This report was prepared by Peter Tabak, Lead Regional Economist for Western Balkans, and Sanja Borkovic, Associate Economist for Western Balkans, at the Economics, Policy, and Governance (EPG) department. The political economy part of the report was written by Oleg Levitin. The authors are grateful for contributions provided by EPG colleagues (Anna Sali, Svenja Petersen, Olivia Riera, Philipp Paetzold, Federica Foiadelli, Alexa Tiemann, Giorgio Manenti, Dragana Marjanovic and Gender Inclusion Team, Dejan Zlatkovic and Chris Basinski), and to Mattia Romani (Managing Director, EPG), Artur Radziwill (Director, Country Economics and Policy, EPG) and Peter Sanfey (Deputy Director, Country Economics and Policy, EPG) and Matteo Colangeli (Associate Director, Head of Albania) for their guidance. The report has also benefited from comments from other departments at the EBRD (Office of the Chief Economist, Country Strategy and Results Management, and Energy Efficiency and Climate Change). The views expressed in this paper are those of the authors only and not necessarily those of the EBRD. The report is based on data available as of June 2019, with the exception of GDP forecasts (November 2019).
Country diagnostics are an EBRD tool to identify the main obstacles to entrepreneurship and private sector development and to help shape the Bank’s strategic priorities and project selection in new country strategies. Each diagnostic informs the EBRD’s policy engagement with the authorities in the country.

Each country diagnostic assesses the progress and challenges of the country of operations in developing a sustainable market economy. Private sector development and entrepreneurship are at the heart of the Bank’s mandate in the regions of operation of the bank, but the private sector in all EBRD countries faces a range of problems and obstacles. The diagnostic highlights the key challenges facing private companies and shows where each country stands vis-à-vis its peers in terms of six qualities of transition – competitive, well-governed, resilient, integrated, green, and inclusive – and points out the main deficiencies and gaps in each quality.

The diagnostics draw on a range of methodologies and best practice for assessing how big different obstacles are. Extensive use is made of in-house expertise across the EBRD, along with surveys such as the Business Environment and Enterprise Performance Survey (BEEPS) and the Life in Transition Survey (LiTS), as well as other cross-country surveys and reports from institutions such as the World Bank, World Economic Forum and OECD. For some larger countries, the diagnostics also draw on specially commissioned studies of selected issues that are critical for private sector development in the country.

The diagnostics are led by the EBRD’s Country Economics and Policy team, drawing substantially on the expertise of sector, governance and political experts in the Economics, Policy and Governance department (EPG) and consulting widely with relevant experts across the EBRD when preparing the final product. The diagnostics are shared with the EBRD Board during the country strategy process and published during the public consultation period.

The views expressed in the diagnostic papers are those of the authors only and not of the EBRD.

For more information, go to: https://www.ebrd.com/publications/country-diagnostics
This report was prepared by Peter Tabak, Lead Regional Economist for Western Balkans, and Sanja Borkovic, Associate Economist for Western Balkans, at the Economics, Policy, and Governance (EPG) department. The political economy part of the report was written by Oleg Levitin. The authors are grateful for contributions provided by EPG colleagues (Anna Sali, Svenja Petersen, Olivia Riera, Philipp Paetzold, Federica Foiadelli, Alexa Tiemann, Giorgio Manenti, Dragan Marjanovic and Gender Inclusion Team, Dejan Zlatkovic and Chris Basinski), and to Mattia Romani (Managing Director, EPG), Artur Radziwill (Director, Country Economics and Policy, EPG) and Peter Sanfey (Deputy Director, Country Economics and Policy, EPG) and Matteo Colangeli (Associate Director, Head of Albania) for their guidance. The report has also benefited from comments from other departments at the EBRD (Office of the Chief Economist, Country Strategy and Results Management, and Energy Efficiency and Climate Change). The views expressed in this paper are those of the authors only and not necessarily those of the EBRD. The report is based on data available as of June 2019, with the exception of GDP forecasts (November 2019).
Executive summary

Albania is a small Western Balkans country, spanning across the sunny coasts of the Adriatic and Ionian Sea, and quite a few mountainous regions. Although it has been emerging as a new tourist destination, the economy is still relatively closed and largely relies on low-productivity agriculture, while the industrial base is narrow, present mostly in low value-added segments. As a consequence, but also due to weak public governance and institutions, it is one of Europe’s poorest countries. When granting Albania the status of EU candidate in 2014, Brussels explicitly conditioned further progress in EU accession on comprehensive reforms, with a particular focus on governance and public administration, fight against corruption and organised crime.

The private sector in Albania is characterised by a large number of very small firms, the majority of which never grow into the next stage of the life cycle. Five main obstacles impair the private sector’s performance and development:

- **Widespread informality**: The informal economy is pervasive, estimated to reach up to 50 per cent of GDP. It is highest in the agriculture sector, but is present in other sectors as well. Informality constrains doing business, decreases government revenues and negatively affects economic growth and competitiveness. The government has exerted some efforts to tackle the issue (e.g., by conducting an anti-informality campaign), but more systemic solutions, including improvements in public governance, are needed.

- **Low competitiveness of the economy**: The country’s competitiveness is mostly based on low labour costs. Foreign direct investments primarily flow into the energy sector, while manufacturing remains under-served. Partially, the situation is also due to weak corporate and public governance. The latter is reflected in an unfavourable business environment, including widespread corruption and difficult access to land, constraining private sector investment and development. As a consequence, the Albanian economy is the least open in the Western Balkans. However, thanks to tourism, Albania exports more services (relative to GDP) than its regional peers or new EU member states.

- **Under-developed infrastructure**: The country faces large infrastructure gaps, with cross-border and internal integration being hindered by poor transport infrastructure. The water sector infrastructure is also weak. Meeting infrastructure needs is made more difficult by high public debt and weak public governance. Public investment management is feeble and non-transparent, missing a standardised review and prioritisation of projects in a single pipeline, which makes non-productive investments highly likely.

- **Unreliability of the energy supply**: Judged by the share of renewables used in electricity production, Albania can be considered a green economy. Namely, it relies almost entirely on hydro-power plants. At the same time, however, it runs large energy security risks, depending on hydrological conditions. Power outages are relatively frequent and pose significant cost to businesses. To make the country more resilient to the ongoing climate change, diversification away from hydro is needed (to solar, wind, biomass and, to a lesser extent, perhaps gas).

- **Labour shortages and skills mismatches**: Poverty and limited employment opportunities drive strong emigration from the country, hurting its competitiveness. Around 1.4 million Albanians live abroad and many more hope to follow. While labour market indicators have improved in terms of gender inclusion, high reservation wages and emigration keep labour participation rates low. Skills mismatches and poor quality of vocational training make it difficult for companies to find adequately skilled labour force.
This diagnostic document consists of the following sections: 1) political economy; 2) economic background and outlook; 3) private sector performance; 4) key obstacles to private sector development; and 5) qualities of a sustainable market economy.
1. Political Economy

Albania is a Western Balkans country, which began its transition in the early 1990s after almost five decades of a communist dictatorship, particularly brutal towards its own citizens and isolationist externally, even by the standards of other eastern European communist regimes of the time. Having experimented with anchoring Tirana to individual strategic partners, including, in the 1950s and 1960s, successively Soviet Union and China, Albania’s communist leader Enver Hoxha fell out with each and every one of them, eventually opting for complete self-isolation for his country. Albania emerged from this only at the beginning of 1990s, when it simultaneously restored diplomatic relations with its two until then arch-enemies – the Soviet Union and the United States. In domestic policies, the peculiarities of Hoxha’s regime included massive surveillance and repression, and bans on private ownership and religion. Hoxha made certain efforts towards overcoming the country’s notorious regional and clan divisions, but the record of these efforts was uneven, since they were, as the rest of his policies, part and parcel of the authoritarian rule.

The legacy of the previous ideological extremes complicated democratic development during the transition, particularly with respect to the culture of dialogue between political opponents and consensus building. On the other hand, the desire of Albanians to overcome that difficult legacy, including the suffocating self-isolation, provided a strong boost to entrepreneurship, pursuit of freedoms domestically and enthusiastic opening up to the outside world. Throughout the transition, Albanians invariably came out in various sociological surveys as the strongest believers, among regional neighbours, in free markets, democracy, and the benefits of Euro-Atlantic institutions. This desire to compensate for the decades of isolation and deprivation has been supported by some specific historical features of the Albanian society, which include patriotism, solidarity, informality, entrepreneurial spirit, hospitality and respect for foreigners.

Albania benefits from a favourable location on the cross-road of corridors connecting the Adriatic and Black Seas. It has direct access to the sea, comparing in this respect favourably with some land-locked Balkan countries, certain natural and mineral resources, and a young population. Unlike most of its regional neighbours it has a relatively ethnically homogenous population, and no record of inter-faith tensions. Albania was the first Western Balkans country to acquire full membership of NATO, which supports its stability. Albania does not have open questions in relations with its immediate neighbours, and it is an active participant in the intensifying regional cooperation, making it part of a wider Western Balkans market with more than 20 million people.

Nevertheless, Albania’s progress in transition has been uneven. It shares common weaknesses with other Western Balkan countries, which include weak rule of law and a difficult business environment, excessive informality of the economy, and limited administrative capacity. Tackling the latter will require further work on establishing a stable, merit-based, depoliticized civil service.

Political polarisation and uneven culture of political dialogue have complicated reform efforts of successive governments. Despite a wide range of political parties and the record of multi-party governing coalitions, the Albanian political system has developed since the beginning of transition as effectively bipartite, with the two largest political parties, the centre-right Democratic Party (PD) and centre-left Socialist Party (PS), alternating in power in the course of almost three decades. During the same period, Albanian society has remained effectively divided into two large camps of the supporters of the PD and PS respectively. Initial ideological differences between these two political parties have been accompanied by a clash of personal and regional loyalties. While over the time the ideological differences have become less noticeable (both PD and PS and, for that matter, all other mainstream political
parties in Albania, are strongly pro-market, pro-business, and pro-Western), personal loyalties and animosities, fuelled by accumulated mutual injuries, have multiplied. The electoral pattern has seen a party (either PD or PS) that wins general elections once, usually win them again after four years. The PD had governed since the beginning of transition until 1997, then again in 2005–2013. The PS replaced it in power in 1997–2005. After eight years in opposition, it returned to power in 2013, and won subsequently the 2017 general elections. The next regular general elections are due in 2021.

The uncompromising political infighting hampers the reform process, which is otherwise strongly supported by a considerable cross-party consensus and overall public buy-in of the reform objectives aimed at turning the country into a well-functioning, modern market economy. The elections are often seen in Albania not as a mere competition of political programmes and personal competences, but literally as a “fight for survival”. Furthermore, the ethos of “winner takes it all” has had an impact on the character of the parliamentary debates, and the role of the political opposition and of the civil society (which is also often divided, mirroring wider political schisms) in political and economic decision making. Parliamentary walkouts and protracted boycotts by the opposition are frequent, and the logic of political infighting often compels the opposition to resist legislative proposals that it would have supported if it were in power.

