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**COMMISSION STAFF WORKING DOCUMENT**

**ECONOMIC REFORM PROGRAMME**

**OF**

**ALBANIA**
**(2023-2025)**

**COMMISSION ASSESSMENT**

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## 1. EXECUTIVE SUMMARY

**Although economic growth in Albania will slow in 2023, the economic reform programme (ERP) expects it to firm up in 2024 and 2025.** In 2022, the economic recovery slowed, but GDP growth remained strong at 4.8%, driven by private investment and consumption. Inflation rose to an annual average of 7%, prompting the central bank to start tightening monetary policy by raising its policy rate. The ERP projects economic growth to slow to 2.6% in 2023 due to a less favourable external environment that is set to dampen exports. In addition, the tighter financing conditions and increased uncertainty about the impact of Russia's war against Ukraine affect private consumption and investment. In 2024, growth is expected to rebound to 3.9% and stay close to this rate in the medium term, mainly supported by private consumption and investment and exports. The main downside risks are related to overly optimistic projections for net exports and private investment growth. As the impact of high import prices looks set to fade, inflation is expected to meet the 3% target in 2024. Moderate employment growth in 2023-2025 is projected to reduce the unemployment rate gradually to 9.8% by 2025.

**Fiscal consolidation has accelerated, and the ERP aims to achieve a positive primary balance from 2023.** Following strong revenue growth, considerable savings on interest and personal expenditure and lower-than-planned execution of foreign financed public investment, the 2022 budget deficit was 3.7% of GDP. This is lower than originally envisaged despite additional expenditure to shelter households and small businesses from the high energy and food prices. Supported by increasing revenue, including the EU's budget support for energy, the budget deficit is set to fall in 2023 to 2.6% of GDP. At the same time, the primary balance is set to reach a small surplus, in line with the new fiscal rule. In the medium term, a decreasing expenditure-to-GDP ratio is projected to lower the budget deficit to just above 2% of GDP and to further increase the primary surplus. In 2022, the public debt ratio fell much more than expected in the ERP, by 8.6 percentage points (pps) to 64.6% of GDP, which is below the 2019 pre-crisis level. The reduction is expected to continue by about 1 pp per year.

The main challenges Albania faces are the following.

- **The planned fiscal consolidation is set to gradually rebuild fiscal space, but this should be complemented by a tighter control of fiscal risks and greater transparency of budget revisions.** The gradual reduction of the public debt ratio and a return to a positive primary balance should be implemented to rebuild fiscal space in the medium term. This should be accompanied by a steady reduction of public-sector arrears throughout the fiscal year. Applying the budget revision process provided for in the budget law for all budget amendments would make fiscal planning more transparent. Furthermore, a systematic risk assessment would help inform decisions on state guarantees and on-lending to public bodies and contribute to debt sustainability and limit fiscal risks.

- **A higher tax revenue ratio based on well-prepared tax reforms, coupled with more efficient spending, is crucial for financing the necessary investment in human and physical capital to boost productivity.** The planned fiscal consolidation needs to be supported by increasing the tax revenue ratio, including by broadening the tax base, reflecting the results of the consultation with civil society stakeholders to ensure the quality, applicability and acceptance of tax reforms. A higher tax revenue ratio is crucial for ensuring that human capital development, including social protection, education and health, is adequately financed. To monitor public expenditure on R&D, the respective data has to be collected first. In addition to increasing expenditure on measures that boost growth, steps should be taken to make public investment spending more efficient. This can be achieved by strengthening the approval process for investments and advancing the necessary legal amendments to fully integrate public-private partnerships (PPPs) into this process.

- **There is a need to increase funding and capacity for skills and training, social protection, and healthcare to improve employability and social inclusion.** 30.7% of the population aged 15-64 are economically inactive (not currently working or looking for work). Participation in vocational education and training (VET) is growing but level remains relatively low compared to its regional peers and economic demand – only 17.7% of upper secondary students enrolled in VET schools in 2021. Skill mismatches and quality issues in education and vocational training persist, as schools have yet to develop curricula that attractive for students or that are relevant to the needs of the labour market. The fact that few adults participate in lifelong learning hinders the matching of skills supply and demand. Even growing sectors such as ICT struggle to recruit staff, so providing digital skills training and promoting work-based learning in the digital sector could yield substantial benefits. High inactivity rates are reflected in the high percentage of people living at risk of poverty or social exclusion (45% in 2021, compared to 21.6% in the EU-27). The social protection system relies heavily on cash transfers, which have low adequacy, but efforts are under way to establish a systemic review and increase of the benefits. Social services are limited and unevenly distributed around the country, and local governments have limited capacity to provide them. To tackle these issues and improve access to and availability of social services, a Social Fund mechanism has been set up.

- **Albania should step up efforts on connectivity, the green transition and adapting to climate change.** The country remains a net importer of electricity, which contributes to its trade imbalance. The energy sector also remains unstable and ineffective, with insufficient supply security due to a heavy dependency on hydroelectricity, which is vulnerable to climate change. Russia's war against Ukraine has led to higher and more volatile energy prices, increasing costs and charges for households and businesses. Albania needs to manage water resources better, and tackle waste and waste-water issues addressed. Smart and sustainable mobility could help address business needs and energy challenges.

- **Further efforts are needed to nurture competitiveness, and tackle the informal economy and the digital transition.** Micro and small businesses, which account for a far higher level pf employment and added-value than the EU average, still struggle to access finance. Diversification of production and exports is also low. Albania could improve competitiveness by further improving digital skills, by addressing infrastructure and property issues, and by introducing prevention policy measures. Research and innovation funding remains below the regional average. The informal economy remains an obstacle to business development and competition, despite some results of "fiscalisation" (the obligatory electronic recording of sales subject to VAT) and other measures to combat it.

**The policy guidance jointly adopted at the Economic and Financial Dialogue of 24 May 2022 has been partially implemented**. Fiscal consolidation progressed, control of arrears and fiscal risks improved, and the reform of public investment management began. Some tax measures planned in the draft medium-term revenue strategy (MTRS) were implemented, but the formal consultation and adoption of the strategy were dropped. Although the share of expenditure on social protection increased, the share on education decreased, and health expenditure stalled. No data was available on R&D expenditure. The Bank of Albania began normalising monetary policy and ended the provision of unlimited liquidity to banks. It prepared a draft regulation for data collection on the real estate sector but had not conducted asset quality reviews of the major systemic banks. The longstanding dispute over bailiff tariffs was resolved but the government introduced no measures to promote the use of the national currency.

**The key challenges identified in the 2023-2025 ERP partly correspond to those identified by the Commission, but the proposed policy response is not sufficiently reflected in the fiscal framework.** The programme's macro-fiscal framework is based on optimistic projections for net exports and private investment above historical averages. In addition, although the planned pace of fiscal consolidation adequately supports the policy mix, the composition of the fiscal adjustment does not sufficiently reflect the identified expenditure needs for improving the availability of the public goods that are needed to increase productivity. The analysis of structural obstacles fails to examine key sectors of the economy, notably industry and services (except tourism). While the analysis of the green transition does look at some of the challenges facing Albania, on which a specific measure is included, the shared European growth model on the green and digital transition needs to be further improved, especially in the current geopolitical context. In line with the EU strategy for the digital agenda in the Western Balkans, the reform of the development of the broadband infrastructure is expected to benefit the economy. The reform measures largely address the identified key challenges. However, the ERP does not include any measures to improve the quality of higher education.

## 2. ECONOMIC OUTLOOK AND RISKS

**GDP growth decelerated but was still robust at 4.8% in 2022[1], higher than the ERP estimate[2], driven by private investment and consumption. ,**. The increase in private investment remained solid and private consumption grew even faster than in 2021, leading to higher-than-expected economic growth despite shrinking public investment and consumption and a negative contribution of net exports. The robust rise in private

(1) Macroeconomic and fiscal estimates and forecasts covering the period 2022-25 have been taken from the ERPs themselves; if available, preliminary macroeconomic and fiscal outturn data for 2022 have been taken from the relevant national sources (national statistical office, ministry of finance, central bank).

(2) The tables of this assessment reflect the ERP estimates, not the preliminary 2022 outturn published by the statistical office.

consumption was supported by continued strong employment growth, which brought the unemployment rate down to 11%. Real private wages grew by about 5%. On the production side, construction and services were the main growth driver, partly due to buoyant tourism.

