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COMMISSION STAFF WORKING DOCUMENT

ECONOMIC REFORM PROGRAMME

OF

ALBANIA
(2018-2020)

COMMISSION ASSESSMENT

Contents

1. EXECUTIVE SUMMARY

Albania's economic expansion is expected to continue in 2018-2020. The economic reform programme (ERP) projects GDP growth will strengthen above the level of 4 % on the back of rising domestic demand. Consumer spending is seen as the major growth driver in a context of an improving labour market, rising confidence and growth-friendly financial conditions. Investment growth is expected to moderate as two large foreign direct investments in the energy sector are completed. Although Albania's exports are projected to increase at a solid pace as the EU economy expands, their contribution to GDP growth is expected to be fully offset by import growth. Nevertheless, the possibility of stronger-than-projected import growth in view of the expected acceleration in consumer spending seems to be the main downside risk to the programme's forecast of real GDP growth.

Sustaining the ongoing economic recovery requires further reform efforts and the tackling of macroeconomic weaknesses in relation to public finances and the financial sector. Helped by an International Monetary Fund (IMF) programme, the country has started to consolidate its public finances and an appropriately accommodative monetary policy has supported the economic upswing. Some important business-relevant reforms have been launched, such as the comprehensive overhaul of the justice system. Nevertheless, enduring macroeconomic weaknesses and structural obstacles to growth call for sustained efforts to address the following main challenges.

- **The public debt-to-GDP ratio has been reduced but remains a major source of macroeconomic vulnerability.** Public debt (including guarantees) is still close to the relatively high level of 70 % of GDP and is associated with significant rollover, interest rate and exchange rate risks. The country's fiscal adjustment plans have been attenuated and pushed back compared with last year's programme; this will delay achievement of the medium and long-term targets for public debt. The envisaged decline of the debt ratio relies mainly on favourable economic growth and restraint in public consumption. It is associated with significant downside risks from lower-than-expected GDP growth, contingent liabilities, and new public-private partnerships. There is considerable scope for raising more revenue by improving tax compliance and broadening the tax base.

- **Non-performing loans have been reduced, but bank lending to businesses remains sluggish.** Banks are well capitalised, highly liquid, and have a very low loan/deposit ratio. While lending to households has been rising at a decent rate, bank lending to the business sector is barely expanding. The stock of non-performing loans on banks' balance sheets has been reduced, mainly through mandatory write-offs, but still seems to constrain bank lending. The proportion of foreign exchange loans remains high and poses challenges to the stability of the banking system and the conduct of monetary policy.

- **Albania's competitiveness continues to be hampered by inefficiencies in the energy sector, including insufficient security of supply.** The ERP recognises this and again includes measures to further unbundle and liberalise the energy market following the adoption of the required legal basis. However, implementation of these measures was limited in 2017. Moreover, in pursuing the objective of diversifying energy sources, the ERP focuses on gasification and ignores the potential of renewable energy sources.

- **Issues related to property rights and land registration continue to affect the competitiveness of the Albanian economy. This is a cross-cutting issue affecting infrastructure and industrial development, agriculture, the property market and, importantly, access to finance.** Progress towards establishing a comprehensive cadastre has been slow. The ERP maintains a narrow view of the issue, prioritising only agricultural land. There has been limited progress in establishing the legal basis for the creation of the much-needed e-cadastre.

- **Despite some improvements, employment and labour market participation remain low and the incidence of undeclared work significant.** A key bottleneck to competitiveness and growth is the lack of a workforce with the right skills for the labour market. There have been positive developments in improving the relevance and quality of vocational education and training, but entrepreneurial and soft skills are still underdeveloped. The narrow coverage of active labour market policies and the weakness of employment services are coupled with limited links with passive social schemes. There is still no comprehensive approach to addressing the high incidence of undeclared work. Poor and vulnerable households face limited access to education, jobs and social protection measures. There is a serious risk that the restructuring of the administration will reduce its capacity to progress with the design and implementation of employment and social policies.

The policy guidance jointly adopted at the Economic and Financial Dialogue of 23 May 2017 has been partially implemented. The fiscal deficit has been kept relatively stable, but the public debt-to-GDP ratio has been reduced less than planned. The budgetary framework has been complied with, but it does not provide a particularly strong anchor. There has been some limited progress in unbundling the electricity and gas markets with the preparation of an unbundling plan and the establishment of a new gas company. No progress has been made on promoting and monitoring energy efficiency measures. There has been some facilitation of registration of assets to simplify the registration of property, while no progress has been made on setting up the e-cadastre. Coverage of activation measures remains very low and work on linking them with social protection support has been limited. No progress has been made in reducing undeclared work or setting up a comprehensive approach to doing so. The structural reform measures planned for completion in 2017 in last year's ERP were only partially implemented.

Overall the programme's macro-fiscal framework is slightly optimistic. The reconfirmed commitment to lowering public debt is in line with the priorities identified by the Commission in previous years. Structural obstacles to competitiveness and the reform measures presented in the ERP to some degree match bottlenecks and reform needs identified by the Commission. The diagnostic focuses on access to finance, land ownership, the informal economy, business regulation, the skills gap and the overall quality of education. However, it neglects issues like the judiciary, property rights related issues and contract enforcement. The mix of structural reform measures is relevant overall, but the focus of some measures, especially in the field of employment, skills and social inclusion, is not clear.

2. ECONOMIC OUTLOOK AND RISKS

Albania's economic reform programme (ERP) projects a strengthening of domestic demand which will push output growth above 4 % in 2018-2020. Private consumption is set to accelerate based on moderate growth in employment, gradually increasing wages and rising consumer confidence. Additional support to consumer spending is expected from a higher rate of household borrowing promoted by an easing of banks' lending standards. It is also projected that private investment activity will be supported by improving financial conditions over the medium term. Public investment is planned to increase to 5 % of GDP. The level of investment growth is nevertheless expected to be relatively moderate compared to the double-digit growth rate in 2017, when the construction of two large energy projects (the Trans Adriatic Pipeline and the hydropower project on the river Devoll) was culminating. In line with medium-term budget planning, government consumption is projected to expand at less than half the rate of GDP. Export growth, which was extraordinarily strong during a catch-up phase in the past 2 years, is expected to moderate to a more sustainable pace. Import growth, too, is seen declining in parallel with import-heavy investments. The positive contribution of net exports to GDP growth is expected to vanish by next year. Seen from the production side, the ERP projects that all economic sectors will contribute to growth based on their average historical performances. Overall, annual GDP growth is seen rising slowly, but steadily, from 3.9 % in 2017 to 4.4 % in 2020. Without specifying the underlying determinants, the ERP projects — rather optimistically — a parallel increase in Albania's potential growth rate to 4.3 % in 2020. The output gap is to turn slightly positive by 2020.

