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COMMISSION STAFF WORKING DOCUMENT

ECONOMIC REFORM PROGRAMME

OF

ALBANIA
(2019-2021)

COMMISSION ASSESSMENT

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Contents

1. EXECUTIVE SUMMARY

Albania's economic reform programme (ERP) projects economic growth to accelerate to 4.5% by 2021 based on strong private domestic demand. GDP growth in 2018 was robust at 4.2%. Private demand is expected to continue driving economic growth in 2019-2021, based on greater employment, rising wages and favourable lending conditions for households. Private investment activity is projected to pick up significantly in this period, driven by emerging capacity constraints and favourable financing conditions. Net exports are expected to make only a marginal contribution to the economic expansion. The growth outlook appears optimistic in light of a worsening external environment, continued low levels of lending to businesses, and enduring weaknesses in the business environment.

The ERP expects Albania to cut public debt from 67% to below 60% of GDP by 2021 by reducing current expenditure and stabilising tax revenue. The 2018 budget deficit has turned out lower than planned with estimated 1.5% of GDP, mostly due to lower than expected capital spending. The ERP expects the budget deficit to fall to 1.2% of GDP in 2021 by reducing current expenditure but does not provide details of a fiscal consolidation strategy. The relatively low public expenditure does not allow for significant expenditure cuts which partly explains the moderate pace in debt reduction. The relatively low tax revenue is planned to stabilise without major reforms outlined and will thus remain below potential. Public investment is set to increase to over 6% of GDP by 2021, but achieving this increase could be difficult due to weaknesses in the planning and management of capital expenditure.

The main challenges Albania faces are outlined in the bullet points below.

- **Public debt is still high, and large financing needs are weighing on debt sustainability; tax collection is also below potential.** The planned debt reduction strongly depends on high economic growth until the end of the programme period. Advancing the fiscal consolidation can mitigate the risk of not achieving the debt reduction target in case of lower growth in coming years. Stronger fiscal rules on timing, enforcement, correction measures, and monitoring by an independent fiscal institution could all help in reaching the medium-term debt target. The high level of undeclared work and tax evasion provides ample scope for increasing tax revenues without raising tax rates. Unrecorded arrears and contingent liabilities undermine the credibility of the public debt position.
- **The ERP assumes rising investment, but does not address conditions necessary for increasing private investment or for improving the efficiency and growth impact of public investment.** Private investment in Albania is hampered by shortages of skilled labour and the low quality of public services accessible to entrepreneurs. Entrepreneurs also lack productive and entrepreneurial know-how, financial literacy, and access to finance. Albania's investment in education and health has been below the regional average, and the ERP plans to decrease even further the share of budget allocations to education and health. The increases planned for public investment should also be used to finance education, health and research, and this investment must be more efficient and more effective.
- **Albania's competitiveness continues to be hampered by inefficiencies in the energy sector, including insufficient security of supply.** The dependence on hydropower for electricity generation (98%) makes the economy vulnerable to climate change and hydrological conditions. In addition, Albania is a net importer of electricity contributing to the considerable trade imbalance. Investment in energy

efficiency could contribute to lowering these vulnerabilities. Albania has adopted legislation on the liberalisation and unbundling of the gas and electricity markets in line with the EU's third energy package, but it is not yet fully implemented.

- **The tourism sector in Albania has a great potential, but it is underdeveloped.** A comprehensive tourism strategy has been developed, but it has seen significant delays in its adoption, which jeopardises the sustainable development of this sector, in spite of its significant potential to contribute to economic development and to offer competitive export growth. There is a need to develop relevant Vocational Education and Training (VET) programmes in the tourism field.
- **High youth unemployment and inactivity, low female employment, high share of informal and vulnerable employment, insufficient social care services and low quality of education are key obstacles.** Active labour market policies need to better target vulnerable jobseekers, provide more upskilling and be more relevant to labour market needs. Social assistance allowances are not sufficient to lift the poor above the extreme poverty line. Social care services for inclusion of vulnerable people are insufficient and many local government units lack capacities and resources to plan and deliver them. Educational outcomes are weak at all levels and the VET reform is delayed. Early childhood education suffers from very low investments and low enrolment for children from vulnerable families. Participation in adult education is particularly low.

The policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2018 has been partially implemented. Progress was partial on the reduction of public debt through fiscal consolidation measures. The number of taxpayers increased but at the same time a number of tax exemptions were introduced. The value-based property tax was not fully implemented. The ERP reported on future payment obligations to PPPs but not on their fiscal risk assessment. There has been some legal progress in unbundling the electricity and gas markets but the Power Exchange has not been established. Some progress has been made in broadening the energy mix but not in promoting energy efficiency. There has been some progress with registration of property, while no progress has been made on setting up the e-cadastre and land consolidation. Human resources at the Directorate of Employment and Skills Development Policies remain limited. More activation support was provided to (ex)-beneficiaries of economic assistance, but their coverage is still low. The State Labour Inspectorate improved detection of undeclared work, but its capacities were not increased. The curricular reform in basic education is almost finalised, but teachers need further support.

The ERP sets out reform plans that are partially in line with the priorities identified by the Commission. The programme's macro-fiscal framework is slightly optimistic. The achieved debt-ratio and the reconfirmed commitment to lowering public debt are in line with the Commission's recommendation in previous years but the approach to achieving the fiscal targets could be more strategic. The diagnostic on structural obstacles focuses on access to finance, agricultural land ownership, business regulation, and trade facilitation. However, it does not cover issues like diversifying the production base, property rights, entrepreneurship support and contract enforcement. The measure on pre-university curricular reform does not address the need for continuous support to teachers. VET reform and modernisation of public employment services respond to challenges, but their pace needs to be sustained. The measure on social protection does not address low capacity and resources of local government units. Three new measures in the area of education are not sufficiently developed and seem to address structural issues only partially.

2. ECONOMIC OUTLOOK AND RISKS

The ERP projects that economic growth will gradually accelerate from 4.3% to 4.5% over 2019-2021, helped by strong private consumption and investment. The pace of economic growth increased to 4.2% in 2018, driven by private consumption, rising employment, low interest rates, and low inflation. For 2019-2021, the ERP expects that the main contributions to growth will come from private consumption (increasing by an average of 2.4 pps over the period), and investment (increasing by an average of 1.5 pps over the period). The ERP expects private consumption to be supported by higher rates of employment, rising wages, and favourable lending conditions for households. Private investment is projected to increase significantly, partly in response to an already high level of capacity utilisation. Net exports are expected to only marginally contribute to the economic expansion, as strong annual growth in exports (of 7% per year on average) is forecast to be offset by a relatively strong growth in imports (of 4.7% per year on average) in line with investment-related needs. The ERP projects strong growth in agriculture and industry, but services are expected to remain the main driver of labour demand. Increasing labour force participation will boost labour supply. However, only slight improvements are expected for labour productivity, on which the ERP provides no details. Employment is projected to grow on average by a rather robust 2.7% per year, bringing the unemployment rate gradually down to 9.8% by the end of the programme period. The ERP estimates that the current negative output gap will close in 2019 and turn slightly positive in the following 2 years.

In addition to the described baseline scenario, an ‘optimistic’ and a ‘pessimistic’ scenario are presented (including deviations in terms of lending to the economy, euro-area growth, and the pace of structural reforms). The negative scenario assumes that shocks bring growth down to 2.8-3%, which would result in a fiscal deficit of 2.3-2% of GDP. The optimistic scenario forecasts growth 1 pp. above the baseline and fiscal deficits dropping to 1.3-0.7% of GDP over the programme period

The baseline scenario appears optimistic on the projected increase in both exports and investment in the current external environment. The expected acceleration of growth is partly based on a benign external outlook for global and EU growth, which is more optimistic than recent forecasts by the IMF (WEO, January 2019) and European Commission (Autumn Forecast 2018). In particular, the economic outlook for Italy, Albania’s main export destination and investment partner, deserves particular attention. Moreover, the programme’s assumption for oil prices appears too high. Projections for less volatility in metal prices, in the wake of the Chinese economic slowdown and international trade disputes, do not appear to be sufficiently reflected in the ERP. These developments in the prices of oil and metals could significantly affect Albania, which is a primary commodity exporter of oil and chrome. The expected acceleration in investment growth to around 6-7% over the programme period would be about 2 pps higher than in any year since 2011. Such an acceleration seems optimistic, given the low levels of bank lending to private businesses and the slowdown in implementation of reforms after the administrative restructuring. The planned increase in public investment to 6% of GDP would be in line with the country’s needs, but would require significant efforts to improve institutional capacity for the planning and execution of public investment. The programme does not provide arguments for its projection that agricultural production will make a stronger contribution to growth than it has done in recent years.

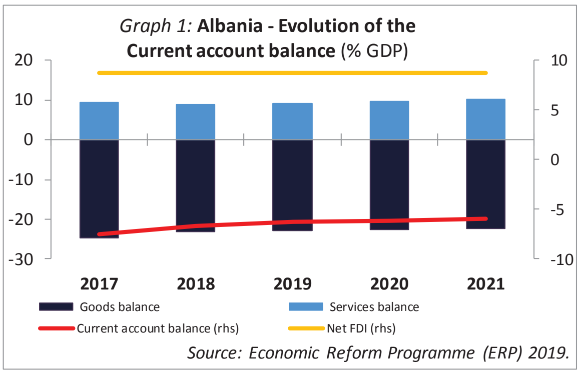
The ERP expects inflation to return to target by 2020 based on rising domestic inflationary pressures. The annual average of the consumer price index rose by 2.1% in 2018, considerably below the 3% target of the central bank, and marking the seventh consecutive year of below-target average annual inflation. Over the last year, the stable rate of inflation mainly reflected the disinflationary impact of the increase of the lek's value. For the most part, it was domestically produced goods (like unprocessed food items) that contributed 1 pp. to the inflation rate. The value of the lek increased by 8% in real effective terms in 2018. This was greater than the increase that was expected from improving fundamentals which prompted the central bank to intervene temporarily on the foreign exchange market to contain the disinflationary impact of the currency appreciation. The central bank expects the exchange rate pressure on prices to dissipate over 2019 and that instead inflationary effects of domestic demand will dominate which could bring inflation in line with its target by 2020. The ERP's technical assumption that the nominal exchange rate will remain unchanged at its average of 2018 does not seem to reflect that the recent strong appreciation is expected to dissipate. The ERP lacks an analysis of the possible impacts on Albania's external competitiveness of future fluctuations of the lek, increasing wages and inflation.

Table 1:
Albania - Comparison of macroeconomic developments and forecasts

	2017		2018		2019		2020		2021	
	COM	**ERP**	COM	**ERP**	COM	**ERP**	COM	**ERP**	COM	**ERP**
Real GDP (% change)	3.8	**3.8**	4.1	**4.2**	3.9	**4.3**	3.9	**4.4**	n.a.	**4.5**
Contributions:										
- Final domestic demand	5.0	**4.1**	4.7	**3.8**	4.3	**4.3**	4.4	**4.0**	n.a.	**4.4**
- Change in inventories	0.0	**0.9**	0.0	**:**	0.0	**:**	0.0	**:**	n.a.	**:**
- External balance of goods and services	-1.2	**-1.2**	-0.6	**0.4**	-0.4	**0.0**	-0.4	**0.4**	n.a.	**0.1**
Employment (% change)	3.3	**2.7**	1.7	**2.1**	0.6	**2.8**	1.3	**2.6**	n.a.	**2.6**
Unemployment rate (%)	13.7	**14.1**	12.7	**12.8**	11.1	**11.7**	10.6	**10.7**	n.a.	**9.8**
GDP deflator (% change)	1.4	**1.4**	3.8	**1.9**	2.4	**2.0**	2.3	**2.2**	n.a.	**2.5**
CPI inflation (%)	2.0	**2.0**	2.3	**2.1**	2.6	**2.7**	2.8	**3.0**	n.a.	**3.0**
Current account balance (% of GDP)	-7.5	**-7.5**	-6.3	**-6.7**	-6.4	**-6.3**	-6.4	**-6.1**	n.a.	**-6.0**
General government balance (% of GDP)	-2.0	**-2.0**	-2.0	**-2.0**	-1.9	**-1.9**	-1.7	**-1.6**	n.a.	**-1.2**
Government gross debt (% of GDP)	70.1	**70.1**	69.9	**69.1**	67.6	**65.5**	65.2	**63.6**	n.a.	**59.9**

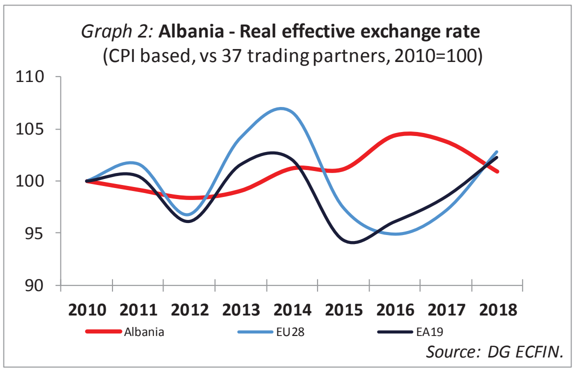
Sources: Economic Reform Programme (ERP) 2019, Commission Autumn 2018 forecast (COM).

