albania's Small Business Act Profile confirms that in order to increase the number of jobs in the private sector, it is essential to scale up the institutional capacity of business support services that aim to improve access to finance and offer support for scaling-up, and to facilitate the internationalisation of firms. Furthermore, the unclear land ownership represents an additional burden for companies, notably in agriculture, tourism as well as contributing to informality. The continued lack of diversification, including in terms of export destination, contributes to Albania's economic vulnerability. Despite the significance of the agriculture (which generated 21.2% of gross value added in 2019 according to EuroStat, the largest in the region), agricultural incomes and investment are low, and the food trade balance is in deficit. Albania is in the process of developing a new Business and Investment Development Strategy (BIDS) for the period 2021-27. However, its content and potential benefits are not presented in the ERP. Given Albania's small domestic economy, integration into the global economy could be a crucial growth path, in this respect Albania could have foreseen efforts to strengthen the Quality Infrastructure necessary for the free movement of good, enabling Albanian firms to place goods on the market in line with rules that are in compliance with the EU single market.

**Weak contract enforcement and a high regulatory burden on businesses continue to hamper private-sector development.** Albania still needs to streamline its business regulations, ensure better impact assessments of legislative proposals, wider and more complete and regular stakeholder consultations and put in place strong monitoring mechanisms. The lack of a regular work contract, social and health insurance and under-declared salaries represent the main forms of informality.

**The rule of law must be strengthened to improve the business environment and to fight corruption in Albania.** The ambitious reform of the justice system, which continues to be implemented, should promote an effective and independent judicial system.

Such measures are crucial to combat corruption and the informal economy and is a prerequisite for creating a business environment conducive to investment growth.

**The ERP's analysis of businesses obstacles leaves out key aspects affecting the investment climate.** While it covers issues linked to the low skills, the need for better access to finance, and highlights government measures to support micro and small businesses during the COVID-19 pandemic in 2020 through different support schemes, it does not refer to the low level of digitalisation and innovation as well as the limited capacities for research and innovation (although some reform measures to address these obstacles are included in the ERP). The same applies to the low level of FDI and product diversification and exports. Furthermore, issues related to the implementation of the rule of law reforms, corruption, unclear property titles and proper functioning of judiciary system, which remain serious impediments to businesses and attractiveness of foreign investments, are also not included in the ERP diagnostics.

**The informal economy continues to constrain Albania's economic development.** The informal economy is estimated to account for at least one third of GDP<sup>12</sup>, despite some efforts to tackle it, and 30% of the workforce employed in the non-agricultural sector is estimated to be in undeclared work (Labour force survey, 2019). The number of employees without a written contract is among the highest in southeast Europe (SME Policy Index, OECD, 2019). Moreover, between 2016 and 2019 the number of workers who reported that they are receiving lower remuneration than in their written contracts, increased by 23%, reaching 34% (SELDI, 2016). The State Labour and Social Services Inspectorate, the law enforcement institution entrusted with ensuring decent working conditions in the workplace and tackling informality in the labour market, is not empowered with adequate human and financial resources.

**The informal economy has a large negative impact on the business environment:** it keeps tax revenues low and reduces the fiscal space for investments. In addition, the lower payment of social contributions undermines the funding of the social security system. The poor quality of social services and security are among the reasons cited by Albanians as a reason to migrate. Informal economic activity also implies a lower use of banking intermediation, which is particularly an issue in Albania and leads to reduced access to finance. Informal businesses also under-cut? declared businesses, thus leading to unfair competition.

**The high regulatory burden contributes to informal economic activity,** as it adds further costs to doing business. The tax burden and the complexity of the tax administration can encourage tax evasion, and in recent years Albania's taxation system has become more complex, with many exemptions and a variety of thresholds for tax registration. The introduction of fiscalisation is therefore welcomed, as it strengthens financial inclusion of individuals and SMEs. The Bank of Albania is also working on countering the informal economy by encouraging the transition from cash transactions into recordable digital transactions.

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<sup>12</sup> Informal Economy in Albania, Academic Journal of Interdisciplinary Studies, MCSER Publishing, Rome-Italy, Vol 2 No 8, 2013.

**Informal employment is often linked to poverty and social exclusion.** It tends to affect workers with fewer skills and less education, in less productive sectors, notably in agriculture and in some service sectors where enforcement of regulations is weaker. To foster the formalisation of the labour market, and as part of the response to the COVID-19 pandemic, Albania adopted the Skema2 employment programme to subsidise formal employment of unemployed people who had lost their jobs in the informal sector. However, this programme is insufficient in scale, with only 1 500 potential beneficiaries, and its scope (as it does not foster skills).

The ERP analysis of the informal economy and informal employment is not comprehensive, as it focuses largely on measures within the competences of the Bank of Albania and the tax authorities. The analysis does not make it clear what the estimated level of informality is and which are the most affected sectors of economic activity. Albania still lacks a comprehensive strategy to tackle and monitor all aspects of informality, and would benefit from a clear action plan with baselines, including clear and measurable targets to establish the regular performance-based monitoring of its implementation and results.

**The Economic and Investment Plan for the Western Balkans will help increase the competitiveness of Albania's economy backed by a green and digital transition.** A substantial investment package, which is at the heart of the Economic and Investment plan, will direct a large majority of support towards key productive investments and infrastructure. This will support the twin green and digital transition and the development of connected, competitive knowledge-based, sustainable, innovation oriented and thriving economy, with an increasingly dynamic private sector. Circular-economy principles, as a basis for the Economic and Investment Plan and defined in the green agenda for the Western Balkans. The principles could significantly foster sustainable production and consumption. Increasing resources productivity within the economy would allow local SMEs to benefit from the business opportunities of increased resource efficiency and by further access to innovative technologies.

**Building a common regional market has the potential to further enable competitiveness and growth.** The common regional market is based on EU standards and will help the country integrate in regional and European value chains. It will also help make the economy more attractive for FDI in tradable sectors, notably by increasing the size of its market. Further connectivity with neighbouring countries in transport and energy will strengthen access to, and integration into, the regional market. The new Additional Protocol 6 of the Central European Free Trade Agreement (CEFTA) to liberalise trade in services also opens new opportunities in the dynamic service sectors, and therefore should be implemented swiftly. Regulatory and investment moves to create a regional digital space and more integrated labour markets with neighbouring economies will offer new possibilities for the country's young people. This is especially important given the high rates of youth unemployment.

#### **Reform Measure 6: “Strengthening the fight against informality”**

This measure is a well-designed measure which can have an impact in the reduction of informality, but it mainly focuses on the fiscalisation aspects and it is not inscribed in a wider comprehensive strategy to tackle all aspects of informal economic activity and

informal employment. Implementation has just started and it foresees that all the businesses subject to the law on fiscalisation should be using electronic invoices by the end of 2021. The proposed indicators are relevant but there is no indicator to measure the tax gap, the expected increase in revenues, nor on the informality in the labour market. The breakdown for the expected costs is not provided and there is no indication of the source of funding. Furthermore the risk analysis does also not take into account the effects of the delays that may result from the COVID-19 pandemic, or the election process.

### **Reform measure 7: “Developing a legal framework to support innovative start-ups”**

This measure was carried over from the previous ERP. It seems to have good momentum and strong commitment from the government to nurturing the nascent innovation ecosystem. However, efforts need to be stepped up to ensure the adoption of the law on start-ups and streamline the institutional framework responsible for fostering research and innovation while also monitoring its impact.