Table 1:

Macroeconomic developments and forecasts

	2016		**2017**		**2018**		**2019**		**2020**	
	COM	**ERP**	COM	**ERP**	COM	**ERP**	COM	**ERP**	COM	**ERP**
Real GDP (% change)	3.4	**3.4**	4.0	**3.9**	3.8	**4.2**	4.2	**4.3**	n.a.	**4.4**
Contributions:										
- Final domestic demand	4.2	**4.2**	4.9	**4.9**	3.8	**3.6**	4.6	**4.3**	n.a.	**4.3**
- Change in inventories	-1.2	**:**	-0.3	**:**	-0.2	**:**	-0.1	**:**	n.a.	**:**
- External balance of goods and services	0.2	**0.2**	-0.6	**0.8**	0.2	**0.6**	-0.3	**-0.1**	n.a.	**0.1**
Employment (% change)	6.1	**6.1**	3.5	**3.6**	3.6	**2.7**	3.8	**2.6**	n.a.	**2.5**
Unemployment rate (%)	15.6	**15.6**	14.2	**13.9**	13.7	**12.9**	13.0	**12.0**	n.a.	**11.2**
GDP deflator (% change)	-0.2	**-0.2**	1.8	**1.6**	2.0	**1.9**	2.3	**2.0**	n.a.	**2.3**
CPI inflation (%)	1.3	**1.3**	2.0	**2.0**	2.4	**2.7**	2.7	**3.0**	n.a.	**3.0**
Current account balance (% of GDP)	-7.6	**-7.6**	-7.9	**-7.6**	-7.8	**-6.7**	-8.2	**-6.5**	n.a.	**-6.5**

Sources: 2018 Economic Reform Programme (ERP), Commission 2017 autumn forecast (COM).

A baseline scenario with output growth of around 4 % is not implausible in the current context, but the projected trajectory appears slightly optimistic. Steady output acceleration in 2018-2020 is likely to be prevented by decelerating investment activity as the two large energy projects approach completion. Certainly, the negative effect on GDP growth is mitigated by the associated decline in import growth. However, it seems slightly optimistic to expect the remaining impact to be overcompensated by higher consumer spending and public investments. For this reason, the Commission's most recent forecast projects a dip in GDP growth of 0.2 percentage points (pps) in 2018. Similar growth moderations can be found in forecasts by international institutions. In addition to the baseline projection, the ERP presents two alternative growth scenarios. In the pessimistic scenario the baseline projection is shifted downwards by 1.5 pps over the programme period. In the optimistic scenario the baseline projection is shifted upwards by 1.0 pp. The scenarios are said to cover situations in which, respectively, downside and upside risks materialise regarding various internal and external factors. These scenarios are not developed in any detail and should rather be considered as the lower and upper limits of an uncertainty band around the baseline projection.

Inflation remains below target and the central bank intends to keep monetary policy on an accommodative course. The annual average of the consumer price index rose by 2.0 % in 2017. Annual inflation has now run at below the central bank's 3 % target for 5 consecutive years. This reflects the absence of upward price pressures from a domestic economy that is still operating below potential, in combination with disinflationary impacts from the external environment. In this context, the central bank has kept its key policy rate at the historic low of 1.25 % since May 2016. The central bank expects average inflation to firm slightly to 2.2 % in 2018 and to return to target around mid-2019 as economic growth strengthens further. In this scenario, the central bank intends to maintain an accommodative monetary policy stance, but to remain flexible regarding the intensity of monetary stimulus. Specifically, it has signaled that it will not reduce the monetary stimulus before the fourth quarter of 2018. Interest rates for private borrowers have remained relatively stable at low levels, with an average lek-euro interest rate differential of around 2.5 %. Within Albania's floating exchange rate system, the lek remained on an appreciating path in 2017. Its average annual value against the euro increased 2.4 % in 2017. In nominal and real effective terms the currency's value was up by 4.5 % and 4.2 % respectively year-on-year in the fourth quarter of 2017. For 2018-2020, the ERP assumes constant nominal exchange rates.

The large current account deficit is expected to remain relatively stable over the programme period. Albania has a relatively narrow production base, resulting in a large structural deficit on the trade balance for goods. This is partially offset by revenues from foreign tourism and the export of manufacturing services for foreign-owned products. The current account also benefits from a large volume of remittances sent home by Albanians abroad. A revision of balance of payments data in September 2017 has lowered the level of the current account deficit. Based on the new methodology, the deficit has declined from 8.7 % in 2015 to 6.3 % of GDP in the 12 months to September 2017. This was mainly due to a sharp improvement in the services account, but also to a revival of goods exports. The ERP projects the current account deficit will remain at around 6.5 % of GDP over the programme period. This is some 4 pps lower than projected in last year's ERP. The difference is the combined result of the revised data methodology and the unexpected narrowing of the deficit in 2017 which is expected to be sustained. The value of goods exports is expected to grow at an annual rate of close to 10 %, which is not implausible given the expansion in Albania's export markets (mainly the EU). Goods imports are expected to decelerate temporarily in 2018 (as the construction phase of the two major energy projects nears completion). However, they will pick up in the following 2 years, to an annual growth rate of 6.4 %. Considering the expectation of strongly growing domestic demand over the next 2 years, this projection may be on the low side. Services exports are expected to benefit from continuing solid growth in foreign tourism and projected to expand at an average annual rate of 7.8 %. The essence of the ERP's forecast for the external sector is that a widening deficit on the trade balance for goods is offset by a growing surplus on the service balance, resulting in a relatively stable current account deficit over the programme period. Overall, the main risk associated with this projection seems to be that the expected strength of domestic demand will result in higher-than-projected import growth and hence a higher current account deficit.

Inflows of foreign direct investment are expected to finance the current account deficit fully. Over the past 10 years, foreign direct investment (FDI) inflows have financed 76 % of Albania's current account deficit. In the 12 months to September 2017, net FDI even exceeded the deficit by 41 % while the construction of the two large energy projects was peaking. The ERP projects that net FDI will remain strong and exceed the current account deficit by about 20 % in each of the programme years. The ERP recognises that FDI inflows associated with the two large projects, which are about to be completed, will diminish, but seems to expect — without any discussion — that this will be compensated by new FDI projects. However, Albania's success in attracting foreign investment in recent years has been heavily concentrated in non-tradable and natural resource-based industries. There is a risk that new investment opportunities in these industries will dry up and that investments in other sectors like tourism will be on a smaller scale. Attracting FDI to higher value-added activities would integrate the economy better into global supply chains, boost productivity and create more and better jobs throughout the economy. This, however, would require wide-ranging structural reform to bring about substantial improvements in the investment environment. Gross external debt stood at 68.4 % of GDP at the end of September 2017, down from 73.5 % at the end of 2016. About 80 % of the external debt is long-term. More than half of the long-term debt is owed by the government and most of the rest consists of intercompany lending between direct investors and subsidiaries. Although sizeable, the composition of the external debt means that it does not give rise to immediate concerns. Foreign exchange reserves totalled EUR 3.0 billion (25.7 % of GDP) at the end of 2017 and are expected to rise by around 10 % annually over the next 3 years. Currently, the reserves cover about 6½ months' worth of imports of goods and services, providing an adequate safeguard against adverse shocks.