The current account deficit is expected to continue to fall and be mainly financed by Foreign Direct Investment (FDI). In 2018, high electricity exports and a decreasing share of commodity imports reduced the traditionally high trade deficit by 3 pps to an estimated 21.6% of GDP. Net FDI (which mainly financed the current account deficit) grew exceptionally strongly, thanks to one-off inflows of investment in energy projects. Over 2019-2021, imports of goods are expected to stabilise, keeping the trade deficit at around 21% of GDP. Services exports are projected to benefit from continued strong growth in foreign tourism, but the services surplus is expected to slightly decrease in 2019-2021 compared to previous years. The current account is also projected to benefit from continued inflows of remittances from the Albanian diaspora, although these remittances are forecast to grow at a slower pace compared to their growth in more recent years. Overall, the current account deficit is expected to decline at a slower pace than in 2017-2018, falling from 6.7% to 6% of GDP over the programme period. This projection is subject to downside risks (i.e. the real decline may be smaller) due to: (i) the volatility of hydropower-based electricity production, (ii) the uncertainty over the share of imports in quickly-growing domestic demand, and (iii) the possibility of slower-than-expected growth in Albania's main trading partners. The ERP projects that net FDI will grow by between 6% and 7% in 2019-2021, less than in 2018, and will cover on average 130% of the current account deficit.



Graph 1: **Albania - Evolution of the Current account balance** (% GDP)

Source: Economic Reform Programme (ERP) 2019.



Graph 2: **Albania - Real effective exchange rate** (CPI based, vs 37 trading partners, 2010=100)

Source: DG ECFIN.

External vulnerabilities are mitigated by improved external debt metrics and solid forex reserves. A slowdown in the European economy — and in particular the Italian economy — may negatively affect the net flow of remittances. This would have a negative impact on the current account and on net FDI inflows, which would affect financing of the current account. Gross external debt stood at 64.5% of GDP at the end of September 2018, down from 68.4% at the end of 2017. About 80% of the external debt stock is long-term. More than half of this external debt is owed by the government and most of the rest consists of intercompany lending between direct investors and subsidiaries. Although the external debt is sizeable, its composition means that it is not a cause for immediate concern. Foreign-exchange reserves provide a good safeguard against adverse shocks, and are expected to rise by around 10% a year over the next 3 years. Foreign reserves totalled EUR 3.0 billion (25.7% of GDP) at the end of 2018, and comfortably cover more than 6 months of imports of goods and services. The central bank assesses external debt sustainability as being more vulnerable to exchange-rate risks than to interest-rate shocks, but it states that its reserves are sufficient to mitigate those risks.

Bank balance sheets are expected to improve further, but poor collateral execution and the dominance of foreign currencies pose risks. Financial intermediation also remains shallow. Banks are well capitalised, highly liquid, and predominantly funded by deposits. However, the stock of non-performing loans remains high, and has continued to act as a drag business lending. This has made financing conditions more onerous. The low financial literacy of SMEs and large number of 'unbankable' business plans contributed to sluggish credit growth. The ratio of non-performing loans (NPL) to total gross loans declined by 3 pps to 11% at the end of 2018, mainly as a result of mandatory write-offs. This ratio is now expected to decline below 10% over the programme period. However, collateral execution remained weak and might hamper the further reduction in NPLs. The share of foreign-exchange loans in total loans fell only slightly to 55.1% in 2018, while foreign-exchange deposits increased slightly to 52.2% of total deposits. [1]The banking sector holds over 20% of its assets in government securities, exposing it to sovereign risks. In addition, a quarter of domestic loans and deposits remain exposed to exchange-rate risks. The banking sector could be made more stable by the planned strengthening in the resolution function at the central bank and by bringing the macro-prudential framework closer to EU standards. Overall, financial inclusion remained low,

[1] The effect of the strong exchange rate appreciation in 2018 is likely to distort the actual changes in forex loans and deposits.

with only 40% of adults and about 75% of SMEs holding bank accounts. There is a high rate of physical-cash use. The central bank has drawn up a plan for increasing financial inclusion, which is important for reducing remittance fees, illicit financial flows, and the size of the informal economy. A stronger development of the still very small non-banking financial sector could support financial inclusion as well as access to finance for SMEs.

Table 2:

Albania - Financial sector indicators

	2014	2015	2016	2017	2018
Total assets of the banking system (EUR million)	9244	9435	10248	10768	11 398
Foreign ownership of banking system (%)**	87.1	84.1	82.6	81.4	80.8
Credit growth* (%)	2.0	-2.8	0.4	0.2	0.5
Deposit growth	4.6	2.6	5.2	0.7	1.3
Loan-to-deposit ratio	59.0	57.4	57.2	57.0	52.3
Financial soundness indicators					
- non-performing loans	22.8	18.2	18.3	13.2	11.1
- net capital to risk-weighted assets	16.8	16.0	15.7	16.6	18.2
- liquid assets to total assets	10.5	10.9	12.8	13.0	14.8
- return on equity	10.5	13.2	7.1	15.7	13.0
- forex loans to total loans (%)	61.5	60.0	57.8	55.7	55.1

* Adjusted for loan write-offs

**of total sector assets

Sources: Economic Reform Programme (ERP) 2019, IMF, Bank of Albania, ECFIN CCEQ.

3. PUBLIC FINANCE

The 2018 fiscal balance improved more than planned, largely due to underspending on the capital budget. The budget deficit is estimated to have narrowed from 2% of GDP in 2017 to 1.5% in 2018. The deficit turned out lower than the initially forecast 1.9% of GDP, mainly due to underspending on the capital budget, with an implementation rate of below 70% (in November 2018). Also, current spending was lower than planned (86% in November 2018), due to lower personnel, social insurance and interest expenditure. At the same time, tax revenues were more than 10% below forecasts, as the unexpectedly fast appreciation of the currency affected income from VAT and excise duties on imports.

The deficit is forecast to remain below 2% in 2019, mainly by maintaining expenditure at current levels. The ERP contains the same deficit target (of 1.9% of GDP) as the medium-term fiscal framework (MFF). However, Chapter 4 of the ERP also mentions a revised target of 1.7% of GDP. Based on the preliminary data from 2018, both targets would lead to a widening deficit. The ERP also plans to reduce total spending from 30% of GDP to below 29.6% of GDP, due to a decreasing current expenditure ratio. The ERP also forecasts that the share of capital expenditure will increase to 6.2% of GDP. Multiple tax exemptions and ad hoc expenditure items (such as a bonus for giving birth) were introduced for 2019. It is estimated that this will reduce revenues by 0.28% of GDP and increase expenditure by 0.43% of GDP. Tax revenue as a share of GDP (excluding social insurance contributions) is forecast to shrink from 16.9% to 16.6% in 2019 due to: (i) lower revenue from production and imports, and (ii) lower growth in VAT revenue than in recent years.

Table 3:

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

	2017	2018	2019	2020	2021	Change: 2018-21
Revenues	27.7	28.0	27.8	27.8	27.8	-0.3
- Taxes and social security contributions	22.2	22.4	22.2	22.3	22.4	0.0
- Other (residual)	5.5	5.6	5.5	5.4	5.3	-0.3
Expenditure	29.7	30.0	29.6	29.3	28.9	-1.1
- Primary expenditure*	27.7	27.5	27.3	26.8	26.2	-1.3
of which:						
Gross fixed capital formation	5.5	6.2	6.2	6.0	5.9	-0.3
Consumption	9.4	9.3	9.1	9.0	8.7	-0.5
Transfers & subsidies	12.1	11.9	11.7	11.6	11.3	-0.5
Other (residual)	0.7	0.2	0.2	0.3	0.3	0.1
- Interest payments	2.1	2.5	2.4	2.5	2.7	0.2
Budget balance	-2.0	-2.0	-1.9	-1.6	-1.2	0.8
- Cyclically adjusted	-1.6	-1.8	-1.9	-1.7	-1.2	0.5
Primary balance	0.1	0.5	0.5	0.9	1.5	1.0
- Cyclically adjusted	0.4	0.7	0.5	0.9	1.4	0.7
Gross debt level	70.1	69.1	65.5	63.6	59.9	-9.2

* Excluding arrears clearance

Sources: Economic Reform Programme (ERP) 2019.

The ERP outlines plans for a back-loaded fiscal consolidation in 2019-2021, while aiming to increase capital expenditure as a share of GDP. The small primary surplus is expected to remain unchanged in 2019 (compared to the initial plan for 2018) and improve in the next 2 years, rising from 0.5% to 1.5% of GDP in 2021. The cyclically adjusted budget balance also suggests a restrictive stance in 2020 and especially in 2021, in line with the expected positive output gap. Over the programme period, total spending will drop by close to one percentage point of GDP (from 30% to below 29% of GDP), due to a slight decrease in current expenditure and an increase in capital expenditure to an average of 6% of GDP. The revenue-to-GDP ratio is forecast to remain broadly unchanged despite the significant potential to increase tax revenue and social contributions by fighting informality and tax evasion. Overall, tax revenue is forecast to stabilise at 16.6% of GDP, thus remaining below the regional average. Despite the government's plan to fight informality and the forecasts for strong employment growth, social insurance contributions as a share of revenue are expected to remain unchanged. This means there is little prospect of a reduction in the social insurance deficit. The ERP envisages debt reductions of 1.9 pps from 2019 to 2020 (to 63.6% of GDP) and 3.7 pps between 2020 and 2021 (to 59.9% of GDP). This would mean shifting the bulk of the adjustment to the last year of the government's legislative term.

Box: The budget for year 2019

On 26 October 2018, the government presented the draft budget for 2019 to parliament. Parliament adopted the budget on 3 December 2018. The budget targets a deficit of 1.9% of GDP and a primary balance of 0.5% of GDP.

* Overall, tax revenue is expected to increase by 1.3 pps of GDP due to: (i) increasing revenues from VAT, personal income tax, and social security contributions (all due to economic growth); (ii) higher rates of formal employment; and (iii) improved collection efficiency. New tax measures will also boost tax revenues by 0.28% of GDP. The main revenue measure is the reduction of the dividend tax rate, which is expected to increase tax revenues by +0.2 pps of GDP thanks to increasing tax declarations, although overall taxes on profits are expected to turn out lower in 2019 (-0.018 pps of GDP) compared to 2018.

* Overall expenditure is expected to grow by 5.1% and reach a share of 29.6% of GDP (down from 30% of GDP in 2018). Current expenditure is set to increase by 1.1% of GDP, mainly for personnel expenditure (0.27% of GDP) and social insurance outlays (0.47% of GDP). Expenditure for new policy measures would come to 0.43% of GDP. Capital expenditure (of central government) is to increase by 0.35% of GDP to a share of 4.7% of GDP, no details are provided on investments of local governments.

Main measures in the budget for year 2019	
Revenue measures*	**Expenditure measures****
• VAT exemptions of certain activities in the tourism sector (-0.02 pps of GDP) • Personal income tax reduction for about 15 400 employees (-0.02 pps of GDP) • Reducing the dividend rate from 15% to 8% (increasing revenues by 0.25 pps of GDP due to expected higher rates of declaration) • National tax revenues reduced by 1 pp. of GDP due to: (i) restricting gambling (-4 billion leks), (ii) changes in taxes on plastic packaging (+0.5 billion leks), and (iii) an increase in royalties on chrome exports (+0.03 pps of GDP) • Increase in excise revenues due to higher excise duties on packets of cigarettes and on other tobacco products (+0.04 pps of GDP) • Increase in customs-duty revenues of 5.6% due to: (i) an increase of taxable imports, and (ii) customs tariff unification (of tariff band category 8418) to 10% (0.002 pps of GDP) • Net revenue gain from new tax measures: 0.28 pps of GDP	• New wage policy (0.1 pps of GDP) • New pension policies (0.14 pps of GDP) • Baby bonus (0.11 pps of GDP) • Contingency reserve for justice reform (0.08 pps of GDP) • Expenditure increase from new policy measures: 0.43 pps of GDP

* Estimated impact on general government revenues.
** Estimated impact on general government expenditure.
Source: ERP/MFF

High public debt remains a key concern but the government's target of reducing debt to below 60% of GDP by 2021 seems within reach. In recent years, the public debt ratio has been declining gradually, in compliance with the fiscal rule. This decline has continued even though the target date for reaching a debt level (including guarantees) of below 60% had been postponed for the last three consecutive years. The 2019 programme sticks to the target date of 2021, stipulated in last year's programme. Supported by the appreciation of the lek, the gross-public-debt-to-GDP ratio in 2018 was most likely less than originally estimated (67% instead of 69.1%).[2] With this lower estimated starting base in 2018, a reduction of about 7.5 pps of GDP over 3 years appears feasible. However, the pace of debt reduction over the ERP horizon is back-loaded, with no significant fiscal adjustment planned for 2019. The current benign growth outlook provides scope for a more front-loaded debt-reduction path over the ERP cycle.