The current Government, with PS’s leader Edi Rama as Prime Minister, was established in 2017 (reshuffled at the beginning of 2019). This second PS-led Government has continued the work commenced by the first PS-led Government formed after the electoral victory in 2013, including as regards an ambitious programme for the modernisation of Albania. This programme is underpinned, in the first place, by a genuine realisation of the Albanian leadership that without strengthening governance, radical improvement of the business environment and establishing the rule of law, the country will not be able to attract the foreign investment necessary to cover its development needs and enable sustainable growth. A second factor is the gravitational pull of, and scrutiny by, the EU, which is a key external anchor for reforms. When granting Albania the status of EU candidate in 2014, Brussels explicitly conditioned further progress on the EU track with comprehensive reforms, with a particular focus on governance and public administration, and the fight against corruption and organised crime.
The main areas of the modernisation agenda include reform of governance and business environment, reform of public administration designed to establish a modern civil service, reform of local self-government, rule of law and fight against corruption, and addressing some long over-due structural issues where several waves of previous reforms had not produced desired results, such as the problem of restitution and land titles. The comprehensive reform of the judiciary, in the past one of the most corrupt sectors of the system, started by PM Rama’s administration, has been one of its greatest achievements, alongside the public administration reform. Both have been recognised by the EC and were among the key factors behind its decision to recommend to the European Council the opening of the EU accession negotiations. Based on the assessment of the progress in the implementation of the comprehensive EU reform agenda, the Council of the EU in its Conclusions on the Enlargement adopted in June 2018 set out the path towards opening the accession negotiations with Albania in June 2019. In May 2019, the EC issued strong unconditional recommendation to the Council to launch EU accession negotiations with the country. However, at the European Council meetings in June and October 2019 no consensus was reached on this issue. Consequently, on 18 October 2019 the European Council decided to postpone the decision and to revert to this issue again before the EU-Western Balkans Summit in May 2020.

The favourable factors for the prospects for accomplishing the reform agenda include the strong majority currently enjoyed by the governing party both at the central level and in the local offices. The government is able to benefit from the overall cross-party consensus on the main fundamentals of economic policies and to tap into remaining reserves of principled popular support to the modernisation agenda as long as it is perceived as bringing the country closer to Europe and other western allies. The main political risks come from the above-mentioned polarisation and fractious character of Albanian political life.
2. Economic background and outlook

Albania remains one of Europe’s poorest and least developed countries. Despite relatively strong growth rates (above those of other European emerging markets) over the past two decades, Albania’s GDP per capita is still less than one third of the EU average and less than half of that of the new EU member states (EU-11). The poverty rate in 2017 was estimated at 31 per cent.¹ The average gross monthly wage in 2018 stood at around €400, with significant differences by industry and sector. Namely, average monthly gross wages ranged from as high as €835 in financial sector to only €220 in accommodation and food services, and €270 in manufacturing.² Similarly, public sector employees earn on average one third more than their private sector counterparts.

As in other countries, GDP growth slowed significantly after the crisis. Post-crisis economic growth decreased to below 3 per cent annually (from above 6 per cent in 2000–2008) and unemployment has remained at double-digit levels. Despite the latter, employers report shortages of skilled labour, caused by the weak education system but also substantial emigration, with around one third of the population living outside of Albania. Another important drag on growth is wide-spread informality, present in particular in agriculture and tourism.

After services, agriculture is the second most important sector of the economy. At around one half of GDP, services have risen in prominence in recent years, supported by positive developments in tourism, as the country is emerging as a new tourism destination. However, agriculture remains an important source of income, accounting for around one fifth of GDP (almost twice as much as the industry) and employing 40 per cent of the workforce.³ On the other hand, the country’s industrial base is narrow, with a small manufacturing sector, focused mostly on low-value-added and labour-intensive processes in the textiles and footwear industry. Industrial output is also heavily dependent on hydrological conditions, since Albania relies almost entirely on hydro power plans in electricity generation.

GDP growth has been primarily consumption-led in recent years. The average growth rate over the past ten years stood at 2.7 per cent. It was mainly driven by household consumption (1.6 percentage points), followed by net exports (0.9 percentage points), while the contribution from investment was negligible. However, in the past four years there is an upward trend in growth, and a recovery of investments.

¹ World Bank (2019a), page 5. Measured as the share of population living on less than US$5.5 per person per day, 2011 PPP.
² INSTAT. The figures might be somewhat undervalued due to the practice of giving “envelope wages”, i.e., a part of wage is undeclared and handed to employees in cash.
³ Based on administrative data from INSTAT.
**Further catch-up is likely in the short term, but with downside risks.** Growth stepped up to 4.1 per cent in 2018, on the back of better industrial performance, primarily as a result of good hydrological conditions and, consequently, higher electricity production. The economy is projected to expand by 2.8 per cent in 2019, driven mainly by private consumption, and to accelerate to 3.5 per cent in 2020. The moderation in growth relative to the most recent years is due mainly to a combination of the economic slowdown of Italy and the rest of the eurozone, the further delay in starting EU membership talks, and internal risks associated with both contingent liabilities stemming from unsolicited public-private partnership programmes (lacking transparency and accountability), and with the ongoing political instability.

**In order to speed up convergence to the EU income levels, the growth model needs to shift away from consumption to investments and exports.** Expansion of domestic consumption in a small economy like Albania cannot be the driver of long-term growth. The focus rather needs to be on investments, thus raising productivity and, subsequently, exports. The private sector in Albania should also be supported by a more favourable business climate, including an improved regulatory environment, stronger rule of law, higher lending activity by banks and an education system more responsive to business needs. The improved business environment would then help attract more foreign direct investment, bringing in productive know-how and opening new businesses opportunities for domestic firms.
3. Private sector performance

Small and medium-sized enterprises (SMEs) are more important in Albania than in the EU. In 2017, there were around 107,500 registered businesses in the country. Only 166 of them were large companies (more than 250 employees), while almost 90 per cent of all firms had less than five employees. Compared to the EU, SMEs in Albania generate significantly more employment (80 vs. 66 per cent) and value added (68 vs. 57 per cent). The former is particularly true for micro businesses (employing 40 per cent of the workforce vs. 30 per cent in the EU) and the latter for small and medium-sized companies (creating 48 per cent of the value added, 12 percentage points more than in the EU).

SMEs produce mostly for the domestic market ... SMEs in Albania suffer from a number of issues, from lack of skills and difficult access to finance, to low competitiveness and weak integration into global supply chains. As a consequence, they operate mostly locally. In 2017, SMEs made only 10 per cent of their turnover abroad (vs. 23 per cent in large companies). Within SMEs, micro enterprises export the least, with only 3 per cent of turnover coming from selling goods in international market.

... and are a major employer in the majority of sectors. The only sector where large companies dominate, employing more than half of the workforce, is electricity, gas and water supply. SMEs, on the other hand, are the most prominent type of enterprise in the accommodation and food services, and the trade sector, providing work for between 95 and 99 per cent of employees. SMEs (in particular, medium-sized companies) are also an important employer in construction and manufacturing, accounting for around three-quarters of employment.

Micro firms are the backbone of the economy, but their performance has weakened recently. Micro companies employ the majority of the Albanian workforce (40 per cent), dominating in particular accommodation and food services, and trade. The total number of employees in micro companies grew to over 190,000 in 2017 (from 150,000 in 2013), but the companies scaled down their operations over the same period, decreasing turnover and investment both in absolute and relative terms.6

Efficiency of SME investment in general seems to have gone down. Both SMEs and large companies had lower turnover and created less value added per employee in 2015–2017 than in 2013–2014. But, unlike large firms, SMEs7 scaled up investment per capita in the same period. The lack of subsequent increase in turnover or value added might indicate a reduced efficiency of investment.

4 SMEs comprise three size classes of companies: (1) micro – employing 1–9 persons, (2) small – employing 10–49 persons, and (3) medium-sized – employing 50–249 persons.
5 Financial, agricultural and fishing activities are not included.
6 In 2017, the turnover of these companies fell to 20 per cent of total corporate sector turnover (from 26 per cent in 2013), while investment comprised only 14 per cent of total investment (down from 23 per cent four years before).
7 Except for micro firms.
The private sector in Albania is faced with multiple challenges. In general, private sector investment and development are constrained by an unfavourable business environment, including widespread corruption, and by a difficult access to land and finance. Also, a large informal economy (estimated to reach up to 50 per cent of GDP) creates unfair competition among firms and constrains business operations.

Despite some improvements, weaknesses in the business environment persist. A survey by the Albania Investment Council\(^8\) showed that businesses complain most about the tax system (number of taxes, fiscal burden, and taxation procedures) and access to loans. Paying taxes has been confirmed as one of the most problematic areas by the World Bank Doing Business 2019 report as well. Namely, a medium-sized company spends on average 252 hours a year and has to pay in taxes and contributions more than in other WB economies (37.3 per cent of the profit versus 22.1 per cent in the WB-5\(^9\)). Although there were some improvements in paying taxes over the past few years,\(^{10}\) the country still ranks only 122\(^{nd}\) in this category out of 190 countries. Another two areas demanding more attention are dealing with construction permits (151\(^{st}\)) and getting electricity (140\(^{th}\)).\(^{11}\) For example, it takes 18 procedures, 299 days and 5.6 per cent of warehouse value to obtain a construction permit in Albania. On the other hand, the country performs well in trading across borders (24\(^{th}\)) and protecting minority investors (26\(^{th}\)). Overall, Albania ranks 63\(^{rd}\) out of 190 economies in the ease of doing business, up more than 20 places compared to a few years ago.

Access to finance is difficult. At around 35 per cent of GDP, credit to the private sector in Albania is low by regional standards, and acts as a drag on investment. This is a consequence of multiple factors, on both the supply and demand sides: weak investment opportunities, high NPLs, weak demand by private sector, low financial literacy of SMEs, and high informality, including improper accounting practices. Since 2018, banks can lend to businesses only on the basis of formal financial statements. Although this measure was introduced to combat informality, it may in the short term constrain further access to finance and private sector activities.

A typical Albanian company has relatively little sector-specific experience and misses many modern tools of the private sector.\(^{12}\) In other words, business sophistication is low. This is a consequence of the lack of productive know-how, also related to relatively low FDI inflows. The dominant, so-called “fasson” industry (producing shoes and textiles, mostly for Italian brands), bases its competitiveness on low wages and low margins, and can be driven out of business by relatively small changes in the exchange rate.

---

\(^8\) See Secretariat of the Investment Council (2015)

\(^9\) The tax and contribution rates in WB-5 range from 13.0 per cent of profit in Macedonia, to 15.2 per cent in Kosovo, 22.2 per cent in Montenegro, 23.7 per cent in Bosnia and Herzegovina and 36.6 per cent in Serbia.

\(^10\) E.g. introduction of an online system for filing and paying taxes

\(^11\) Some recent progress includes the introduction of an electronic platform making the application process for construction permits easier (in mid-2016), speeding up of the process for obtaining a new electricity connection, and improvement of the monitoring and regulation of power outages.

\(^12\) See O’Brien et al. (2017)
Private sector development in Albania suffers from several important issues: (1) widespread informality, (2) low competitiveness of the economy, (3) under-developed infrastructure, (4) unreliability of the energy supply, and (5) labour shortages and skills mismatches. The following section covers the issues in more detail.
4. Key obstacles to private sector development

4.1. Widespread informality

The informal economy in Albania is among the biggest in the region. Informality is present in all economies, but is especially pervasive in less developed ones. The negative correlation between the level of informality and GDP per capita is a well-known fact. Unfortunately, there has not been a lot of comprehensive research on the size of the informal economy in Albania. The available estimates are quite diverse and range from 25 to 50 per cent of GDP. Informality takes a wide spectrum of forms: unlicensed (usually micro) businesses, licenced businesses that under-report their revenues, profits, employment or wages, unregistered barter trade, smuggling of non-prohibited goods, and illegal activities such as drug, arms or women trafficking. Estimated as a per cent of total employment, informality in Albania is highest in the Western Balkans region. According to the ILO, 60 per cent of all Albanian employees in 2013 worked in the grey zone (vs. 48 per cent in North Macedonia or 20 per cent in Serbia). This does not come as a surprise as, in general, in countries where agriculture is an important sector and accounts for a large share of workforce, informal employment, including in agriculture, is high. Excluding agriculture, informal employment for Albania drops to 33 per cent, but it is still a large percentage.