The activities expected in 2021 have been described in some detail but the ones planned for 2022 and 2023 are not clear, rendering the monitoring of its implementation difficult. While one of the main actions planned is the implementation of the innovation and entrepreneurship pillar of BIDS 2021-2027, there is no explanation of what is to be addressed under the BIDS. The measure could have been more ambitious, for instance it could have taken the form of a fully-fledged innovation programme encompassing activities to stimulate smart specialisation, business angels, and the creation of innovation hubs that would build on centres of research, (such as universities), and linked to a range of measures to boost digital skills. Furthermore, responsibilities should have been identified for the implementation of the major ongoing exercise of Smart Specialisation Strategy (S3) (reform measure 10), notably in light of the Albanian commitments under the Innovation Agenda for the Western Balkans and Horizon Europe.

### **Reform measure 8: “Improving access to finance for SMEs”**

This measure was also carried over from the previous ERP, but most of the comments made in the Commission’s 2020 assessment have not been incorporated. The digitalisation of SMEs and the streamlining of funding instruments to improve SMEs’ access to finance are welcome activities, and could have an impact on competitiveness, if matched with a substantial increase in the institutional capacity of business support services.

The first activity aims to establish z the unit to promote SMEs within the Ministry of Finance and Economy in 2021. This was expected to be carried out in 2020 but no explanation for its postponement has been provided. An EU-funded assessment of the grant scheme offered by AIDA was conducted during 2020, and the activities were expected to be built upon the findings. However, this is not mentioned in the description part of the reform measure. It is also not clear whether the redesigned grant schemes will already start in 2021, and how much additional funding is expected to be provided.

The measure also envisages that SMEs will use of an online centralised information platform to find financial support. However, there is a risk that it may not reach those SMEs which are not online, or entrepreneurs with limited digital skills. As Albania remains a small market for investors, the activity on e-commerce could have a

meaningful impact if it is developed in a context of the Common Regional Market, as highlighted in the Economic and Investment Plan for the Western Balkans. The expected indicators and targets are nevertheless very modest and no information is provided on the costing and budgeting of this reform, thus calling into question its potential impact.

**Reform measure 9: “Modernisation of retail payment instruments”**

This measure was also carried over from the previous ERP. It aims to create the conditions needed to improve the range of available banking services. This could contribute to improving access to finance, enhancing the level of entrepreneurship, and to combating the informal economy, money-laundering and tax evasion. The measure is well designed and the activities are outlined clearly, with a specific timeframe and funding, as are the risks and mitigating measures. This measure is also pertinent as the number of electronic transactions have increased considerably during the COVID-19 pandemic, and the banking system was able to provide for this service, having been required to do so by the unprecedented conditions. However, the measure does not explore potential synergies with other government measures such as the payment of social benefits.

**Box: Monitoring performance in light of the European Pillar of Social Rights**

The European Pillar of Social Rights, proclaimed on 17 November 2017 by the European Parliament, the Council and the European Commission, sets out 20 key principles and rights concerning equal opportunities and access to the labour market, fair working conditions, and social protection and inclusion for the benefit of citizens in the EU. Since the 20 principles are essential for countries if they are to achieve fair and well-functioning labour markets and welfare systems, they are equally relevant for candidate countries and potential candidates. The new reinforced social dimension for the Western Balkans includes an increased focus on employment and social reforms through greater monitoring of relevant policies (EC, 2018). The Western Balkans Ministers’ Declaration on improving social policy in the Western Balkans (6 November 2018) confirms that they will use the Pillar to guide the alignment of their labour markets and welfare systems with those of the EU.

**Relative to the EU-27 average, there is scope for improvement in all available indicators of the Social Scoreboard supporting the European Pillar of Social Rights<sup>13</sup>.** Albania has steadily improved employment and unemployment rates. The share of young people not in employment, education or training (NEETs) decreased only very slightly between 2017 and 2019 (0.4 pps.), meaning Albania remains among the worst performers in the region. The gender employment gap (20-64) was wider than the EU-27 average in 2019 (15 pps. vs 11.7 pps.), but had improved on previous years. The share of people at risk of poverty or social exclusion was very high (49%) in 2018. This is the second highest level in the Western Balkans and Turkey, among countries where these data are available. Albania is a medium performer in the region as regards the income quintile ratio.

ALBANIA		
Equal opportunities and access to the labour market	Early leavers from education and training (% of population aged 18-24)	Worse than EU average, improving
	Gender employment gap	Worse than EU average, improving
	Income quintile ratio (S80/S20)	Worse than EU average, improving
	At risk of poverty or social exclusion (in %)	Worse than EU average, improving
	Youth NEET (% of total population aged 15-24)	Worse than EU average, improving
Dynamic labour markets and fair working conditions	Employment rate (% of population aged 20-64)	Worse than EU average, improving
	Unemployment rate (% of population aged 15-64)	Worse than EU average, improving
	GDHI per capita growth	N/A
Social protection and inclusion	Impact of social transfers (other than pensions) on poverty reduction	Worse than EU average, deteriorating
	Children aged less than 3 years in formal childcare	Worse than EU average, trend N/A
	Self-reported unmet need for medical care	Worse than EU average, deteriorating
	Individuals’ level of digital skills	Worse than EU average, trend N/A

**Albania’s education outcomes remain very low, partly due to low levels of funding.** There are significant rural-urban and socioeconomic differences in access to education and the early school leaving rate remains the highest after Turkey.

**The social protection system does not adequately target those in need.** Although there is a social assistance scheme, the allowances paid are too low to prevent poverty. This is documented by the low impact of social transfers (excluding pensions) on poverty reduction which was only 11.03% in 2018 compared to 32.38% in EU-27. The effects of the social assistance reform on better targeting still need to be assessed by tracking the share of households in the poorest decile/quintile that are covered by the scheme. The capacity of local governments, which are responsible for providing social care, is too low. The pension system has almost universal coverage, albeit with low pensions. About 600 000 adults do not have health insurance, primarily informal workers, low-income groups, minorities (Roma people), and people living in rural and peri-urban deprived areas. 21.5% of people aged 16 and over reported an unmet need for medical care in 2018; this was 12 times higher than

the EU-27 average (1.7%).

**Data availability improved in 2019 with the first publication of the Survey on Income and Living Conditions (EU-SILC), but some headline indicators of the Social Scoreboard are still not measured (GDHI) or are not publicly available.** Despite an announced publication in December 2020 of EU-SILC data for 2019, the publication was postponed and the data were not available by mid-April 2021. Although the delay is being attributed to COVID-19 pandemic, the data were collected before its outset. Micro data from SILC have not yet been made available to researchers to carry out up-to-date analyses of social protection and inclusion policies. Employment data are regularly measured both in the Labour Force Survey and by National Employment Services.

<sup>13</sup> The Social Scoreboard includes 14 headline indicators, of which 12 are currently used to compare Member States performance (<https://ec.europa.eu/eurostat/web/european-pillar-of-social-rights/indicators/social-scoreboard-indicators>). The indicators are also compared for the Western Balkans and Turkey, with one small adjustment in the age bracket for the unemployment rate (reducing the upper age limit to 64 instead of 74) for Albania and Kosovo\* due to data availability. The assessment includes the country’s performance in relation to the EU-27 average (performing worse/better/around the EU-27 average; generally 2019 data are used for this comparison) and a review of the trend for the indicator based on the latest available three-year period for the country (improving/deteriorating/no change). Data from 2017-2019 are used and can be found in Annex A.