Banks are well capitalised, highly liquid and with a reduced stock of non-performing loans, but their lending remains subdued. The ratio of non-performing loans (NPL) to total gross loans declined to 13.2 % at the end of 2017, 5.1 pps lower than a year earlier, mainly as a result of mandatory write-offs. The declining NPL ratio is positive for bank lending to the business sector which has, however, remained sluggish. Bank lending showed only slight growth in the second half of 2017 when adjusted for loan write-offs. Financial intermediation is constrained by the high level of informality as well as weaknesses in contract enforcement and collateral recovery. The accommodative monetary policy has kept the lek-euro interest rate spread for new loans at the low level of 2.5 % and has continued to support a gradual shift towards lending in lek. The share of foreign-exchange loans in total loans fell slightly in 2017, mainly as a result of lek appreciation. Unhedged foreign-exchange loans, which carry the risk of lek depreciation, constituted 53 % of households' and 42.5 % of businesses' foreign-exchange credit in mid-2017. Overall, the banking system maintains adequate buffers to absorb shocks as capital adequacy and liquidity ratios exceed regulatory requirements and profitability has been improving. Banks are also not reliant on foreign-based parent banks for funding because the loan-deposit ratio is low and declining (see Table 2). However, the preponderance of short-term deposits among funding sources is leading to maturity mismatches and hindering long-term financing by banks. On the asset side, government securities account for around 25 %, exposing banks to sovereign risk.

Table 2:
Financial sector indicators

	2013	2014	2015	2016	2017
Total assets of the banking system, mEUR	9,877	10,872	10,728	11,906	11,873
Foreign ownership of banking system by asset, %	88.6	87.1	84.1	82.6	
Credit growth*, %	-0.2	0.2	0.3	-0.7	-0.2
Deposit growth, %	3.7	1.5	1.9	1.1	1.0
Loan to deposit ratio	58.4	57.7	56.8	55.8	54.8
Financial soundness indicators, %					
- non-performing loans to total loans	23.2	22.8	18.2	18.3	13.2
- core capital to risk weighted assets	18.0	16.8	16.0	15.7	16.6
- liquid to total assets	27.6	31.9	32.3	31.3	30.2
- return on equity	6.4	10.5	13.2	7.1	15.7
- forex loans to total loans	63.0	62.4	60.8	58.6	55.9

**: Adjusted for loan write-offs*
Sources: 2018 Economic Reform Programme (ERP), Macrobond, Bank of Albania, ECFIN CCEQ.

3. PUBLIC FINANCE

In 2017, the fiscal deficit remained close to 2 % of GDP despite economic growth strengthening further. Total revenue increased by 5.7 % year-on-year, driven by higher tax revenues and social insurance contributions. The ratio of revenue to GDP increased from 27.6 % in 2016 to 27.7 % in 2017, which was better than planned in last year's ERP. Compared to the budget as revised in December 2017, total revenue was 2.8 % below target. Total expenditure increased by 6.4 % year-on-year based, in particular, on rising public consumption, social transfer payments and capital expenditure. The ratio of expenditure to GDP increased from 29.4 % in 2016 to 29.7 % in 2017. Compared to the revised budget, total expenditure was 2.7 % below target. The under-execution of expenditure was partly the result of an under-execution of capital spending following significant overspending the previous year. Public investment is crucial to addressing large gaps in infrastructure; a recurrent failure to adhere to spending targets indicates ongoing weaknesses in public investment management. Overall, the headline budget deficit increased from 1.8 % of GDP in 2016 to 2.0 % in 2017, which is identical to the projected deficit in the original budget and the two revised versions. The ERP projects that the primary general government surplus fell from 0.7 % of GDP in 2016 to 0.4 % in 2017. The new rule in the Organic Budget Law banning frontloaded public spending in election years was complied with.

For the programme period, the ERP projects back-loaded fiscal consolidation with a gradually declining debt-to-GDP ratio. Essentially, the current programme envisages budget stabilisation in the short term as the overall fiscal deficit is projected to remain at 2.0 % of GDP in 2018. Fiscal consolidation is planned to resume subsequently with an overall deficit of 1.7 % in 2019 and 1.2 % in 2020. The primary surplus is set to rise gradually to 1.5 % of GDP by 2020. Compared to last year's ERP, the new programme postpones and attenuates fiscal consolidation. For 2019 the targeted fiscal balance has been made 0.8 pps less ambitious with regard to both the overall and the primary balance despite a slightly more positive projection for GDP growth. The projected narrowing of the fiscal deficit is expected to be achieved through a combination of rising revenues (by

0.4 pps between 2017 and 2020) and a cutback in expenditure (by 0.3 pps over the same period) relative to GDP. The rise in the revenue ratio is the result of a gradual increase of tax revenues partly offset by lower social security contributions. The decline in the expenditure ratio is planned to be achieved primarily by keeping the average annual growth rate of public consumption (3.2 %) at half the growth rate of nominal GDP (6.4 %) in 2018-2020. This will require considerable spending discipline which has not been detailed in the ERP. The cutback is, however, more modest than in last year's ERP. The projected paths for the fiscal deficit and for nominal GDP growth would allow the debt-to-GDP ratio (including state guarantees) to decline gradually by 6.4 pps to 63.5 % over the 3 years to the end of 2020. Overall, the government's planned fiscal stance is sufficiently strict to reduce the debt ratio further, as required by the fiscal rule.

Table 3:

Composition of the budgetary adjustment (% of GDP)

	2016	2017	2018	2019	2020	Change: 2017-20
Revenue	27.6	28.5	28.2	28.1	28.1	-0.4
- Taxes and social security contributions	22.0	22.4	22.6	22.8	22.9	0.5
- Other (residual)	5.6	6.1	5.6	5.3	5.2	-0.9
Expenditure	29.4	30.5	30.1	29.8	29.4	-1.1
- Primary expenditure*	26.9	28.1	27.6	27.1	26.7	-1.4
of which:						
Gross fixed capital formation	5.4	6.2	6.5	6.2	6.1	-0.1
Consumption	9.5	9.3	9.0	8.8	8.5	-0.8
Transfers & subsidies	12.1	12.3	12.0	12.1	12.0	-0.3
Other (residual)	-0.1	0.3	0.1	0.0	0.1	-0.2
- Interest payments	2.5	2.4	2.5	2.7	2.7	0.3
Budget balance	-1.8	-2.0	-1.9	-1.7	-1.3	0.7
- Cyclically adjusted	-1.7	-2.0	-2.0	-1.7	-1.3	0.7
Primary balance*	0.7	0.4	0.6	1.0	1.4	1.0
Gross debt level	72.4	71.5	68.7	66.4	63.5	-8.0