Informality is present in many sectors, especially in agriculture. The sector suffering most from informality is agriculture, due to infrequent registration of business entities and weak fiscal control. Almost half of the country’s population lives in rural areas and there are not many employment opportunities outside the agricultural sector. On the other hand, economies of scale are hard to achieve because of small farm sizes, often unclear land titles due to the absence of a comprehensive land register, and absence of a properly functioning land market. As a consequence, the rural population engages mostly in small-scale, inefficient, subsistence or semi-subsistence farming. This alleviates poverty to some extent, but the lack of tax compliance at this stage has also knock-on effects on the supply chain downstream. But informality in Albania is not limited to agriculture. Informal practices in areas related to business activities, such as construction, tourism, trade, crafts and freelance professions, might be even more disruptive. Informal practices range from unregistered activities, to tax evasion, to arbitrary occupation of land or constructions without permit.

Causes of informality are numerous... Although informality existed to some extent during the period of centralised economy, it rose significantly in prominence after the 1990s, with the start of transition to a market economy. Namely, the formal sector was shrinking due to

14 A part of the wage is officially declared, while the other part is subject to a verbal agreement and given to employee in cash (so-called envelope wages). This way, companies reduce their tax and social contributions.
15 The average farm size in 2012 was 1.20 ha, while the average plot size was 0.26 ha (INSTAT via Guri et al. 2015). This means that an average farm consists of more than four plots. The latter are sometimes several kilometres away from each other. Such a high fragmentation of land is a consequence of land reform, i.e. de-collectivisation process, in early 1990s, when the land in state farms and cooperatives was equally distributed to rural households (without restitution to former owners).
the restructuring of the public sector, accompanied by massive job losses, giving way to the growth of the informal one. On the other hand, the legal, institutional, fiscal and regulatory framework lagged behind the development of the private sector. The main factors currently contributing to pervasive informality in Albania are the following:\textsuperscript{16}

- Poverty, i.e., people with few chances for formal employment and little means for living have to rely on informal activities to secure the survival;
- Heavy administrative burden, complex procedures and frequently changing tax rules, making it difficult and costly to comply;
- Selective/discretionary enforcement of tax laws and regulations due to corruption and bribery in public administration;
- Lack of trust in public institutions, combined with lack of transparency about government spending and relatively weak quality of public services;
- Perception of a high tax level; and
- Unfair competition from informal businesses.

...as well as consequences. Informal firms create unfair competition for the formal ones, but informality also decreases budget revenues and hinders investments and development of businesses, constraining economic growth.

Unfair competition from informal firms is repeatedly among the top constraints for doing business. Four out of ten firms surveyed in the fifth round of the EBRD/World Bank Business Environment and Enterprise Performance Survey (\textbf{BEEPS V}) competed against firms in the informal sector. According to the BEEPS, 20 per cent of all Albanian businesses perceived competition from the informal sector as a major or very severe obstacle to doing business and 17 per cent cited it as the number one obstacle. Competitiveness of compliant firms is affected in different ways, from higher price competitiveness of firms that evade taxes to issues arising from the lack of documentation from suppliers working in the informal economy. Also, the interaction with government officials might be time-consuming and costly (especially if bribery included). These are strong motivators for many firms to operate in the grey zone. If the businesses believed that their competitors would register and comply with the laws and regulations, they themselves would be more willing to do the same. Another issue is the perception of high tax levels, as shown in recent research.\textsuperscript{17}

\textbf{Budget revenues in Albania are among the lowest in Europe}. Widespread informality, tax evasion informal economy and weaknesses in tax administration result in limited tax revenues\textsuperscript{18} and, consequently, low level of overall government revenues. In 2016–2018, government revenues in Albania stood at an average 27 per cent of GDP annually, i.e., at a similar level as in North Macedonia or Kosovo, but significantly below the EU and other WB countries average (above 40 per cent of GDP). Naturally, the level of revenues constrains government expenditures, and consequently limits the scope and quality of public services, enhancing the perception of an inefficient public sector. This, in turn, holds back private sector activities.

\textsuperscript{16} For more detail, see e.g. National Business Forum. (2016), Muceku and Muca (2014), Bello et al. (2011), Hashorva et al. (2011)

\textsuperscript{17} See e.g. National Business Forum (2016)

\textsuperscript{18} For a more detailed analysis of tax revenues, see IMF (2016)
Furthermore, widespread informality negatively affects economic growth and competitiveness.

![General government revenue (per cent of GDP)]

Source: IMF WEO and authors’ calculations.

Although informality brings some short-term benefits to businesses, such as savings on taxes, in the long term it implies opportunity costs due to the foregone growth. Besides inhibiting private sector activities due to an insufficient amount and low-quality public goods (e.g., under-developed transport infrastructure) caused by constrained government spending, there are also other channels through which informality acts as a drag on growth. Informal firms in general have low levels of human and physical capital and difficulties in access to finance, and they focus on the short term, which keeps them in a vicious circle of low investment and low productivity. In other words, they are likely to remain non-competitive and small. They also use resources for unproductive purposes such as hiding informal activities, while the government, on the other hand, has to spend more on enforcing compliance. This means an economy-wide waste of (scarce) resources.

Reversing informality would need a concerted effort. The difficulty with fighting informality, especially when it is widespread, lies in the – somewhat paradoxical – fact that many economic players perceive primarily the benefits from the status quo. As explained in Olters (2003), individuals benefit from higher, tax-free salaries and cheaper goods and services, firms from the absence of (costly and lengthy) interaction with government officials, while corrupt public officers and politicians receive additional income. Also, elected politicians might be reluctant to adopt measures that will reduce economic benefits of their voters. On the other hand, the costs are mainly on the public side and consist of the lower amount of (lower quality) public goods, due to reduced tax revenues. Although everyone knows they would benefit from better schools and hospitals, more roads or sewerage, no one is willing to start first with the formalization. On top of that, a perception of an inefficient public sector relaxes taxpayers’ discipline, reinforcing the “informality trap”. The way out would be a battle fought on several fronts, from improving public governance (by strengthening public institutions, including tax and customs administration, and lowering corruption, intrusiveness and inefficiency of the administration), to strengthening the government-business relationship (e.g., by actively consulting formal businesses on issues and measures), to simplifying the tax system and educating the public on the consequences of informality. But, first and foremost, the government’s commitment to combat the informal economy should be perceived as credible.

The Albanian government has taken some measures to combat informality... In September 2015, the government started a programme against informality, launching a public awareness campaign, waiving penalties for businesses that become fully compliant before end-2015, and setting up a lottery to incentivize customers to claim their tax receipts. The number of controls and inspections (targeting unregistered employees, use of cash registers, and issuance of fiscal invoices) increased, and higher penalties for non-compliance were imposed. The last phase of the fight against informality was carried out in the last quarter of 2017, focusing mostly on large businesses.

Government measures have yielded some positive results, the most visible one being the formalization of informal employment. The employment rate went up from 51 per cent in 2014 to 60 per cent in 2018. However, according to the European Commission (EC, 2018), the undeclared work is not addressed comprehensively and stronger enforcement is needed, coupled with incentives to encourage formal hiring. Also, labour inspections lack sufficient administrative, human and financial capacities.

**...but a more comprehensive and systemic approach would be needed.** Between 2015 and 2017, tax revenues increased by 2 percentage points, to 27.4 per cent of GDP. The increase came primarily on the back of higher social insurance contributions thanks to the increased formal employment.20 However, tax revenues as a percentage of GDP did not continue the upward trend in 2018 and, according to the IMF,21 there is even a risk of a 1 percentage point reversal in the next five years. This indicates only a partial success in fighting informality and calls for more action. Otherwise, given that revenues are far below potential, government spending would stay parsimonious, with a bleak perspective on improving the quality of public services. Therefore, a more comprehensive approach, relying on improved public governance, provision of better public goods and a credible action plan is needed.22 Without that, some recent measures, such as the reduction of the VAT exemption threshold (from annual turnover of ALL 5 million to ALL 2 million) and the measure to force banks to use companies’ official tax data for lending decisions might lead to more under-reporting of revenues and even more difficult access to finance for SMEs, respectively, hurting private sector development, without contributing too much to decrease the informality. An important motivation to strengthen formal business activities could be the EU accession process.

### 4.2. Low competitiveness of the economy

**Wages in Albania are among the lowest in Europe, but so is productivity.** At below 12,400 constant 2010 US $ in 2018, labour productivity in the country is around one half of that in the EU-11 and around 20 per cent lower than in WB-4.23 The low level of productivity is a consequence of lack of productive know-how, unfavourable business environment, skills shortages, low sophistication of businesses, and low investment in R&D, weighing on the innovation capacity of the economy. Also, the economy lacks diversification, with 40 per cent of the workforce being employed in agriculture, mostly in low-skilled and low-productivity jobs.

**Despite some improvements, Albania still ranks low on global competitiveness measurements.** In 2018, it occupied 76th position in the World Economic Forum’s Global Competitiveness Index among 140 countries, and 63rd in the World Bank’s ease of doing business among 190 countries. The country lags furthest behind the frontier in the areas of innovation capability, financial system development, ICT adoption, enforcing contracts, dealing with construction permits and getting electricity.

---

20 Share of social insurance contributions in GDP increased by 0.6 percentage points, followed by rise in local government revenue (including the property tax, the simplified profit tax for small businesses, and other local taxes) of 0.4 percentage points and profit tax and VAT, by 0.3 percentage points each.
21 IMF (2019)
23 ILO modelled estimates. Labour productivity is measured as output per worker (GDP constant 2011 international $ in PPP). Data for Kosovo are missing.
Foreign direct investment (FDI), which could enhance competitiveness of the economy, has been limited. At around US$2,350 per capita in 2017, the FDI stock in Albania is around one fourth of the EU-11 average and 55 per cent of that in the WB-5. This might be linked to the fact that Albania is more restrictive in FDI rules than other WB countries, as well as to the lack of fair competition and standard rules of free market. In order to attract FDI, the government adopted a new Law on Strategic Investments in 2015. The law outlined investment incentives and offered fast-track administrative procedures to strategic investors (both foreign and domestic). Several sectors were defined as “strategic” ones, including energy and mining, transport, telecommunications, urban waste, tourism, agriculture and fisheries. As a result, the FDI stock surged by more than 50 per cent in 2016–2018. However, the lion’s share of that increase (70 per cent) went into the natural resources sectors (energy and mining), with the two main energy projects being the 215 km long gas-interconnector, Trans-Adriatic Pipeline (TAP), and the Devoll hydropower plant. Observed by origin, more than half of investment in Albania come from EU countries (mainly Greece, Netherlands and Italy), but Swiss and Canadian investors are also important, accounting in total for 30 per cent of the FDI stock.

...especially in manufacturing. At end-2018, energy and mining accounted for 40 per cent of the total FDI stock, followed by the information and communication sector (16 per cent), and financial services (14 per cent). Less than 10 per cent of all FDI in the country went into manufacturing. According to the Albanian Investment Development Agency (AIDA), one of the major obstacles for foreign companies to invest more in the sector was related to land.
access, i.e., the difficulty to identify state assets, while the other important issue was finding qualified staff.\textsuperscript{28}

As a consequence, \textbf{Albania is under-integrated in global value chains (GVCs)}. Albania represents the least integrated economy in GVCs in the SEE region. In 2018, 55 per cent of its exports were exported and sourced through value chain integration, while the remainder of the country’s exports had no value chain linkages. Albania is equally integrated in both forward and backward linkages in global value chains.\textsuperscript{29}

Although GVC participation has increased since the year 2000, in recent years the GVC share of exports has declined. Despite GVC participation below that in SEE countries (and below the EBRD average), the country experienced above average growth rates in GVC participation between 2000 and 2018. This means the country could be classified as weakly integrated, but with increasing GVC participation in recent years. However, there has been also a less favourable trend over the past three years. Namely, the share of exports with no GVC linkages has increased since 2015, indicating that Albania’s role in value chains declined in recent years.\textsuperscript{30}

\textsuperscript{28} See O’Brien et al. (2017), page 34.
\textsuperscript{29} Forward linkages indicate that Albania sells intermediate goods to third countries for further export processes. Backward linkages indicate that Albania sources intermediates which it needs to process for its own exports ("import to export").
\textsuperscript{30} Exports with no GVC-linkages are usually consumed in the country of importation (mostly final goods or commodities).
Trade openness has not risen over the past decade. The trade openness of the country, measured as a sum of imports and exports of goods and services over GDP, increased from around 50 per cent in the 1990s to over 80 per cent in 2007, but has decreased since. Over the past ten years it fluctuated between 70 and 80 per cent. At 78 per cent in 2017, it was significantly below that of the EU-11 and WB peers, which both exceeded 100 per cent. Not surprisingly, the country exports less than the EU-11 or WB-5, with exports accounting for less than one third of GDP. However, taken separately, exports of goods and services paint a bit different picture.