## 5. OVERVIEW OF THE IMPLEMENTATION OF THE POLICY GUIDANCE ADOPTED AT THE ECONOMIC AND FINANCIAL DIALOGUE IN 2020

Overall: Partial implementation (55.9%) <sup>14</sup>	
2020 policy guidance	Summary assessment
<p><b>PG 1:</b></p> <p>Keep the increase of fiscal deficit and public debt temporary while accommodating the fiscal costs of post-earthquake reconstruction and addressing the pandemic impact in a transparent and cost-effective manner</p> <p>Set time-limits for tax-relief measures, while paying all VAT refunds in time</p> <p>Adopt the medium-term revenue strategy, with a particular focus on reviewing tax expenditures</p>	<p>There was <b>partial implementation</b> of PG 1</p> <p>1) <b>Substantial implementation:</b> The medium-term fiscal framework plans for a reduction of fiscal deficit and public debt from 2021, while the 2021 budget accommodates significant reconstruction-related spending. The COVID-19-related financial support to households and business was transparent, legitimate, targeted and cost-effective (distributed via existing channels).</p> <p>2) <b>Partial implementation:</b> The deferral of tax payment medium and large companies and the provision of tax relief for small businesses were limited to 2020 and partly extended to 2021. For 2021, the tax exemptions were announced for small businesses without time limit (below ALL 10 and ALL 14 million turnover exempted from VAT and profit tax respectively). New regular VAT refund claims were paid on-time in 2020 but the tax authorities have sought new agreements with some companies to delay payment of VAT refund arrears.</p> <p>3) <b>Limited implementation:</b> the government postponed the development and adoption of the medium-term revenue strategy was to 2022. The Ministry of Finance and Economy is working on a tax expenditure review, supported by the World Bank.</p>
<p><b>PG 2:</b></p> <p>Publish on a regular basis a breakdown of all arrears of public expenditure and prevent any increase of their stock above the level of end-2019.</p> <p>Assess and approve all investments, which involve public funds, through the same approval process, based on the same minimum quality and fiscal affordability criteria.</p> <p>Increase the institutional capacities for monitoring and containing fiscal risks stemming from public-private partnerships, concessions and state-owned enterprises.</p>	<p>There was <b>partial implementation</b> of PG 2.</p> <p>1) <b>Full implementation:</b> A breakdown of all arrears was published regularly and their stock did not increase above the 2019 level.</p> <p>2) <b>Limited implementation:</b> Albania postponed the unification of the approval process due to the COVID-19 pandemic and capacity problems; capacity building efforts continued.</p> <p>3) <b>Partial implementation:</b> The Financial Risk Unit has continued to monitor and report on fiscal risks related to PPPs, concessions and SOEs without additional staff. It improved its capacity with the support of technical assistance from the World Bank, funded through regional EU programmes.</p>

<sup>14</sup> For a detailed description of the methodology used to assess policy guidance implementation, see Section 1.3 of the Commission's Overview and Country Assessments of the 2020 Economic Reform Programmes available at [https://ec.europa.eu/info/publications/economy-finance/2017-economic-reform-programmes-commissions-overview-and-country-assessments\\_en](https://ec.europa.eu/info/publications/economy-finance/2017-economic-reform-programmes-commissions-overview-and-country-assessments_en).

<p><b>PG 3:</b></p> <p>Closely monitor financial stability challenges arising as a result of the coronavirus pandemic and take appropriate action if needed</p> <p>Resolve remaining legal impediments to NPL resolution in the realm of the government, especially the bailiff deadlock that lingers on collateral execution, also in order to mitigate a potential renewed build-up of NPLs as a consequence of the coronavirus pandemic.</p> <p>Develop the market for forex hedging instruments, taking into account international expert advice, in the context of strengthening the use of the national currency.</p>	<p>There was <b>partial implementation</b> of PG 3.</p> <p>1) <b>Substantial implementation.</b> The authorities have taken several measures to provide borrower relief and help smoothing the adjustment of the banking system to the major economic shock experienced, thereby ensuring that banks continue supporting the economy. They issued guidance and kept close communication with banks to ensure efficiency and transparency in the restructuring process and mitigate operational risks. In addition to prudential measures, banks were also required to efficiently administer expenses, including bonuses and the distribution of dividends. The full impact of the crisis in particular on asset quality is yet to become visible, likely requiring further adjustments.</p> <p>2) <b>Limited implementation:</b> There has been no progress in resolving the bailiff deadlock that continues to linger on collateral execution. Credit registry has been enforced with additional information that captures the performance of the portfolio during the pandemic.</p> <p>3) <b>Partial implementation:</b> Based on the IMF's recommendations, an action plan has been drafted, including a set of measures to be taken in order to develop hedging instruments. Its implementation has been delayed during the pandemic, but the BoA has taken first steps by introducing forward instruments into its forex interventions as an alternative to spot instruments.</p>
<p><b>PG 4:</b></p> <p>With a view to mitigating the economic consequences of COVID-19 pandemic and stimulating economic recovery, establish an effective and transparent mechanism to support the businesses affected by the crisis, in particular small and medium-sized enterprises and self-employed.</p> <p>Extend social protection coverage and provide incentives for businesses and employees in the informal economy sector to register and to facilitate their transfer to the formal economy.</p>	<p>There was <b>partial implementation</b> of PG 4.</p> <p><b>Substantial implementation.</b> The government has reported on the support packages implemented for businesses, SMEs and the self-employed and has specified the number of beneficiaries. It has also presented a brief assessment on the impact of COVID-19 to the sectors of economy. Businesses have applied for support packages through the General Directorate of Taxation (GDT) by submitting the list of employees, who were entitled to benefit from the salary support schemes. Information was public on how they should submit electronically through the website of GDT and periodical information was shared also in media as regards the number of businesses and employees benefiting from the schemes.</p> <p>1) <b>Partial implementation.</b> There have been positive practices, which need to be extended further, considering the high presence of informality in the labour market in Albania. Through the COVID-19 support packages the authorities have tackled the unemployed category, by doubling the unemployment benefit. About 2 923 unemployed job seekers have benefited from this measure. A programme launched in September 2020 targeted job seekers who lost their jobs due to COVID-19, irrespective of whether they were formally or informally employed by subsidising wages and compulsory insurance to businesses that would employ them. Between September and December 2020 the programme benefited 1 650 individuals, of which 560 were previously informal workers.</p>