Despite successful measures to prolong maturity, short-term debt and gross financing needs remain a risk to debt sustainability. Short-term debt still accounts for 35% of the total, but interest-rate risks were lowered as the share of domestic debt with variable interest rates was reduced. Gross financing needs remain above 20% of GDP and pose a risk to debt sustainability. The domestic market, mainly banks, is expected to remain the main financing source. External sources are expected to finance up to 25% of the government's gross financing needs, mostly through concessional and semi-concessional project loans from bilateral and multilateral sources that do not pose sustainability risks. However, with the increasing share of commercial financing through the planned eurobonds, sustainability risks might rise. Externally held debt has increased as a percentage of public debt, but is set to decrease by about 2% per year in terms of GDP, mainly due to currency appreciation. Key objectives of the debt-management strategy are to: (i) shift public debt to longer maturities, and (ii) reduce roll-over risks. These two objectives will partly be achieved by increasing the share of debt that is denominated in foreign currencies, but limiting foreign-currency-denominated debt to 55% of total debt.

The main risks to fiscal consolidation are: (i) a slowdown in economic growth and (ii) the underestimation of fiscal risks from both contingent liabilities and weaknesses in public financial management (both at central- and local-government level). The risk analysis of the ERP confirms that the fiscal consolidation targets may not be achieved if there is a significant slowdown in economic growth. Key risks to debt reduction are the underestimation of fiscal risks related to both contingent liabilities from public enterprises and the growing number of PPPs. PPPs have now reached a value of 31% of GDP, with additional projects planned that would increase the total value by 15 pps of GDP for 2019 (IMF 2019). At the same time, there has not been a corresponding increase in the numbers of staff available to monitor and assess these complex contracts and projects. This means that the public financial obligations related to the PPPs are not being comprehensively assessed and statistically recorded. Information on publicly guaranteed debt differs between the figure given in the ERP (3.3% of GDP rising to 5-6% of GDP in the medium term) and the MFF (2.9% of GDP, forecast to decrease to 2.6% of GDP by 2021). There does not appear to be any risk analysis of this publicly

[2] This is a preliminary figure, which might still be subject to minor modifications. The Albanian debt calculation includes public guarantees (which are usually not included in the deficit defined by the Excessive Deficit Procedure EDP), but does not include arrears (which are included in the IMF calculation of the deficit). The debt ratio is based on the IMF forecast of nominal GDP according to the budget law.

guaranteed debt. Weak management of the public finances has led to a stock of arrears on debt payments by local governments and from VAT refunds. The IMF estimated that these arrears were worth 1.5% of GDP by the end of September 2018. There were also arrears in public energy corporations and possibly other public entities. These arrears are not accounted for in the MFF, but their correct inclusion as expenditure would certainly increase the fiscal deficit, and possibly also increase financing needs.

Box: Debt dynamics

The main debt-increasing component are interest payments, while GDP growth, and from 2018 onwards the positive primary balance are contributing to the declining debt ratio. The stock-flow adjustments reflect the Eurobond issuance in 2018 and the planned issuances in 2020 and 2022. According to the risk analysis in the ERP, external debt sustainability is more vulnerable to exchange-rate fluctuations than to global interest-rate movements. The dynamics show that debt reduction is most sensitive to economic growth, a finding which is in line with the results of the IMF's latest debt-sustainability analysis. There has recently been a shift towards a greater share of the country's debt being held outside Albania, and this trend looks set to continue. This means there will be an increase in exchange-rate risk. However, the large foreign reserves and the appreciation of the currency in recent years means that the impact of this can be contained. In 2018, the actual debt ratio is likely to be 67.2% of GDP, and the primary balance is likely to be 0.7% of GDP. This shows that the debt reduction was significantly greater than initially assumed in 2018, due mainly to the currency appreciation and under-expenditure on the budget. The debt-reducing effects of the primary balance are likely to continue, opening more space to front-load the debt reduction.

Table 4:
Albania - Composition of changes in the debt ratio (% of GDP)

	2017	2018	2019	2020	2021
Gross debt ratio [1]	**70.1**	**69.1**	**65.5**	**63.6**	**59.9**
Change in the ratio	-2.2	-0.9	-3.6	-1.9	-3.7
Contributions [2]:					
1. Primary balance	**-0.1**	**-0.5**	**-0.5**	**-0.9**	**-1.5**
2. "Snowball" effect	**-1.6**	**-1.6**	**-1.8**	**-1.6**	**-1.6**
Of which:					
Interest expenditure	2.1	2.5	2.4	2.5	2.7
Growth effect	-2.7	-2.8	-2.8	-2.7	-2.7
Inflation effect	-1.0	-1.3	-1.4	-1.4	-1.5
3. Stock-flow adjustment	**-0.6**	**1.2**	**-1.3**	**0.7**	**-0.6**

[1] End of period.
[2] The snowball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator).
The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other effects.
Source: Economic Reform Programme (ERP) 2019, ECFIN calculations.

Albania's public finances continued to suffer from relatively low levels of tax collection and high levels of informality. Although significant progress was made in tax collection and administration, tax revenue as a percentage of GDP remains below the regional average, and the social insurance system is suffering from a large deficit. The low revenue mobilisation is mainly due to the large size of the informal economy, but is also attributable to widespread evasion of tax or social contributions — even in the formal economy (e.g. by using lower prices or wages for tax declarations). VAT evasion is estimated at 30-40% of potential VAT, and roughly 30% of employments are estimated to remain undeclared. Moreover, the recent introduction of tax exemptions as investment incentives further undermines revenue collection and promote tax fraud, because they complicate the taxation system and make it less transparent.

The link between policy objectives and corresponding budgetary allocations remains weak. In general, public investment has focused on physical infrastructure to address Albania's large infrastructure gap, which is mainly in energy but also in water supply. However, actual investment allocations fluctuated greatly between sectors from year to year. Allocations for health and education are below the regional average, and social protection coverage is low. The government plans to further decrease the already-low allocations to education (which will fall from 2.5% to 2.2% of GDP), health (which will fall from 3.0% to 2.7% of GDP) and social protection (which will fall from 9.0% to 8.6% of GDP) over the programme period. These allocation plans do not help to tackle the brain drain and shortages of skilled labour. Nor do they help to encourage convergence to European standards in these fields. While current expenditure will remain at a reasonable level, the government's hiring plans for staff in the public sector seem to be under-executed. This might lead to shortages in staff (and subsequent quality problems for public finances and public investment management) at a time when the budget plans to increase capital expenditure.

Albania's fiscal framework lacks strong enforcement mechanisms and an independent fiscal institution. The fiscal rules in Albania provide for a long-term target of 45% of debt to GDP, with an obligation to decrease this ratio each year compared to the previous year until the target is reached. Budget plans for 2019 comply with the fiscal rules on debt reduction, the deficit target (the deficit must be lower than the capital expenditure), and the limit on payments to PPPs. The contingency reserve for exchange rate fluctuations (0.2% of GDP for 2019 and 0.4% for 2020 and 2021) is overall low but in line with the requirement of the budget law, namely 0.7% of total expenditure. The main weakness of the existing framework is that it does not prescribe a timeline or minimum requirements for the consolidation path. There is no independent fiscal institution to monitor fiscal policy and the implementation of the fiscal rule. The authorities do not envisage the establishment of such an institution over the programme horizon due to capacity constraints. However, an independent fiscal body, even if small, could help strengthen the current rules-based framework by assessing compliance or by providing independent budget analysis or revenue forecasts. The quality of fiscal data is improving and alignment with European System of Accounts (ESA) 2010 standards is ongoing with support from Eurostat.

4. STRUCTURAL CHALLENGES AND REFORM PRIORITIES

Much of Albania's growth and export potential is linked to nature-based sectors such as coastal tourism, agriculture, hydropower and mining. At the same time, this dependence on natural resources coupled with a dependence on volatile water resources, creates vulnerabilities. Albania's exposure to, and sensitivity towards, the quality of natural assets, natural disaster risks, and climate change affect important sectors such as agriculture, energy and tourism and, therefore, the livelihoods of large parts of the population, especially the less well-off. Furthermore, the uncertainty on property titles remains a serious impediment to investments, including in tourism and the agricultural sector, but also limits private sector investment and access to finance.

The Commission has conducted an independent analysis of the Albanian economy to identify the key structural challenges to boost competitiveness and inclusive growth, drawing from Albania's ERP itself but also using other sources. This analysis of the economy shows that Albania experiences several structural weaknesses across many sectors. However, the main challenges in terms of boosting competitiveness and long-term and inclusive growth are (i) improving the labour market relevance, quality and targeting of active employment policies, including upskilling of adults and VET, (ii) tapping renewable and energy saving potentials and fully opening the energy market as well as (iii) ensuring sustainable development of the tourism sector.

4.1. Key challenges

Key challenge #1: Improving the labour market relevance, quality and targeting of active employment policies, including upskilling of adults and VET

Active labour market policies show some improvements in 2018, especially in job mediation, but remain insufficiently targeted, underfunded, limited in scope and unavailable in rural areas. Employment promotion programmes (EPP) are not targeted or tailor-made enough for unemployed people who are more in need such as long-term unemployed, women with family responsibilities, beneficiaries and ex-beneficiaries of economic assistance, older people, low qualified, and Roma/Egyptian. Overall, the programmes do not provide an adequate support to vulnerable jobseekers to transit into higher productivity jobs or to integrate the labour market in a sustainable way. Another type of active employment policies are vocational training courses, which are generally of a too low quality for a successful transition to the labour market. Young people (15-29) face a challenging labour market transition, with almost 30% of them not being in employment, education or training (NEET). Vulnerable youth is also insufficiently targeted by EPP. While the number of students enrolled in secondary vocational education and training (VET) has increased over the last years, it is still low. The labour market transition from VET is rather low (46.9% employed one year after graduation). The reform of secondary VET is delayed, including improvement of the quality at offer and its relevance to the labour market, linkages to the private sector and accessibility. Reintegration of vulnerable people is insufficient as social care services, responsibility for which was decentralised to the local level, are missing in many areas or are underdeveloped. Many local government units lack capacities and resources to plan and deliver social care services and almost half of them lack experience due to the inexistence of such services in their territory. The central government does not seem to devote enough attention to this issue. Early childhood education and care (ECEC) suffers from lack of policy framework, very low investment and low enrolment of children from vulnerable families. The lack of ECEC and social care services puts an additional obstacle to the employment of women whose employment rate is 14 pps lower than that of men.

Key challenge #2: Tapping renewable and energy saving potentials and fully opening the energy market

The Albanian economy is hampered by the inefficiency of its energy market and the insecurity of its energy supply. Albania depends almost exclusively on hydropower for its electricity generation (98%), which has a positive contribution to decarbonising its electricity sector but makes it highly vulnerable to unfavourable hydrological conditions in the summer, as well as to the impact of climate change. As a result, Albania is in most of the recent years a net importer of electricity (up to 40% annually) and the sustainability of its power supply poses a challenge. The government plans to convert the currently inactive oil-fired Vlora thermal power plant into gas-fired use in the mid-term after connection to the Trans Adriatic Pipeline (TAP). This would stabilise the generation of electricity during droughts in the southern part of Albania. Albania is part of the trans-Adriatic pipeline project, which aims to connect Albania, Italy and Greece with a single gas pipeline. Although the project is progressing on schedule, Albania is still not connected to any international gas networks. It has an outdated pipeline network of almost 500 km, which is mostly not operational. This means businesses and industry rely heavily on the electricity sector.

Given its natural endowments, Albania has the potential to develop renewable energy sources. In addition to hydropower potential, and expected gas interconnection, Albania is endowed with solar irradiation and wind speeds, which would make solar photovoltaic and onshore wind cost competitive in many locations (IRENA, 2017). The exploitation of these renewable energy sources has only just begun, but, Albania already held the first renewable energy auction of the Energy Community in November 2018. However, the current installed capacity of these technologies is very small. The implementation of feed-in tariffs provides a promising opportunity for the future, but has had only a limited impact on the development of solar energy so far because of the small size of the auctioned capacities. The government has announced plans for the implementation of 120 MW of solar and 70 MW of wind power capacity by 2020. The support schemes offered for renewable energy are of limited range and both private households and SMEs have a limited access to the relevant technologies.