**: Excluding arrears clearance*

Sources: 2018 Economic Reform Programme (ERP), ECFIN calculations

The 2018 budget suggests stability in fiscal policy, but postpones the previous ambition of further consolidation. Parliament adopted the 2018 state budget on 30 November 2017. Fiscal plans assume that nominal GDP will grow by 6.1 % in 2018, which is slightly higher than projected in the Commission's autumn 2017 forecast. The budget deficit of 2.0 % of GDP is identical to the planned and realised deficit in 2017, but 0.2 pps higher than projected in last year's ERP. Compared to the 2017 outcome, the budget projects an increase in total revenue of 8.0 %. Revenues from VAT are expected to rise somewhat faster, partly because the threshold for VAT registration has been lowered to include many small, previously exempt businesses. This is to some degree mitigated by the reduction in the VAT rate applied to five-star hotels from 20 % to 6 %. Social insurance contributions are expected to be almost flat following an unexpected double-digit surge in 2017 which is credited to the fight against informality. Property tax revenues are projected to increase by two thirds due to the introduction of new property valuations as of 1 April. This is, however, expected to be almost fully offset by declining revenues from other local taxes, resulting in virtually no growth in overall revenues from local taxes. Compared to the budget outcome for 2017, total expenditure is projected to increase by 7.7 %. In contrast to the revenue side, the items on the expenditure side of the budget are not explained in the ERP. Interest payments and capital spending account for the bulk of the expenditure increase. A rise of 30.1 % in interest payments seems implausibly high given the on-going stability in euro and lek interest rates. The budgeted rise of 26.2 % in capital expenditure is the combined result of under-execution of this budget line in 2017 and the government's aim to raise public investment to around 5 % of GDP in the programme period (5.2 % in 2018).

Beyond 2018, plans for fiscal consolidation rely on spending restraint, but the underlying measures are unclear. The ERP does not provide information about fiscal measures or analytical support for the budget projections, which are presented as tables. Total expenditure relative to GDP is projected to decline by 0.7 pps between 2018 and 2020, mainly due to relatively moderate increases in public consumption. Interest expenditure is projected to rise at a double-digit annual rate, reflecting an expectation of increasing interest rates in domestic and foreign markets. This would raise interest expenditure to 2.7 % of GDP in 2020. Social insurance outlays, the biggest expenditure item, are linked to the annual rate of inflation, and social transfers' share of GDP is expected to remain stable at 12 % of GDP. Total public investment is projected to remain relatively stable in line with the government's aim to keep capital expenditure close to 5 % of GDP. The major downside risk to the ERP's expenditure targets seems to be the absence of the disciplinary anchor provided by the IMF programme in 2014-2017. On the revenue side, risks stem mainly from the possibility that nominal GDP growth will fall short of the projection. In addition, without further revenue measures, meeting the target of keeping the revenue-to-GDP ratio stable will require sustained efforts to improve revenue collection. There is ample scope for this given the large informal economy.

The ERP's medium-term budgetary projections entail a number of additional risks which have not been fully evaluated in the programme. Apart from the risks inherent in implementing fiscal discipline under conditions of uncertainty, Albania's budget position may be affected by financial obligations for which the government can ultimately be held responsible. Public guarantees represent one such source of risk, even if they are fully accounted for in the public debt and were reported to amount to 3.2 % of GDP at the end of 2017, down from 3.6 % a year earlier. Around 83 % of total guaranteed debt has been issued in favour of the state-owned energy sector where reforms are still incomplete. A further long-standing risk to the budget outlook is the obligation, confirmed by international court rulings, to provide compensation to former owners of property expropriated in the communist era. The budget line dedicated to such compensation payments may be insufficient to cover all eventual claims. Most importantly, plans to increase the use of public-private partnerships and concession contracts entail significant fiscal risks in the form of contingent liabilities for the state budget. The government's control of these arrangements has to be tightened to mitigate these risks. Finally, there are continuing risks entailed in financial management by local governments; their expenditure represented 3.0 % of GDP in 2017.

Box: Debt dynamics

The debt ratio started to fall in 2016 as the primary balance moved into surplus. The ERP projects that the debt ratio will continue to fall on the back of a sustained primary surplus, rising inflation and a pick-up in real GDP growth. The implicit interest rate is expected to rise only moderately. The low level of stock-flow adjustments indicates that the government does not expect significant net flows of guarantees or exchange rate movements.

Table 4:

Composition of changes in the debt ratio (% of GDP)

	2016	2017	2018	2019	2020
Gross debt ratio [1]	**72.4**	**71.5**	**68.7**	**66.4**	**63.5**
Change in the ratio	-0.2	-0.9	-2.8	-2.4	-2.9
Contributions [2]:					
1. Primary balance	**-0.7**	**-0.4**	**-0.6**	**-1.0**	**-1.5**
2. "Snowball" effect	**0.2**	**-1.3**	**-1.6**	**-1.4**	**-1.4**
Of which:					
Interest expenditure	2.5	2.4	2.5	2.7	2.7
Growth effect	-2.4	-2.7	-2.8	-2.8	-2.7
Inflation effect	0.1	-1.1	-1.3	-1.3	-1.4
3. Stock-flow adjustment	**0.2**	**0.9**	**-0.6**	**0.0**	**0.1**

Notes:

[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) 2018, ECFIN calculations

The public debt ratio continued to decline, but it is still high and entails significant risks. At the end of 2017, Albania's public debt (including public guarantees) stood at 69.9 % of GDP. This was 2.5 pps below the debt ratio at the end of 2016 and marked the second consecutive year with a falling debt ratio. It was, however, also 1 pp. higher than projected in last year's ERP. Almost all of the public debt is owed by central government. In a benign interest rate environment, the debt generated interest payments worth 2.1 % of GDP in 2017, down from 2.7 % in 2015. The authorities have been able to lengthen the average maturity of the public debt stock significantly and reduce the share of variable rate instruments. This shifting debt composition means that rollover and interest rate risks have been lowered. Almost half of the debt is denominated in foreign currencies, mostly the euro. Just over half of the public debt is held domestically, mainly by the banking sector, and much of it is still short-term and has to be refinanced frequently. Albania is vulnerable to changes in market sentiment and host-country regulatory requirements that could influence debt holders' willingness to hold Albanian securities. Further debt reduction is therefore essential to mitigate debt-related vulnerabilities and rebuild room for policy manoeuvre.