<p>Ensure transparency and predictability of measures, by consulting new legislation with businesses and social partners.</p>	<p>2) <b>Partial implementation.</b> Albania has adopted a law on public consultation and the dedicated website where draft laws are published for consultation is online at <a href="http://www.konsultimipublik.gov.al">www.konsultimipublik.gov.al</a> COVID-19 support measures were mainly announced in media by the government, as taken under urgent circumstances with not proper consultation with all the relevant actors. This has generated critics by some of private stakeholders, and as a response, the category of businesses/sectors of economy entitled to support measures was amended accordingly. Overall, further efforts are needed to ensure full implementation of the Law on Public Consultation in practice, to ensure proper timing for comments by the stakeholders, and proper reflections in the draft law.</p>
<p><b>PG 5:</b></p> <p>Considering the big investments to be made for the post-earthquake reconstruction speed up the adoption the secondary legislation for the laws on energy efficiency and energy performance of buildings and provide incentives for energy efficiency measures in the private sector and households.</p> <p>Increase access to healthcare and public health insurance coverage while reducing the share of out-of-pocket payments on total health expenditure.</p>	<p>There was <b>partial implementation</b> of PG 5</p> <p>1) <b>Partial Implementation.</b> There has been good progress on the adoption of relevant legislation/secondary legislation on the energy efficiency including in buildings, and of regulations related to minimum criteria for energy performance in buildings, and the methodology for calculating the optimal cost levels in energy performance requirements in buildings;. However there is no information about the incentives for energy efficiency measures in the private sector and in households. The draft amended Energy Efficiency Law was adopted by Parliament on 8 March 2021. The government removed from the law on energy efficiency the creation of an energy efficiency fund, instead proposing an energy efficiency obligation scheme for utilities in the sector, as set down in the amended law on energy efficiency.</p> <p><b>Partial implementation:</b> Although good efforts were made to increase access to healthcare services and cope with COVID-19 pandemic, it is still very much needed to reduce the share of out-of-pocket payments in total health expenditure, reduce the unmet need for medical care (including dental care) and increase the number of medical staff, especially doctors. The refund scheme for COVID-19 treatment for ambulatory patients cared for at home is improving, but much should be done to cover real expenditure, including spending on testing kits. Albania has made some capital investments in healthcare infrastructure and services, especially primary care, and more healthcare services are now provided by public hospitals, but structural problems remain in access to quality services, especially in rural areas and for the most vulnerable groups.</p>
<p><b>PG 6:</b></p> <p>Take short-term measures to preserve employment including through short-time work schemes, and once the COVID-19 pandemic subsides, ensure an increased provision of active labour market policies, especially training, upskilling and reskilling.</p>	<p>There was <b>substantial implementation</b> of PG6:</p> <p>1) <b>Full implementation:</b> Albania responded swiftly to the lockdown. Since Albania has no short-time work schemes, the government deployed other types of support to preserve employment. During the second quarter of 2020, the government made minimum salary payments for three months to support 65 574 self-employed people and employees in small businesses with an annual turnover below ALL 14 million and granted lump-sum payments of ALL 40 000 to 9 435 employees and laid-off employees in larger businesses closed down by government restrictions, to 68 391 employees of small businesses impacted by a reduction of economic activity, and to 4 927 employees of all types of</p>

<p>Improve the adequacy of social assistance benefits and set up an objective mechanism for their regular update, taking into account the data from the Survey of Income and Living Conditions.</p> <p>Take more effective steps to increase availability of social care services through enhancing ability of municipalities to identify needs for social services and to prepare social care plans.</p>	<p>accommodation structures. Additional lump-sum payments of ALL 26 000 were provided in August to 4 553 employees in public transport. Companies also received liquidity support in form of zero-interest loans to cover employee salaries for three months.</p> <p>The government increased the budget for ALMPs by about 50% (from ALL 390 million to ALL 590 million). Confronted with a small demand for revised ALMPs, the government acted swiftly to introduce two new employment promotion programmes (through a bylaw) through which it supports the reemployment of people who lost their jobs due to the crisis. This support is also offered to people formerly employed in informal economy, which is a very positive step. In 2021, more support will be necessary in form of training, upskilling and reskilling.</p> <p><b>2) Partial implementation:</b> The government took a timely emergency measure to double the benefits paid under the Economic Aid scheme during the three-month lockdown (April to June 2020). The budget for the scheme was also increased for 2021, from ALL 4.6 billion to 7.1 billion. As a result, benefits were again doubled during the first half of 2021. This has improved the adequacy of benefits temporarily, but cannot be considered to be a structural revision of benefits. Albania has not assessed benefit adequacy taking into account EU-SILC and other data (e.g. minimum wage). There is no roadmap towards a structural revision (increase) of benefits and towards establishing a transparent mechanism for their annual review. However, the ERP announces that an assessment will take place and a mechanism will be established in 2021, and the benefits are to be revised in 2022.</p> <p><b>3) Partial implementation:</b> The number of approved social care plans increased considerably in 2021, from 24 to 50. Given that the plans were developed with the help of donors and NGOs, it is unclear to what extent municipalities' ability to identify needs for social services and prepare social care plans was enhanced. Government action concentrated on 21 municipalities, in which social services staff received training. Other capacity issues relating to social services in municipalities (ability to prepare applications for the Social Fund and plan, manage and deliver social services) remain a challenge.</p>
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## **6. ASSESSMENT OF OTHER AREAS AND STRUCTURAL REFORM MEASURES INCLUDED IN THE ERP 2021-2023**

The ERP identifies the areas where there are the most significant key obstacles, such as the business environment, education and skills, labour and employment, the informal economy, and research and development. It also addresses the negative impact on the economy due to the COVID-19 pandemic and the 2019 November earthquake, identifying tourism and services as being among the hardest hit sectors. It provides a general assessment of the current reforms towards formalisation of the economy, while acknowledging that informal economic activity remains a significant concern, as illustrated by the volume of cash transactions and non-declared workers. However, there is limited analysis of the sectors where the informal activity is most prevalent, and the challenges in tackling it. The text describes the challenges in the education system and the need to better match the skills offered through the education system and VET with market demand, also addressing aspects of closer cooperation between the private sector and universities/schools.

Infrastructure challenges related to energy, water and the transport sector should have been included in this part of the text. The low level of digitalisation, innovation, and research and innovation capacities - which generate the increased demand for both new services and for improved infrastructure and knowhow - were also not analysed in the text, even though the ERP includes reform measures to address these obstacles. The level of FDIs, product diversification, and exports all affect the country's competitiveness and growth and the generation of jobs, but these are also not analysed. Furthermore, issues related to the rule of law, corruption, unclear property titles and the proper functioning of judiciary system remain serious impediments to businesses and reduce Albania's attractiveness for foreign investments.

### **Energy and transport market reform**

This part of the analysis is well developed in terms of identifying the main obstacles in the energy sector. Power generation in Albania remains vulnerable to the hydrological situation; this influences the need for electricity imports to secure an uninterrupted power supply in the country, and increases the financial burden for the state-owned power generation company. As part of the efforts to improve connectivity and security of supply, the power line interconnecting Albania and Kosovo has become operational. The share of on-technical losses in electricity consumption was maintained at a low level (6%) during the three first quarters of 2020.

The analysis is also well developed in terms of identifying the main obstacles in the transport sector. Further reforms are necessary in this area; transport was one of the main business environment obstacles identified by Albanian companies in the World Bank 2019 Enterprise survey. However, there is no reference to framework policy documents for the transport sector. A new National Transport Strategy must be prepared and adopted.

### **Reform Measure 1: "Further liberalisation of the energy market"**

The measure to further liberalise the energy market was rolled over from the previous ERP. Its activity aiming to unbundle energy distribution and supply is in line with the obligations under the EU Third Energy Package and Albania's own strategies and must be fulfilled in 2021. The Albanian Power Exchange is foreseen to be made operational in

2021-2022 but it is not clear which activities will take place in which year. More details are needed on which activities on security of supply are taking place in which year specifically. If this were clarified it would ensure more transparency and make it easier to monitor implementation. The effective liberalisation of the energy market is still not effective, and there are no mitigating measures in this respect.