Exports of goods are almost negligible and rather concentrated in a few products and markets. While exports of goods comprise over 50 per cent of GDP in EU-11, and around a quarter of GDP in WB-5, in Albania goods exports make less than 7 per cent of GDP. The main export products are low value-added, labour-intensive products and raw materials such as textile and footwear (produced mainly for Italian clients), oil, chrome and refined fuels. Over 2014–2018, textile and footwear accounted for 40 per cent of total exports on average, followed by minerals and fuels (22 per cent). This is in line with GVC data, since raw materials are mostly seen as forward linkages, with other countries using these raw materials as inputs for producing other products. On the other hand, textiles and footwear exports have strong backward linkages due to the high imports content (fabrics and yarn), which is then processed further and re-exported to the country of final consumption or further exportation. These industries are mostly low-skilled. The textile industry in particular has limited spillovers in the context of GVCs and low domestic value added due to the tight margins and low-skilled labour. Besides being highly concentrated in products, goods exports are also highly concentrated in markets. One country (Italy) absorbs half of Albania’s exports. The next two most important trading partners are Kosovo and Spain. Together, these three countries import two thirds of Albanian goods exports.

Unlike exports of goods, exports of services are larger than in the EU-11 or WB-5. Exports of services increased fivefold since the early 2000s, reaching €2.9 billion or around one fourth of GDP. This is a larger share than that in the EU-11 or WB-5 (17 and 19 per cent of GDP, respectively). The increase in services exports came mostly as a result of the rise in travel and tourism-related services.
### 4.3. Under-developed infrastructure

**The country faces large infrastructure gaps.**
Regional integration and internal integration are both below potential. According to IMF estimates, the public infrastructure gap to the EU average is highest in Albania among the WB countries, at almost 70 per cent. Despite some improvements, the country continues to lag significantly behind the EU in transport infrastructure, installed capacity for power generation and telecommunication networks (especially fixed broadband subscriptions). That potentially distracts foreign investors and limits the country’s integration into European supply chains. The inadequate infrastructure also hampers the further development of tourism.

To bridge the gap, transport infrastructure needs rehabilitation and further development.

![Roads and railways](source: WEF GCI 2018)

- **Roads:** Road-based transportation is predominant in Albania, and the majority of investments in the transport sector over the past decade went into improving the road network. Still, road connectivity is among the weakest in the WB region and half of the regional and local network is in a poor or very poor condition due to under-maintenance. Despite the slow pace of change, some progress has been made in the sector. For example, in 2018 the first road tolling was introduced (for the Milot-Morine highway).

- **Railways:** Following efforts to develop the railway infrastructure in the decades after the World War II, trains became the main means of transport in the country. However, with the fall of communism and a consequent increase in the use of buses and cars, and construction of motorways, the railway network started to deteriorate, with declining traffic. Currently, the city of Durres, on Albania’s Adriatic coast, is the country’s main railway hub with routes to two other cities (Skoder and Elbasan) and, at 15 kilometres of railroad per 1,000 square kilometres of land, the railroad density in Albania is the lowest in the WB region. Also, there is only one active private railway operator licensed for freight transport. In early 2018, the new Railway Code, aiming to regulate rail transport by separating train operations from infrastructure management, entered into force. Under the reforms in the sector, the establishment of new regulatory bodies has been announced, as well as the opening of the rail market to competition.

- **Airports:** Air connectivity is also weak, with Albania lagging behind most regional peers. According to the World Economic Forum GCI, Albania ranked 102nd out of 140 countries on integration with the global air transport network in 2018. Tirana International Airport (TIA) is currently the only airport in the country with international service. That is a consequence of the concession agreement from 2005, envisaging

---

31 Atoyan et al. (2018). The index comprises six public infrastructure components: railway density, motorway density, airport capacity and utilization, installed capacity for power generation, phone lines and cellular subscriptions, and fixed broadband subscriptions.
32 According to the OECD estimates, between 2010 and 2016, road maintenance cost in Albania comprised around 5 per cent of the total road spending (versus e.g. 24 per cent in Bulgaria and 33 per cent in Serbia).
33 The train station in the capital, Tirana, was closed in 2013.
34 Excluding Kosovo, for which data are not available.
35 Such as the National Safety Authority, the Infrastructure Manager, the Railway Undertakings, the Railway Regulatory Authority and the National Authority for Investigation of Accidents and Incidents in railways, and the independent Railway Licensing Authority.
36 Based on data from the International Air Transport Association (IATA).
a monopoly on all commercial air traffic in Albania to the TIA during the 20-year concession period. However, in 2016 the government renegotiated the concession agreement, withdrawing the monopoly. In early 2019, a 35-year concession was awarded to another airport (Kukes), primarily to serve low-cost carriers.

- **Waterway transport**: The maritime transport is based on four sea ports, with the leading one (Durres) accounting for a dominant part (80 per cent) of international ship-borne traffic. To speed up the port’s connectivity to global shipping networks, further investments are needed. Albania saw only a moderate increase in shipping connectivity over the past decade, but it remains among the lowest in the wider region. Inland waterway transport is limited to two lakes (Ohrid and Skadar) shared with neighbouring countries (North Macedonia and Montenegro, respectively) and regulated by bilateral agreements.

In 2016, the government adopted the national transport strategy and action plan for 2016–2020 for all transport modes, aiming to enhance the efficiency of the transport system and its integration into the regional and EU network.

The water sector infrastructure is in a poor condition. While Albania is rich in water resources, it suffers from shortages of water for drinking and irrigation. The water distribution network is old and severely deteriorated, and losses are high. As a consequence, water supply is unreliable and water quality rather poor. For example, water supply is limited to 12 hours per day on average, while almost one third of the population does not have access to safe and clean drinking water. Due to under-billing, bypassing of water meters, illegal connections, and improperly working metering devices, the share of so-called non-revenue water is high, estimated at 65 per cent of the produced drinking water in 2017. The development of wastewater services lags behind that of water supply services; only 50 per cent of the population is covered by the public sewerage system, compared to 78 per cent having access to water supply system. The National Water Supply and Sewerage Master Plan 2011–2040 estimates the investment needs of the sector at around €6 billion by 2040.

![Connectivity to global shipping networks](source: UNCTAD)

**Meeting infrastructure needs is made more difficult by high public debt**... Public debt has been on a downward path since 2016, but at 67 per cent of GDP (according to government data) at end-2018 remains high, and should also be augmented by the value of arrears (originating primarily from delayed VAT refunds). The IMF estimated the latter at 1.5 per cent of GDP at end-September 2018. Besides adding to the debt level, the arrears negatively affect economic activity and undermine trust in the state. Another issue is the relatively short

---

37 The data in the paragraph come from the Water Regulatory Authority of Albania (2018), unless indicated otherwise.

38 World Bank WDI

39 IMF (2019)
government debt maturity. That is particularly true for domestically issued debt, about half of which needs to be refinanced annually. Also, the banking sector is highly exposed to the sovereign as around one-quarter of banking sector assets is invested in government securities. At end-2018, local banks held over 60 per cent of the government domestic debt.

...and weak public governance. The public investment management needs strengthening. In order to finance large infrastructure projects, especially in energy and transport, the government increasingly relies on poorly designed public-private partnerships (PPPs). In early 2017, a one billion euro PPP plan for a major renovation of infrastructure, more than hundred schools and a hospital was announced. According to the IMF, the stock of PPPs (covering more than 220 projects) in 2018 was at 31 per cent of GDP, and 2019 budget documents envisaged potential new PPPs of up to 15 percentage points of GDP. While PPPs are a legitimate way to finance public investments, the Albanian ones face multiple issues:

- Non-transparent procurement processes: use of unsolicited proposals instead of competitive bidding ensuring value for money,
- Generation of contingent liabilities and fiscal risks,
- No assessment of fiscal risks; lack of cost-benefit analyses,
- Questionable hidden agenda: postponing the payments, masking the public debt level, and
- Reputational damage to proper PPPs.

Although budgetary payments for PPPs have been limited by law (envisaging that total net payments arising from concessions or PPPs should not exceed 5 per cent of actual tax revenues in the previous budget year), these limits cannot compensate for the absence of a proper risk analysis. Another worrisome development is the envisaged establishment of the Albanian Investment Corporation, which would use public property and assets to attract strategic investments. Due to numerous issues, the proposition has been faced with strong opposition from IFIs.

---

40 Like other EU candidate countries, Albania also struggles with EU funds absorption.
41 IMF (2019)
42 No operational independence from the government; questionable governance and oversight; self-assessment of fiscal risks of the projects; implicit government guarantees; not a subject to Public Procurement Law; damage to development of a unified framework for managing public investments.
4.4. Unreliability of the energy supply

Albania relies almost exclusively on hydropower in electricity generation ... Albania gets over 90 per cent of electricity from renewables, three times more than its WB peers or EU countries. While renewables in Albania include biomass, hydropower, solar and wind energy, electricity has historically been generated almost entirely by hydropower plants.

... running large energy security, but also fiscal risks. Although the dominant use of hydro sources contributes to decarbonisation of the electricity sector, it also makes the electricity generation highly sensitive to hydrological conditions, varying significantly between months and years. With sufficient amounts of rainfall, the country is able to produce electricity and even export it, but in periods of drought it has to import. Albania is a net importer of electricity most of the time. Over the 2000–2018 period, it was (net) exporting electricity in only three years. On average, electricity imports accounted for one third of electricity consumed. Beside energy security risks, there are also some fiscal ones. Namely, given that hydrological conditions are usually similar across the region, the import prices in times of need are high. The higher cost is not passed to the end users but absorbed by the state companies in the sector and, in the end, by the budget.

There has been an improvement in distribution efficiency, but losses in the power grid remain high. The transmission and distribution losses totalled 23 per cent in 2018. Still, Albania has made a significant improvement in this area since 2013, when losses were as high as 43 per cent.

Power outages are relatively frequent and pose significant cost to businesses. The previous round of BEEPS survey revealed that a similar percentage of firms (around 55 per cent) experienced power outages in Albania and other WB countries. However, outages caused more damage to Albanian ones in terms of value lost (five per cent versus three per cent of sales). Although there are indications that the situation has improved in the meantime, Albania still lags behind other countries in the region, and well behind the EU-11. For example, in 2016, the average duration of interruptions in Albania was about 97 hours (versus 62 hours in Kosovo, 27 hours in Montenegro and 6 hours in North Macedonia) and the average number of interruptions per customer per year was 43 in Albania (versus 35 in Kosovo, 20 in Montenegro, and 13 in North Macedonia).

Similarly, the World Bank Doing Business report 2019 reveals significantly higher power interruption duration and frequency, as well as minimum outage time in Albania, compared to the WB-5 and EU-11.

The country needs to diversify away from hydro power and minimize negative environmental impact. With the ongoing climate change, energy security is becoming an even more important concern. The greater share of other renewables in energy generation is important also given the

---

43 Although Albania is usually a net importer of electricity, its overall dependence on energy imports is one of the lowest in Europe. According to EUROSTAT, only around 20 per cent of the country’s energy needs in 2016 was met by imports, compared to 35 per cent in WB-5 and 42 per cent in EU-11.