**The ERP expects growth to slow further to 2.6% in 2023 before recovering to almost 4% in 2024-2025**. The slowdown in 2023 is due to a less favourable external environment that is dampening exports of services, tighter financing conditions, and increased uncertainty holding back private consumption and investment. These factors are expected to be only partly compensated by an increase in public consumption and investment. As import growth is forecast to decelerate sharply, net exports are projected to have a slightly positive contribution to growth. From 2024, private consumption and investment and exports are expected to return as the main drivers of growth, which is estimated to stay close to 4% in the medium term. Despite assumed average private investment growth of 4.2% per year, total investment is projected to fall from an average of 23.4% of GDP in 2020-2022 to 22.3% in 2023-2025 as post-earthquake reconstruction should end in 2023. Real growth of exports of goods and services is expected to average 4.3% per year in 2023-2025, whereas imports of goods and services are projected to grow by 2.2% on average. This should result in an average positive growth contribution of 0.6 pps per year from net exports. Employment is expected to rise by an average of 0.5% per year in 2023-2025, gradually reducing the unemployment rate to 9.8% in 2025. The mobilisation of the inactive population is expected to remain the main driver of labour supply, given the shrinking population (caused by high emigration and low fertility rates). The ERP projects the output gap to turn slightly negative in 2023 and to gradually close by 2026.

**The main downside risks are related to overly optimistic projections for net exports and private investment growth and a lack of focus on policies that can boost productivity.** The growth projections for 2023 and 2024 were lowered by 1.6 pps and 0.1 pps respectively compared with last year's ERP, which reflects the expected impact of the external situation on the Albanian economy. However, the forecast for 2025 and beyond remains the same. For 2023 and 2024, the economic growth projection is still above international and Commission forecasts. In particular for 2024, the projected growth contribution of net exports and private investment exceeds historical averages as well as international projections, but the ERP presents no policies to support this forecast. On the production side, the ERP expects the contribution of agriculture, mining and services to growth to exceed historical averages but does not explain why. The composition of the fiscal plan, in particular from 2024, does not fully reflect the expenditure needs of the ERP policies to support the projected growth scenario, namely investment in human and physical capital to increase productivity. Furthermore, the ERP does not consider the possible impact of the shrinking working-age population, which is a further downside risk to the growth projections because businesses are already suffering from a lack of skilled workers.

*Table 1*

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

| | 2021 | | 2022 | | 2023 | | 2024 | | 2025 | |
|---|---|---|---|---|---|---|---|---|---|---|
| | COM | ERP | COM | ERP | COM | ERP | COM | ERP | COM | ERP |
| **Real GDP** (% change) | 8.5 | **8.5** | 3.2 | **3.7** | 2.6 | **2.6** | 3.4 | **3.8** | n.a. | **3.9** |
| *Contributions:* | | | | | | | | | | |
| **- Final domestic demand** | 9.1 | **9.0** | 4.0 | **3.6** | 2.4 | **2.3** | 3.2 | **2.8** | n.a. | **3.3** |
| **- Change in inventories** | 0.5 | **0.8** | 0.0 | : | 0.0 | : | 0.0 | : | n.a. | : |
| **- External balance of goods and services** | -1.2 | **-1.2** | -0.7 | **0.0** | 0.3 | **0.3** | 0.1 | **0.9** | n.a. | **0.6** |
| **Employment** (% change) | -0.8 | **-0.4** | 1.2 | **4.6** | 0.9 | **0.5** | 0.9 | **0.5** | n.a. | **0.4** |
| **Unemployment rate** (%) | 12.2 | **12.0** | 11.4 | **11.2** | 10.9 | **10.7** | 10.5 | **10.2** | n.a. | **9.8** |
| **GDP deflator** (% change) | 5.9 | **5.9** | 6.6 | **5.1** | 4.3 | **3.0** | 3.6 | **1.2** | n.a. | **1.1** |
| **CPI inflation** (%) | 2.0 | **2.0** | 7.1 | **6.7** | 4.3 | **3.6** | 3.4 | **3.0** | n.a. | **3.0** |
| **Current account balance** (% of GDP) | -7.7 | **-7.6** | -8.3 | **-7.6** | -7.9 | **-6.9** | -7.4 | **-5.6** | n.a. | **-5.1** |
| **General government balance** (% of GDP) | -4.1 | **-4.5** | -3.4 | **-3.2** | -3.0 | **-2.6** | -1.9 | **-2.2** | n.a. | **-2.2** |
| **Government gross debt** (% of GDP) | 73.2 | **73.2** | 69.4 | **68.8** | 67.5 | **67.5** | 66.4 | **66.3** | n.a. | **65.3** |

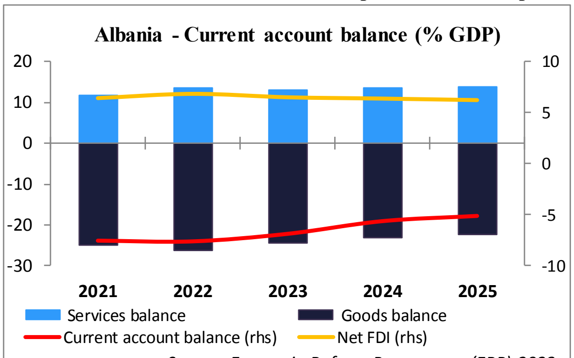
*Sources: Economic Reform Programme (ERP) 2023, Commission Autumn 2022 forecast.*

**Inflation climbed to an average of 6.8% in 2022 but looks set to fall back to the 3% target in 2024.** The inflation rate peaked at 8.3% in October 2022 but has since declined as price increases in food, energy and transport have decelerated and financial market conditions have tightened. Some of the foreign price pressures have been absorbed by the 2.5% average appreciation of the lek against the euro. This was mostly due to significant external inflows from tourism and foreign direct investment (FDI), and the unchanged regulated electricity price for Albanian households and small and medium-sized businesses (SMEs). In response to the inflation rate overshooting its 3% target and the broadening of demand-driven price pressures, the Bank of Albania (BoA) stopped the provision of unlimited liquidity to banks in February 2022 and began to tighten its accommodative monetary policy stance in March 2022. It raised the policy rate in several steps by 2.75 pps to 3% in March 2023. The ERP expects average inflation to fall to 3.6% in 2023 before converging to the 3% target in 2024 as international price pressures fade and domestic inflationary pressures become more muted in line with the slightly negative output gap. The inflation forecast for 2023 seems optimistic considering persistent foreign price pressures, including in the EU. Amid the overall increased uncertainties, the European Central Bank and the Bank of Albania have agreed to extend until January 2024 Albania's liquidity line for the amount of EUR 400 million, which has been in place since 2020 without ever being used. The ERP does not include projections for the inflation rate in the EU, but it is assumed that the effective lek exchange rate will appreciate slightly and external interest rates will rise in 2023.

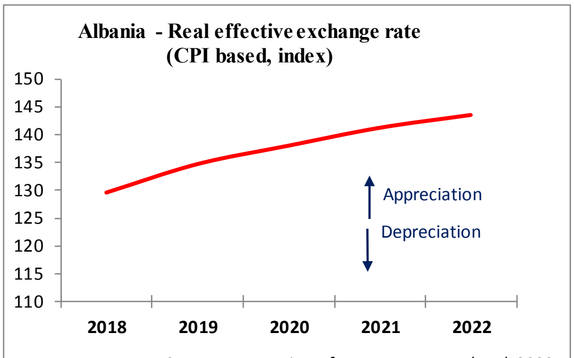
**Despite the terms of trade shock, the current account deficit decreased in 2022, and the ERP expects it to fall further in the coming years.** Sharply increased import prices widened the nominal goods trade deficit despite the strong growth of goods exports. However, high nominal GDP growth resulted in the trade deficit decreasing by about 1 pp. to 23.7% of GDP. At the same time, the services trade surplus surged by 30% , to 13.3% of GDP, which has contributed to a 1.6 pps decrease in the current account deficit to 6% of GDP. The ERP expects the current account deficit to fall further in 2023 and 2024 reaching 5.1% of GDP in 2025. This improvement is based on the assumption of a gradually decreasing goods trade deficit and an increasing services surplus. These are set to more than offset the projected increase in the primary income deficit and a gradually decreasing contribution of remittances as a share of GDP. The forecast growth of the services surplus and the primary income deficit are higher than in last year's ERP. The expected improvement of the goods trade deficit might be limited if import needs and prices are higher than projected, e. g. for electricity and investment goods.