Annex 1, Table 11 mentions that in the fourth quarter of 2020, customers connected to 20 kV grids will be supplied through the liberalised market. However, there is no information confirming whether this has already been implemented. The number of customers supplied through the liberalised market would be a good indicator under measure 1, as would the number of independent renewable energy producers (or the total renewable energy power capacity installed) selling electricity through the free market.

### **Reform measure 2: “Diversifying energy sources through the promotion of renewable energy sources and energy efficiency improvements”**

The measure on the diversification of energy sources was rolled over, and it includes the promotion of the use of renewable energy sources other than hydropower. The regulatory framework already includes some measures to encourage the use of renewable energy sources; these are expected to stimulate energy efficiency in buildings, households and industry. The activities planned for 2021-2023 are quite ambitious and aim to integrate wind, solar, and biomass energy projects into the power generation capacities. Not that the trans-Adriatic pipeline, an international strategic investment, is complete, it is important to include gas capacities as energy sources in the analysis.

There has been progress in the implementation of the National Renewable Energy Action Plan (NREAP 2019-2020), which aim to expand renewable installed electricity and generators to 738 MW to achieve the national target on renewable energy consumption (38%) in 2020. Of this 738 MW, 490 MW is from photovoltaics (PV), 150 MW from wind, 57 MW from hydropower and 41 MW from waste. So far, six PV plants are operating, providing about 12 MW capacity, and another twelve plants are in the process of obtaining authorisation. Although the project for a 100 MW power plant failed and the applicant's permit was not extended, the construction of a 140 MW PV plant in Karavasta (Lushnjë - Fier) was signed in May 2020 and construction is expected to start in 2021. A tender for a 100 MW PV plant in Spitala was announced on 2 December 2020, and call for tender for wind farms will be launched in 2021.

The net metering scheme is operational and attracts interest of small producers for photovoltaic up to 2 MW. The Ministry of Infrastructure and Energy (MoIE) is putting pressure on OSHEE to improve its procedures for issuing connection permits for photovoltaics, and MoIE and OSHEE are still negotiating about the methodology for calculating the electricity price from self-producers. These aspects need to be addressed in the measure for 2021.

Secondary legislation on energy efficiency and on energy performance in buildings has been prepared and is awaiting adoption by the parliament, while the Council of Ministers adopted several decisions on energy efficiency in 2020. However, energy audits, measures and projects on energy efficiency and energy savings need to be accelerated. The indicators in measure 2 do not seem relevant and should be improved. Suitable indicators for measuring Solar, wind power capacity contracted (and installed), % of losses (and energy saved) in transmission and distribution networks, Number of

performance audits produced, number of large consumers having implemented, or secured finance for, EE measures (and energy saved), could be suitable indicators to measure progress of measure 2.

The measure presents a good assessment of the impact on competitiveness.

The costing tables do not show TA and investment figures, although there are several ongoing and planned projects financed by donors through grants and loans. In addition, there is no budget for the establishment of the new National energy agency and its operation, which could jeopardise the efficient implementation of the actions foreseen by the measure.

### **Reform measure 3: “Rehabilitation and construction of the railway segment Durres-TIA-Tirana”**

Rehabilitating and extending the Durres-Airport-Tirana railway will allow the development of intermodal transport, and should double the speed of travel of passenger and freight transport between Tirana and Durres, which should boost traffic and reduce road congestion. This measure was rolled over from the previous ERPs. There was no progress on the measure and the proposed activities were all postponed by one year. The risks and mitigating measures are well presented, as are the impact on job creation (including gender balance principle) as well as environmental and energy efficiency considerations. However, there is no mention of the land acquisition and the potential risk from land expropriation. Furthermore, the ERP should reflect that cargo activities from the Port of Durres to a new port to be constructed near Porto Romano. The timeline of the activities for year 2022 and 2023 need to be revised taking into consideration new contractual timelines for design preparation (revision) and construction. A contract for the rehabilitation of the Tirana-Durres railway was signed in early February 2021. This strategic investment is also benefiting from EU funding under the European Economic and Investment Plan (as part of Rail Route 2 linking the capitals of Tirana and Podgorica, and extends to the port of Durres, and is a key project for the region). The indicators used are at project level and need to be further developed to reflect the sector reform, which includes information on the electrification of the railway line, although there is little indication on when this is planned to take place. New information has been added regarding the link between investment and the revised National Transport Plan.

### **Agriculture, industry and services**

The analysis of the main obstacles is concentrated in the tourism sector, while failing to address the water sector, agriculture and other services. This limits the usefulness of the ERP as document for economic policy coordination and prioritisation, and this means that the coherence of economic policies is not ensured. The agricultural sector managed to survive the COVID-19 pandemic crisis in 2020, even achieving positive growth in the first three quarters of the year. Nevertheless, it remained prone to structural problems such as land consolidation, land fragmentation, and property ownership issues. However, the ERP text does not analyse the agricultural sector at all.

As regards industry the ERP does not provide any analysis of this significant sector. It does not mention the new Business and Investment Development Strategy that Albania is currently developing, even though the sector specific analysis and recommendations normally contained in such a document might be relevant to different sectors of the economy. The exception is the reform of the water sector: this is a reform priority for

Albania in order to ensure water supply, improve water quality, proper waste water treatment, insure access to water in tourist areas, improve good governance and reduce non-revenue water use stemming from informal connections.

As regards services the analysis examines the impact of the COVID-19 pandemic, notably its considerable consequences for the tourism sector. The impact on tourism may be even more pronounced than in other countries of the region apart from Montenegro, due to the size of the sector in Albania. However, the analysis of areas of the service sector aside from tourism is very weak.

#### **Reform measure 4: “Reform on the Water and Waste Water Sector”**

The reform targeting water and wastewater still appears ambitious, in terms of both the service targets and the budget foreseen (unchanged since ERP 2019-2021). Investments require time to mature and be implemented, and low capacity for implementing the reform at utilities or central level remains a key challenge.

There is little information on the projects being implemented or in the pipeline. This includes measures for reducing losses, which is described as a major national objective, together with increasing service hours of water supply on the coastline. An indicator on loss reduction should be considered to measure progress on this key national objective. The indicator on the number of hours supply seems to be the countrywide. If this is the case, a sub indicator covering the coast should be considered in order to measure the second national objective.

Implementation of the reform has brought results in terms of regularising illegal or informal connections to the networks. This has led to lower administrative losses and improved revenues for utilities. This should improve cost coverage and boost utilities’ financial sustainability. However, an indicator to measure the cost recovery ratio achieved (operation costs, total costs) should be considered in order to measure performance.

It would be advisable for the sector to design an energy efficiency programme, as electricity accounts for the bulk of utilities’ expenses. Other than steps to reduce technical water losses, which generate energy savings in pumping costs, but frequently higher require investment costs and longer implementation time, low- to medium-cost measures (such as changing old pumps or the impeller of non-performing pumps) are not considered. These would bring short term benefits and savings with a fast return period on investment, as shown in a 2015 study by GiZ and demonstrated in practice in a few projects.

#### **Reform measure 5: “Better marine and maritime governance and services”**

This is a new measure focused on maritime tourism. The reform is small in scale and seems to be an isolated initiative. The description of the measure is insufficient to give a clear picture of current conditions in the sector, whereas a clear overview is needed to understand the impact of the proposed measure. Baselines are not included and neither are final targets. While the reforms in the tourism sector are welcome, as it is an untapped sector with high potential for economic development, the measure needs to be better integrated in the overall sector development policies and plans. The risks are well identified including the impact of the pandemic.