44 INSTAT
45 Atoyan et al. (2018). At the same time, the EU new member state averages are about two hours and one time, respectively. Measured by System Average Interruption Duration Index (SAIDI) and System Average Interruption Frequency Index (SAIFI)
fact that energy incentives for hydropower stimulated an uncontrolled development in the previous period,\textsuperscript{47} causing damage to protected areas and rising discontent of local communities.

<table>
<thead>
<tr>
<th>Unreliability of power supply</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interruption duration (SAIDI)</td>
</tr>
<tr>
<td>ALB</td>
</tr>
<tr>
<td>80</td>
</tr>
<tr>
<td>60</td>
</tr>
<tr>
<td>40</td>
</tr>
</tbody>
</table>


<table>
<thead>
<tr>
<th>Power outages 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Power outages in firms per month (number)</td>
</tr>
<tr>
<td>EU-11</td>
</tr>
<tr>
<td>8</td>
</tr>
<tr>
<td>6</td>
</tr>
<tr>
<td>4</td>
</tr>
</tbody>
</table>

Source: WB WDI.

Besides hydro power, Albania has great potential in other renewables (solar, wind, biomass) as well. As a Mediterranean country, spanning across the sunny coasts of the Adriatic and Ionian Sea, Albania is blessed with a large number of sunny days (ranging from about 290 in the North-East to 325 in the South-West). As such, it is well located to benefit from low solar power prices. In addition, solar power generation would be uncorrelated with hydro generation, contributing significantly to improvement of energy security, fiscal position and decarbonisation targets. The solar power potential in Albania is estimated at 1,500–1,700 kWh/m\textsuperscript{2} per year. The first solar park (a 100 MW station worth €70 million) is to be built in the southern Vlora region. Along the Adriatic coastline, but in other parts too, there is also the opportunity to exploit wind power. In addition, the biomass potential from agricultural waste is estimated at about 2,300 GWh per year.\textsuperscript{48} The Government intends to increase further the use of renewables. In 2017, a law promoting renewable energy was adopted, introducing schemes to support solar- and wind-energy producers\textsuperscript{49} through a competitive procedure.

**Use of natural gas as an alternative energy source would also enhance energy security.** With Kosovo and Montenegro, Albania is one of the few European countries not connected to the European gas transmission system. In the past, the country had a significant gas sector but domestic production is now negligible, limited to the industrial South of the country. The arrival in Albania of Caspian Sea gas through the trans-Adriatic pipeline (TAP) could provide an important new source of energy security, but should be deployed on a limited scale to ensure decarbonisation targets are achieved. The TAP, a project aiming to connect Albania, Italy and Greece with a single gas pipeline, is progressing on schedule. Close to 85 per cent of the project was completed by the end of 2018. The pipeline is expected to be operational in 2020. The government is also planning to convert the (inactive since construction in 2011\textsuperscript{50}) oil-fired Vlora thermal power plant into a gas-fired one (after connection to the TAP), which would stabilise the power generation during drought periods in the South of the country. According to the government’s Gas Master Plan for Albania, approved in February 2018, gas consumption should reach around 1.5 billion cubic metres per

\textsuperscript{47} Support schemes for the small hydropower plants with a capacity of up to 15 MW have been in force since 2007.


\textsuperscript{49} Above 2 MW for solar power and 3 MW for wind power.

\textsuperscript{50} Due to a faulty cooling system and high commodity prices.
year by 2030, driven by power generation and industrial consumption.

**Liberalisation of the electricity market is ongoing.** The Power Sector Law from 2015 established the framework for a fully liberalised electricity market in Albania. Following the adoption of the Law, a number of important reforms were made but progress has since slowed. The market is still closed by a contract between state-owned generation and supply companies. Some progress was made in legal unbundling of the power distribution operator (OSHEE) from its supply activity, but functional unbundling is still not in place. Also, consumers are restricted in changing the electricity supplier. Currently, electricity in Albania is sold through a set of agreements between companies or at regulated prices. This makes it impossible to determine the true value of electricity in the country. In order to create price transparency, the Albanian Power Exchange (APEX) is being developed but its establishment has been delayed several times from the Law deadline (March 2017). Finally, in May 2019, the government adopted a decision to set up a power exchange, with day-ahead and intraday markets, which should increase the security of power supply. The government expects the market to be fully liberalized by 2025.  

4.5. **Labour shortages and skills mismatches**

**Albania has a long history of emigration.** The emigration started in the 15th century, following the death of the country’s national hero, Scanderbeg, and the ensuing Ottoman invasion. According to some estimates, around one quarter of the population left for the neighbouring countries (Italy, Greece, Dalmatian coast). Over the next several centuries, emigration continued, driven by extreme poverty. During the socialist regime (1945–1990), leaving the country was illegal and severely punishable, temporarily halting the population outflow, but with the collapse of the socialist system and opening of the country it started again. In the 1990s, emigration was very high, mostly illegal in nature, dominated by young males, and concentrated on neighbouring countries (Greece and Italy). It was stimulated by the transition crisis in 1991–1994 and collapse of the pyramid savings schemes during late 1996 and early 1997, when two-thirds of Albanian families lost most of their savings and a large-scale political and social unrest ensued. The next decade was marked by the maturation of the cycle and mainly legal migration flows, one of them being through family unification. The economic and social status of Albanian immigrants improved, resulting in substantial remittances (usually between 10 and 20 per cent of GDP). In the current decade the emigration flows have intensified again.

**As a consequence, a substantial part of the country’s population lives abroad.** In 2013, Albania was among top-20 emigration countries globally. According to some estimates, its diaspora counts more than 1.4 million people, which makes it one of the largest in the world.

---

51 Three new companies were established, but the transfer of human resources to the companies has been delayed. Clear separation of supply and distribution system is crucial for the establishment of retail market competition.
53 For more detail on emigration from Albania, see UNDP (2018) and Gedeshi and Jorgoni (2012). The whole chapter derives strongly from these papers.
54 World Bank (2016)
relative to the population of the country. The majority of emigrants (70–75 per cent) reside in two countries, Greece and Italy. However, over the years and with the global financial crisis, the trend of Albanian emigrants has shifted towards other European countries, such as Germany, Netherlands, Scandinavian countries, United Kingdom, but also towards the United States and Canada.

**Strong emigration and “brain drain” hurt the country’s productive potential.** Besides depriving the country of the productive workforce in general, with important implications for economic growth, emigration is especially worrisome with regard to the migration of highly educated persons and professionals (the so-called “brain drain”). Being among the top-15 countries in the world by emigration of tertiary educated, Albania is severely hit by the “brain drain”. There have been three groups of people driving the process. The first one consists of highly qualified staff such as engineers, agronomists, teachers, geologists, economists, doctors and similar, that started to emigrate in the 1990s. Today, it is often about younger-age professionals, such as engineers, IT specialists, doctors and nurses. The second group consists of university lecturers, researchers and other professionals. It is estimated that between 1990 and 2008 over 40 per cent of university and research staff emigrated from the country. Finally, the third group are students studying abroad, including those who stay in the host country (or migrate to another one) after completing the studies. The number of Albanian students studying abroad rose from around 4,500 in 1998 to almost 25,000 in 2016, two to five times higher than in other WB countries. Surveys show that only a minority of them (up to five per cent) has firm intentions to return to the country.

**The majority of remaining adult population has a desire to leave as well.** According to a UNDP study, Albania ranked third among more than 150 countries by percentage of adult population wishing to emigrate in 2013–2016. Some 56 per cent of adults viewed themselves as potential emigrants. At the same time, this was 20 percentage points more than in 2010–2012, the greatest increase worldwide. Similarly, the Gallup’s worldwide survey conducted between 2015 and 2017, revealed that 60 per cent of Albanian adults wanted to emigrate, four times more than the world average, ranking Albania fourth out of 152 countries. The studies also show that the major reasons for emigration are high unemployment, low wages, poverty, as well as limited social protection and services.

Despite strong emigration, the unemployment rate remains at double digit levels. After peaking at 18 per cent in 2014, the unemployment rate has been on a decline since. However, at 13 per cent in 2018 it is still high. Interestingly, the rate is somewhat lower for women than for men (12.3 versus 13.2 per cent). Besides the weak demand for labour, high unemployment might be connected to supply side factors as well (including skills mismatches or high reservation wages due to strong remittances inflows). Another feature of the Albanian labour market (characteristic also for other WB countries) is a high share of long-term

55 World Bank (2016); Data refer to 2013.
56 They usually took jobs requiring little qualification, effectively translating the “brain drain” into “brain waste”.
57 UNDP (2018)
unemployment, with negative consequences for the persons concerned due to the loss of skills and social relationships, as well as for economic growth and public finances. In 2010–2018, around 70 per cent of unemployed in Albania were long-term unemployed, i.e. out of work for 12 months or more. As such, they have fewer chances to (re-)enter the labour market.

The unemployment rate is highest for the young, especially for the highly educated. The youth unemployment rate (at 28 per cent in 2018) in Albania has been consistently above the overall unemployment rate, about twice as high. The unemployment is highest for those with university degrees (34 per cent in 2018), and lowest for low-educated (25 per cent). This might reflect the divergence in the quality of education at different levels as evidenced by the WEF’s GCI 2017–2018. Namely, Albania ranked 24th (out of 137 countries) on the quality of primary education, but only 42nd on the quality of the higher one. Anecdotal evidence also suggests that parents in Albania do not mind that their children obtain primary and secondary education in Albania, but they prefer to send them abroad for university degrees. This might be already reflected in the tertiary education gross enrolment ratio, which dropped from 70 per cent in 2014 to 57 per cent in 2017.69

Skills mismatches are present in the forms of over-qualification and under-skilling.60 The former means that individuals work in jobs for which they are over-qualified or in areas unrelated to their field of study, while under-skilling refers to employing people without adequate skills as a consequence of shortage of properly skilled people. This is to a large extent a consequence of a mismatch between skills that businesses need and graduates’ fields of study. In Albania, there is a lack of graduates with technical skills at both secondary and tertiary levels, while tertiary education is dominated by humanities and business/finance.61 In addition, university curricula are mainly theoretical, with insufficient practical information.

59 http://uis.unesco.org/country/AL (Participation in Education) as of 03072019
60 See the Ministry of Social Welfare and Youth (2014).
61 According to the National Employment and Skills Strategy 2014–2020, businesses lack specialists and technicians in the areas of agriculture and agro-processing, textile and footwear, tourism, construction, transport and communication, energy, and information and communication technology. Similarly, there are very few graduates in the areas of technology, cost accounting, agronomy, production logistics, textile engineering, mechanical engineering, information technology, analysis and programming, while the opposite is true for education studies, business administration, finance, law, English, language, history and geography.
Technical and vocational education and training (TVET) is underdeveloped. The geographical coverage is narrow, with TVET institutions being located in a limited number of towns, so that various areas are completely excluded from the TVET. Also, the private sector is insufficiently involved in the planning and delivery of the programmes. In 2015–2017, enrolment in TVET stood at around 20 per cent of the total enrolment in secondary education. There was also a significant gender bias, with male students having three times higher enrolment rates than the female ones (30 per cent versus 9 per cent). The reasons are related to the culture, but also to the location of schools, lack of transportation, unsafe dormitories, etc. In February 2017, a new law on vocational education and training was adopted, but secondary legislation has not been yet.