Albania's focus on hydropower disregards some significant risks. The government plans to increase energy generation focus on the construction of new hydro-power plants, which raises serious concerns about the wider environmental impact and could have significant negative effects on local communities and on tourism. Moreover, in view of the expected increase in tourism and intensification of the agricultural sector, as well as the impact of climate change, the water resources of Albania may come under strain. Therefore, it will be necessary for Albania to widen its strategic approach by diversifying its electricity generation through increased investments in solar and wind power, as well as developing a comprehensive water management strategy, accounting for all competing uses.

Energy efficiency should receive greater attention from the government. In spite of some progress in recent years, electricity distribution losses in 2018 remained high at 24.4%. In implementation of the energy efficiency law, Albania has adopted an action plan for the period until 2020, aiming at reducing energy use by 6.8%. However, the implementation of the action plan is lagging. Albania's economy remains three times more energy intensive than the EU 28 average. Improving energy efficiency will decrease the energy needs of the economy, and therefore reduce production costs, improve energy security and reduce the trade deficit. The transport and residential sectors, which are responsible for up to 70% of the final energy consumption, should be the main target for energy efficiency measures.

Albania has adopted legislation on the liberalisation and unbundling of the electricity and gas markets in line with the EU's third energy package, but it is not yet fully aligned and implemented. Some progress has been achieved in the legal unbundling of distribution from supply activity, but functional unbundling has not yet been finalised. Electricity prices are still regulated but should be gradually liberalised once legislation is implemented. The electricity market remains closed by regulated wholesale contract between state-owned generation and distribution companies, which needs to be phased out.

Key challenge #3: Ensuring sustainable development of the tourism sector

Albania has the potential to become an important tourist destination in Europe, but the sector remains underdeveloped. The tourism sector in Albania has emerged as a significant contributor to growth with almost 6 million inbound tourists in 2018 compared to 4 million in 2015 (4.7 million in 2016, 5.1 million in 2017) and directly generated 8.5% of GDP in 2017. The sector, together with the satellite services, contributes an estimated 26.2% to GDP and 24.1% to total employment. The World Travel and Tourism Council (2016) forecasts annual average growth rates of 6.2% until 2027. In 2016, travel and tourism directly supported 85,500 jobs (7.7% of total employment), but this is expected to rise by about 3% annually to reach 120,000 jobs or

10.1% of total employment in 2027 (WTTC, 2016). Indeed, the tourism sector can have a multiplier effect on employment through side services and related sectors. However, if tourism is to reach its full potential, the government must overcome several critical structural obstacles.

The lack of standardisation in the tourism sector – linked to weak coordination and planning - hampers the development of tourism. Tourism faces challenges of coordination, planning and undisciplined development. The competitiveness of the sector is weakened by the lack of well-defined rules and regulations of tourism activities. The quality of the provided services would improve by introducing a system of harmonised classification, licensing, certification and monitoring. Moreover, according to Albania's ERP 2017-2019, the unfair competition due to high level of informality puts additional pressure on the process of standardisation. More efforts are also needed to enable access to market information, and to develop marketing as well as a destination management system.

The underdeveloped infrastructure further constrains the development of tourism. The lack of accommodation facilities with large capacities and high air transport prices in comparison to neighbouring countries negatively affect the competiveness of the sector. The government provides fiscal incentives for the construction of four and five star hotels. Recent investors' interest may lead to some improvements of accommodation capacity in the medium term.

Seasonality poses another clear challenge. Tourism demand (particularly foreign) is mainly concentrated in the summer months, with 50% of visitors arriving in July and August. There is a strong need to diversify, expand and integrate tourism by offering a variety of attractions, activities and services, which would enhance opportunities for tourists all year round and increase their average spending with 3.5% to 5% annually. The promotion of green and rural tourism would support this diversification.

The tourism sector also suffers from weaknesses in the business environment. Uncertainties over property ownership and poor access to basic infrastructure, energy and waste management affect the tourism sector in particular. There is also a lack of skills relevant to the tourism sector due to a lack of a well-planned platform for vocational training. In spite of some improvements, the overall business climate, including the weak access to finance, prevents small and medium sized enterprises (SMEs) from keeping pace with the increasing number of tourists and meeting their requirements. To stimulate growth and development of domestic tourism enterprises, the government will need to develop a platform for supporting the private sector and stimulating innovation, know-how transfers and the provision of business advice. Improving the business environment would also attract more FDI in the sector.

The government is committed to the development of tourism and has made important steps, but further efforts are needed. The government has been working with the support of international partners on developing a tourism strategy, but it has not yet been adopted. Current plans focus on the development of yacht ports, 5-star hotels and agri-tourism. The government and the tourism service providers should work to enhance the attractiveness of Albania as a tourist destination, including its rich cultural heritage and under-visited inland. There has been limited cooperation between the government, local authorities, civil society and the private sector on how to prioritise actions to improve quality and innovation and how to ensure sustainable development.

There is limited understanding in Albania of responsible tourism. As a result, environmental damage has occurred by the unmanaged tourism growth (particularly on the coast). The economic and social opportunities have not always been maximised or fairly distributed. Preserving natural resources is key for securing the income sources of households and firms in sectors relying on natural endowments such as agriculture, energy, water, extractive industries and tourism. The government should ensure that society is benefiting from the boom in the tourism sector especially in rural and inland areas.

4.2. Labour market, education and social policies

Labour market developments

Positive overall developments on the labour market continued in 2018. Between 2017 and 2018, the labour force participation rate for people aged 15-64 increased by 1.2 pps to 68.3%, the unemployment rate decreased by 1.3 pps to 12.8% and the employment rate improved by 2.1 pps to 59.5%. Employment is high in comparison to the region, but it hides a high underemployment. At the beginning of 2018, job creation was identified as one of five major cross-sectoral priorities of the current government. A comparison between Albania and the EU average based on 2017 figures shows a labour force participation rate lower by 6.5 pps and an unemployment rate higher by 6.3 pps, resulting in an employment rate lower by 10.3 pps. Between 2014 and 2017, the gap with the EU has narrowed by around 4 pps for both labour force participation and employment rate indicating a potential for convergence.

Female employment gap remains unchanged, young people continue to face major difficulties on the labour market despite significant recent improvements, and high structural unemployment persists. The gender employment gap (15-64) at 14 pps (2017) is wider but not far from the EU average (10.5 pps). However, no clear improvement has been observed over the past years. Low availability of early childhood care and social care services for elderly increases vulnerability of women in terms of their labour market integration. The employment rate of young people (15-29) improved by 10.3 pps since 2014 to 38.5% in 2018 and their unemployment rate dropped by 9.4 pps to 23.1% over the same period. However, these rates are still 21 pps lower, respectively 11.3 pps higher, than for the whole population aged 15-64. Albania remains among the worst performers in the region in the number of young people not in employment, education or training (NEET). One in four young people (15-24) is NEET increasing to almost 30% for 15-29 years old (2017). The NEET rate peaks at 37.7% for the age group 25-29, pointing at a very challenging labour market transition for young people. A high proportion (65% or 125,675 individuals) of all NEETs in 2017 were inactive non-students not looking for a job. There is a high structural unemployment, with two thirds of unemployed being long-term unemployed, and skills mismatches. Inactivity rate (15-64) is high for low-skilled (36.4% in 2018), followed by people with secondary education (31.4% in 2018).

Active labour market policies (ALMPs) show some improvements in 2018, but remain insufficiently targeted, underfunded, limited in scope and unavailable in rural areas. Financing of ALMPs is at low 0.065% of GDP with no increase since 2016. The main measure is job mediation with a 50% annual increase in the number of placed jobseekers (23,136 in 2017 versus 34,669 in 2018), resulting in 46% of all registered jobseekers employed through this ALMP in 2018. However, only 5.16% (3,858) registered jobseekers enrolled newly in 2018 in another ALMP, the Employment Promotion Programmes (EPP). Despite apparent focus on female and young jobseekers, these programmes do not adequately target the most vulnerable youth and do not necessarily provide women with an adequate support to transit into higher productivity jobs. They also insufficiently target other vulnerable categories such as women with family responsibilities, older, low qualified, (ex)-beneficiaries of economic assistance and Roma/Egyptian unemployed. Targeting of long-term unemployed improved in 2018, but remains low. The majority of EPP are pure wage subsidies, which limits the prospects of upskilling and of sustainable integration into formal labour market. Another category of ALMP is short-term, supply-driven training provided in vocational training centres (VTCs) with 7,064 jobseekers benefitting in 2018 (decline from 9,461 in 2017). However, impact of VTCs on improving skills and integrating the labour market is low. There has been no progress as regards availability of employment services in rural areas. The newly adopted Employment Promotion Law (March 2019) and the expected establishment of the National Agency for Employment and Skills within 90 days has a potential to allow a swift progress in the reforms of ALMPs, including a reinforced analysis of prospective needs of the labour market and a reform of vocational training for adults.

The structure of employment and a high level of informality excludes more than every second worker from enjoying labour rights. A high share (52.9% in 2017) of own-account workers and contributing family members indicates a high degree of vulnerability (no access to full employment rights, social security or health insurance) and a significant underemployment (seasonal, ad hoc, home and casual workers). Agriculture employs 42.4% of people (LFS 2017) including also those engaged only in subsistence agriculture. The biggest challenge is a large extent of undeclared work, be it work without a contract, non-payment of social contributions or underreporting of wages. The share of informal employment in the non-agricultural sector is 30.3% (LFS 2017). The State Labour Inspectorate (SLI) has occasionally increased controls, which led to a higher detection. However, structural challenges related to SLI functioning remain unaddressed. Despite the pressing need, only isolated measures/campaigns have been undertaken by SLI and the General Directorate of Taxation in the absence of a comprehensive cross-sectoral approach or a strategy for tackling undeclared work.

Social dialogue remains very weak both in the public and private sector. The mandate of the National Labour Council (NLC) was renewed in March 2018, but clear representativeness criteria are still under discussion in the tripartite working group established by the responsible Ministry. The Secretariat of the National Labour Council is not yet fully staffed. Consultations in the NLC take place without adequate preparation and remain limitedly meaningful. The establishment of regional tripartite councils is still expected. Bipartite social dialogue is underdeveloped. Finally, the amicable labour disputes resolution system needs further consolidation.

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

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

Albania faces challenges with regard to a number of indicators of the Social Scoreboard[3] supporting the European Pillar of Social Rights. This is the case for equal opportunities, access to the labour market and social protection and inclusion. There have been some improvements in employment and unemployment rates. However, Albania faces substantial underemployment. As regards the share of young people not in employment, education or training (NEETs), despite improvement over the last years Albania remains among the worst performers in the region. The gender employment gap (15-64) is wider than EU average (14 pps vs 10.5 pps) and has not improved in recent years. Poverty projections indicate still high poverty rates, affecting particularly the unemployed, the low-skilled, people in rural areas, elderly, vulnerable women, persons with disabilities, Roma and Egyptians.

ALBANIA		
Equal opportunities and access to the labour market	Early leavers from education and training (% of population aged 18-24)	Worse than EU average, improving
	Gender employment gap	Worse than EU average, no change
	Income quintile ratio (S80/S20)	N/A
	At risk of poverty or social exclusion (in %)	N/A
	Youth NEET (% of total population aged 15-24)	Worse than EU average, improving
Dynamic labour markets and fair working conditions	Employment rate (% of population aged 20-64)	Worse than EU average, improving
	Unemployment rate (% of population aged 15-74)	Worse than EU average, improving
	GDHI per capita growth	N/A
Social protection and inclusion	Impact of social transfers (other than pensions) on poverty reduction	N/A
	Children aged less than 3 years in formal childcare	Worse than EU average, trend N/A
	Self-reported unmet need for medical care	N/A
	Individuals' level of digital skills	N/A

Albania also struggles with very low education outcomes on all levels of education, which is partly due to its low financing. There are high rural and socioeconomic differences in access to education. Despite investments in VET, the system remains insufficient to address the skills mismatch. Lifelong learning and skills development outside formal education system are very weak and inadequate, especially outside urban areas.

The social protection system is not adequate and targeted to cover those in need. While social assistance exists, the amount of allowances is insufficient to prevent poverty. Effects of reform of social assistance on better targeting still need to be assessed. Capacity of local governments, to which the responsibility for provision of social care was decentralised, is too low. The pension system has an almost universal coverage, albeit with low pensions. The coverage of health care insurance is very low and even less so for some vulnerable categories.