## **Research, development and innovation and the digital economy**

The analysis of the main obstacles in the area of research, development and innovation and the digital economy gives a realistic picture of the state of play and the current challenges. It acknowledges that the current funding level of 0.06% of GDP is still far from the national target of 1%. It also recognises that there is still a need to increase investment in research and take other measures to strengthen research and innovation capabilities at national level. In addition, it also acknowledges that cooperation between universities and - industries/business remains weak and that both sides need to broaden and deepen their cooperation. However, it does not explore why this is or how it can be addressed.

The state of play on innovation is mentioned, but the analysis does not go further. It does not cover needs and potential solutions, though it does include some reform measures to address these obstacles. There is a short analysis of why broadband important, followed by a long description of ongoing and planned measures. However, some aspects, such as poor broadband coverage in some rural areas, are not mentioned.

### **Reform measure 11: “Development of the broadband infrastructure for digital economy”**

This measure was carried over from the 2020 ERP. The overall reform is in line with the EU strategy for the Digital Agenda for the Western Balkans and aims to address Albania’s low broadband penetration, particularly in rural areas. The information on the reform has been updated and supplemented by references to new developments in the sector. The measure also takes into account the ongoing crisis due to the COVID-19 pandemic and its impact on the sector.

The measure builds on two important activities that were completed in 2020: the adoption of the national broadband plan, and the completion of the feasibility study and cost-benefit analysis for the broadband infrastructure. However, the planned time-frame for the completion of the activities in 2021 might be overly optimistic.

## **Economic integration reforms**

Unfortunately, the data provided under the section on analysis of main obstacles does not include 2020 statistics, even those of the first three quarters of 2020. The analysis relies only on 2019 trade statistics. This is problematic, as the COVID-19 pandemic in 2020, especially the lockdown the March to June 2020, impacted on businesses, including exports and imports, and had a wider impact across the region and the world. All of these issues will have affected trade statistics. Albania has fulfilled its commitments under CEFTA: in April 2020 it ratified the Additional Protocol 6. However, the reporting of the activities under the National Trade Facilitation Committee is not up to date, as it still mentions an expected meeting in November 2020.

### **Reform Measure 12: “Facilitating cross-border movement of goods”**

This is a relevant measure undertaken in the framework of Albania’s active involvement in the regional trade integration through CEFTA, MAP REA and the Regional Cooperation Council. The measure was carried over from the previous ERP. The activities foreseen for 2020 will be undertaken during 2021-2023. These include enhancing the cross border trade at the border crossing point with North Macedonia by

opening the single operational one-stop shop. Furthermore, the new computerised transit system is intended to be fully operational by 2023.

However, apart a reference to the COVID-19 pandemic, there are few explanations of the reasons for the delays in the measure's implementation.

### ***Education and skills***

Skills, VET and higher education and reform measure 15 are analysed in section 4, under key challenge #1.

Albania's budget allocation to education is very low at 2.7% of GDP in 2021, 0.6 pps. lower than in 2019 and 1.9 pps. below the EU-27 average (2018 figures). After continuous improvements in previous PISA rounds, the results for 2018 are mixed: results improved for mathematics, plateaued for reading and deteriorated for sciences. Overall, Albania ranked 55th of 77 countries. Education performance in Albania is inequitable, and girls and socio-economically advantaged students perform better than boys and disadvantaged students (PISA 2018). The enrolment rate of children from more vulnerable families in early childhood education is significantly lower (by more than 20 pps.) than the enrolment rate of children whose families are wealthier or whose parents hold a university degree (INSTAT 2018). Drop-out rates tend to be higher among pupils from Roma/Egyptian communities, and several measures are in place to promote education. These include financial support, exemption from or reduction of tuition fees, and special quotas for admission to higher education. The share of early school leavers continues to fall (16.3% in 2019), but remains the second highest in the region. In addition, assessment practices are still based on the old model and do not evaluate pupils based on competences.

#### **Reform measure 13: “Finalise and support the implementation of pre-university curricular reform, teacher training and employment”**

Albania introduced new competency-based curricula in pre-university education. However, teachers received only a very basic three-day theoretical training course on the new curricula, and deployment of more in-depth training and other support is slow. In fact, the allocation to teacher training remains very low, forcing the ministry to focus mainly on cost-effective professional networks of teachers, with a budget of EUR 40 000 per year. The measure also plans to train pre-school teachers and head teachers, with a small annual allocation of EUR 60 000. The plan to establish lifelong learning training centres in universities to organise teacher training in pre-university education is a positive step. Nevertheless, the measure does not tackle the issue of non-alignment of initial teacher training programmes with the new curricula in pre-university education. Furthermore, the measure does not propose activities to prevent a rise in the school drop-out rates and address the increase in learning poverty stemming from the COVID-19 crisis.

#### **Reform measure 14: “Inclusiveness and equality in education”**

The measure aims to strengthen inclusiveness and equality in education, with special emphasis on the participation of children from vulnerable groups, including children from the Roma and Egyptian minorities and children with disabilities. It aims to extend the provision of free textbooks to children in grades 8 and 9. The policy of replacing collective classes in rural areas with regular education and providing transport for



students should increase systematically in the coming years to ensure a lasting impact, along with new initiatives to enlarge capacity in dormitories. Other positive activities include the increase in staff numbers in school psycho-social services and the increase in the number of assistant teachers; this latter measure aims to integrate students from ethnic minorities and students with special needs into mainstream schools. However, more efforts are needed to establish dedicated schools for children with special needs (e.g. deaf students) and provide complementary equipment and ad hoc training. There are no activities to assist the most vulnerable groups with online learning (such as the provision of special IT tools) or prevent students from dropping out of school. The budget does not appear realistic to take stock of all the challenges in inclusiveness and all the concerned categories. The budget for training the heads of professional networks of assistant teachers and training assistant teachers themselves is too low (EUR 27 000 per year). Unfortunately, the measure does not aim to increase inclusiveness in kindergartens except in the last year of pre-school, for which it provides assistant teachers.

### ***Employment and the labour market***

This area and reform measure 16 are analysed in section 4 above, under key challenge #1.

### **Social dialogue**

Bipartite social dialogue remains very weak in both the public and private sectors. As regards the national tripartite body (National Labour Council, NLC), a bylaw was adopted in January 2020 clarifying the representation criteria for social partners. Moreover, the secretariat was fully staffed with three members, one for each constituent party. However, consultations are being treated as a formality and documents are shared with social partners only shortly ahead of the meetings. Moreover, the NLC's six committees are not functional and so cannot prepare the NLC's plenary meetings. Albania still plans to set up regional tripartite councils. Lastly, the system for the amicable resolution of labour disputes needs further consolidation.

### ***Social protection and inclusion***

This area and the relevant reform measures (reform measures 17 and 18) are analysed in section 4 above, under key challenge #2.