Improving the quality of education is even more important given the youthfulness of the nation. The Albanian population has been shrinking (due to emigration and falling birth rates) and aging, but is still the second youngest in Europe, after Kosovo. Almost half of the population is below the median age of 35 years. A young labour force generally attracts global businesses and investors, but to realise the full potential of young people, a country must invest in them, especially in education.
5. Qualities of a sustainable market economy

In the EBRD’s Assessment of Transition Qualities (ATQs), Albania ranks 27th out of 38 EBRD countries of operations. In the EBRD’s recently adopted new methodology for measuring transition, ATQs are composite indices on six desirable qualities of a sustainable market economy (competitive, well governed, green, inclusive, resilient, and integrated), obtained by combining information on a large number of indicators and assessments.

In the majority of qualities Albania underperforms compared to the region and EBRD average. The country lags behind the SEE and EBRD average most in the Green and Inclusive qualities (around 1 index point difference), while the gap between Albania and advanced economies is largest for Well-governed (3.5 index points difference), followed by Inclusive, Resilient and Competitive (2.9–3.1 index points difference).

The following sections provide brief snapshots of each quality.

**ATQ scores 2018**

(index, WB-5

-5

− best)

Albania SEE EBRD Advanced economies*

---

* Canada, Czech Republic, France, Germany, Japan, Sweden, United Kingdom and United States

---

**Source: EBRD calculations**

---

64 The score is calculated as a simple average of scores for the six transition qualities

Competitive [ATQ = 5.0]

The country is characterised by an unfavourable business environment with widespread corruption, high informality and low productivity. These, in turn, have repercussions on the competitiveness the economy. Albania’s competitive advantage relies on low labour costs, while high value added activities remain limited. In the EBRD Competitive quality index, Albania is ranked 19th out of 38 countries, scoring below the EU-11 countries and around the WB-5 average.

Market structures and institutions for competition

- Despite recent improvements, the weaknesses in the business environment and regulatory framework remain a significant challenge to private sector development. In 2018, the country ranked 63rd out of 190 countries on the ease of doing business (World Bank), lower than any other EU-11 or WB-5 country, except for Bosnia and Herzegovina. Important obstacles to doing business in Albania are the red tape, difficult access to finance, widespread corruption, frequent changes to tax regulations and difficult access to land.
- Difficult procedures, administrative burden and volatiles tax rules are among the factors that also contribute to the high degree of informality in the economy, estimated to reach up to 50 per cent of the GDP. A high degree of informality creates unfair competition among firms and is deemed to constrain business operations.
- SMEs play a prominent role in the economy, offering employment opportunities to a high share of the population (80 per cent66, versus 66 per cent in the EU). According to the EBRD adjusted SME index67, the strength of SMEs in the country, given their role, could be further enhanced. Albanian SMEs lag behind those in other EBRD countries primarily in the areas of non-bank financing and business skills and standards (in particular financial literacy).

<table>
<thead>
<tr>
<th>Rank</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>63rd</td>
<td>in the ease of doing business among 190 countries (World Bank)</td>
</tr>
<tr>
<td>151st</td>
<td>in dealing with construction permits, 140th in getting electricity, 122nd in paying taxes (World Bank)</td>
</tr>
<tr>
<td>76th</td>
<td>in global competitiveness index among 140 countries (WEF)</td>
</tr>
<tr>
<td>92nd</td>
<td>in economic complexity out of 129 countries (OEC)</td>
</tr>
<tr>
<td>27th</td>
<td>in knowledge economy index among 37 EBRD countries of operation (EBRD)</td>
</tr>
<tr>
<td>112th</td>
<td>in the quality of research institutions among 140 countries (WEF)</td>
</tr>
</tbody>
</table>

- Business sophistication of a typical Albanian company is low, as a consequence of the limited know-how and alignment with international standards and best practices. Among the rest, this is signalled by a low relative number of ISO 9001 certifications68, where Albania lags behind most of the regional peers and, especially, EU-11 countries.

Capacity to generate value added and to innovate

- The productivity of the economy is low. Labour productivity is lower by more than 20 per cent than in the WB-469 and by 50 per cent than in the EU-11. Among the rest, this

---

66 Including micro companies
67 This index measures progress with reforms aimed at supporting the financing and development of SMEs in the economies where the EBRD invests.
68 Compared to population size
69 Data for Kosovo are unavailable
could be explained by a large share of the population (around 40 per cent) being employed in agriculture, with positions not requiring specialised skills, a limited business sophistication, weak capacity to innovate and unfavourable business environment.

- **Albania’s competitive advantage lies on low labour costs.** This remains one of the few incentives for FDI, although overall FDI inflows (in sectors other than energy and mining) are still very limited. This is also partly associated with the country’s weak integration into global value chains.

- **Capacity to innovate** is limited. Albania is ranked 31st out of the 38 countries of operation in the 2018 EBRD adjusted Knowledge Economy Index70, lagging behind both the EU-11 and WB-5, especially on the innovation system. Gross spending on R&D remains limited (at 0.2 per cent of GDP) and below the regional (0.5 per cent) and EU-11 average (1 per cent).71 Only a minor share of resources comes from the private sector participation. Besides limited financing, innovation is restrained by the low number of researchers. According to some estimates, in the first two decades following the fall of communism, half of the country’s university professors, researchers and intellectuals who graduated abroad, worked outside of the country. As a consequence, Albania is characterised by a relatively low number of patents, ranking 85th out of 140 countries (WEF).

- Low quality of education and skills shortages are a serious impediment on growth. While PISA scores have been constantly improving, they remain low. A half or more of the students perform poorly in reading and mathematics. Improvements in this area would require an overarching reform effort and increase in spending on education. Albanian public expenditures on education in 2018 were at 3.2 per cent of GDP, vs 4.6 per cent in the EU in 2017. The ability to retain highly skilled people or talent is another issue relevant for the country, especially against a backdrop of strong emigration it has been facing. For instance, Albania ranked 116th out of 137 countries on capacity to retain the talent in 2017.72

---

70 The index was established in 2018 in order to assess obstacles to innovation and the development of knowledge economies in the EBRD regions. It comprises 38 different indicators, grouped in four pillars: (i) institutions for innovation, (ii) skills for innovation, (iii) the innovation system, and (iv) ICT infrastructure.

71 The figure for Albania refers to 2008, the latest one available, while data for other countries are from 2016.

72 WEF GCI 2017–2018
Well governed [ATQ = 5.1]

The main governance weaknesses are weak rule of law, inefficient judiciary and widespread corruption. Albania ranks the worst in corruption perception among the WB countries. The government is taking efforts to address the issues, also in view of the EU accession, but the process is slow and bumpy.

- Albania scores better than the WB-5 average on most of the World Bank World Governance indicators, except for the rule of law and control of corruption. The country suffers primarily from weak and inefficient judiciary, and inconsistent implementation of laws and regulations. According to the Transparency International, weaknesses in law enforcement all over the Western Balkans are a consequence of captured political systems in which politicians exert enormous influence on all walks of public life, while being close to wealthy private businessmen or, sometimes, even to criminal networks. Strong presence of organised crime in Albania (ranked 108th out of 140 countries) undermines trust in state and its capability to fight it.

- The government has declared fight against corruption one of top priorities and started to take actions in that direction. However, after a notable improvement in 2013–2016, the corruption perception has worsened recently. In the 2018 Corruption Perceptions Index, Albania ranked 99th out of 180 countries, down by eight places from the year before and by 16 from two years earlier. Partially, the downgrade in 2018 is linked to a political stalemate, which led to the blocking of important anti-corruption reforms. A widespread corruption and bribery is also reported as an obstacle to doing business by more than 90 per cent of companies in the Foreign Investors Association of Albania (FIAA) survey from November 2018.

- Corruption also poses major money laundering risk in Albania. Significant criminal proceeds (from e.g. smuggling, drug and human trafficking) combined with the large informal economy, widespread use of cash and corruption in judiciary makes the country highly vulnerable to money laundering. A report by the Moneyval, published in December 2018, highlighted numerous deficiencies in this regard. In order to avoid a possible ‘grey-listing’ by the Financial Action Task Force in February 2020, the country should implement the Moneyval recommendations as soon as possible.

68th in the overall quality of institutions among 140 countries (WEF)
126th in judicial independence, 108th in organized crime, 111th in property rights protection, 106th in intellectual property protection among 140 countries (WEF)
99th out of 180 countries in Corruption Perceptions Index (Transparency International)
98th in enforcing contracts, 78th in the strength of auditing and reporting standards, 70th in the quality of land administration among 140 countries (WEF)
26th in protecting minority investors among 190 countries (World Bank)

- In order to fight the high level of corruption in the judiciary, which impeded its functioning and diminished the public trust in it, an extensive judicial reform is currently under way. One of the key laws adopted in the reform package was the “vetting law”.

73 See Council of Europe(2018)
74 The Council of Europe’s Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL)
Although it is a step in the right direction, the resulting dismissal of judges, or their withdrawal due to the conflict of interest, has led to a number of unfilled vacancies and accumulation of files. Also, the reform is going ahead slowly, both in terms of the vetting process and in terms of the establishment of the new anti-corruption institutions. Some concerns over the transparency of the process have also been raised.

- Property registration and rights needs strengthening. Access to land is particularly difficult issue in Albania. Land ownership is highly fragmented, as a consequence of the de-collectivisation process in the 1990s. Land titles are often not clear, with multiple persons claiming right to a particular land plot, which together with the lack of a properly functioning land market, discourages investors. Issues are further exacerbated by the weak rule of law. Sectors that would benefit the most from the resolution of the issue are those with a high development potential: agriculture and tourism.

- In 2018, Albania made enforcing contracts easier by establishing a simplified procedure for small claims and introducing time standards for certain court events. Still, the country scores 98th out of 140 countries in contract enforcement. It takes almost a year and a half and more than one third of the claim value to resolve a commercial dispute through a local first-instance court.

- Similarly, regulatory burden remains an obstacle for doing business, calling for streamlining of business regulations. To develop, businesses need clear and predictable rules, simple procedures, and level playing field. The government is aware of the regulatory burden issue and has been planning some measures to tackle it, but without numerical targets for performance indicators and without specifying e.g. which areas will be affected by the simplification activities. According to the European Commission, Albania also needs to better assess the impact of legislative proposals, consult stakeholders regularly and enhance monitoring mechanisms.

- At 27 per cent of GDP, government revenues are among the lowest in Europe. Among the rest, that is due to pervasive informality, complex tax system and weak tax collection. The government conducted an anti-informality campaign in 2015–2017, which contributed to increase in number of registered employees, but there is still a lot of room for improvement. Public administration should also be reformed and de-politicized.

- According to the EBRD assessment, corporate governance is weak in most areas (stakeholders and institutions, structure and functioning of the board, transparency and

---

75 The average farm size is 1.20 ha (2012).
76 World Bank Doing Business 2019
77 For more detail, see the Albania’s Economic Reform Programme 2019–2021.
78 EC (2019a)
79 Cigna et al. (2017)
disclosure, internal control), except for one – the rights of shareholders – where it is estimated as fair. Some of the reasons for the former are related to the underdeveloped economy, absence of powerful investor groups and guidelines and codes of practices required by investors, weak corporate culture, frequent government intervention\textsuperscript{80}, as well as a lack of capital market and listed companies. The vast majority of businesses in the country are run directly by their owners.\textsuperscript{81} Besides the lack of professional management, which is hurting the development potential of the companies, there are often succession issues as well.

\textsuperscript{80} Cipi et al. (2014) \hspace{1cm} \textsuperscript{81} Berberi (2016)
The country has a significant potential in renewable energy, but almost exclusive reliance on hydro sources in electricity generation poses energy security risks. Thus, an increase in the share of renewable energy sources other than hydro is needed. Energy efficiency could be enhanced. Despite some progress, a quarter of electricity is still lost in transmission and distribution. Waste management, wastewater treatment and air quality also need to be improved.