**Foreign direct investment (FDI) inflows are forecast to gradually decrease as a share of GDP but still finance the current account deficit.** Following a strong growth of almost 19% year-on-year, FDI inflows reached 6.7% of GDP in 2022, but they are expected to gradually decline in the medium term to 6.2% of GDP in 2025. FDI inflows fully financed the current account deficit in 2022 and should continue to cover the bulk of the expected current account deficit in 2023-2025. The FDI projections appear plausible in light of the recent completion of two very large energy projects that boosted inflows in 2016-2019 and large investment projects currently in the pipeline. These projects are likely to generate inflows that are more evenly spread over the coming years. External debt is estimated to have dropped by some 10 pps to 54.6% of GDP in 2022. The BoA's risk analysis shows that the external debt ratio is more sensitive to currency depreciation than to an increase in interest rates. However, the appreciation trend of the lek indicates that such a risk is limited. Moreover, this risk is sufficiently safeguarded against by foreign exchange reserves, which have consistently increased over recent years and exceeded EUR 5 billion at the end of 2022, covering 7 months of imports of goods and services and over three times the short-term external debt.

**Graphs: external competitiveness and current account**



Source: Economic Reform Programme (ERP) 2023.



Source: Economic Reform Programme (ERP) 2023.

**The financial sector remained stable, but there could be more credit risks in the wake of rising interest rates.** Bank profitability (return on equity) improved strongly in 2021 to 12.9% but fell to 12.3% in 2022. Overall banking sector capital in relation to risk-weighted assets remained unchanged and well above the regulatory minimum, but not all banks fulfil the macroprudential requirements adequately. Liquidity declined in 2022 but was still above the regulatory limit set by the Bank of Albania. The ratio of non-performing loans to total loans continued to slightly decrease, falling to 5.1% from 8.4% in 2019. However, there are concerns that the interest rate risk could transform into credit risk as bank loans, about 75% of which carry variable rates, are being repriced. In light of this, the recent resolution of the dispute over the private bailiff services' fees is well timed, and the government should ensure that all other parts of the insolvency and resolution framework are fully operational. Another remaining source of vulnerability is banks' exposure to sovereign risk given the high share of government securities among their assets. The growth of credit to the private sector[3] accelerated from 6.9% in 2021 to 11.2% year-on-year in 2022 although commercial lending fell at the end of the year as interest rates increased in line with the usual monetary policy transmission lags following the policy rate hikes. Both the share of foreign currency denominated loans and foreign currency deposits grew in the banking sector, partly reflecting high inflows from tourism and FDI (foreign currency deposits, in particular, increased strongly to 55% of total deposits). The BoA reconfirmed its commitment to strengthen the regulation and supervision of the banking sector; the Bank updated its stress testing methodology and continued to improve the availability of data to monitor the real estate sector. Given its progress in aligning its supervisory and regulatory frameworks with EU standards, BoA applied for an equivalence assessment by the European Banking Authority. However, Albania remained under increased monitoring by the Financial Action Task Force (FATF) to address strategic deficiencies in its regime to counter money laundering and terrorist financing. There appears to be scope to increase the financial sector's role in reaching climate and energy targets in line with European and international commitments by adopting policy measures in the area of sustainable finance (such as sustainability disclosures, sustainable finance taxonomies etc.).

*Table 2*

**Albania - Financial sector indicators**

| | 2018 | 2019 | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|
| **Total assets of the banking system (**EUR million) | 11 398 | 12 380 | 13 156 | 14 980 | 16 598 |
| **Foreign ownership of banking system** (%)* | 83.4 | 77.1 | 76.0 | 75.1 | : |
| **Credit growth** (%, aop) | -1.7 | 3.0 | 6.1 | 6.9 | 11.2 |
| **Deposit growth** (%, aop) | -1.2 | 2.5 | 5.8 | 8.5 | 8.0 |
| **Loan-to-deposit ratio** (eop) | 53.9 | 55.6 | 54.7 | 54.8 | 56.1 |
| **Financial soundness indicators** (%, eop) | | | | | |
| **- non-performing loans to total loans** | 11.1 | 8.4 | 8.1 | 5.7 | 5.0 |
| **- regulatory capital to risk-weighted assets** | 18.2 | 18.3 | 18.3 | 18.0 | 18.1 |
| **- liquid assets to total assets** | 14.8 | 15.1 | 13.6 | 13.3 | 11.0 |
| **- return on equity** | 13.0 | 13.5 | 10.7 | 12.9 | 12.3 |
| **- forex loans to total loans** | 55.1 | 50.1 | 48.5 | 48.8 | 49.3 |

* foreign equity ownership of total banks' equity

*Sources: Economic Reform Programme (ERP) 2023, IMF, Bank of Albania.*

## 3. PUBLIC FINANCE

**Strong revenue growth coupled with some expenditure savings and a high GDP denominator lowered the fiscal deficit to 3.7% of GDP in 2022.** The government introduced four budget amendments outside of the regular revision process in 2022 (January, March, July, December). As in previous years, they were not all triggered by unexpected events. The budget amendments: (i) significantly raised expected revenue

(3) Adjusted for written-off loans and exchange rate impacts

(+2.5 pps of GDP); (ii) increased support to the state-owned electricity utilities to keep the regulated electricity prices for households and SMEs unchanged (1.4% of GDP); and (iii) allocated direct support worth 0.9% of GDP to vulnerable households facing difficulties in meeting higher food and fuel costs. Based on the new GDP estimate[4] in the ERP and the budget implementation data, tax revenue ended up at 26.3% of GDP in 2022. This was 1.1 pps above the 2021 value and 8.3% above the original target in the 2022 budget. Total expenditure was up 0.2 pps year-on-year at 31.6% of GDP, 2.2% below the amended target. This included central government capital expenditure of 5.4% of GDP as well as direct support of 1.4% of GDP to the publicly owned energy utilities. Tax revenue grew by 13.8% year-on-year in 2022 and was driven by strong growth across all tax categories except national taxes and excises. In particular, profit tax (+33.9%) and import-related revenue (VAT and customs duties) saw an exceptional rise. Overall expenditure increased by 9.2% compared with 2021. Current spending rose by 8.4% while capital expenditure turned out 14.6% higher than in 2021, only because it was used to clear arrears in December. Sizeable savings compared to the original budget were achieved on interest costs, personnel expenditure and foreign-financed capital spending. The budget deficit of 3.8% of GDP was about 1.2 pps lower than projected in the original budget and 0.7 pps below the 2021 deficit.

**The ERP envisages a moderate pace of fiscal consolidation mainly driven by a decreasing spending ratio.** Following an exceptional increase in revenues in 2023, the revenue ratio is projected to fall back to its 2022 level in 2024-2025. The planned reduction of expenditure as a share of GDP, which looks set to see the biggest fall (1.6 pps) in 2024, should underpin the budget balance's gradual improvement in 2023-2025. In 2024 this is mainly related to ending the exceptional support to the electricity sector and the completion of the post-earthquake reconstruction. From 2025, this reduction is due to the gradually decreasing spending on personnel and operation and maintenance as a share of GDP. Capital spending is also expected to decrease by about 0.6 pps of GDP, while interest costs are projected to rise significantly, reflecting tighter financing conditions. The primary balance is forecast to turn positive already in 2023, one year earlier than has been expected in the previous ERP. The cyclically adjusted primary balance shows the largest improvement in 2023, which implies a pro-cyclical tightening given the estimated negative output gap. However, this fiscal stance would support monetary policy in reducing inflation towards the target.

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(4) The budget law requires Albania to use a projected nominal GDP not higher than the latest available IMF forecast for fiscal purposes. However, nominal GDP growth in 2022 is expected to have been 8.9%, about 3.4 pps above the original estimate used for the budget preparation.