Data availability is a particular issue in the area of social protection and inclusion. The last measurement of poverty and exclusion was carried out in 2012. The low availability of statistics as well as reliable and timely data significantly affects the ability to conduct thorough analyses and impact assessments as a basis for evidence-based policies and measures. Employment data are regularly measured both in the Labour Force Survey and by the National Employment Service.

[3] The Social Scoreboard includes 14 headline indicators, of which 12 are currently used to compare Member States performance (https://ec.europa.eu/eurostat/web/european-pillar-of-social-rights/indicators/social-scoreboard-indicators). The 12 indicators are also compared for the Western Balkans and Turkey. The assessment includes the country's performance in relation to the EU-28 average (performing

Social protection system

Poverty rates are presumably high and recent reliable data is crucially missing. Despite collection of Statistics on Income and Living Conditions (SILC) since 2016, no poverty data have been published so far. The poverty rate was last measured in 2012 and stood at 39.1%. The poverty rate estimate for 2018 is 35.2% (World Bank). Groups reportedly at higher risk of poverty are the unemployed, the low-skilled, people in rural areas, elderly, vulnerable women, persons with disabilities as well as Roma and Egyptians. The highest level of poverty is observed in the northeast of the country.

The social protection system does not provide for adequate protection of those in need. Unemployment benefits in Albania reach only a small fraction of registered unemployed (2.7%). A reformed economic assistance scheme was rolled out countrywide in January 2018 to improve targeting, administrative efficiency and to reduce fraud. While available data (November 2018) show increased share of new beneficiary households among the recipients since January 2018, there is a lack of evidence/analysis on whether improved targeting of those most in need is being achieved. The relative financial weight of the scheme is only 0.025% of GDP (2018). The effectiveness of the scheme is questionable, as the allowance remains below the extreme poverty threshold, and only a small share of persons living in poverty are covered. As regards disability benefits, a new assessment system will be piloted in two administrative units in Tirana in 2019, which should result in improved targeting and efficiency.

Activation of vulnerable people has received more attention, but inclusion through social care services is insufficient and many local governments lack capacities and resources to plan and deliver them. In 2018, more activation support was provided to beneficiaries and ex-beneficiaries of economic assistance with 3,958 people employed through job mediation and additional 648 people enrolled in vocational training courses. Attendance in the latter is newly supported through a specific employment promotion programme approved in 2018. The activation support coverage is still very low and insufficiently tailor-made to this target group. Another dedicated employment promotion programme covered 21% of registered disabled job seekers in 2018. The figure is however not representative of inactive disabled people who require more tailor-made support. A particularly challenging area are social care services which are undeveloped, underinvested and lacking in many areas. With the ongoing reform, local government units are expected to assess needs in their territory and to prepare social care plans, but they lack capacities and resources and almost half of them (27 out of 61) lack experience due to inexistence of such services in their territory.

Enrolment in pre-school education has increased significantly, whereas a policy framework for early childhood education and care (ECEC) is missing. Policy attention focuses on enrolment in the last pre-school year that currently stands at 88% of all children with an objective of reaching 98% within five years. The share of children aged 3-4 attending early childhood education was 73% in the school year 2017-2018 which is a significant increase by 18 pps over the last 10 years. However, these figures hide a significantly lower (by more than 20 pps) enrolment rate of children from more vulnerable families compared to children from wealthier families or from parents with a university degree. Attendance of Roma children (3-6 years) in early learning services

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worse/better/around EU-28 average) and a review of the trend for the indicator based on the latest available 3-year period for the country (improving/deteriorating/no change). Data from 2014-2017 are used.

increased substantially to 66% in school year 2016-2017 compared to only 26% in 2011. Only 5% of education budget goes to ECEC, which is around 0.16% of GDP, significantly below the EU average of 0.7% of GDP. Kindergartens in urban centres have insufficient capacity and are non-existent in some remote areas. Only 15% of children aged 0-3 years have access to organised day care or pre-school services. One third of municipalities do not have nurseries, leaving the rural population with no access to this service.

Pensions are almost universal, but low, and health insurance coverage is very low. The pension system used to be segmented between rural and urban areas and the average pension represents 37% and 65% of average salary respectively (2017). The ratio of contributors to beneficiaries constantly increased from 0.98 in 2013 to 1.21 in 2017, but the social insurance scheme continues being in deficit and the general state budget funds around 40% of its expenditure. Only 46% of women and 37% of men benefit from public health insurance coverage. There are very pronounced differences in coverage depending on geographical location, educational attainment and personal income.

Education and skills

Albania continues to struggle with low quality of education. Public education expenditure is low at 3.1% of GDP (2017 and 2018), 1.5 pps lower than EU average (2017). Despite consistent and substantial improvements, Albania continues to occupy low ranks in PISA tests (2015): 50.3% of students perform poorly in reading and 53.3% in mathematics. Lacking these basic competences, young people face difficulties with their further learning and life challenges later on. Early school leaving rate dropped significantly from a high of 42% in 2007 to 19.7% in 2017, but continues to be high, partly due to socio-economic needs, lack of sufficient financial means, traditional cultural values, and access issues, such as remoteness. Due to resource and capacity limitations, educational professionals may be forced to provide a reduced curriculum. Resource constraints also affect pupils with special needs and mixed abilities. Schools in rural, mountainous and isolated areas face additional problems.

Albania has made progress on curriculum reform in primary education, but teachers need more support. A new curriculum for the fifth grade will be introduced in the school year 2019-2020 thus finalising the curricular reform for grades 1-9. Teachers have received basic training, but new curricula require skills they did not learn at university and adequate mentoring and ongoing support are missing. New university curricula for teachers in grades 1-9 will be introduced in the academic year 2019-2020. Resources related to infrastructure, facilities and teaching material are insufficient. In higher education, some progress was made in performance-based financing, institutional and programme accreditation. There are however issues, many of which were raised during recent student protests, linked to high tuition fees, insufficient scholarships, lack of investment in dormitories, libraries and laboratories, insufficient assessment of lecturer performance, corruption and plagiarism, and lack of cooperation with and financial contribution from companies. Public higher education has become more expensive and less accessible also due to competition for public funding from private universities.

The reform to improve vocational education and training (VET) is delayed. The public VET sector is very small, but the proportion of VET enrolment in secondary education increased from 13% in 2013 to over 20% in 2018. Despite increased attention and budgetary allocations in support of VET, multiple challenges remain such as skills mismatches, poor quality of offer and relevance of training, unequal access, and weak linkages to the private sector. Some northern/north-eastern and southern parts of Albania are completely uncovered by any type of VET provision. Tracer studies of VET graduates confirm their unsatisfactory integration in the labour market (46.9% employed, 27.6% unemployed not in education or training in the year following graduation). The adoption of secondary legislation to the VET law of 2017 is delayed. Activities are ongoing but lack a proper legal framework. The adoption of the Employment Promotion Law (March 2019) is expected to unblock the slow pace of reform. There have been positive developments in form of openings of new two-year postsecondary/non-tertiary VET programmes and private training provision. Both have the potential to expand further. Bylaws for the Albanian Qualification Framework (AQF) have been drafted, but not yet adopted, and the capacities for full AQF implementation are currently weak.

There are few opportunities for lifelong learning and skills and career development. Problems include the lack of adequate adult training facilities and offers, especially outside bigger urban centres. Adults, especially older workers, do not consider it worthwhile to invest in further training. Adult (25-64) participation in formal or non-formal education and training is extremely low (0.9% last 4 weeks, 9.2% last 12 months in 2017) compared to the EU average (10.9% last 4 weeks in 2017, 45.1% last 12 months in 2016). The generally low skills base discourages exploration of further avenues of learning. Suitable strategies to fight unemployment and exclusion need to address people's basic skills issues and include remedial education measures.

4.3. Competitiveness and sectoral issues

Business environment

Albania's business environment continues to suffer from structural weaknesses and progress is slow. The economy's competitiveness improved in comparison to the year before (4.9), but is still below the SEE average (5.50) ranking at 5.02 on a 1 to 10 scale (EBRD, 2018). There was only limited progress in the World Bank Doing Business report 2019 as Albania improved two ranks compared to the previous year and still ranks 63rd among 190 economies, which is lower than most regional peers. The top three business environment obstacles identified by Albanian firms were electricity issues; competitors' practices in the informal sector; and corruption (BEEPS V, 2015). There are additional issues with insufficient clarity of land ownership (see analysis of agriculture sector below). This issue continues to affect agriculture, tourism and infrastructure development, investment and access to finance and contribute to informality.

The entrepreneurial skills and financial literacy of the population remain underdeveloped and affect the access to finance. Only 40% of adults and about 75% of SMEs are holding bank accounts. Despite the historically low interest rate and the decreasing ratio of NPLs, the credit growth to the corporate sector, especially SMEs, is not picking up. Further efforts are needed in particular to improve the financial literacy among the population and financial inclusion, as well as fight informality. Creating a network for business support services aiming at improving access to finance and scaling-up of existing firms is key to increasing the number of jobs in the private sector.

Weak contract enforcement and the large regulatory burden continue to hamper private sector development. Albania needs to significantly streamline its business regulations, including better impact assessments of legislative proposals, regular stakeholder consultations and strong monitoring mechanisms. More could also be done on the harmonisation of regulations with the Code of Administrative Procedures and on eGovernment to facilitate access to administrative procedures. The public financial management reform strategy for 2014-2020, which aims at strengthening policy implementation, underwent a mid-term review in 2018. The revised priorities include improving budget planning and management and strengthening internal control implementation across government, as well as preventing arrears at central and local government level. They also aim to follow up on internal and external audit recommendations, improve investment planning and management, and public procurement review and compliance with procurement rules. Finally, focus is also on granting more institutions online access to the treasury and analysing the fiscal risks of state-owned enterprises.

Strengthening the rule of law is key for improving the business environment and fighting corruption in Albania. The ambitious justice reform, which is currently under implementation, is expected to promote an effective and independent judicial system. Independent judicial institutions are crucial for the effective fight against corruption and informality. It is also a prerequisite for creating an environment that is investment and business friendly. Effective measures to further strengthen the rule of law, ensure adequate and timely contract enforcement and increase the transparency of legal changes would positively impact the business environment and contribute to an increase in productivity and competitiveness.

Informal economy

The informal economy continues to constrain the economic development of Albania. In spite of measures taken to address the informal economy, it is estimated to account for at least one third of GDP. This is causing tax revenue losses, a lack of labour protection and unfair competition among firms. The significant informality, as well as the substantial share of unpaid family workers in the agricultural sector, negatively impact the quality of the labour market and undermines the social protection system. Around 32% of the workforce is estimated to be undeclared (ACER, 2016). Around 40% of employees declared not to have a written contract with their employer, while 30% of employees declared that they do not pay for social and health security benefits in 2016. The number of employees without a written contract is well above the average of the rest of the countries in southeast Europe. The government introduced a country-wide campaign on fighting informality in 2016. However, the design of the measure was rather broad and focused mostly on mobilising additional budget revenues. They were implemented through an increased number of controls and inspections rather than offering incentives for regularisation of activities of companies and employment.

Research, development and innovation

Albania's capacity in research, development and innovation (RDI) is low and has few positive effects on the economy. According to the Global Innovation Index 2018, Albania ranks 83rd in the world out of 126 countries with an efficiency ratio of 0.44, which ranks it 110th. About 0.1% of the population work in research in 2018, which is less than one-third of the EU average. The low level of innovation in the economy limits the potential of the country to increase its productivity and engage in medium to high value added products. The number of patent applications increased from 3 in 2011 to 21 in 2017, but still remains modest. With a national target for 2018 of 0.6% of GDP, the R&D spending is lower than in most of the Western Balkan countries and far below the EU average of 2%.

Exports remain predominantly low value added and industrial innovation needs more support. Albania does not yet have a business incubator, or any science or technology parks. However, there are a few institutional support services promoting innovation and linking universities and research centres with innovative SMEs. A Triple Helix Competition took place in 2015-16 and Albania participates in the donor-supported

Entrepreneurship Programme for the Western Balkans. Albania's RDI institutions are not well-integrated into global RDI programmes and it has a low success rate in Horizon 2020. There is only very low engagement of the private sector in RDI programmes.

Digital economy

Digitalisation is hampered by the low penetration of fixed internet services and weak digital skills. While Albania performs reasonably well in terms of mobile broadband penetration (around 63%), fixed broadband penetration in households remains a challenge. Approximately 38% of the population has access to fixed internet. Moreover, the gap between internet access in rural and urban areas remains huge with around only 1% of the population in rural areas having access to broadband internet.