- Almost all of electricity in Albania is generated from hydro sources. Although this contributes to decarbonising the electricity sector, it also exposes the country to energy security, fiscal and environmental risks, intensified by the ongoing climate change. Around one third of the country’s electricity needs has been satisfied by imports.
- Besides hydro, the country has an important potential in other renewables (solar, wind, biomass) as well, which the government intends to use more. In 2017, a Law promoting renewable energy was adopted, introducing schemes to support solar- and wind-energy producers through a competitive procedure.\(^{82}\)
- Under the Energy Community Treaty, Albania has committed to increase the share of renewable energy to 38 per cent by 2020. In 2016, this share stood at 37 per cent. However, Albania plans to construct significant additional hydropower plant capacity. Similarly, new gas power plants (the largest one being a plant of up to 500 MWe at Korce) are to be built, undermining to some extent the decarbonised electricity supply.
- **Energy intensity** in Albania is lower than in other WB countries, but almost double higher than in the EU. In 2017, to generate EUR 1 000 of GDP\(^3\), 288 kilogrammes of oil equivalent were needed in Albania (vs. 118 kilogrammes in the EU-28). In Albania, transport accounts for the largest share of final energy consumption (40 per cent in 2017\(^{84}\)), significantly above the EU or WB-5 share (around 30 per cent). On the other hand, the shares for industry and households are lower than those observed in the EU-28 and WB-5. In 2016, the country adopted the national transport strategy and action plan 2016–2020, aiming to ensure a sustainable transport network and improve energy efficiency.

---

82 Until 2017, only incentives for hydropower were offered.
83 At 2010 prices
84 EUROSTAT
transmission and distribution have been reduced, but remain high, at 23 per cent of the total generated capacity in 2018. In 2015, the country adopted the law on energy efficiency, but implementation of the action plan, aiming to reduce energy use by 6.8 per cent by 2020, is lagging behind. The Law also envisages three state institutions being responsible for creation and implementation of the energy efficiency policy – Ministry of Infrastructure and Energy, Energy Efficiency Agency and Energy Efficiency Fund. However, the Agency and the Fund are still not operational. In 2018, Albania adopted a new National Energy Strategy 2018–2030 aiming to align its energy market with EU rules and directives, which will also improve country’s energy independence.

The waste management is inadequate, with weak collection systems for the municipal solid waste in urban areas and their absence in the rural ones. As a consequence, dumping in uncontrolled sites is the main method of the waste disposal. According to the European Commission, there are around 200 non-compliant landfills and dumpsites. Incineration is limited but poses worries, and it is also common to burn household and other waste in the open. There is not much recycling (some sorting of glass bottles, paper and cardboard, and copper scrap; EEA, 2018). Other issues include mining and medical waste. Only around half of the population in 2011–2015 was covered by a sewerage system, and the coverage differs significantly between urban and rural areas. Similarly, the wastewater treatment is limited (in 2015, only 19 per cent of population was connected to wastewater treatment plants), with the existing plant facing operational and maintenance issues. Another big issue is that two thirds of the produced drinking water is non-revenue water.

Air quality is an issue in urban areas, especially capital Tirana, due to traffic, substandard public transport, construction works and a high population density. The government has taken some measures (e.g. a ban on importing cars older than 10 years and not meeting the Euro 5 emission standard as of January 1, 2019), but the national strategy for air quality has not been adopted and the legislation in this area is not aligned with the acquis.

Thanks to the fact that almost all of electricity is produced from hydro sources and that high energy intensity industries no longer operate, Albania’s contribution to the global greenhouse gas emissions is (at 8.9 million ton/year of CO2 equivalent in 2012), lowest among the EU-11 and WB countries.

---

85 The Law is not fully aligned with the acquis.
86 The Energy Efficiency Agency was formally established in December 2016. It started functioning in October 2018, but is still understaffed. As for the Energy Efficiency Fund, a working group has been set up within the Ministry of Energy and Infrastructure to prepare its set up.
87 The strategy sets the target to reduce power distribution losses further, to 10 per cent in 2030, improve the collection rate of power bill payments to 98 per cent in 2030 (from 90 per cent in 2018), and increase renewable energy consumption to 42 per cent of the total consumption in 2030.
88 EEA (2018)
89 EC (2019b)
90 There is an incinerator in Elbasan (a waste-to-energy plant), and two more to be constructed, in Tirana and Fier. They “pose concerns in terms of compliance with EU Directives on Waste, the waste hierarchy principle with incineration as the least preferred waste management option, and with the EU targets for recycling” (EC, 2019).
91 UNECE (2018)
92 EUROSTAT
93 World Bank World Development Indicators
Inclusive [ATQ = 4.8]

High share of informal employment, low female participation in labour market and high youth unemployment represent the main inclusion challenges. Also, financial inclusion is well below the regional average. Poverty and limited employment opportunities drive a strong emigration from the country. Skills mismatches could be improved by improving the quality of tertiary education and developing further the vocational education and training.

- Informal employment is a prominent feature of the Albanian labour market. It has declined substantially since the launch of campaign against informality (2015), but at 36 per cent in the second quarter of 2018\(^\text{94}\) remains one of the highest rates in the WB region. Young men and older women are affected most by informal employment, and more than half of the informally employed are low-educated. Observed by sector, informality is greatest in the agriculture. Poverty is higher in rural areas and leads to an uncontrolled migration to urban parts to find jobs and secure a living. In general, informal economy workers are particularly vulnerable (due to low paid jobs, often unsafe working conditions, no healthcare and social insurance, lack of training preventing them claiming better jobs) and continue to pass vulnerability on to others, e.g. their children. Vulnerable employment in Albania is estimated at 57 per cent of total employment\(^\text{95}\), almost five times higher than in EU-11 and double the rate in the second worst performer among WB countries.
- One of the key inclusion challenges to be addressed is the low female labour market participation. In 2018, the participation rate for the working age female (15–64) stood at around 60 per cent, 17 percentage points lower than for men. For young women (15–24), the participation rate is only 28 per cent, 16 percentage points lower than for men. Limited access to child care support (available only in urban centres) is highlighted as the major barrier to higher participation rates for women in Albania. Women spend on average six times more time than men on unpaid care activities\(^\text{96}\). Beside this, high remittance inflows and cultural patterns (prolonged cohabitation with parents) also negatively impact labour market entry for youth as well.

<table>
<thead>
<tr>
<th>36 per cent of workforce is informally employed</th>
</tr>
</thead>
<tbody>
<tr>
<td>52 per cent of women (15–64) is employed</td>
</tr>
<tr>
<td>(vs 67 per cent for men)</td>
</tr>
<tr>
<td>28 per cent of youth (15–24) are unemployed</td>
</tr>
<tr>
<td>39 per cent of 15+ population has a bank account (vs. 65 per cent in WB-5)</td>
</tr>
</tbody>
</table>

- In 2018, the employment rate of the female working age population (15–64) was 52 per cent as compared to 67 per cent for their male counterparts, rendering a 15 percentage point gender gap in employment. Still, the gap has narrowed since 2010, when it stood at around 19 percentage points. Women in Albania are more often employed in low-income sectors and informally, while over half of the employment is considered to be vulnerable, mainly in agriculture. There are no legal restrictions to women’s employment in Albania. However, there is both horizontal and vertical gender segregation of the labour market. Women represent only 41.4 per cent of those employed in the non-agricultural sector. Almost half of women (48 per cent) work in the agricultural sector, followed by the

\(^{94}\) World Bank (2019b)  
^{95}\text{Modelled ILO estimate}  
^{96}\text{Charmes (2015)}
services sector (38 per cent). The rest (14 per cent) works in the industrial sector. There is also pronounced vertical gender segregation, as men are over three times more likely to be employers compared to women (male employers comprise 3.5 per cent of male employment compared to 1 per cent for female\textsuperscript{97}). Female entrepreneurs in Albania are under-represented in all sectors of the economy.

The unemployment rate has been on decline since 2015, but remains double digit. In 2018, it counted 12.8 per cent, with the female unemployment rate slightly lower than that of men (12.3 per cent vs. 13.2 per cent), signalling that once women enter the labour market they fare fairly well. The youth unemployment is of a particular concern. Although the rate went down from close to 40 per cent in 2015 to 28 per cent in 2018, the fact that it remains more than double the overall rate indicates that the relative position of youth in the labour market has not improved. The share of young people neither in employment nor in education and training in Albania is among the highest in the region, at 27 per cent in 2018.

Albania has the lowest tertiary education attainment rate in the WB region\textsuperscript{98}, with only 23.5 per cent of 30–34 year-olds having completed tertiary or equivalent education in 2017.\textsuperscript{99} One of the reasons might be the perceived low quality of the education. Namely, the above average unemployment rates for the highly-educated indicate potentially severe skills mismatches.

Vocational education and training is underdeveloped in Albania, with limited geographical coverage. Also, the private sector is insufficiently involved in the planning and delivery of the programmes. In 2017/2018 most students were enrolled in tourism and hospitality programmes, followed by ICT and transport.

Financial inclusion is low. In 2017, only 37 per cent of women and 41 per cent of men had bank accounts, well below the WB-5 average (62 per cent and 69 per cent, respectively).\textsuperscript{100} Similarly, borrowing from financial institutions and use of credit cards lagged behind the region (9 per cent of population aged 15+ versus 12 per cent).

Albania is faced with strong emigration, with around 1.4 million Albanians living abroad. According to the World Bank (2010), one out of three households in Albania had at least one member living abroad, and one half of these had more than one. In the long run, continued emigration, especially of the young and highly-skilled, will generate mismatches between the available skill levels and the required composition of the work force in the country.

\textsuperscript{97} Source: World Bank World Development Indicators 2015
\textsuperscript{98} Data for Kosovo are unavailable
\textsuperscript{99} EUROSTAT
\textsuperscript{100} World Bank Global Findex Database 2017
Resilient [ATQ = 5.3]

Albanian banking sector is stable but faces few challenges. While banks do well in terms of capitalisation, liquidity and profitability, they have high exposure to the sovereign and hold still significant non-performing loans. Against a backdrop of widespread informality in the economy, banks are not able to adequately support credit growth. Also, at over 50 per cent, euroisation is high, posing risks to financial stability. In terms of energy resilience, Albania is lagging behind the SEE region, except for the restructuring and unbundling of the electricity sector.

Financial resilience

- The Albanian financial system is dominated by banks. At end-2018, bank assets comprised 90 per cent of total financial system assets (or 97 per cent of GDP). Majority of banks (11 out of 14) is foreign owned, accounting for 78 per cent of total assets of banking sector. On the other hand, assets of investment funds (4 funds in total) and non-bank financial institutions (31) comprised 4.5 and 3.3 per cent of GDP, respectively.101

- The banking sector is well-capitalised, liquid and profitable. Since 2010, the capital adequacy ratio has been significantly above the regulatory minimum (12 per cent). In 2018 it stood at 18.2 per cent with some differences in level across banks, depending on their size and origin of capital (the ratio is highest for the small banks and those with foreign capital). Liquidity indicators, in both domestic and foreign currency, are also above the regulatory minimum. At end-2018, liquid assets comprised 35 per cent of total banking sector, while deposits covered almost twice the volume of loans. The latter indicates that bank lending is still far from its potential. The reasons behind are on both demand and supply side (sluggish demand, widespread informality, lack of creditworthy borrowers, tight credit standards by banks, weak land property rights, difficult foreclosure of collateral, etc.). Deposits are the main source of bank funding (accounting for over 80 per cent of banks’ liabilities), followed by banks’ own funds. As a result, reliance on external financing sources is limited. The profitability of the Albanian banking sector is comparable to that of WB-5 and EU-11 countries. In 2018, return on assets (ROA) and return on equity (ROE) stood at 1.3 per cent and 13 per cent, respectively. Progress has been made in aligning banking supervision with international standards, but the implementation of Basel II is still incomplete and further action is expected in terms of introduction of Basel III regulatory framework.