The current budgetary framework aims to achieve debt sustainability in the longer run but lacks a credible and operational anchor. The current fiscal rule mandates a debt ceiling of 45 % of GDP and annual budget balances that ensure a falling debt ratio until the target is reached. The rule is relatively soft as it does not set a deadline for the target to be reached or require an independent body to monitor compliance. At this stage the authorities do not plan to change the recently adopted budgetary framework. However, the current government has committed itself to reduce the debt ratio to below 60 % by 2021. The ERP's projection for the downward path of public debt is consistent with this medium-term target, but due to downside risks to growth and budget execution additional fiscal measures might be required to achieve it.

4. STRUCTURAL REFORMS

Albania faces several obstacles to improving potential growth and competitiveness. A weak judiciary, insufficient enforcement of property rights and burdensome administrative procedures are institutional weaknesses that have been only partially addressed so far. This is hampering both local businesses and potential FDI inflows, unfortunately these important weaknesses are not being taken into account despite ongoing reforms. Cadastral issues and still unclear land ownership continue to hamper access to finance, hurt public revenues and limit the consolidation and defragmentation of agricultural land. Albania has great potential for renewable energy production but the market is still not fully liberalised, the energy supply relies on hydropower and energy efficiency remains low. There was no improvement in the quality of the structural reform part of the ERP compared to last year's programme. Some key obstacles to growth and competitiveness are properly identified, but overall the quality of the area diagnostic and the design and description of measures varies significantly between the respective areas.

The reform measures included are mostly rolled over from last year's ERP (15 out of 17), and overall they respond to the challenges identified. This shows the stability and consistency of the government's medium-term economic planning. There is a mix of legislative, administrative and infrastructure reforms without overemphasising infrastructure, but rather looking at genuine structural reforms. Overall, the cost estimates, the respective budget impact and the links between sectors and measures given are not comprehensive, which makes this element more difficult to assess. Some measures, for example in the areas of research, development and innovation and water/waste water, are based on such low funding that there will be no impact on the economy at all. Many measures also depend heavily on co-financing by international financial institutions or donors. This raises questions about whether they will prove to be sustainable when maintenance funding is needed and about the capacity of the administration to design targeted reforms on its own. The Commission's assessment of last year's ERP has been partially taken into account. In most areas, measures are directly linked to the diagnostic provided in the respective section of the ERP. In many cases the evaluation of the measures' expected outcomes is not realistic enough or not clearly analysed.

Public finance management

Public finance management (PFM) in Albania has demonstrated several structural shortcomings such as a lack of transparency, weak ICT infrastructure and inefficient use of public resources. The current ERP lists the relevant shortcomings and correctly identifies the main obstacles hindering competitiveness and sustainable economic growth. It does not, however, specify issues related to the lack of transparency in public procurement and the work of public-private partnerships . It provides limited analysis of issues related to service delivery and government accountability.

The new measure establishing a fiscal cadastre addresses only a part of the PFM shortcomings identified and is highly ambitious in its implementation framework given the previous delays. The budgetary impact of the PFM reform strategy remains unexplored, in particular regarding cost per activity for 2018-2020 and the expenditures part. Nevertheless, the new fiscal cadastre is expected to bring additional revenue. The expected impact on competitiveness and employment is described in very general terms. The potential implementation risks are correctly identified but could be further elaborated. The measure under the 2017-2019 ERP aimed at developing a PFM strategy and internal control reforms was dropped without a justification being provided.

Energy and transport market reforms

Albanian's energy and transport sectors constitute a strategic resource for sustainable economic growth, given the variety of its energy sources and its geographical location. The main obstacles to competitiveness in the transport and energy markets include the lack of efficient rail transport, the inefficient or inadequate capacity and operational structure of maritime infrastructure, the economy's low energy efficiency, the energy import dependency, and the climate change risks of electricity production from hydropower (100% of domestic electricity generation). The ERP diagnostic to a large extent recognises this. In the energy sector, the ERP identifies the need to fully implement commitments under the Energy Community and to diversify energy sources, including by better exploiting the country's renewable energy potential. With regard to improved energy security, it refers to reduced losses across the distribution network but misses to highlight the potential of energy efficiency for reduced consumption. In the transport sector, the ERP diagnostic focuses on the low quality of transport infrastructure as an impediment to Albania's integration into regional and global supply chains under the connectivity agenda. Such integration would contribute significantly to improving competitiveness.

All four reform measures included in this area are rolled over from the previous ERP and address to a large extent the key obstacles identified in the analysis. The two measures in the energy sector are highly relevant, but cover mainly the supply side, while the demand side is discussed less. On the supply side, it focuses only on gasification. There are no measures for realising the potential of renewable energy sources and accomodating renewable electricity into the grid (beyond hydro). Energy demand management, including measures to stimulate investment in energy efficiency and renewables (e.g. solar, wind energy), would contribute to improving the economy's competitiveness and energy security.

The measure to further liberalise the energy market is necessary and is in line with the obligations under the Third Energy Package and Albania's own strategies. The reform measure is not embedded in the overall framework of accompanying actions, like strengthening of the regulatory body, demand management, energy efficiency, or the need for price reforms. The price and tariff reform will require further efforts, while bill collection rates have improved significantly.The assessment provided, showing no budgetary impact, appears questionable. The overall impact on competitiveness is well developed while the impact on employment is provided in general tems. The potential risks to implementing the reform measures are well developed. The risk of lack of coordination with the authorities of Albania, as well as risks to the environment, may also be considered.

The measure connecting the country to the international gas network to create conditions for gasification in line with the development of the Trans Adriatic Pipeline project will promote energy diversification. However, activities planned in 2017 showed limited progress and are instead carried over to 2018. 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.

The two transport measures do not address regulatory and structural needs related to the connectivity agenda, which would have a more direct impact on competitiveness. Given Albania's shortcomings in infrastructure, the feasibility study for the extension of the Adriatic-Ionian corridor appears appropriate. However, the project is at a very preliminary stage and can hardly be considered a structural reform even if it does address a structural need. The expected impact on competitiveness is presented in broad terms, aiming at a reliable and safe transport system without figures for the expected increase in passenger or freight traffic. Potential social outcomes are not explained. Related issues, like the maintenance budget, have not been discussed. However, the potential risks are correctly identified.

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. The construction project is broadly on track and its practical realisation is expected to start by 2019. However, there are no activities planned for 2019 and 2020 despite the complexity of the project. The main risks to implementation of the reform measure are outlined and mitigating measures are proposed.

Sectoral development

Agricultural sector development

The small average size of agricultural holdings, the absence of a comprehensive land register and unclear land ownership remain key obstacles to the development of the sector. The diagnostic section correctly points to these challenges, but still fails to flag other problematic areas such as phytosanitary issues, veterinary capacity and high informality. Moreover, the ERP does not assess the negative consequences of climate change for the agricultural sector. In view of agriculture's significant economic contribution to both GDP and employment in Albania, the consolidation and defragmentation of agricultural holdings remains a major priority. This should allow the development of a more efficient and market-oriented agriculture sector, enabling economies of scale.