*Table 3*

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

| | 2021 | 2022 | 2023 | 2024 | 2025 | Change: 2022-25 |
|---|---|---|---|---|---|---|
| **Revenues** | 27.0 | 28.2 | 29.5 | 28.3 | 28.3 | 0.1 |
| - Taxes and social security contributions | 25.2 | 26.5 | 27.0 | 26.7 | 26.7 | 0.2 |
| - Other (residual) | 1.9 | 1.7 | 2.5 | 1.6 | 1.6 | -0.2 |
| **Expenditure** | 31.6 | 31.4 | 32.1 | 30.5 | 30.4 | -1.0 |
| - Primary expenditure* | 29.7 | 29.4 | 29.3 | 27.4 | 27.1 | -2.3 |
| *of which:* | | | | | | |
| Gross fixed capital formation | 7.7 | 6.6 | 6.7 | 6.1 | 6.2 | -0.4 |
| Consumption | 8.7 | 8.5 | 8.7 | 8.5 | 8.2 | -0.4 |
| Transfers & subsidies | 12.2 | 11.7 | 11.9 | 12.0 | 11.9 | 0.2 |
| Other (residual) | 1.1 | 2.6 | 2.0 | 0.8 | 0.9 | -1.8 |
| - Interest payments | 1.9 | 1.9 | 2.8 | 3.1 | 3.3 | 1.4 |
| **Budget balance** | -4.5 | -3.2 | -2.6 | -2.2 | -2.2 | 1.0 |
| - Cyclically adjusted | -6.1 | -3.3 | -2.3 | -2.2 | -2.2 | 1.1 |
| **Primary balance** | -2.6 | -1.2 | 0.3 | 0.9 | 1.2 | 2.4 |
| - Cyclically adjusted | -4.2 | -1.3 | 0.5 | 0.9 | 1.1 | 2.5 |
| **Gross debt level** | 73.2 | 68.8 | 67.5 | 66.3 | 65.3 | -3.5 |

* Excluding arrears clearance

*Sources: Economic Reform Programme (ERP) 2023, Commission calculations.*

**Windfall tax revenue and one-off grants are set to help Albania achieve a positive primary balance in 2023.** The 2023 budget and the medium-term macro-fiscal framework, which serves as a basis for the ERP, are based on the latest fiscal outturn data available at the time (November 2022). This marks an improvement over the previous years' practice. The budget deficit is expected to fall to 2.6% of GDP while the primary balance is set to improve substantially to 0.3% of GDP from -1.2% estimated for 2022. Exceptional energy-related EU budget support and one-off revenue from retroactively taxing exceptional profits of private electricity producers[5] are expected to lift total revenue by 1.3 pps to 29.5% of GDP. Total expenditure is set to grow by 0.7 pps to 32.1% of GDP, mainly to cover the increase in public sector wages and interest costs. Budget support to the electricity sector is set to decrease by 0.8 pps to 0.6% of GDP. Capital expenditure (including local governments) is set to increase marginally by 0.1 pps to 6.7% of GDP, mostly related to foreign-financed investments, while post-earthquake reconstruction is set to end in 2023. The planned income tax reform, which was postponed to 2024, would broaden the tax base as self-employed people and freelancing professionals would be subject to the personal income tax regime instead of the profit tax, from which most of them (with a turnover below ALL 14 million) have been exempted since 2021.

(5) According to its legal basis, this exceptional revenue has to be used for social expenditure.

*The 2023 budget*

Following the presentation of the draft budget on 25 October, the 2023 budget was adopted by the Albanian Parliament on 25 November 2022. Two months later, Parliament approved the last amendment of the 2022 budget, which the government had introduced on 1 December 2022 by a normative act. The 2023 budget aims to achieve a fiscal deficit of 2.6% of GDP and a positive primary balance of 0.3% of GDP.

The budget provides for a 6% salary increase for health and education employees, funding for the local elections in May 2023, subsidies for electricity prices, and contingencies for foreign grant projects and unplanned expenditure needs.

Total revenue is expected to reach 29.5% of GDP due to a higher disbursement of grants (1.4% of GDP, mostly from EU budget support), a retroactive tax on exceptional profits of private electricity producers, the effect of the increase of the minimum wage on social contributions, and an increase in VAT from higher import prices. In addition to the inflation indexation of pensions, the end-of-year pensioners' bonus was changed from a one-off item to a regular expenditure item. While this regular bonus makes the budget more predictable, it remains an untargeted action that is not integrated into the social insurance system. The birth bonus is also a regular untargeted payment. As in 2022, most of the support to the state-owned electricity producers is budgeted as direct budget support instead of being provided via loans or guarantees, which increases transparency.

Main measures in the budget for 2023:

| **Temporary/permanent Revenue measures** | **Temporary/permanent Expenditure measures** |
|---|---|
| • 33% tax on private electricity producers' windfall profits in 2022 (0.38% of GDP)<br>• EU energy-related budget support (0.4% of GDP)<br>• New gambling tax and harmonisation of excises (0.1% of GDP)<br>• Vehicle and fuel sales tax (0.28% of GDP) | • Salary increases in health and education (0.1% of GDP)<br>• Support to state-owned electricity producers (0.5% of GDP)<br>• Increase of the reserve fund to cover elections costs and unplanned support needs due to the volatile external environment (0.7% of GDP) |

**After a larger-than-expected fall in the public debt ratio in 2022, the ERP projects a continued trend of moderate debt reduction by about 1 pp. per year..** The debt ratio fell by 8.64 pps to 64.6% of GDP in 2022**,** more than 4 pps below the level projected by the ERP. This marked improvement, which was mainly due to a lower-than-planned deficit and the much larger than expected growth in nominal GDP, has brought the debt ratio below its pre-Covid-19 level, which the ERP expected only for 2025. The ERP projects a moderate pace of debt reduction of about 1.1 pps per year on average in 2023-2025, slightly slower than in the previous ERP (average of 1.4 pps per year). Guaranteed debt, which is fully accounted for in the public debt stock, increased from 2.9% of GDP in 2020 to an estimated 3.3% of GDP in 2022 and is set to remain at around 3% of GDP in the medium-term.

**The maturity of public debt lengthened, but there are still risks related to the shallow domestic market and the rising share of foreign currency debt.** Although the share of short-term securities in the domestic debt portfolio fell to about 30%, the tightening financing conditions and the shallow domestic market for government securities pose risks. The yield for 12-month bonds increased by about 3.25 pps from its average level in 2019-2021 to 5% in January 2023 in response to the monetary policy tightening. Similar increases were observed across all maturities, and the slope of the yield curve has remained unchanged. In addition, the exchange rate risk has increased due to the share of foreign currency denominated debt rising over the last 2 years to 48.5% of total public debt and the share of debt owed to private foreign creditors climbing to about 30% of the foreign public debt, caused by the annual issuance of large Eurobonds in 2020-2021. To mitigate the exchange rate risk, the medium-term debt strategy limits foreign currency denominated public debt to 50% of the total public debt stock, and 0.7% of GDP has to be earmarked in the budget for fluctuations in the exchange rate. There will be high refinancing needs for foreign debt when a Eurobond and a private loan guaranteed by the World Bank are due in 2025 and another large Eurobond repayment is due in 2027. To meet these refinancing needs, the government is prepared to issue a new Eurobond in 2023-2024 if financial conditions improve and may combine it with a liability management transaction.

***Debt dynamics***

| Albania | | | | | |
|---|---|---|---|---|---|
| **Composition of changes in the debt ratio (% of GDP)** | | | | | |
| | **2021** | **2022** | **2023** | **2024** | **2025** |
| **Gross debt ratio [1]** | **73.2** | **68.8** | **67.5** | **66.3** | **65.3** |
| Change in the ratio | -1.3 | -4.4 | -1.3 | -1.2 | -1.1 |
| *Contributions [2]:* | | | | | |
| **1. Primary balance** | **2.6** | **1.2** | **-0.3** | **-0.9** | **-1.2** |
| **2. "Snowball" effect** | **-7.5** | **-3.9** | **-0.9** | **-0.1** | **0.1** |
| *Of which:* | | | | | |
| Interest expenditure | 1.9 | 1.9 | 2.8 | 3.1 | 3.3 |
| Growth effect | -5.5 | -2.5 | -1.7 | -2.4 | -2.5 |
| Inflation effect | -3.8 | -3.4 | -2.0 | -0.8 | -0.7 |
| **3. Stock-flow adjustment** | **3.5** | **-1.7** | **-0.1** | **-0.2** | **0.0** |

[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) 2023, Commission calculations.*

The debt dynamics are based on slightly optimistic growth expectations and assume: (i) a stable exchange rate; (ii) a drop in the inflation rate to 3.6% in 2023 and to 3% in 2024-2025; and (iii) an increase in the implicit interest rate. The debt ratio recorded a large fall in 2022, driven by a strong snowball effect due to high inflation and growth and a sizeable stock-flow adjustment related to the use of deposits from the 2021 Eurobond issue. In 2023, a much smaller snowball effect is expected as interest expenditure climbs by almost 1 pp. of GDP while the debt-reducing impact of both inflation and real growth moderates. From 2024, the snowball effect is set to diminish further because rising interest costs and decelerating inflation are projected to outweigh the rising impact of higher growth. Overall, it is the increasing primary surplus that is expected to drive the moderate reduction of the debt ratio in 2024-2025. The table is based on the values provided in the ERP. However, due to the much larger than expected debt reduction in 2022, the debt path will shift to a lower level.