The development of e-commerce is hindered by challenges in consumer protection legislation and a lack of promotion by the government. In 2017 only 7.7% of enterprises used internet for e-commerce. The lack of digital skills negatively affects both demand and supply sides of digital products and digital skills need to be better integrated in the education system. Digitalisation and development of digital skills have a potential to contribute to tackling high unemployment, especially in the rural areas and could create positive spill over effects on other sectors of the economy such as tourism and facilitate exports.

Investment activity

Investment has stabilised at the level of one quarter of GDP in recent years, driven by FDI, as well as domestic investment. FDI inflows have increased significantly in the last ten years following the liberalisation of the markets and the reforms on improving the business environment. In 2018, net FDI is estimated to reach 8.1% of GDP, which is one of the highest levels in the region. Better integration of the economy into global supply chains would help boost productivity and create more and better jobs. The EU remains the main source of FDI into Albania and held 56% of the total stock at the end of third quarter of 2018. The FDI flows during the first half of 2018 increased by almost 27% as compared to the same period in 2017, reaching almost EUR 500 million. The main countries of origin for FDI stock were Greece, Switzerland, the Netherlands, Canada and Italy, with the EU accounting for 56% of the total stock by the end of 2017. Most foreign direct investments are concentrated in the energy sector and transport infrastructure. However, the implementation of the main energy projects, namely the hydropower plants on the river Devoll and the Trans Adriatic Gas Pipeline, slowed further following a peak of activity in the first half of 2017. Albania has a great potential to attract more FDI notably in the tourism sector, energy and agriculture, which would contribute to job creation and economic growth.

The key obstacles to increased investments are weaknesses in the business environment, insecure property rights, an underdeveloped real estate market and increasingly shortages of skilled labour. Domestic investment is constrained by muted bank lending to private businesses and many of the SMEs face problems accessing bank financing. Micro-enterprises (less than 5 employees) often cannot access microfinance due to their lack of know-how and because of informality. The low level of public technical support (e.g. extension services, certification, standardisation) to SMEs and farmers also poses a challenge for businesses aspiring to grow or to export. The lack of clarity in land ownership (the absence of a cadastre) and the poor functioning of the land market hold back private investment in the country further and affect the implementation of large public projects.

Public investment, amounting to about 4-5% of GDP, experienced a significant increase in the recent years, but has been hampered by weaknesses in the public investment management framework with regular underspending compared to originally planned budgets. Key weaknesses of the public investment management system are linked to the planning process, which lacks prioritisation and transparency, shortcomings in the project preparation stage, and insufficient monitoring during the implementation stage. New Public Investment Management guidelines were approved in March 2018, which need to be fully implemented and rolled out across government.

Trade performance

Despite its relative openness to trade, the Albanian economy is not well-integrated in global supply chains. The exports of goods and services amounted to around 78% of GDP in 2018 and the overall trade volume has been continuously increasing during the last years. During 2018 the exports of goods grew by 13.7% and imports of goods grew by 2.4%. The trade deficit for goods was 6.3% lower than in 2017, accounting for about EUR 2.6 billion. EU countries remain the main destination for both exports and imports, accounting for 65.9% of total trade in goods in 2018. Italy (34.1%), Greece (6.9%), Germany (6.6%) and China (6.3%) are the main trade partners. 92% of Albanian products can access the EU market without customs duties. Albania is mainly exporting manufactured goods (footwear, garments), minerals and construction materials. Service exports amounting to 58% of total exports are dominated by tourism and related services. Albania has historically run a large goods trade deficit, which is partly offset by a surplus in the balance of services. Goods exports continued to show little diversification in terms of products and destinations while the potential for agricultural exports remained untapped. The trade in goods with the Western Balkan countries increased by 6% in 2018, mostly on account of the increase in trade with Kosovo by 23% in 2018, but still is not reaching its full potential.

Trade remains constrained by non-tariff barriers with complex and unsynchronised border procedures. Non-tariff barriers, as well as limited quality certification services and laboratories available, continue to restrict trade. There is a large untapped potential for trade growth subject to cross-regional connectivity improvements and elimination of technical barriers to trade. The authorities recognise the challenges and have started to implement measures that mostly focus on liberalising trade with the neighbouring countries within the framework of the Regional Economic Area (REA).

Albania is encouraged to continue implementing all the aspects of the REA Multiannual Action Plan (MAP). The REA MAP is based on EU standards and will facilitate Albania's integration in regional and European value chains and will also help increase the attractiveness of the economy for FDIs in tradable sectors. Further connectivity with neighbouring countries in transport and energy will further strengthen the access to, and integration in, the regional market. The creation of a regional digital space and of more integrated labour markets with neighbouring economies will offer new possibilities for the country's youth, which is also important in light of the high youth unemployment.

Transport

Given the geographical location of the country, Albania's transport sector is strategically important for competitiveness and economic growth. Albania is ranked 109th out of 140 countries for transport infrastructure in the World Economic Forum's Global Competitiveness Report 2018, which is below its regional peers. Rail transport is inefficient. The Albanian railway network operates below its actual capacity, due to lack of investment, maintenance operations, and outdated network. The unbundling of train operations from infrastructure management has not yet been achieved. Implementing legislation is under preparation for the establishment of relevant structures and agencies, in particular the Railway Regulatory Authority. Maritime infrastructure is underdeveloped with inadequate capacity. The low quality of its transport infrastructure is an impediment to Albania's integration into regional and global supply chains and has a direct impact on the development of tourism and transit services.

The lack of infrastructure combined with improper maintenance leads to a very high number of road traffic accidents. The Albanian vehicle fleet has increased dramatically within the last ten years, and the overall number of fatal traffic accidents after some decrease in the past has stagnated in the last 2-3 years. The estimated rate of fatality in Albania is 136 deaths per million inhabitants, which is almost three times the EU average of 49 deaths per million (WHO Global Status Report 2018). Almost 40% of all persons killed on the roads are pedestrians, compared to about 21% in the EU. There is no data on the cost of accidents, but they are likely to have a significant impact on the economy, due to their frequency.

Agriculture

Agriculture is characterised by low productivity and land fragmentation, which continues in the absence of a comprehensive land register. Overall, the contribution of the agricultural sector to GDP is estimated at 18.4% in 2018**.** The share of the labour force employed in agriculture still stood at 42.4% in 2017 (LFS 2017), but remains high even by regional standards with a high share of women. Farmers suffer from low access to credit, which hampers their ability to invest in new technology and in acquiring new skills. Improving the advisory system in agriculture, for the farming and agro-processing sector as well as channelling investment into agriculture, agro-processing and diversification could raise productivity and rural income as well as agricultural exports.

Industry

Albania's industrial sector is weak and exports are concentrated in a few product groups and are of low sophistication and value added. The ERP does not provide any information or analysis of the industry in the country, nor does it propose any measures or policies. Industry accounted for around 13.9% of GDP in 2017, or 23.9% including construction. Manufacturing generates about 6% of GDP. Metallurgy, textile, mining and extraction of petroleum are the sectors with the largest output and main industrial exports are clothing, chrome, oil and refined fuels.

Services

The economic growth of Albania is driven by the services sector. Services represent an estimated 54.4% of GDP in 2017 and is the biggest contributor to employment with 40.4%. The services sector has been developing well in recent years backed by the significant increase in tourism and construction. The positive developments in the exports of services allowed to generate a higher trade surplus on the services side and positively contributed to offsetting the structural trade deficit in goods. The diversification of the services sector, namely development of services in the financial and ICT sectors would allow decreasing vulnerabilities caused by the reliance on tourism and its exposure to external shocks such as political risks, weather and seasonality. Besides tourism, the ERP does not provide any diagnostic on the services sector despite its significance for the country's economy.

ANNEX A: IMPLEMENTATION OF THE POLICY GUIDANCE ADOPTED AT THE ECONOMIC AND FINANCIAL DIALOGUE IN 2018

Overall: Partial implementation (45.0%)[4]	
2018 policy guidance	**Summary assessment**
PG 1: Introduce further fiscal consolidation measures with a view to meeting the indicated medium-term target of reducing public debt to below 60% of GDP in 2021.	There has been **partial implementation** of PG 1: The decrease in the debt ratio was larger than expected (from 70% to 67% of GDP - preliminary data), but this was mainly due to the accelerated appreciation of the lek and the under execution of the capital budget, not due to fiscal consolidation measures. The ERP confirmed the debt target of below 60% of GDP for 2021 but slower-than-expected economic growth and contingent liabilities could derail fiscal adjustment plans.
PG 2: Support fiscal consolidation by strengthening tax administration further:	There has been **partial implementation** of PG 2. 1) **Limited implementation:** No detailed information in the ERP, but the programme for reform of public financial management is continuing, and this reform also affects the revenue administration.
broadening the tax base and avoiding new tax exemptions:	2) **Partial implementation:** The tax base has been broadened, as formal employment increased and the VAT registration threshold was lowered. However, fiscal packages for 2018 and 2019 (the 2019 package was approved in 2018) introduced a number of tax exemptions on profits and buildings. They also introduced: lower VAT rates for 4-star and 5-star hotels and certain services in tourism; lower tax rates for software developers; VAT exemptions for certain imports; and reduced income tax for agricultural cooperatives and certified agri-tourism.
fully implementing the valuation-based property tax:	3) **Partial implementation:** A value-based property tax was introduced. but the instructions on the calculation of the property value are still outstanding. A fiscal registry for the valuation-based property tax is being created, as is a property agency. However, neither will be fully in place until 2019. So far, the value-based property tax is being collected in a few pilot municipalities on the basis of existing documentation not yet integrated in the fiscal registry.
ensuring that new Public-Private Partnerships are only contracted on the basis of solid cost-benefit analyses and fiscal risk assessments	4) **Limited implementation:** Use of cost-benefit analysis as basis of the selection of PPPs has not been reported in the ERP. Early 2019, a legal amendment has been presented to parliament which foresees increasing the quality of feasibility studies on PPP projects. The fiscal risk statement on the

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

	2018 budget assessed that the amounts of direct public payment obligations stemming from PPP contracts are compliant with the budget law. There is no assessment of the fiscal risks from PPPs. During the ERP mission, the MOFE reported that it aims to strengthen and institutionalise its fiscal risk assessment of PPPs as of 2019 with tools provided by the World Bank.
PG 3: Conduct monetary policy in line with reaching the inflation target	There was **substantial implementation** of PG 3: 1) **Full implementation:** The monetary policy stance was kept appropriately accommodative, as inflation and inflation expectations remained below target and credit growth remained subdued.
Increase the transparency of monetary policy communication by publishing time series on core inflation and inflation expectations.	2) **Full implementation**: The central bank of Albania started to publish core inflation and inflation expectations (of consumers, businesses and financial agents) on its webpage in February 2019.
Implement the remaining measures of the NPL resolution strategy, also with a view to addressing factors hampering access to finance for corporates.	3**) Substantial implementation:** The authorities have made further progress in implementing the NPL action plan, including by creating an out-of-court restructuring scheme. Nevertheless, some important issues have yet to be implemented (drafting the by-laws to the bankruptcy law, resolving the deadlock around the private bailiffs' scheme, and improving the credit registry).
Based on regular analysis of relevant indicators and impact assessment, explore other measures in line with the Memorandum of Cooperation to increase the use of the national currency at all levels.	4) **Partial implementation:** The share of loans in foreign currencies has decreased (possibly supported by the currency's appreciation), while the share of deposits in foreign currencies has not changed. The central bank has followed up with a number of measures, but the government has not yet started to investigate potential follow-up measures
PG 4: Ensure effective liberalisation of the energy market	There was **limited implementation** of PG4: 1) **Limited implementation**: Legal unbundling of distribution system operator OSHEE SA from its supply activity with the establishment of three new companies has taken place, but functional unbundling has not yet been finalised. The unbundling model was approved by the supervisory council of OSHEE and the Minister of Energy and Industry.
and functioning of the power exchange.	2) **Limited implementation:** The legal amendments allowing the creation of a Power exchange were adopted in February 2018. However the Council of Ministers decision for the establishment of APEX Company was not adopted within the legal deadline 30 September 2018.
Adopt the legal provisions to effectively implement the national energy strategy	3) **No implementation:** Amendments to the law on Power sector have been adopted in February 2018 that postpone the deadlines for further liberalization in the electricity sector.
and further broaden the energy supply mix, focusing on incentivising energy efficiency	4) **Limited implementation:** The TAP project is progressing on time and will, when completed, allow a broadening of the energy mix. There was no progress in implementing energy efficiency legislation.
and renewable energy production beyond hydropower	5) **Partial implementation**: The revised national renewable energy action plan for 2018-2020 envisages that 38% of gross final energy