The foreseen consolidation and defragmentation of agricultural land, rolled-over from the previous programme, still does not give consideration to creating the technical conditions for the land consolidation process. Nevertheless, the reform activities envisage a partial digitalisation of the agricultural land register**.** The activities planned in 2017 were only implemented to a limited extent; most were postponed until 2018. At the same time, further efforts should be made to clarify property rights and develop a comprehensive land cadastre. The adopted land consolidation strategy could be linked to the development of the land cadastre in general, which would require a further update. The budgetary impact and cost per activity are considered insufficient. The expected impact on competitiveness is properly described, yet it does not specify social outcomes, in particular the impact on gender given the high employment rate of women in the agricultural sector. The potential risks section correctly points out the possible opposition from land owners and rural communities. However, others, such as delays due to property rights disputes as well as lack of funding, should also be considered.

Industry sector development

In general, Albania's industrial sector is weak and exports are concentrated in a few product groups of low sophistication and value added. The ERP correctly identifies the main shortcomings, and its focus on developing the industrial sector's potential in line with the 'circular economy' perspective is welcome. However, by defining only the processing of different raw materials available in the country it fails to provide a comprehensive analysis of the industry sector**.** Other obstacles to competitiveness and growth as well as the scope for potential sector development should be elaborated upon.

The ERP highlights water and waste water as key issues in the Albanian economy, particularly the insufficient and non-sustainable water supply which constitutes an obstacle to competitiveness, especially in the tourism sector. However, it fails to analyse the significance of the water sector for Albania's hydropower and other related sectors.

The proposed measure introducing a non-food industry development policy outlines some preparatory actions towards a more strategic policy approach, in particular in the processing industry. It covers a number of independent feasibility studies, the results of which are expected to promote investment in the copper industry and increase free mining and processing facilities. However, it does not determine the tools for achieving this objective, namely practical incentives for private companies to invest in this sector. The technical-economic studies on nickel-silicate industries and quartz industry were only partially implemented in 2017 and are planned to proceed in 2018. It remains unclear whether there is any interest from potential investors. The expected impact on competitiveness as well as potential social outcomes should be further developed. The cost per activity and the overall budget impact appear to conflict with the ambitious level of the reform and the expected outcomes. The potential risks to implementing the reform measure are widely covered and mitigation measures are presented.

Overall, the measure on water and waste water is in line with actions to combat informality and aims to ensure good governance and effective investments. The measure is well defined and highly ambitious. The objectives set, in particular the complete abolition of informality in the water sector by the end of 2018, appear over-optimistic, however. The overall social outcomes of the reform measure are well developed, whereas the impact on competitiveness and growth could be extended through other relevant sectors such as tourism and energy. The assessment of the cost per activity and budgetary impact should be provided. 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.

Service sector development

The Albanian economy is led by the service sector. In 2017, services again increased their share of gross value added to 53.4%[1]. The ERP provides no diagnostic on the services sector. The measure under the 2017-2019 ERP aimed at the standardisation of the tourism industry was excluded from the current ERP without any reason being given despite its expected solid growth (as noted in the *Economic outlook and risks* section above) and high potential impact on competitiveness. No other measure on services is included in the 2018-2020 ERP.

Business environment and reduction of the informal economy

Insufficient clarity of land ownership, corruption, weak contract enforcement, limited access to finance, especially for SMEs and a large informal economy are the key weaknesses of Albania's business environment. The entrepreneurial skills and financial literacy of the population remain underdeveloped. The diagnostic section of the ERP identifies only some of the key obstacles to competitiveness and growth. The ERP diagnostic also highlights the necessity to establish an e-permit portal as a 'one-stop shop' service to facilitate the issuance of regulatory permits. The report on policy

[1] Provisional data

guidance implementation provides a comprehensive update on measures undertaken in 2017 to reduce the regulatory burden and the NPL ratio as well as to encourage entrepreneurship among women. More could have been said about the need for significant streamlining of business regulations, including better impact assessments of legislative proposals and better stakeholder consultations. Actions to reduce the informal economy are not specified as a reform measure, but they are described in the programme and should contribute to improving the business environment.

The measure to reduce the regulatory burden on businesses as well as the measure aiming to reduce the NPL ratio in the banking system address relevant obstacles to competitiveness and growth. They also aim at stimulating job creation and promoting female entrepreneurship. The reform measure on reducing the regulatory burden needs to be implemented in the broader context of tackling the other challenges identified in the sector. The same comment applies to the measure on improving access to finance by tackling the high number of NPLs. The activities of both measures planned for 2017 were partially implemented. The timeline for implementing the reform measure was prolonged until 2019 in both cases. The measures set out clearly the expected impact on competitiveness and social outcomes, which are main shortcomings in the business environment. The potential risks are correctly assessed.

Research, development and innovation and the digital economy

Albania's capability in both research, development and innovation (RDI) and the digital economy is at an early stage and has few if any positive effects on the economy yet. The lack of cooperation and coordination between academia, the private sector and the government constitutes the main obstacle to competitiveness and growth. Albania's RDI institutions are integrated into the global RDI programmes only to a very limited extent. This explains their low success rate in the EU R&D framework programme Horizon 2020. Public expenditure on RDI as a share of GDP is low. The current ERP diagnostic provides analysis of some of these shortcomings. The ERP correctly underlines the importance of well-developed broadband infrastructure for boosting the digital economy and establishing electronic platforms in the service sector. This is in line with the priorities of the 2020 Digital Agenda. However, the ERP does not address the low engagement of the private sector in RDI programmes. The implementation of the 'triple-helix' model is important and a 'smart specialisation' strategy should also be considered.

The measure aiming at improvement of the institutional capacity of the research and innovation system will address some constraints in the area. The activities planned for 2017 were only partially implemented. The National Agency for Funding in Higher Education was established. However, the activities for 2018-2020 are defined too broadly without clear objectives. They focus on developing institutional capacity rather than implementing specific measures in the field. The envisaged cost per activity and budget impact conflict with the ambitious level of the reform measure. This means the expected impact is more than questionable. Moreover, pure capacity-building cannot be seen as a structural reform. Some risks are identified and devising a strategic framework for the sector is considered as a mitigating measure. The measure aiming to support the development of innovation policies has been dropped from the programme without justification. This is unfortunate as the establishment of an innovation hub and the incubator for the ICT start-ups had a lot of potential.

The measure on implementation of the legal and regulatory framework for developing the broadband infrastructure is in line with Albania's 2020 Digital Agenda. It addresses some key obstacles to competitiveness and growth. However, the proposed activities are defined in very generally terms and describe the preparations for reform implementation rather than the reform itself. They could be extended by listing the range of activities needed to establish the broadband infrastructure. The timeline runs only until 2019. The cost per activity and budgetary impact are well defined. The expected impact on competitiveness and social outcomes, as well as the potential risks, are correctly identified. However, no mitigating measures are proposed.