**The main sources of fiscal risks remain the state-owned hydroelectricity providers and the financial governance of public sector utilities.** The state-owned energy utilities' dependence on regular public guarantees and loans is a source of fiscal risks. This situation is aggravated by the hydropower sector's vulnerability to fluctuations in rainfall and to climate change risks, for which mitigation measures still need to be developed. About two thirds of public guarantees are issued to the energy sector, including for foreign borrowing. In 2022, adverse weather conditions caused a decline in domestic electricity production, and import costs surged. As a result, the government provided direct on-lending of 0.4% of GDP and budget support of 1% of GDP to the sector. Until now, no payments have been made under the guarantees provided to the private sector as part of COVID-19 support, which amount to 0.6% of GDP. In future, the government intends to base decisions on guarantees and on-lending to public bodies on criteria such as the recipient introducing reforms to strengthen financial performance and management and the intended use of the funds. As part of the energy sector reform, the Ministry of Finance and Economy now monitors the financial performance of public sector bodies. This has helped identify a rise in mutual arrears in the public sector.

***Sensitivity analysis***

The sensitivity analysis in this year's ERP extends to 2026 and provides some detail on the expenditure and financing categories. However, there is no information provided on the revenue side, except for the total revenue, which includes grants and non-tax revenue. Although the ERP refers to the effect of automatic stabilisers, their impact is likely to be limited given the large number of informal and agricultural self-employed people and the low social security benefits. The particular economic circumstances in 2023 are integrated into the baseline and assumed to continue somewhat in 2024, leading to only minor deviations between the scenarios. However, assuming a return to a normal environment in 2025-2026, it is expected that shocks will create larger deviations from the baseline. The real GDP growth rates for the optimistic and pessimistic scenarios deviate by +0.5 pps and -1.5 pps, respectively, from the baseline growth scenario of 2.6% in 2023 and its average rate of 3.8% in 2024-2026. Foreign borrowing is kept unchanged across all scenarios.

In the pessimistic scenario, the revenue ratio is assumed to be 0.5 pps below the baseline, current expenditure is about 0.2 pps above the baseline, and capital expenditure is on average 0.5 pps below the baseline. Domestic borrowing and interest expenditure (in nominal terms) is assumed to be lower in the pessimistic scenario compared to the other scenarios, leading to a lower primary surplus. The fiscal deficit is set to be about 0.2 pps higher than in the baseline scenario, except in 2025 when it is lower. The fiscal adjustment under the pessimistic scenario is set to comply with the neutral or positive primary balance rule but not with the rule of a decreasing debt ratio in 2023 and 2024. From 2025 on, the debt ratio should decrease incrementally to 68.4% mainly due to reduced domestically financed investment (by 0.5 pps to 1 pp.) and lower operational and maintenance expenditure.

The optimistic scenario is close to the baseline scenario in terms of revenue (0.1 pps above the baseline in 2023-2024) or the same as the baseline (2025-2026). Nominal expenditure does not change and, in terms of GDP current expenditure, is only 0.1 pps lower in 2023-2024. However, the difference increases by 2025 when it is 0.5 pps lower. Similarly, the difference in the fiscal deficit is 0.2 pps lower in 2023 and gradually decreases to 1.1% of GDP or by 0.6 pps in 2026.

Overall, the public debt-to-GDP ratio would decrease by less than 1 pp. in the pessimistic scenario. This is considerably lower than the baseline and the optimistic scenario in which the reduction would accelerate to about 1.8 pps per year. While the baseline projection for the revenue ratio, which averages 28.3% of GDP, seems realistic, the assumption under the pessimistic scenario of just 0.5 pps lower would still be higher than the ratios observed between 2015 and 2021.

**Given the low revenue targets, the burden of fiscal consolidation is to be borne by reducing expenditure, which prevents more investment in physical and human capital.** The improvement of the fiscal balances is set to be mainly achieved by a 1.5 pps reduction of the expenditure ratio while the envisaged incremental increase in the tax revenue ratio is significantly below the estimated 2 pps that could be achieved with more decisive reforms and a broader tax base. A public consultation on the draft medium-term revenue strategy (MTRS), which aimed for a simpler tax system and a more predictable tax policy, remained suspended, and it seems the strategy's formal adoption is no longer planned. Albania included specific measures in the 2020-2022 fiscal packages to raise revenue by broadening the tax base and simplifying the tax system but not to the extent proposed by the IMF. In addition, other measures were introduced that reduced the tax base. Furthermore, the credibility, quality and applicability of tax policies continue to suffer from the lack of a meaningful consultation with stakeholders. The gradual reduction of the expenditure ratio prevents significantly increasing public investment in human and physical capital, which the country needs. The ERP also acknowledges that expenditure efficiency should be improved to ensure that such investment needs can be met within the available fiscal space. However, despite the announcement of reforms to public investment management and increased managerial accountability, the potential gains are unlikely to have any impact in 2023-2025 and are hard to quantify. Therefore, the ERP's fiscal framework is not conducive to accelerating productivity growth.

**Recent steps to reform public investment management are promising but do not fully cover public-private partnerships (PPPs).** The 2021 ERP already identified significant shortcomings in the public investment management system. These included inadequate project design, lack of clear criteria for including projects in the medium-term budget, and weak and fragmented management, including of PPPs. A decision of the Council of Ministers in December 2022 on public investment management procedures[6] strengthens and aligns the evaluation procedures of strategic projects for the National Single Project Pipeline (NSPP), managed by an agency under the Prime Minister's office (SASPAC), with the processes required by the medium-term budgetary framework but the NSSP has yet to be established. The improved appraisal procedure also includes a screening for climate impact and is planned to be used for all projects of a certain size, including PPPs. However, other legal amendments, to be launched in 2023, are necessary to align PPPs fully with the revised procedure.

**Monitoring fiscal risks continued to improve but could benefit from a broader mandate, and arrears remain a concern while the new public finance management strategy is not yet in place.** At the end of 2022, the government started to prepare a new public finance management (PFM) strategy with EU-financed assistance, which should guide PFM reforms from 2023 on. Fiscal risk statements, which regularly accompany the budget proposals and have covered PPPs and concessions, were expanded to include disaster risks and the financial assessments of an increasing range of SOEs and utilities. Such assessments proved useful for forecasting the financing needs of the energy sector in 2022. An instruction issued in December 2022 introduced additional reporting requirements of all public bodies on potential fiscal risks, including those related to PPPs, based on a reporting template and the financial data of the entities. If all public bodies report as required, the information available to assess fiscal risks will improve. At the same time, increasing the capacity of the fiscal risk unit and broadening its mandate remains essential. Public sector arrears persist: the ratio of arrears to expenditure rose to 3.7% during the year. However, using the unspent capital budget to clear arrears helped bring this ratio down to 2.2% at the end of 2022. The persistence of arrears even as some spending categories remain under-executed signals problems with fund commitment and

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[6] For details, see structural reform measure 10.

contract management. There is little transparency on possible interest due on arrears, and there is no systematic approach to sustainably prevent arrears reoccurring, including those related to court cases.

## 4. KEY STRUCTURAL CHALLENGES AND REFORM PRIORITIES

Drawing from Albania's ERP and other sources, the Commission conducted an independent analysis of the Albanian economy. This analysis aims to identify the key structural challenges to mitigating the impact of Russia's war of aggression against Ukraine in order to boost competitiveness and inclusive growth. The results show that Albania continues to experience several structural weaknesses across many sectors. The main challenges to mitigating the impact of war, the ongoing impact the COVID-19 pandemic and support recovery in terms of boosting competitiveness and long-term sustained and inclusive growth are:

i. increasing funding and capacity for skills and training, social protection and healthcare to improve employability and social inclusion;

ii. speeding up connectivity, the green transition and adaptation to climate change;

iii. increasing competitiveness, in particular by improving business support services, funding research and innovation, continuing to address the informal economy and implementing reforms to facilitate the digital transition.

The three key challenges identified by Albania did not correspond to those identified by the Commission. Instead, they were more closely related to those identified by the Commission in 2022, rather than the 2023 ones. For key challenge 1, the focus differs as Albania only included increasing innovation and skills. It did not include funding, social protection, or healthcare, which it kept in key challenge 2. Albania did not have a key challenge on connectivity, the green transition and adaptation to climate change. For key challenge 3, the country focused on business support and tackling the informal economy, but it did not include the digital transition.

To promote competitiveness Albania also needs to tackle corruption, improve the rule of law, and strengthen its institutions. Addressing these fundamental challenges is a prerequisite to successfully transform economy. The Commission is closely following the issues on strengthening the rule of law, including the ongoing justice reform, and those related to corruption, in its annual Albania country report.

Furthermore, the country should proactively implement the Energy Community's Decarbonisation Roadmap to achieve the agreed climate and energy targets, and strive towards establishing a carbon pricing instrument compatible with the EU ETS.