	consumption will come from renewable energy sources. In June 2018, the Government approved some support measures for the promotion of the use of electricity from renewable sources of sun and wind, as well as procedures for selecting projects for their benefit. The Government has approved the construction of small photovoltaic plants with a total capacity of about 30 MW. The developer of the first photovoltaic plant has been selected through an auction. A net metering scheme for photovoltaic (PV) or wind energy with a capacity of up to 500 kW is being put in place, but is not yet operational.
PG 5: Further strengthen the process of cadastral, land and property registration, including clarification on land ownership, with a special emphasis on de-fragmentation and consolidation of agricultural land, and swift case handling in case of court procedures. Reinforce measures to finalise the property restitution and compensation process.	There was **limited implementation** of PG 5: 1) **Limited implementation:** the process of property registration has continued, but defragmentation of ownership is not taking place due to lack of land market and adequate policies in that respect. In order to clarify the judicial review options, in 2018 the High Court has set out a list of categories of cases subject to judicial jurisdiction.2) 2) **Partial implementation**: the compensation and restitution process continues based on the 2015 legislation, but no legal actions have been taken to facilitate the finalization of the process. In view of the progress made by the authorities over the last few years with the domestic compensation mechanism, the Council of Europe ended in 2018 its supervision of the enforcement by Albania of domestic decisions on restitution or compensation.
PG 6: Ensure sufficient capacities for the implementation of employment policies, in particular for youth and women, and improve linkages between active and passive employment measures. Address undeclared work, including by strengthening the labour inspectorate.	There was **partial implementation** of PG6: 1) **Limited implementation:** Despite efforts to implement the National Employment and Skills Strategy (NESS), the human resources available in the Directorate of Employment and Skills Development Policies at the Ministry of Finance and Economy remain limited and do not allow for a proper implementation of the strategy. 2) **Partial implementation:** The new action plan for NESS until 2022 is under finalisation. In 2018, more activation support was provided to beneficiaries and ex-beneficiaries of economic assistance with 4,752 people employed through job mediation or after attendance in vocational training courses (VTCs). A new employment promotion programme was introduced which enables (ex)-beneficiaries of economic assistance to attend freely VTCs and receive a stipend during their attendance. Nevertheless, the quality and labour-market relevance of these VTCs are generally too low to significantly improve employability. 3) **Partial implementation:** The budget of State Labour Inspection (SLI) has been increased by 11% in 2018 compared to 2017 and used for example to modernise equipment of inspectors. However, despite repeated requests by SLI, the number of staff, including inspectors, has not been increased. Inspections can annually cover only about 6% (about 10,000) out of the total of about 160,000

	companies. Nevertheless, SLI has been able to detect more cases of undeclared work in 2018 compared to 2017.
Support the development of basic education and increase the investment in initial teacher training.	4) **Substantial implementation:** Curricular reform of grades 1-9 is almost finalised with 5th grade being piloted in school year 2018-2019 and to be implemented countrywide in school year 2019-2020. Current teachers received training for implementation of competence-based curricula before their deployment for each grade. Further training, adequate mentoring and ongoing support to teachers are however missing. The review of the content and structure of curricula for initial teacher training in higher education institutions has started, and their introduction is expected in the academic year 2019-2020.

Annex B1: Assessment of the structural reform measures included in the ERP

Measure 1: Further liberalisation of the energy market

The measure to further liberalise the energy market is rolled over from the previous ERP, and is in line with the obligations under the EU Third Energy Package and Albania's own strategies. However, the measure is not embedded in the overall framework of accompanying actions, such as strengthening of the regulatory body, demand management, energy efficiency, or price reforms. The price and tariff reform will require further efforts, while bill collection rates have improved significantly. Energy demand management, including activities to stimulate investment in energy efficiency would contribute to improving the economy's competitiveness and energy security.

No timeline is given for the completion of the liberalisation activities, while some of them are delayed from the previous year and are also lagging behind the government's legal obligations. No explanation is provided for the delays of implementation in 2018 in particular the non-completion of the functional unbundling and the establishment of the power exchange. The costing provided, showing no budgetary impact of the liberalisation activities, appears questionable. The overall impact on competitiveness is well-developed while the impact on employment is discussed only in general terms. The potential risks to implementing the reform measures are well developed, while mitigating measures remain general.

Measure 2: Diversification of energy sources

The measure on diversification of energy sources is rolled over, but has been supplemented, in line with the economic analysis to include the promotion of the use of renewable energy sources beyond hydropower. The addition is welcome in view of the significant potential the country presents for photovoltaic and wind energy production, as well as the low share of those energy sources in the energy balance of the country. However, the ambition of the outlined measure is limited and the environmental impact of the energy policy as a whole is not discussed. A net metering scheme for the buy-in of excess energy produced by households is not in operation.

The planned connection of the country to the international gas network to create conditions for gasification in line with the development of the Trans Adriatic Pipeline project will contribute to energy diversification. Implementation of planned activities is progressing in line with the presented timeline. The cost of implementing the measure has not been properly accounted for. If efficiently implemented, the measure is expected to strengthen competitiveness in the long term by diversifying the supply, ensuring supply security and potentially lowering energy costs. The absence of potential risks is justified by the measure's secured funding, but ignores non-financial risks such as environmental risks and lack of coordination.

Measure 3: Rehabilitation and reconstruction of the railway segment Durres-Tirana International Airport-Tirana

The transport measure is rolled over and still does not address the regulatory and structural needs related to the connectivity agenda, which would have a more direct impact on competitiveness. The implementation of the measure aiming at rehabilitating and extending the Durres-Airport-Tirana railway will allow the development of intermodal transport, but its estimated competitiveness impact appears over-optimistic, especially in view of the underdeveloped railway infrastructure. The construction project is broadly on track and its practical realisation is expected to start in 2019. The expected impact is to double travel speed for passenger and freight transport between Tirana and Durres, which should boost the traffic and reduce congestion on road.

The main risks to implementation of the reform measure are outlined, and mitigating measures are proposed. However, no concrete information is provided on the land acquisition plan, which is indispensable for the completion of the project, and no mitigating measures are planned to cover the expropriation risks.

Measure 4: Consolidation and defragmentation of agricultural land

The planned consolidation and defragmentation of agricultural land, rolled-over from the previous programme, shows no progress due to the lack of legal, institutional and administrative basis. The reform activities envisage a partial digitalisation of the agricultural land register**.** However, the activities planned for 2018 were only partially implemented. No activities are planned to establish the necessary conditions for land consolidation like clarify of property rights and development of a comprehensive land cadastre, territorial planning, environmental protection etc.

The budgetary impact assessment and cost per activity are insufficiently developed. The estimated impact on competitiveness is quite ambitious and can rather be expected in the medium- to long-term. The real gender issues related to agricultural land ownership (issuing of certificates mostly to the male members of the family) are not discussed. The key performance indicators are not properly selected, nether to reflect the activities implemented, nor the possible short-term outcomes of land consolidation. The potential risks section correctly points out the possible opposition from land owners and rural communities. However, other risks, such as delays due to the lacking legal framework or property rights disputes should also be considered.

Measure 5: Reform of the water and wastewater sector

Water resources are crucial for the development of the economy of Albania and in particular the sectors of energy generation, tourism and agriculture. As such, the rolled-over measure on water and waste water is appropriate. The measure is in line with actions to combat informality and aims to ensure good governance and effective investments. However, integrated water resource management, taking into account the needs of the whole economy, is not properly targeted. The activities planned for 2019 are overambitious, while there is little information on the intended improvements in the outer programme years, which are vague and insufficient. Delays in the implementation have been reported, and some of the activities not implemented in 2018 have not been included in plans for the following years.

The measure appears quite ambitious, given the investment required and the administrative capacity needed to implement this investment. The cost of the reform is still under development, which points at a lack of maturity of the project. The impact on competitiveness focuses mostly on social outcomes, rather that the potential impact on competitiveness. The key performance indicators are very ambitious and the deadline for their attainment is not clear. The potential risks and respective mitigating measures are broadly defined, but do not specify the potential risks in rural areas, where water supply utilities are managed by local authorities.

Measure 6: Property tax reform and establishment of fiscal cadastre

The measure is rolled over from the ERP 2018-2020. The implementation of the property tax is an instrument that strengthens the overall domestic revenue mobilisation and public finance management, but its relation to improvements in the business environment is not specified.

The full implementation of the market value based property taxation is expected to be applied to all 61 municipalities in 2020. Activities planned in the ERP 2018-2020 related to the adoption of the relevant legislation in 2018 are mostly completed while staffing of the fiscal cadastre unit remains to be completed in 2019. The piloting of the fiscal cadastre in four municipalities planned in 2019 is no longer in the current ERP with no specific explanation for why it has been removed. The potential implementation risks are correctly identified. The indicators for monitoring the activities are not well defined and there are only general targets at the end of the implementation of the measure in 2021.

Measure 7: Reduce regulatory burden to business

The reform measure on reducing the regulatory burden to businesses is rolled over from the previous ERPs, and it needs to be implemented in the broader context of tackling the other challenges identified in the sector. The timeline for implementing the reform measure was prolonged until 2021, pointing to some delays in implementation. The expected impact on competitiveness and social outcomes, address the main shortcomings in the business environment. The potential risks are correctly assessed, while mitigating actions require further elaboration. The activities in 2019 do not indicate the areas that will be affected by the simplification activities. Indicators for the measures are not directly related to the outlined actions and no numerical targets have been set. The costs of implementation in 2019 remain the same as in 2018 while there is no clear indication on the budget costs for 2020-2021. Table 10a and 10b on costing and budgeting do not reflect the narrative part. Measures 7 and 8 are very similar and should be merged in next year's ERP.

Measure 8: Reduce red tape and increase the efficiency of the institutions offering services to citizens and entrepreneurs

This is a new measure, which encompasses some of the business obstacles related to bureaucracy within state institutions and corruption. It aims to increase the level of e-services to citizens and businesses and improve the quality of services. The expected impact on competitiveness clearly set out. The measure is aligned with other national strategies, like the 2015-2020 Public Administration Reform Strategy, and the corresponding 2018-2020 action plan. Given the track record, the political prioritisation of this issue, the donor support received and the actions foreseen in the action plan, this is a realistic measure. The implementation is going to be financed through the state budget and costing and budgeting are properly reported. However, the indicators are formulated in a general way and no baseline is offered in order to measure success. The potential risks, are generally considered.

Measure 9: Effective implementation of the national plan to reduce the level of NPL in the banking sector

This is a rolled over measure which addresses a significant obstacle for business competitiveness: access to finance. The programme does not discuss alternative sources of financing and broader credit growth issues. The activities planned in 2018 have been substantially implemented except for the establishment of the credit registry, the contested bailiff fee schedule and the bankruptcy bylaws. The measure clearly sets out the expected impact on competitiveness and considers social outcomes. The potential risks are correctly assessed. As the level of NPLs are decreasing, Albania could consider broadening this measure in next year's ERP to include access to finance for the private sector. The key performance indicators need to be better elaborated.

Measure 10: Providing a single and transparent investment legal regime in the country

This is a rolled over measure from the previous ERP, which is relevant and coherent with Albania's commitments under the Regional Economic Area multiannual action plan. Its impact on the investment climate and therefore on competitiveness is well-defined. While the measure aims to provide a single and transparent legal regime for investment, it is not clear how/whether this investment regime would have any role in the increased transparency of the public procurement procedures.

On the expected risks, the ones related to engaging various stakeholders, policy makers and interested parties have a significant impact, which have caused the prolongation of the timeline for its implementation until 2021. Therefore, the instruments to mitigate these risks need to be better elaborated. The finalisation of the scanning of sectors with a direct link to smart specialisation should be considered already in 2019 or 2020 as the process of scanning has already started in late 2018 with the establishment of an inter-institutional working group. The Regional Economic Area multiannual action plan targets an earlier deadline for the design of smart specialisation platforms at national level. Costing and budgeting of the measure has not been provided, which puts at risk its implementation.

Measure 11: Improve the institutional capacity of research and innovation system

The measure aiming at improvement of the institutional capacity of the research and innovation system is rolled over and could address some constraints in the area. The activities planned for 2018 were only partially implemented. The activities for 2019-2021 are defined too broadly without clear objectives. The costing has been further developed and the planned budget is better aligned than it was in the previous ERP with the ambitious level of the measure. However, the sources of funding remain unclear. Some risks are identified, and devising a strategic framework for the sector is offered as a mitigating measure. Progress has been achieved in the engagement of the private sector, which should improve the implementation of the Triple-Helix Model.