**ANNEX A: OVERVIEW OF THE MAIN INDICATORS PER AREA/SECTOR OF THE ECONOMY**

Area/Sector	2016	2017	2018	2019	EU-27 Average (2019 or most recent year)
<b>Energy</b>					
Energy imports dependency (%)	20.2%	38.2%	21.1%	N/A	60.62%
Energy intensity: Kilograms of oil equivalent (KGOE) per thousand Euro	227.07 <sup>w</sup>	228.07 <sup>w</sup>	217.10 <sup>w</sup>	N/A	112.92
Share of renewable energy sources (RES) in final energy consumption (%)	36.94%	35.90%	36.84%	36.67%	19.73%
<b>Transport</b>					
Railway Network Density (meters of line per km <sup>2</sup> of land area)	11.06 <sup>w</sup>	11.62 <sup>w</sup>	11.62 <sup>w</sup>	5.88 <sup>w</sup>	49.0 <sup>(2018)</sup>
Motorization rate (Passenger cars per 1000 inhabitants)	151.1 <sup>w</sup>	146.8 <sup>w</sup>	159.9 <sup>w</sup>	174.1 <sup>w</sup>	519 <sup>(2018)</sup>
<b>Agriculture</b>					
Share of gross value added (Agriculture, Forestry and Fishing)	22.6%	21.8%	21.1%	21.2%	1.8%
Share of employment (Agriculture, Forestry and Fishing)	40.2% <sup>w</sup>	38.2% <sup>w</sup>	37.4% <sup>w</sup>	36.4% <sup>w</sup>	4.36%
Utilised agricultural area (% of total land area)	41.1 <sup>w</sup>	40.8 <sup>w</sup>	40.8 <sup>w</sup>	N/A	40.0% (2017, EU-28)
<b>Industry (except construction)</b>					
Share of gross value added	14.0%	12.8%	14.1%	13.3%	19.7%
Contribution to employment (% of total employment)	12.8% <sup>w</sup>	12.5% <sup>w</sup>	12.7% <sup>w</sup>	13.1% <sup>w</sup>	18.1%
<b>Services</b>					
Share of gross value added	53.2%	54.9%	54.5%	55.6%	73.0%
Contribution to employment (% of total employment)	40.5% <sup>w</sup>	42.4% <sup>w</sup>	42.9% <sup>w</sup>	43.5% <sup>w</sup>	70.8%

<b>Business Environment</b>					
Rank in WB Doing Business (Source: World Bank)	90	58	65	82	N/A
Rank in Global Competitiveness Index (Source: World Economic Forum)	93	80	76	81	N/A
Estimated share of informal economy in GDP (as % of GDP) (Source: IMF)	Up to 28.3%	N/A	N/A	N/A	N/A
<b>Research, Development and Innovation</b>					
R&D intensity of GDP (R&D expenditure as % of GDP)	N/A	N/A	N/A	N/A	2,2%
R&D expenditure – EUR per inhabitant	N/A	N/A	N/A	N/A	EUR 688.6
<b>Digital Economy</b>					
Percentage of households who have internet access at home	N/A	N/A	84%	85%	86% <sup>(2018)</sup>
Share of total population using internet in the three months prior to the survey [NB: population 16-74]	N/A	N/A	62.6% <sup>w</sup>	68.6% <sup>w</sup>	85% <sup>(2018)</sup>
<b>Trade</b>					
Export of goods and services (as % of GDP)	29.0%	31.6%	31.6%	31.6%	49.4%
Import of goods and services (as % of GDP)	45.8%	46.6%	45.3%	45.3%	45.7%
Trade balance (as % of GDP)	22.4%-	-22.7%	-20.2%	-20.8%	N/A

<b>Education and Skills</b>					
Early leavers from education and training (% of population aged 18-24)	19.6% <sup>w</sup>	19.6% <sup>w</sup>	17.4% <sup>w</sup>	16.3% <sup>w</sup>	10.2%
Youth NEET (% of population aged 15-24)	27.0% <sup>w</sup>	25.9% <sup>w</sup>	26.5% <sup>w</sup>	25.5% <sup>w</sup>	10.1%
Formal child care - children aged less than 3 years (% of total)	N/A	N/A	N/A	N/A	35.3%
Individuals' level of digital skills (% of individuals aged 16-74 who have basic or above basic overall digital skills by sex)	N/A	N/A	N/A	21%	56%
<b>Employment</b>					
Employment Rate (% of population aged 20-64)	62.1% <sup>w</sup>	63.9% <sup>w</sup>	65.6% <sup>w</sup>	67.1% <sup>w</sup>	73.1%
Unemployment rate (% of labour force aged 15-64)	15.6% <sup>w</sup>	14.1% <sup>w</sup>	12.8% <sup>w</sup>	12.0% <sup>w</sup>	6.8%
Gender employment gap (Percentage points difference between the employment rates of men and women aged 20-64)	14.4 pps. <sup>w</sup>	16.5 pps. <sup>w</sup>	16.5 pps. <sup>w</sup>	15.0 pps. <sup>w</sup>	11.7 pps.
<b>Social Protection System</b>					
% of population at risk of poverty or social exclusion	N/A	51.8%	49.0%	N/A	20.9%
Impact of social transfers (Other than pensions) on poverty reduction	N/A	12.55%	11.03%	N/A	32.38%
Self-reported unmet need for medical care (of people over 16)	N/A	19.0%	21.5%	N/A	1.7%
Income quintile share ratio S80/S20 for disposable income by sex and age group (Comparison ratio of total income received by the 20% with the highest income to that received by the 20% with the lowest income)	N/A	7.47 <sup>w</sup>	6.98 <sup>w</sup>	N/A	4.99

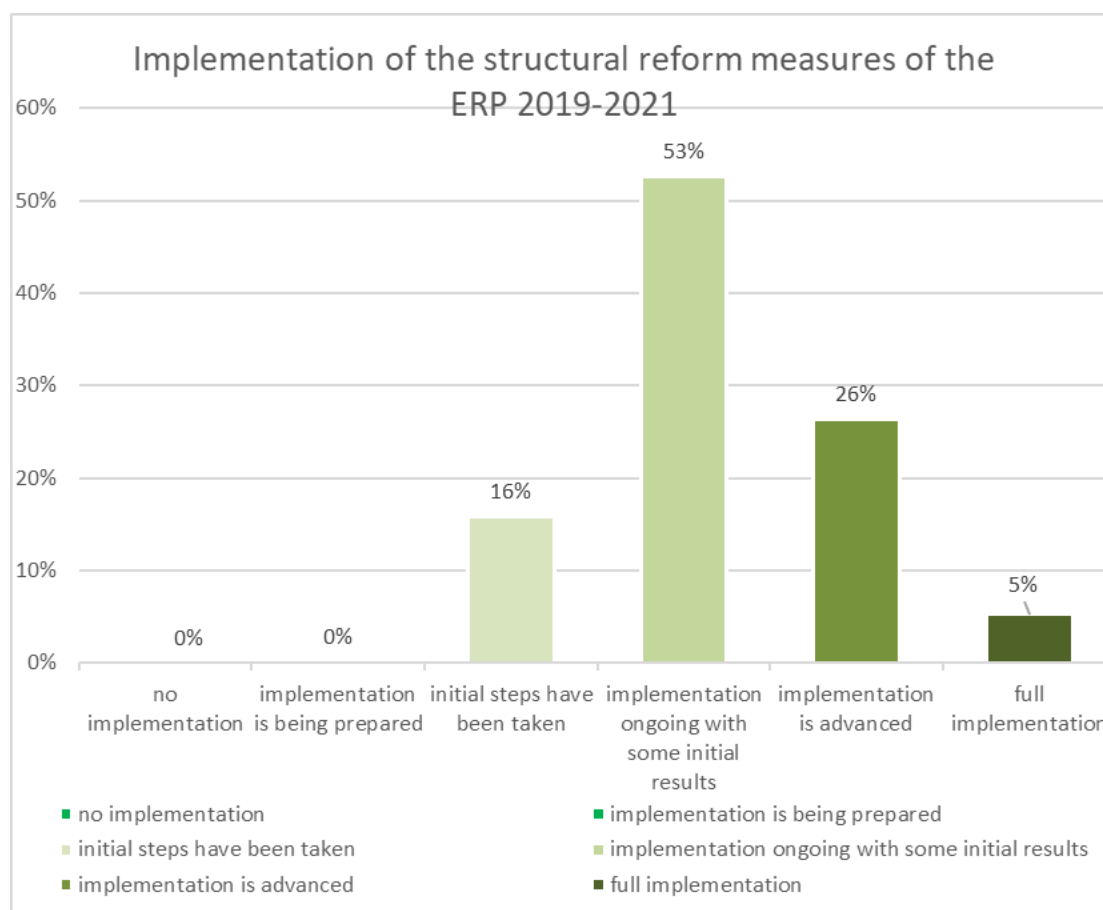
*w: data supplied by and under the responsibility of the national statistical authority and published on an "as is" basis and without any assurance as regards their quality and adherence to EU statistical methodology'*