***Key structural challenge 1: Increasing funding and capacity for skills and training, social protection, and healthcare to improve employability and social inclusion***

**Albania's labour market indicators show a stable continuous improvement in the last several years**, which also indicates resilience to economic shocks. There was an increase in both the employment and activity rates: according to the Labour Force Survey, in Q3-2022 the total number of employees had grown by 3.8% compared to Q3-2021, with the participation rate (population aged 15 to 64) standing at 73.4% compared to 70.1% in Q3-2021. The level of unemployment had decreased by 0.7 pps compared to Q3-2021, standing at 10.6% in Q3-2022 (population aged 15 to 64), which was even below pre-pandemic levels.

**The share of the active population with low educational attainment remains high and participation in lifelong learning is low.** In 2021, a high share (41.4%, compared to 24.9% in the EU-27) of the labour force (aged 25-64) and the majority of registered jobseekers had at most a primary education, indicating a need for investment in reskilling and upskilling. However, opportunities for lifelong learning are still very limited in number and scope – there are not enough opportunities to respond to the needs of the labour market. Participation in adult training remains low, as identified in the Adult Education Survey conducted in 2016. In 2016, only 9.2% of adults (aged 25-64) participated in lifelong learning, which is significantly lower than the EU average (43.7% in the same year). LFS data on participation in education and training in the past 4 weeks confirm very limited access to lifelong learning opportunities (only 0.8%, 2019, last data available).

**Investment in human capital, ranging from education and training to healthcare and social protection, is still underfunded and needs more targeted investment and prioritisation**. The rate for young people aged 15-29 not in education, employment or training (NEET) is 26.1%, which, combined with a persistent problem of skills mismatches and low wage levels, results in significant brain drain.

**Skills mismatches and quality of education are still highlighted as key areas for improvement** by social partners, especially employers' and youth organisations. These findings are also confirmed by regional surveys on labour migration, showing that 30% of respondents consider that skills learned in the education system do not match the needs of their job, and 45% of surveyed companies identify applicants' lack of skills as a reason for unfilled vacancies (2022). These issues contribute to the high inactivity among young people and high emigration. Both are key challenges to be addressed through the Youth Guarantee and by adopting curricula based on labour market needs and investing in career support and quality jobs.

**Reform measure 1: Increasing the quality and access to VET**

The measure, rolled over from the two previous ERPs, aims to address many of the existing challenges in the sector. It plans to do this by adopting and implementing the 2023-2030 national employment and skills strategy, implementing the plan for optimisation of public VET providers, investing in VET infrastructure, and training of VET teachers.

The measure is one of the strategic priorities in the new 2023-2030 strategy for employment and skills, which continues the momentum of the government's increased investment in human capital. One of the big challenges is implementing of the optimisation plan for VET providers, for which the Ministry of Finance and Economy needs to increase investment in the sector. The description of activities and plans under this measure are well described, however, a stronger focus has to be put on VET service providers to stimulate and encourage their engagement to provide VET.

This reform measure is still necessary, as participation of students in VET remains low – only 17.7% of upper secondary students enrolled in VET schools in the 2021-2022 school year. Skill mismatches and quality issues of vocational training persist, as schools have yet to develop curricula with enough work-based learning that attract students and are relevant to the labour market needs. At the same time, career guidance and counselling services should be further expanded to match the variety of needs and expectations of young learners and graduates. Even growing sectors, such as ICT, struggle to recruit staff, so providing digital skills training and encouraging work-based learning in the digital sector could yield major benefits. The ongoing reforms of the VET system have yet to show results.

The private sector's involvement in VET schools is improving. This has been helped by the requirement for a representative of an employers' organisation to be appointed as the head of the governing board of all VET schools. This move has allowed for a closer involvement of the private sector in school management and has strengthened links. The role of employees' organisations in VET needs to be similarly boosted, ensuring an equal focus on decent work, safe working conditions and career support. One of the actions planned under this reform measure, the establishment of the National VET Council, has been rolled over from previous ERPs because the Council is still not operational. Along with the Council, setting up sectoral skills committees is important so that both the private sector and employers' organisations get to shape VET policy design from the beginning.

Albania started developing tools to regularly monitor the labour market and skills needs. In 2021-2022, the National Agency for Employment and Skills (NAES) , with the help of RISI Albania, piloted a regional labour market analysis in Elbasan and Durrës to improve the planning of short-term training. This analysis facilitates an understanding of the main characteristics of jobseekers, the regional job offers and the potential to develop it further. In turn, this can help target the employment promotion programmes and vocational training better. It is planned to progressively deploy this labour market analysis across the country. NAES is also developing a Labour Market Information Observatory, which will build on existing administrative and survey data, aiming to become the primary mechanism for fetching and disseminating labour market information and intelligence.

**Reform measure 2: Improving the employability of the most vulnerable unemployed jobseekers**

This reform measure is newly proposed as part of the 2023-2025 ERP. It brings together the adoption and implementation of the new 2023-2030 Employment and Skills Strategy, creates the crucial strategy to support the exit from the economic aid scheme[7], and includes the gradual roll-out of the Youth Guarantee scheme.

The measure is essential as vulnerable groups require the government's support to enter the labour market. These include specific groups, such as people with disabilities, Roma and Egyptian minorities, people living in poverty and the long-term unemployed. More diverse groups are also supported, such as women and young people.

The above-mentioned challenges of supporting education and training affect these groups: among unemployed jobseekers registered with the Public Employment Service, 45.3% of Roma jobseekers and 13.9% of Egyptian jobseekers had not completed basic education. Two thirds of unemployed jobseekers receiving the economic aid benefit also had the same characteristic.

Albania has taken steps towards setting up a Youth Guarantee scheme based on the EU model to help young people integrate into the labour market. With EU-funded technical assistance, Albania has conducted a mapping of NEETs and a review of the legal framework. A multi-stakeholder group and a technical expert group were set up, and they have developed a Youth Guarantee implementation plan. However, with the gradual implementation of the plan, an increase in the number of staff in employment offices is needed to meet the expected rise in the number of young jobseekers. Investing in social and child care services, especially early childcare and daily centres, is also key to support the active inclusion of mothers and carers in the labour market.

The planned activities to improve of the quality and effectiveness of labour market institutions and services are essential. To achieve this, sufficient staffing of both the Labour department of the Ministry of Economy and the National Agency for Employment and Skills is crucial, as well as training and capacity building of employment offices staff. This will ensure the successful implementation of all labour policies, and in particular the Youth Guarantee and the economic aid exit strategy. It will also help to support vulnerable groups more efficiently overall. A review of the current employment promotion programmes and their effectiveness is also a good step to ensure better quality offers that result in longer-term and more sustainable employment. The National Agency for Employment and Skills (NAES) still needs to accelerate the implementation of employment promotion measures and increase outreach work to people who are economically inactive and those most in need. It is also recommended to consolidate skills development opportunities for the unemployed and inactive to build up skills sets and raise the levels of education attainment. The integrated case management approach of the exit strategy has to be further consolidated. Collaboration with education, social services and other complementary services also has to be further strengthened to build an integrated approach to supporting the most vulnerable jobseekers.

[7] The economic aid scheme is the main non-contributory social programme, consisting of cash payments to persons and households living in poverty and persons with disabilities. The exit strategy from the scheme is a tool to support the beneficiaries to join the labour market and exit the cash benefit scheme.

Overall, the ERP presents a good analysis of the challenges in the area and presents a robust plan of action, which now needs to be implemented efficiently. There is sufficient funding planned in the mid-term budget for this measure. More detailed indicators on vulnerable groups could be selected to improve monitoring and evaluating the measures' impact and effectiveness.

**Reform measure 4: Increasing the coverage and adequacy of integrated social care system to reduce the share of the population at risk of poverty**

The measure is rolled over from the previous ERP, and aims to increase the availability, inclusiveness and effectiveness of social services. It remains very relevant as Albania has a very high percentage of people living at risk of poverty or social exclusion (45% in 2021, compared to 21.6% in the EU-27). The situation has improved since 2019, but the country continues being an outlier with a rate of material and social deprivation of 56.5% in 2020. Income support to socially vulnerable groups (roughly 65 000 families or 10% of the population) helps lower the percentage of people living at risk of poverty to 21.8%, but is not enough to bring those groups above the poverty threshold. The ad hoc increase in benefits has partially addressed the issue of inadequacy, but has not solved structural issues. Therefore, a system for the annual indexation of the economic aid benefits and disability benefits is still needed to guarantee a minimum income based on set benchmarks to measure the cost of living.