Trade-related reforms

Trade remains constrained by non-tariff barriers and complex and unsynchronised border procedures. At the same time, the regulatory regime for investment needs to be harmonised and strengthened. To increase productivity and economic competitiveness, conditions should be improved to foster much-needed investment. The ERP takes stock of the actions needed in this respect, such as improving the qualification of the workforce, combating the informal economy and protecting intellectual property rights effectively.

The trade facilitation reform measure is highly relevant and in line with national priorities and regional initiatives, such as the connectivity agenda agreed in the Berlin Process and the Central European Free Trade Agreement (CEFTA) Trade Facilitation protocol. The planned ratification by the authorities of Additional Protocol 5 under CEFTA is crucial to implementing a number of trade facilitation measures which are also part of the Regional Economic Area multi-annual action plan (REA MAP). The ERP includes the effective implementation of the Customs Code as well as references to the exchange of information with neighbours through the EU-financed system for the electronic exchange of data (SEED) maintenance project. It also contains references to the efforts to establish an authorised economic operator (AEO) programme in Albania that is aligned with the EU's *acquis* in this area and that will facilitate trade for Albanian AEO's within the CEFTA region. The expected impact on competitiveness and social outcomes as well as potential risks are correctly identified. In this respect, it is important to emphasise the need to strengthen the capacity of the National Committee for Trade Policy Coordination and Facilitation, which is critical for implementing the planned measures. Furthermore, to have a greater impact on competitiveness this measure needs to be combined with efforts to expand the country's industrial base (these are still underdeveloped in the ERP) in order to diversify tradable goods.

Education and skills

A key bottleneck to competitiveness and growth is the lack of a workforce with the right skills to be employable on the labour market. Albania does not perform well in Programme for International Student Assessment (PISA), although its results have improved steadily over the years. Major efforts are under way to improve the relevance and quality of vocational education and training (VET), mainly in donor-supported VET institutions. Nevertheless, VET provision is by no means up to the standards. Teachers lack practical skills for teaching and for preparing students for work. Notwithstanding recent improvements in the VET system, its quality, efficiency, attractiveness and relevance to learners are still lower than expected. Greater investment in skills at all levels of education is needed.

The strategic framework for improving skills is in place and implementation of most measures has started. The continuous implementation of the 2014-2020 National Strategy on Employment and Skills and the Pre-university Education Strategy represent positive steps, but more efforts are needed to integrate work-based learning schemes in VET provision. The qualification standards and curricula are being modernised, but schools still lack the capacity to implement them in practice. Entrepreneurial and soft skills that are essential to improving employability need to be strengthened through changes in the curricula, teacher training and new ways of learning. The impacts of the measures taken are yet to be seen.

The two measures aimed at modernising high-school curricula and improving VET to address skills mismatches are ongoing. They tackle key issues for the Albanian education system and include teacher training. However, cooperation between relevant stakeholders is still weak. The revised VET curricula should also target vulnerable groups, but no activities are envisaged for students from disadvantaged backgrounds. The lack of capacity continues to pose risks to implementation, which might be further impacted by the recent administrative restructuring.

Employment and labour markets

Despite improvements on the labour market, the employment rate and labour market participation remain low and the incidence of undeclared work is significant. Unemployment decreased overall, but it remains very high for young people. The high unemployment rate of high-skilled workers reflects the skills mismatch. Labour market participation of women also remains low as they face more barriers related to childcare and care for the elderly and social norms. There are limited links between passive and active employment schemes. The informal economy is being tackled to some extent by fighting tax evasion and promoting tax compliance, but undeclared work is not addressed in a comprehensive manner. Labour inspections suffer from low administrative, human and financial capacities. Stronger enforcement is needed along with the incentives schemes to encourage formal hiring.

Active labour market policies are small in scope and employment services are weak, making their impact on the labour market low. The budget for active labour market policies is stagnating and no new measures have been implemented. The share of active labour market policy beneficiaries increased to 5.5% in 2017. However, this was mainly a consequence of more stringent application of the legislation targeting non-active jobseekers. While instrumental for designing and implementing employment and social policies, tripartite relations remain weak and the extension of the mandate of the National Social Council is still pending.

The measure to modernise the employment offices and expand the scope of active labour market policies is relevant but has been progressing only slowly. The establishment of the National Agency for Employment and Skills would be an important step but this is dependent on the adoption of the Law on Employment Promotion, which has been delayed. Due to ongoing restructuring, the human resources are not yet in place to allow proper planning. There are no monitoring and evaluation mechanisms planned in the measure.

There are serious risks of reduced capacity to progress with the design and implementation of employment and labour market policies. The administrative restructuring has led to the dismantling of the Ministry of Social Affairs and Youth and reduced resources for the new service dealing with employment. This could significantly hamper implementation of the ERP measure, as well as employment and social policies overall. Sufficient staff and funding are crucial to providing effective employment activation and social protection to those in need.

Social inclusion, poverty reduction and equal opportunities

Poverty continues to pose a challenge and is linked to labour market vulnerability. Poor and vulnerable households have insufficient access to quality education. They suffer from limited job opportunities and access to social protection measures. Social and economic inclusion is a particular challenge for people living in rural or mountainous areas, single women, Roma and Egyptians and people with disabilities. Reforms of the social protection system have started. However, local authorities still lack the means to link social support more effectively with activation and active labour market measures.

Implementation of the Social Protection Strategy is under way. The reforms of the cash assistance and disability payments reforms are particularly critical to ensuring better targeting and more transparency and accountability. A system of social care at local level to address regional disparities in poverty and exclusion has not yet been established. Establishing the Social Fund is critical to ensuring the financing of the services at local level. Specific training and coaching for employment programmes have been piloted but the number of people involved in such schemes remains limited.

The measure on social inclusion proposes several fragmented activities, which makes follow-up difficult. They address the main bottlenecks but there is a need to strengthen evidence-based policy-making. Social inclusion measures, implementation of gender equality actions and decentralisation of social care reform require proper analysis, sound statistical data and budgeting. The proposed activities do focus on data collection and analysis, which is an important step forward. However, as in previous years, the measure includes several different activities and there is no indication of monitoring or evaluation mechanisms, nor is it clear which bodies are responsible for the implementation. Sufficient funding and coordination between the ministries and institutions responsible are still missing. The proposed measures could be more targeted and specific so that its impact could be monitored and evaluated.