81st in financial sector development among 137 countries in WEF’s Global Competitiveness Index 2017–18

Banking sector capital adequacy ratio is at 18.2 per cent (end-2018)

14 per cent of loans to enterprises are non-performing at end-2018

137th in financing through local equity market among 137 countries (GCI 2017–2018)

Still high non-performing loans (NPLs) are a source of vulnerability in the system and further reduction is needed. In the aftermath of global economic crisis Albania experienced a significant increase in the NPL ratio, peaking in 2013 at 23.5 per cent. The increase was mainly driven by large companies and came as a consequence of multiple factors, from poor lending decisions...
by banks due to faulty reasoning, external influence or corruption, to lack of corporate structure in companies, deficiencies in external audit and government decisions negatively affecting some ongoing activities.\textsuperscript{102} The NPL ratio fell below 20 per cent in 2015, with the start of writing-off process, and continued trending downwards. In December 2018, the ratio stood at 11.1 per cent, being significantly higher for enterprises than for households (14.3 per cent vs 6.4 per cent).

- The banking sector has a high exposure to sovereign debt. Faced with limited investment opportunities, banks invest heavily into government securities (around 25 per cent for assets, which is above the 17–18 per cent average for emerging and developing economies\textsuperscript{103}). At end-2018, the banking sector in Albania held close to one third of total public debt, or over 60 per cent of the domestic government debt. This implies that a potential sovereign distress might have a direct impact on bank balance sheets.

- The financial euroisation\textsuperscript{104} is high (over 50 per cent), undermining the effectiveness of monetary policy and posing risks to financial stability. At end-2018, 56 per cent of all bank loans were denominated in foreign currency (FX). Over 40 per cent of these loans are unhedged, indicating high exposure to (indirect) exchange rate risk. The major part of unhedged loans (70 per cent) relates to enterprises, while the shares of households and government are significantly smaller (25 and 5 per cent, respectively). In general, unhedged loans were mostly taken for financing investments in real estate and trade (48 and 30 per cent of all unhedged FX loans, respectively). Similarly, deposit euroisation is also high (at 53 per cent at end-2018). A strategy to increase the use of the national currency and strengthen the financial stability is being promoted by the Bank of Albania, Ministry of Finance and the Financial Supervisory Authority.

- Capital markets\textsuperscript{105} are under-developed. The first stock exchange in Albania was the Tirana Stock Exchange (TSE), opened in 1996 as a department of the Bank of Albania. That was just shortly before several big financial pyramid schemes collapsed, with tragic social consequences.\textsuperscript{104} Therefore, the TSE never gained the trust of local businesses, but remained rather a legal concept until 2015, when it was suspended. In 2017, a new stock exchange - Albanian Securities Exchange (ALSE) – was set up, backed by three Albanian-owned banks. Given the lack of central depository of non-government securities in the country, the trading on ALSE has been (temporarily) limited to trading government securities. According to the IMF,\textsuperscript{106} the introduction of new instruments should be strictly regulated, given that neither governance nor market standards are

\textsuperscript{102} For more detail, see San (2018)\textsuperscript{103} See Dell’Ariccia et al. (2018), page 12\textsuperscript{104} For more detail, see Jarvis (1999)\textsuperscript{105} In 2002 it was made an independent institution.\textsuperscript{106} IMF (2018)
Albania Diagnostic 2019

supportive of expanding the range of trading activities.

**Energy resilience**

- Albania is lagging behind the SEE region in domestic and inter-country energy connectivity, private sector participation as well as in energy sector legal framework. On the other hand, it seems to do better than an average SEE country in sector restructuring and unbundling.

- **Electricity market** reforms (liberalisation of the market, unbundling of distribution and supply, establishment of Albanian Power Exchange, regional integration of electricity market) progress slowly. The government expects the market to be fully liberalized by 2025.

- Since 2014, Albania’s electricity system has been interconnected with the neighbouring systems of Greece and Montenegro. There is also a technically functional power interconnection line with Kosovo, but the country has not been able to use it so far.

- Albania is one of the very few European countries still not connected to any international gas networks. However, the trans-Adriatic pipeline (TAP) is progressing on schedule and is expected to be operational in 2020.
Integrated [ATQ = 5.7]

Albania has a room for improvement in both external and internal integration. The goods exports are low, and trade integration of the country consists mainly in assembling and re-exporting so-called “fasson” (textile and footwear) products for Italian clients. Foreign investors are scarce and focus mostly on natural resources sectors. On the other hand, services exports have boomed, mainly on the back of developing the tourism. Addressing the investment needs the country has in the areas of transport, electricity and water infrastructure would enhance the prospects of the sector further, but also the overall business environment and quality of life.

External integration

- The trade openness of the country went up over the past three decades, but at less than 80 per cent of GDP remains low, both compared to the EU-11 and Western Balkans peers. Similarly, exports of goods and services are also comparatively lower, comprising less than one third of GDP. Main export products are low–value added, labour-intensive products and raw materials. Textile and footwear account for a major share of exports (around 40 per cent, down from around 60 per cent in mid-2000s), followed by minerals, fuels and electricity (around 20 per cent). At the same time, textile and footwear is also the only group of products for which Albania has positive trade balance. Albania is the largest exporter of crude oil in the SEE region.

- Despite the economy being relatively closed, exports of services have been growing at a striking pace driven by the tourism. These exports have increased fivefold since the early 2000s and in 2017 accounted for one fourth of GDP, a larger share than that in EU-11 or other Western Balkans countries. The increase in services exports came mostly as a result of rise in travel and tourism-related services.

- Albania has one of the lowest stocks of foreign direct investment (FDI) in Europe. At around US$2,350 per capita in 2017, the FDI stock in Albania was just somewhat over half of the WB-5 average. Numerous issues have been raised with regard to the weak attractiveness of the economy for foreign investors, from a difficult access to land to a dissatisfying quality of labour.

Trade as a share of GDP is at 78 per cent vs. 104 per cent in WB-5 (World Bank, 2017)

FDI stock per capita is 55 per cent of the WB-5 average (UNCTAD, 2017)

94th on quality of infrastructure out of 137 countries (WEF, 2017)

88th on (international) logistics performance index out of 160 countries (World Bank, 2018)

- Natural resources sectors have been favoured by foreign investors, while investments in manufacturing have been limited. As a result of a new Law on Strategic Investments, the FDI stock\textsuperscript{107} increased by more than 50 per cent between end-2015 and end-2018. However, the majority of the increase went into energy and mining, with the major energy projects being the Trans-Adriatic Pipeline and the Devolli hydropower plant. At end-2018, energy and mining accounted for 40 per cent of the total FDI stock. At the same time, the share of manufacturing was below 10 per cent.

- Albania’s international logistic performance ranking improved from 117\textsuperscript{th} in 2016 to 88\textsuperscript{th} in 2018, but remained below that of WB

\textsuperscript{107} Inward FDI, i.e. liabilities
peers\textsuperscript{108}. More specifically, the country ranks poorly across a number of logistic quality indicators; 114\textsuperscript{th} in customs and border efficiency, 110\textsuperscript{th} in trade and transport infrastructure, 95\textsuperscript{th} in ability to track and trace consignments, and 92\textsuperscript{nd} in competence and quality of logistics services.

![Trade openness (% of GDP)](source: WB WDI)

**Internal integration**

- **EBRD’s Transition Report 2017–18** estimates Albania’s **infrastructure investment needs** at around 10 per cent of its annual GDP over 2018–2022. The infrastructure needs surpass those of other WB countries, except for Bosnia and Herzegovina, and appear mostly in the electricity and transport sector.

- **Albania lags behind the WB peers on the** electricity infrastructure, ranking 90\textsuperscript{th} out of 140 countries\textsuperscript{109}, due to still high transmission and distribution losses. On the positive side, the whole population has access to electricity.

The country performs poorly in terms of quality of transport infrastructure, especially regarding the quality of railways (ranked 101\textsuperscript{st} on quality of railroad infrastructure\textsuperscript{110}, and 136\textsuperscript{th} on efficiency of train services\textsuperscript{111} out of 137 countries). The need for investment in the rail system is urgent and highly visible. The city of Durres, on Albania’s Adriatic coast, is currently the country’s main railway hub with routes to two other cities. The majority of investments in the transport sector over the past decade were concentrated on improving the road network, but around half of the regional and local roads are estimated to be in a poor or very poor condition. Air connectivity is also weak, with Tirana airport currently being the only airport in the country with international service. In early 2019, another airport was put under a (35-year) concession, primarily to service flights of low-cost carriers. Finally, maritime transport is based on four sea ports, with the leading one accounting for 80 per cent of international ship-borne traffic.

- **Water sector infrastructure** is outdated and in disrepair, with 2/3 of water being lost during transportation and distribution.\textsuperscript{112} In the WEF’s 2018 GCI, Albania ranked 111\textsuperscript{th} out of 140 countries on reliability of water supply. Around 80 per cent of population has access to water supply, and around 50 per cent to sewerage.

- **On ICT adoption**, Albania ranks 74\textsuperscript{th} out of 140 countries, doing better only than Bosnia and Herzegovina in the WB region.\textsuperscript{113} Only 10 per cent of population in Albania has fixed-broadband Internet subscription (compared to 20 per cent in other WB countries).
## Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>BEEPS</td>
<td>Business Environment and Enterprise Performance Survey</td>
</tr>
<tr>
<td>EPI</td>
<td>Environmental Performance Index</td>
</tr>
<tr>
<td>EU-11</td>
<td>New EU member states (Bulgaria, Croatia, Czech Republic, Hungary, Estonia, Latvia, Lithuania, Poland, Romania, Slovak Republic, Slovenia)</td>
</tr>
<tr>
<td>GCI</td>
<td>Global Competitiveness Index</td>
</tr>
<tr>
<td>IFI</td>
<td>International financial institution</td>
</tr>
<tr>
<td>kgoe</td>
<td>kilogramme of oil equivalent</td>
</tr>
<tr>
<td>NPL</td>
<td>Non-performing loan</td>
</tr>
<tr>
<td>OEC</td>
<td>Observatory of Economic Complexity</td>
</tr>
<tr>
<td>PPP</td>
<td>Purchasing Power Parity</td>
</tr>
<tr>
<td>SEE</td>
<td>South-Eastern Europe (Albania, Bosnia and Herzegovina, Bulgaria, Cyprus, North Macedonia, Greece, Kosovo, Montenegro, Romania, Serbia)</td>
</tr>
<tr>
<td>WB-5</td>
<td>Western Balkans – 5 (BIH, Kosovo, Montenegro, North Macedonia, Serbia)</td>
</tr>
<tr>
<td>WEF</td>
<td>World Economic Forum</td>
</tr>
</tbody>
</table>
References

- Atoyan, R., D. Benedek, E. Cabezón, G. Cipollone, J. Miniane, N. Nguyen, M. Petri, J. Reinke, and J. Roaf (2018), Public Infrastructure in the Western Balkans – Opportunities and Challenges, International Monetary Fund, Departmental Paper No. 18/02
- EEA (2018), Albania Country Fact Sheet: Municipal waste management, European Environmental Agency, September 2018
- EIB (2016), Assessment of financing needs of SMEs in the Western Balkans countries – Country report: Albania

Medina, L. and F. Schneider (2018), Shadow Economies Around the World: What Did We Learn Over the Last 20 Years?, International Monetary Fund Working Paper Series, WP/18/17


O'Brien, T., L. Nedelkoska, & E. Frasheri (2017), What is the Binding Constraint to Growth in Albania?, Center for International Development at Harvard University

Olters, J. P. (2003), Albania’s Informal Economy: An Impediment to Economic Development?, mimeo


UNDP (2018), Reversing Brain Drain with the Albanian Scientific Diaspora, March 2018 (a report by Ilir Gëdeshi and Russell King)

UNECE (2018), Albania: Environmental Performance Reviews - Third Review, United Nations Economic Commission For Europe, Environmental Performance Reviews Series No. 47


World Bank (2019b), Western Balkans Labor Market Trends 2019