Measure 12: Adoption of the legal and regulatory framework for the development of the broadband infrastructure

The rolled-over measure on implementation of the legal and regulatory framework for developing the broadband infrastructure is in line with Albania's 2020 Digital Agenda, and addresses key obstacles to competitiveness and growth. The proposed activities have been developed since the previous programme to include the establishment of broadband infrastructure in pilot areas, which is a positive development. No funding is planned for the intended infrastructural development, which puts at risk the implementation of the measure. The activities planned for 2018 have been implemented to a good extent, focusing on drafting of the legal base. The expected impact on competitiveness are broadly identified, as are social outcomes and potential risks, except for financing risks. However, no mitigating measures are proposed.

Measure 13: Facilitate the implementation of national trade facilitation measures and MAP REA

The rolled-over trade facilitation measure is highly relevant and in line with national priorities and regional initiatives, such as the connectivity agenda and CEFTA Additional Protocol 5. Its implementation is a crucial step towards regional trade facilitation, which is also part of the Regional Economic Area multiannual action plan. The activities planned for 2018 have been partially implemented, while some of them have been partially rolled over to 2019. The measure includes the regional SEED+ project financed by the EU and the promotion of an authorised economic operator programme in Albania, as well as the establishment of a National Single Window for exports. The strengthening of the capacity of the National Committee for Trade Policy Coordination and Facilitation is also planned as part of the measure, but on concrete details are provided.

The expected impact on competitiveness is only discusses in general terms, as are potential social outcomes and risks. No funding is presented for the implementation of the National Single Window project. To ensure greater impact on competitiveness this measure needs to be combined with efforts to expand the country's industrial base in order to diversify tradeable goods.

Measure 14: Finalisation of the pre-university curricular reform, training and hiring of teachers

The measure is a relevant continuation of previous years. It mainly focuses on implementing new competence-based curricula for grades 1-9 to close the process of curricular and textbook reform for pre-university education. There are plans for adapting initial teacher training curriculum in public universities to match with the curricular reform. Current teachers also received training, but new curricula require skills they did not learn at university and additional training, adequate mentoring and ongoing support are missing and are not planned. Absence of such additional support can decrease the effectiveness of the reform. The key activity is planned for 2020 when the assessment of the implementation will take place. This would be followed by necessary reforms if needed.

Measure 15: Inclusive education

The measure refers to a reduction in the number of students attending multi-grade and low-quality classes in rural areas and an increase in the number of special education teachers in the public education system. The measure does not clarify how the transfer of additional 3,000 rural pupils per year to nearby better-quality schools will be ensured, especially considering the poor quality of roads and a lack of public means of transport, and does not include any budget for this activity. The plan to increase the number of special education teachers per 100 each year until 2021 is positive and the cost for 2019 is estimated at EUR 6.8 million. However, no further analysis is developed on the ratio children in need/support teachers. The need for strengthening of inspection function to monitor quality and inclusiveness and reaching out the remote and rural areas is not addressed.

Measure 16: Expanding adoption of digital skills to schools

Over the course of three years, 120,000 students and 8,000 teachers are planned to be equipped with digital and coding skills. This is a donor-led measure and it is unclear how it is linked to the revised curricula of the targeted grades. It is also unclear whether these revised curricula need to be revised again and how sufficient equipment will be ensured. Since overall basic competences and quality in education are weak, the feasibility of implementation is unclear. There are no targets/KPIs explained. It is uncertain to what extent the measure is sustainable and what is the Government’s ownership. The lack of adequate infrastructure in schools to enable continuous and sustainable development of digital skills beyond this project are a matter of concern.

Measure 17: Modernisation of the pre-school education system financing

The measure concentrates on the reform of financing of pre-school education, responsibility for which was transferred to the local level. Roles and coordination in the area remain to be clarified and assessed. Despite the title of the measure which would suggest a more holistic approach, its focus seems to be limited to the injection of additional finances in the system to increase the number of teachers by 10% (440) from 2019 onwards with a goal of reducing the children-to-teacher ratio. This has a potential impact on improving the quality, in particular in major urban centres which suffer from high children/teacher ratio. However, the much needed increase in enrolment rates, especially for children from vulnerable families, is not targeted. No incentives are in place to invest in quality kindergartens, especially in rural areas where they are often missing. With regard to the schedule, it is overambitious to monitor over the first year the effects on the improvement of the quality of pre-school education.

Measure 18: Improve the quality and coverage of VET while ensuring linkages with the labour market

This is a relevant continuous measure from previous years with limited implementation so far. Important activities planned for 2018 were not finalised. Secondary legislation to implement the VET Law from February 2017 is still not adopted, pending the establishment of National Agency for Employment and Skills, which is expected in June 2019 after the adoption of the Employment Promotion Law in March 2019. The overall budget is not detailed and the total cost of modernising the VET system seems underestimated. A tracer study has shown that the VET system in the country is still partly out of tune with labour market demand and students' aspirations. Clarity is missing as regards access to VET for vulnerable groups and in rural areas where delays in implementation are noted in the mid-term review of the National Employment and Skills Strategy.

Measure 19: Modernising public employment services, increasing employment of women, youth and vulnerable people

This is a continuous measure from previous years. The suggested activities are very ambitious but relevant for the continuous modernisation of the National Employment Service (increase in quality of services and their availability in rural areas, training of staff, quality of short-term vocational courses and their relevance to labour market needs). There have been delays in activities planned for 2018: Employment Promotion Law not adopted on time (only in March 2019); National Agency on Employment and Skills not established (expected in June 2019); modernisation of some employment offices not finalised. Employment promotion programmes need to be better tailored to the needs of some vulnerable categories of people. As most measures are at regional level, lack of cooperation between different actors involved, including social partners, poses challenges to implementation.

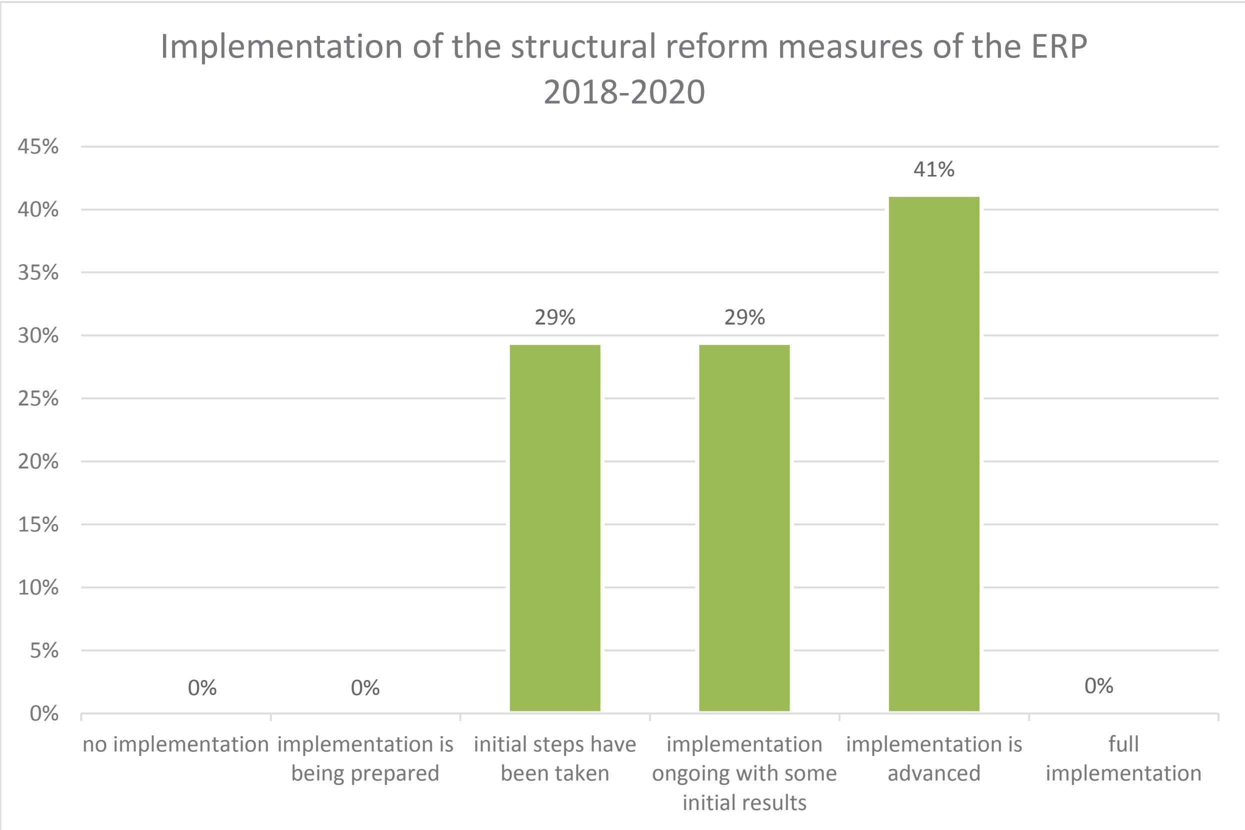
Measure 20: Strengthening social protection, and social inclusion measures

This is a continuous measure from previous years, but links are lacking to what was planned in ERP 2018-2020. There was progress in 2018 as regards adopted legislation, preparations for piloting of new bio-psycho-social model for disability assessment and countrywide deployment of reformed economic aid scheme. On the latter, information is missing on whether people in need are better targeted. Local government units (LGUs) are expected to assess needs for social care services and to ensure their delivery, but many LGUs lack capacity and resources. This is recognised as a risk, but no mitigation is proposed. While the measure targets very relevant structural issues, as in previous years it is too broad to bring effective and targeted implementation and proper follow-up of the implementation. Lack of updated data on poverty and exclusion hinders evidence-based policy-making.

ANNEX B2: PROGRESS WITH STRUCTURAL REFORM MEASURES FROM ERP 2018-2020

There was mixed progress in the implementation of the measures in 2018, with an average score of 3.4 out of 5. The reporting on the implemented activities is good but uneven, with some measures not covered. For some activities the scoring provided is high, but overall the provided information presents an adequate description of the level of implementation.

Implementation is stronger for some measures, such as measure 6 on the establishment of fiscal cadastre, measure 7 on reducing regulatory burden; measure 9 on reducing NPLs; measure 12 on developing broadband infrastructure and measure 20 on strengthening social protection. Implementation is weaker for other measures, such as measure 1 on liberalisation of the electricity market, measure 4 on defragmentation of agricultural land and measure 5 on reform of the water and wastewater sectors.



Annex C: Compliance with programme requirements

The 2019-2021 Economic Reform Programme was adopted by the government on 25 January 2019 and submitted to the Commission on 30 January. No components of the ERP are missing and its structure partly follows the Commission guidance note.

Inter-ministerial coordination

The programme was coordinated by the Ministry of Economy and Finance. All relevant line ministries contributed to the drafting exercise, however, the level of ownership and commitment in responsible ministries varied. The programme suffered significantly from institutional weaknesses due to the government restructuring.

Stakeholder consultation

A draft ERP was disseminated for consultation to international organisations and partners, diplomatic missions to Albania, business associations and chambers of commerce. The ERP includes the written comments provided by stakeholders but they are not reflected in the Programme itself. The ERP was not discussed separately with the social partners.

Macro framework

The programme is in line with the medium-term budgetary framework and the Budget Law of Albania. Information about implementation of the policy guidance 2 is incomplete. The ERP does not provide an analysis of productivity developments, the sectoral growth contributions or the investment environment. Results of analytical work by international institutions that contain this kind of analysis are not reflected in the programme.

Fiscal framework

The ERP does not make clear a link between the analysis of the challenges the economy faces, the proposed reforms, and the corresponding budget allocations. The fiscal policy objectives are not consistent throughout the ERP document and do not take into account the preliminary budget outturn for 2018. The fiscal consolidation targets are not supported by detailed expenditure and revenue plans. Measures for improving tax collection and fighting tax evasion remain vague. There is only limited information on the contributions to and spending by the social insurances. Information on the increasing arrears, local-government revenues and expenditure is largely missing. Fiscal data do not meet ESA 2010 requirements on: the valuation of foreign debt; the consolidation of financial and non-financial transactions; the recording of arrears, of PPPs and of capital transfers and loans within the public sector. With the support of Eurostat, the statistical office is making gradual progress in aligning its fiscal statistics with EU requirements.

Structural reforms

Some of the structural reforms sections diverge from the guidance note, and the measures presentation is of varying quality. The analysis of the structural reform challenges is not comprehensive, and is sometimes not updated from last year. Table 11 in the Annex is incomplete with significant gaps for some measures. The number of measures is limited to 20 while the page limit (40 pages) for Section 4 has been significantly exceeded. The tables on budgetary impact are more comprehensive than the previous year, but are still only partially completed or are not in line with the descriptive part. There is only limited reporting on the implementation of the policy guidance in the area of education, employment and social protection.

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