Source of data in Annex A: EUROSTAT, unless otherwise indicated

## ANNEX B: PROGRESS WITH STRUCTURAL REFORM MEASURES FROM ERP 2020-2022

Table 11: Reporting on the implementation of the structural reform measures of the ERP 2020-2022

While tackling immediate impact of COVID-19 pandemic has been a clear priority in 2020, progress was made in implementing the measures from last year's ERP (average score: 3.3 out of 5). Activity reports provide a fairly accurate description of the level of implementation. The scoring is slightly imprecise for the measures related to access to finance, and to tourism services. Implementation is stronger for some measures, such as measure 3 on the railways, measure 8 on the legal framework for innovative start-ups, or 12 on broadband infrastructure. In contrast, implementation is weaker for other measures, such as measure 5 related to energy, measure 10 on retail payment modernisation, or 17 on VET access where the implementation is varied, with some sub-elements progressing while others not at all or even, in one case, having been cancelled. Implementation of the measure 7 on property tax reform has also been limited.



## ANNEX C: COMPLIANCE WITH PROGRAMME REQUIREMENTS

The ERP exercise was coordinated by the Ministry of Finance and Economy upon an order of Prime Minister's Office. The Minister herself is the national coordinator. An inter-ministerial working group for the preparation of the ERP is in charge and the ERP focal points are appointed in each line ministry.

The authorities have reported about the consultation process which took place during 14 December-9 January. It is understood that the stakeholders are contacted via e-mail although there is no information on the number of agencies/stakeholders that were contacted, nor the list of those agencies which were invited to provide for information. From the material included in the report there has been good feedback with inputs provided by donor institutions, international organisations, (UN WOMEN; UNDP; IOM; WHO) and some embassies (Germany, Slovenia, Switzerland and Austrian Development Agency) as well as the European Investment Bank and EBRD and one business association. Written comments of those who responded to the invitation for consultation were included as annex to the document.

The consultation with parliament or regional and local authorities is missing and there is need for more proactive outreach actions to attract as much as possible the opinion and feedback of different stakeholders. Face to face meetings/virtual meetings with different stakeholders could be one of the methods to be followed. Once the document was adopted by the Council of Ministers it was published in the website of Ministry of Finance and Economy at: <https://financa.gov.al/wp-content/uploads/2021/02/Economic-Reform-Programme-2021-2023.pdf>

### *Macroeconomic framework*

The programme is in line with the medium-term budgetary framework and the Budget Law of Albania and was submitted in time on 1 February 2021. It describes the past economic developments based on the available data and it was published on the website of the Ministry of Finance and Economy. Projections for 2022 and beyond are only provided in form of data without explanation. The basis of projections of export developments and FDI are not mentioned. The horizon of the framework extends to 2025 but data on long-term sustainability (demographic developments, pensions, health expenditure) is not provided at all. Information on the level of implementation of the policy guidance 2 and 3 is incomplete. The ERP does not provide an analysis of labour productivity, skills shortages, migration, brain drain the investment environment. The impact of the pandemic on business sectors and the economic structure is missing, concrete measures for business support in 2021 in the context of the pandemic are not presented.

### *Fiscal framework*

The ERP does not make clear a link between the analysis of the challenges the economy faces, the proposed reforms, and the corresponding budget allocations and lacks details on the expenditure plans. It remains unclear if policies are sufficiently financed, because budget priorities in the ERP are not accompanied by the corresponding budget allocation and they are also not linked to the structural reform part. It is difficult to link policies mentioned in the ERP with the macro-fiscal or budget tables, because the budget headings are aggregating many expenditure types while at the same time new headings for small expenditure items are introduced, which change every year. The ERP document could not take into account the full year's budget outturn for 2020 for which data was made available a few days after the submission deadline, data on public debt changed

significantly within a few weeks after the submission and one week after the submission a budget amendment was adopted with changes on revenue without substantial explanation. One month after the submission of the ERP 2021, the public debt ratio of the year 2020 has again changed (similar last year) so much (2 pps. of GDP) that the plan for public debt reduction from 2021 is not consistent with the actual outturn. (increasing public debt ratio instead of decrease). There is only limited information on the contributions to and spending by the social insurance schemes. Information on arrears, local-government revenues and expenditure is missing. Fiscal data do not meet ESA 2010 requirements, in particular not on: the valuation of foreign debt, the consolidation of financial and non-financial transactions, the recording of arrears, of PPPs and of capital transfers and loans within the public sector and on COFOG. With the support of Eurostat, the statistical office is striving to align its fiscal statistics with EU requirements. Albania regularly sends EDP notifications to Eurostat on a best-effort basis and strives to improve them. It has not yet completed the move from cash-based to accrual accounting, and government finance statistics are not yet aligned with international standards.

The structural reform priorities section mostly follows the guidance note. In terms of the *reporting of the implementation of the policy guidance and the structural reform measures from the 2020-2022 ERP sufficient and up-to-date*, this is mostly accurate with some exceptions. There are 18 reforms in the ERP 2021-2023, i.e. within the limit of max 20 reforms. The page limit is not respected. The structural reform measures contain 60 pages (i.e. 20 pages more than max 40 pages) without taking into consideration the annexes. As is described in each measure, in majority of cases the activities are clearly defined along the three year period of implementation. However, there are cases when the activities are repeated for the next coming years, making it impossible the monitoring of implementation of the measure over the three year period.

With regards to tables 9-12: Table 10.a - costing of structural reform measures - 50% not completed; in some cases it is paradoxically indicated a cost zero- such as for the reform 18- increasing access to healthcare services. On Table 10.b – Financing of structural reform measures - 55% not completed. On Table 11 – It is not reported about structural reform measures in 32% of reform measures of the ERP 2020-2022. The reform measures are related to: i) *Defragmentation and consolidation of agricultural land*; ii) *Reform on the Water and Waste Water Sector*, iii) *Improve institutional capacity of the research and innovation system*; iv) *Finalisation of the pre-university curricular reform, training and hiring of teachers*; v) *Inclusive education*; vi) *Modernisation of the early childhood education system financing*.

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