Overall, spending on social protection programmes is one of the lowest in Europe, at around 9.2% of GDP (2022). Additionally, the social protection budget is largely focused on cash assistance. There is a need to redirect the budget towards the Social Fund and support deinstitutionalisation and community-based care further to ensure more effective results and sustainable action. In the existing plan, the budget allocations for social care and deinstitutionalisation of residential care are also not clearly indicated and need to be more targeted.

Drafting a new social protection strategy will be a key deliverable to plan the long-term strategy for investment in better social protection for Albania's citizens. The extension of Social Fund coverage beyond the third year of the establishment of a new social service is a significant development and crucial to ensure the sustainability of new social services. However, there still is a risk of local government not having and, therefore, not allocating enough financial resources to support and increase the availability of social services, which are under their direct responsibility. Monitoring to see if the services continue being offered beyond the third year is important in order to inform potential corrections of the Social Fund rules. Two points that require further attention are ensuring a shock-responsive social protection system built, in particular, on the lessons learnt from the recent crises; and ensuring the sustainability of funding and clear arrangements for implementing the Social Fund at local and central levels.

The reform of the disability assessment is a very welcome development, and the planned implementation measures are key to ensure it is applied throughout the country and effectively linked through a referral mechanism to social services on offer.

**Reform measure 5: Increasing access to health care**

This measure is rolled over from the previous ERP and demonstrates the continuous commitment of the government to take measures to strengthen the primary healthcare sector. Significant steps have been taken to: (i) ensure uninsured people have access to healthcare services; (ii) increase availability of screening programmes; (iii) support immunisation; (iv) make dental and ophtalmological screenings more easily available to children. Moreover, the government has taken action to retain more medical personnel in Albania.

Albania has reportedly has the highest out-of-pocket health expenditure per capita in Europe, and only a part of the population has health coverage. Therefore, the proposed measures are relevant, but their success will depend on sustained political support, predictable and increased financing, and effective implementation. Inequalities in access to healthcare still persist, especially among people living in poverty, Roma and Egyptian minorities, and people in remote areas. Of all WB6 economies, Albania still has the: (i) lowest health expenditure per GDP, (ii) highest percentage of out-of-pocket expenditure (as % of health expenditure), (iii) lowest number of physicians (per 1k people); and (iv) lowest number of nurses and midwives (per 1k people). The Universal Health Coverage index was 62 in 2019 (SDG Dashboard), which indicates significant challenges. There are major differences in coverage depending on geographical location, educational attainment and personal income.

The large informal sector and low percentages of health insurance coverage mean that a high proportion of the population are uninsured: only 46% of women and 37% of men benefit from public health insurance coverage. Out-of-pocket payments are still high: in 2021, Albanian households paid on average 5.4% of their households' budget on health-related expenditure. These factors result in high self-reported unmet need for medical care (10.6% of the population in 2020), five times higher than the EU average (2% in 2021).

There are still obstacles across the country to the right to health and to sexual and reproductive health services, particularly for vulnerable groups. Greater focus on maternal and new-born care is also needed: maternal and infant mortality rates (15 per 100 000 live births and 7.8 per 1 000 live births respectively) are twice as high as in the EU.

The budget allocated to healthcare as a share of GDP has been steadily increasing, from a low of 2.5% of GDP in 2008 to 3.28% of GDP in 2023. However, this is still below the allocation ratesof regional peers (except Kosovo[*]) and significantly below the EU-27 average of 8.0%.

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[*] This designation is without prejudice to positions on status, and is in line with UNSC 1244 and the ICJ Opinion on the Kosovo declaration of independence.

***Monitoring performance in light of the European Pillar of Social Rights***[8]

*The European Pillar of Social Rights, proclaimed on 17 November 2017 by the European Parliament, the Council and the European Commission, sets out 20 key principles and rights concerning equal opportunities and access to the labour market, fair working conditions, and social protection and inclusion for the benefit of citizens in the EU. The European Pillar of Social Rights Action Plan, adopted on 4 March 2021, aims at rallying all relevant forces to turn the principles into actions. Since the 20 principles provide a compass for upward convergence towards better working and living conditions in the EU, they are equally relevant for candidate countries and potential candidates (CC and PC). The new reinforced social dimension for the Western Balkans includes an increased focus on employment and social reforms through greater monitoring of relevant policies (EC, 2018). The Western Balkans Ministers' Declaration on improving social policy in the Western Balkans (6 November 2018) confirms that they will use the Pillar to guide the alignment of their labour markets and welfare systems with those of the EU.*

**Albania has steadily improved employment and unemployment rates and has shown good resilience in face of the post-COVID-19 and energy crises**. Further improvement in employment results is hindered by a high NEET share.Although it is slowly but steadily decreasing, Albania remains one of the worst performers among CC and PC. Another obstacle is the gender employment gap. There was a slight improvement noted in recent years, but this reversed in 2021. The gap is now wider than the gap in the EU-27 in 2021 (16.3 pps vs 10.8 pps). This is partly driven by the low provision of early childhood education and care, especially for children below the age of 3. Unemployment, especially long-term, is still far from the EU average, which is partly due to low provision and effectiveness of active labour market measures. Albania is a medium performer in the region as regards the income quintile ratio.

| ALBANIA | | |
|---|---|---|
| **Equal opportunities and access to the labour market** | Early leavers from education and training (% of population aged 18-24) | Worse than EU avg., no change |
| | Individuals' level of digital skills (basic or above basic) | Worse than EU avg., improving |
| | Youth NEET (% of total population aged 15-29) | Worse than EU avg., improving |
| | Gender employment gap | Worse than EU avg., improving |
| | Income quintile ratio (S80/S20) | Worse than EU avg., improving |
| **Dynamic labour markets and fair working conditions** | Employment rate (% of population aged 20-64) | Worse than EU avg., improving |
| | Unemployment rate (% of population 15-74) | Worse than EU avg., improving |
| | Long term unemployment rate (% of population 15-74) | Worse than EU avg., improving |
| | GDHI per capita growth | N/A |
| **Social protection and inclusion** | At risk of poverty or social exclusion (in %) | Worse than EU avg., improving |
| | At risk of poverty or social exclusion rate for children (in %) | Worse than EU avg., improving |
| | Impact of social transfers (other than pensions) on poverty reduction | Worse than EU avg., deteriorating |
| | Disability employment gap | Better than EU avg., improving |
| | Housing cost overburden | Better than EU avg., improving |
| | Children aged less than 3 years in formal childcare | Worse than EU avg., trend N/A |
| | Self-reported unmet need for medical care | Worse than EU avg., improving |

**Albania has a very high rate of low-skilled adults and high but decreasing rates of early school leaving.** There are significant rural-urban and socioeconomic differences in access to education and the early school leaving rate remains the highest among CC and PC after Türkiye. Participation in adult learning over the past 12 months is very low (9.2%, 2017) compared to the EU (45.1% in 2021), and more up-to-date data is missing. The overall level of digital skills (23.80%) is the lowest among all CC and PC and far below the EU average (53.92%).

**Risks of poverty and social exclusion are very high and the capacity of the social protection system to reduce them is low.** This is documented by the low and deteriorating impact of social transfers (excluding pensions) on poverty reduction which was only 11.88% in 2021 compared to 32.38% in the EU. Albania has the highest rate of poverty and social exclusion (46.2% in 2020) among all EU Member States and CC and PC for which data are available. Although there is a social assistance scheme, the allowances have low adequacy. However, the government increased allowancesin 2022 and embarked on a process leading to a systemic increase in the benefits. The capacity of local governments to provide social care is very low, but the situation is receiving more attention from the central government, which is funding new services. The pension system has almost universal coverage, albeit with low pensions. Around 600 000 adults, maily informal workers, do not have health insurance, but access to universal healthcare has been improving in recent years. In 2020, 10.6% of people reported an unmet need for medical care. While this value has improved over the last 4 years, it is still five times higher than in the EU (2% in 2021).

**Data availability improved in 2021. However, some headline indicators of the Social Scoreboard are still not measured, or data for the most recent years is not available**. Employment data are regularly measured both by the Labour Force Survey (LFS) and by National Agency for Employment and Skills (NAES), including through the newly established Labour Market Information Observatory, which is however not yet publicly accessible. LFS data are not yet available in Eurostat, but INSTAT has been

(8) The table in this box includes 16 headline indicators of the Social Scoreboard, used to compare performance of EU Member States (https://ec.europa.eu/eurostat/web/european-pillar-of-social-rights/indicators/social-scoreboard-indicators). The indicators are also compared for the Western Balkans and Türkiye. The assessment includes the country's performance in relation to the EU-27 average (performing worse/better/around the EU-27 average; generally 2021 data are used for this comparison) and a review of the trend for the indicator based on the latest available three-year period for the country (improving/deteriorating/no change). For data see Annex B. NEET: neither in employment nor in education and training; GDHI: gross disposable household income.

transmitting LFS microdata to Eurostat since 2017 and has been working on its quality, timeliness and validation.