ANNEX 1: IMPLEMENTATION OF THE POLICY GUIDANCE ADOPTED AT THE ECONOMIC AND FINANCIAL DIALOGUE IN 2017

2017 policy guidance	Summary assessment
PG 1: Continue pursuing fiscal adjustment with a view to meeting the indicated medium-term targets for reducing public debt as a share of GDP. Introduce further fiscal consolidation measures if debt reduction is at risk of falling short of target	There has been **limited implementation** of PG 1. • The fiscal deficit has been stabilised at around 2 % of GDP which – under current economic conditions – is sufficient to meet the obligation of reducing the public debt-to-GDP ratio on an annual basis. It is, however, unlikely to be sufficient to honour the commitment to lower the debt ratio from currently around 70 % to below 60 % by 2021. No further fiscal consolidation measures have been introduced.
PG 2: Persist with recent revenue mobilisation efforts, in particular by (i) strengthening tax administration further;	PG 2 has been **partially implemented**. • **Partial implementation**: Annual tax revenues increased by 7.8 % in 2017 and social security contributions increased by 9.7 % based on 50 000 new contributors. Particularly the latter development suggests the campaign against informality is achieving results.
ii) broadening the tax base based on a review of tax expenditures;	• **Limited implementation**: There has been some modest base-broadening, but there has been no review of tax expenditures other than by the IMF Article IV mission. There has been some backsliding on base-broadening by granting new tax exemptions to the tourist and IT sectors.
(iii) introducing a valuation-based property tax.	• **Partial implementation:** The Local Tax Law was amended in December 2017 and will enter into force on 1 April 2018. The necessary bylaws for implementing a valuation-based property tax were adopted in March 2018. Full nationwide implementation is pending.
PG 3: Implement the remaining measures of the NPL resolution strategy.	There has been **substantial implemention** of PG 3. • **Substantial implementation:** Most measures have been implemented, while a few important elements of the strategy are still pending.
Implement the measures foreseen in the Memorandum of Cooperation to increase the use of the national currency effectively, including differentiated reserve requirements for lek and foreign exchange deposits.	• **Limited implementation:** The BoA has started to follow up with a list of planned measures to be implemented throughout 2018 (including differentiated reserve requirements), but the government has not come up with a list of follow-up measures yet.
Strengthen the supervision of the non-bank financial sector by increasing the capacity of the financial supervisory authority.	• **Substantial implementation:** The capacity of the financial supervisory authority was increased substantially through technical assistance, changing the operational structure and management, and improving vocational training for staff.
Return to a normalisation of monetary policy if inflation rates converge to the target in a sustained way.	• **Full implementation.**

PG 4: Ensure the full unbundling of transmission and distribution activities in the electricity and gas sectors and establish a power exchange. Adopt the legal provisions necessary to promote and monitor energy efficiency improvement measures in compliance with the Energy Community Treaty.	PG 4 has been **partially implemented**. • **Partial implementation**: The Transmission System Operator has been certified subject to certain conditions, which have not been met within the deadline. Regarding the unbundling of distribution from supply activities, an unbundling plan has been prepared and unbundling model has been approved. The legal and functional unbundling of the Distribution System Operator still needs to be finalised. The electricity market remains foreclosed. • **Partial implementation**: Finalised establishment of a new gas company 'Albgaz sha' as a result of removing gas transmission and distribution activities from 'Albeprol sh.a.' • **Partial implementation**: A draft law to amend the law on power sector has been prepared and awaits adoption. • **Limited implementation:** Adoption of the decision of Council of Ministers of 1.12.2017 "On the approval of the 2nd and 3rd National Energy Efficiency Action Plan of Albania, 2017 – 2020".
PG 5: Continue the processes of clarifying the ownership of agricultural land and registering property, and put in place a functioning comprehensive cadastre and an e-cadastre by 2019.	PG 5 has been **partially implemented**. • **Partial implementation**: there has been some facilitation of registration of assets to simplify the procedures included in the Council of Ministers Decision No 994, dated 9 December 2017 'On the registration of acquisitions of agricultural land owned'. • **Limited implementation**: The process continues but is slow. Further efforts are needed to continue with the completion of the reform.
PG 6: Enhance the capacities of employment services and their provision of active labour market measures to the unemployed and inactive. By end 2017, outline concrete plans to address undeclared work. Intensify teacher training to improve quality of teaching and support curricular reform.	There has been **limited implementation of PG 6**. • **Limited implementation**: Most of the implementation measures needed to enhance employment services and their provision of active labour market policies have been delayed or limited. This was mainly due to administrative restructuring of the government, which poses risks for future implementation as well. However, the measures announced do tackle relevant challenges. • **No implementation**: No concrete plans to address undeclared work were taken or announced. The labour inspectorate suffers from low staffing and funding. • **Limited implementation**: Progress has continued, albeit slowly. Teacher training is an accompanying measure to modernisation of curricula, but no stronger or additional measures were taken or announced.

ANNEX 2: COMPLIANCE WITH PROGRAMME REQUIREMENTS

The 2018-2020 economic reform programme was adopted by the government on 25 January 2018 and submitted to the Commission on 31 January, as required. No components of the ERP are missing and its structure largely follows the guidance note provided by the Commission.

Inter-ministerial coordination

The programme was jointly coordinated by the (former) Ministry of Economic Development, Trade, Tourism and Entrepreneurship and the Ministry of Finance. All relevant line ministries were involved and contributed to the drafting exercise. However, the programme suffered significantly from institutional weaknesses around the parliamentary elections and subsequent changes in staffing and organisation regarding ERP coordination between the two lead institutions and line ministries.

Stakeholder consultation

The 2018-2020 ERP was disseminated for consultations to several international organisations, partners for development, diplomatic missions to Albania, etc. Annex II includes the comments provided by stakeholders.

Macroeconomic framework

The programme presents a concise and reasonably comprehensive picture of past developments. Almost all the relevant data are covered, but weaknesses remain, not least regarding labour market and wage statistics. The macroeconomic framework is coherent, consistent and sufficiently comprehensive and provides a good basis for policy evaluation and discussions. This part of the ERP is of the same quality as previous years' programmes. Some of the factors affecting financial intermediation could also have been covered in more detail.

Fiscal framework

The fiscal framework is detailed and well integrated with the policy objectives. It is also consistent with the macroeconomic framework. Data on the implementation of the 2017 budget cover the first 11 months of the year. The factors behind projected revenues are presented clearly, including the expected fiscal impact of economic growth, discretionary measures and better tax administration. However, there is scope for a better description of the planned expenditure measures and their anticipated budgetary impact. Fiscal data do not meet ESA2010 requirements as regards the delimitation of general government, the distinction between financial and non-financial transactions or the recording of accruals. Since November 2014, Albania has submitted regular excessive deficit procedure notifications to Eurostat on a best-effort basis and is expected to gradually align its fiscal statistics with EU requirements.

Structural reforms

The structural reforms sections (4, 5 and 6) broadly follow the guidance note. Section 4 and Table 12 in the Annex give an adequate but not complete overview of the implementation of the structural reform measures from the 2017-2019 ERP. The total number of reform measures is limited to 17 while the page limit (40 pages) for section 4 has been exceeded. The tables on budgetary impact and on implementation of 2017-2019 ERP measures have only partially been completed. Table 9 on employment and social indicators is missing.