***Key structural challenge 2: Speeding up connectivity, the green transition and adaptation to climate change***

**Albania remains a net importer of electricity and this that contributes to its trade imbalance. Russia's war against Ukraine has led to increased and volatile energy prices, increasing costs and changes for businesses and the population in general**. Better energy efficiency could help to alleviate these problems; however Albania also continues to be hampered by other energy issues, including insufficient security of supply. The energy sector is also affected by unstable and non-transparent fiscal liability, which existed even before the recent energy price increases.

**Most of Albania's electricity is produced by hydropower - although this is a renewable source, it creates a dependency that is affected by unpredictable rainfall, and exacerbated by climate change.** This means that the country's electricity import needs fluctuate, leading to calls for more efforts to diversify electricity sources, which is particularly important due to the impact of Russia's war of aggression on Ukraine. The government often involves private investors to do this, such as with the two new photovoltaic parks agreed on in 2022, selected under well organised auctions supported by EBRD. While the government adopted a draft 2020-2030 national energy and climate plan in 2021, it has yet to substantially address the comments of the Energy Community Secretariat. According to the Secretariat, the plan does not link between the targets, policies and measures, lacks a public consultation and is not based on a sound cost-benefit analysis. Alongside making energy use and energy generation more efficient, it is crucial to reform water resource management to help develop Albania's economy. This is particularly important for the tourism and agriculture sectors to mitigate the effects of climate change, which Albania is vulnerable to.

On security of supply, Albania's electricity distribution losses in the power grid increased to 20.62 % in 2021, down from 21.48% in 2020, corresponding to an increase of about 155GWh, due to an increase in electricity consumption. No new energy efficiency funding mechanisms have been put in place, and the implementation of the 2017-2020 national energy efficiency action plan, extended to 2021, did not met its target of 6.8% energy saving. Furthermore, the Energy Efficiency Agency, set up in 2018, is still not fully operational. Albania is a net importer of electricity at a rate of 30% per year, as its hydroelectric production is not enough to cover its needs. Its electricity system is connected with systems in Greece and Montenegro, and construction work on the interconnector with North Macedonia is expected to start shortly. The Albanian Power Exchange (ALPEX) has not yet been created or is operational yet. The country intends to connect the Vlora thermal power plant with the Trans Adriatic Pipeline (TAP) through a natural gas pipeline and a new LNG terminal. This should boost the country and the region's energy security. Albania's oil stock legislation is not in line with EU *acquis*, and its emergency oil stock model has not yet been amended.

**Albania's electricity prices are not fully liberalised.** Since 1 January 2021, all distribution customers connected to 35kV benefit from an unregulated market. From 1 January 2022, 7 358 customers connected on 20/10/6 kV, after meeting the technical conditions of installation of metering system. They therefore entered the liberalised market and have the right to find their own suppliers. If they do not find another supplier, based on the provisions of the power sector law (no. 43/2015, as amended), for two years they will continue to be supplied by FSHU as a last resort supplier. At the end of this period, the system operator will interrupt the power supply to the customer. The next step of de-regulating supply at all voltage levels, except the 0.4 kV level, has yet to be completed. Albania's small hydro-electricity power plants have a significant impact on biodiversity and local communities, notably in protected areas where around 100 concessions are located or planned.

**Albania's potential for renewable energy production is promising, but the market is still not fully liberalised, the energy supply relies on hydropower and energy efficiency remains low.** However, by improving energy demand management, including further measures to stimulate investment in energy efficiency and renewable energies (notably solar energy), Albania could boost the economy's competitiveness and energy security. The power sector law was amended to comply better with EU *acquis* on energy. This allowed for the effective separation of the electricity distribution system operator from the production operator. However, the compliance officer has still not been appointed, and functional unbundling is not yet completed. Albania was ranked 25th in the World Economic Forum's energy transition index (WEF) in 2021, the highest in the Western Balkans. In October 2020, the Albanian Power Exchange (ALPEX) was established as a shareholder company. It is jointly owned by the Transmission System Operators of Albania (OST) and Kosovo (KOSTT). The power exchange company will operate the short-term electricity markets in Albania and in Kosovo. In February 2022, ALPEX selected the winning bidder for the service provider, and a union of three companies (the Hellenic Energy Exchange S.A., ENEX Clearing House S.A. and Hellenic Exchanges – Athens Stock Exchange S.A.) and signed the agreement that will provide the electronic trading platform for the day-ahead and intraday market and services required for the operation of the organised market in Albania and Kosovo. The Albanian power exchange should be made fully operational, as it could be key to an integrated organised electricity market agreed with the energy community.

**Smart and sustainable mobility (including trams, electric buses, digital platforms, alternative fuels infrastructure, and charging stations) could help to tackle business needs and energy challenges**. It could also be a key component in a new growth strategy that could support Albania's decarbonisation efforts and improve mobility in its larger cities. Albania also needs to make significant efforts in implementing and enforcing waste management and improving water and air quality. Waste is also a major issue – closing non-compliant landfills and dumpsites and tackling littering are still big challenges. There are still not enough separate collections of waste streams or economic instruments to promote recycling and reuse and prevent waste generation. Any planned water and wastewater reforms should include a thorough analysis of what is preventing development in these sectors. However, neither smart mobility nor waste management measures were included in the 2023-2025 ERP.

In October 2021, Albania along with other Western Balkan partners endorsed the action plan for the Green Agenda for the Western Balkans. This aims to align with the European Green Deal and contribute to the sustainable socio-economic development and the green recovery of the region after the pandemic. However, despite this endorsement and a reportedly good level of support, notably among female Albanian entrepreneurs, for sustainable and green transformation, in the OECD's 2022 SME policy index, Albania had the second-lowest score in the region for its framework for environmental policies targeting SMEs. It also had the lowest score for incentives and instruments for greening SMEs. Albania needs to ensure capacity building to improve the completeness, quality and consistency of data collected on greening SMEs, access to finance, innovation and public procurement. However, the government needs to make Albanian businesses more aware about the circular economy. According to the 2022 Balkans barometer, Western Balkan economies are far behind in their efforts to shifting towards a circular economy, and Albanian businesses are the second-least prepared for and inclined to a circular economic model in the region. An Albanian Circular Economy Roadmap is being developed with the OECD, funded by the EU, foreseen to be launched in 2024. The lack of government subsidies to help on this is an impediment.

**The ERP's analysis of energy market reforms is well developed, identifying the main obstacles in the energy sector -to hydro power generation.** Power generation in Albania remains vulnerable to the hydrological situation; this has an effect on electricity import needs to secure an uninterrupted power supply in the country, and increases the financial burden for the state-owned power generation company. Electricity prices for households and SMEs remain highly subsidised, which creates disincentives for energy efficiency measures and affects fiscal accounts. Albania has good potential for developing photovoltaic power, and this is included in the measure-. This is important, as diversifying energy sources is necessary to alleviate hydrological crises caused by climate change, such as those the country suffered to a degree in 2022. As part of the efforts to improve connectivity and security of supply, the power line interconnecting Albania and Kosovo has become operational. In addition, it is important for Albania's fiscal sustainability to incentivise energy saving, invest in energy efficiency, and consider adjusting untargeted support currently in the form of stable electricity prices for all households and micro-, small and medium-sized companies. However, as Albania is a member of the Energy Community, the ERP should also provide for the timely alignment with and implementation of the EU Energy Efficiency Directive (2018/2002/EU), following the adoption of the Clean Energy package in November 2021. **The ERP's analysis on the green transition** recognises that barriers to it include a lack of awareness, inadequate data, poor coordination among green economy players, and gaps in human and institutional capacity. It also recognises that there is a lack of knowledge about the opportunities the green economy can offer. The ERP highlights major gaps in human and institutional capacity to put into practice the green economy concept and points out that there is not much political will to implement policies in line with ecological procedures. Albania has only put forward one reform measure in this area, which is designed to tackle an important issue (F-gases). The measure is relevant and seems to be well conceived. However, beyond this (and not mentioned in the analysis or addressed by related measures), Albania also needs to tackle the need for integrated low-carbon transport systems and waste issues. More energy diversification, as already mentioned, is also crucial in light of Russia's war of aggression on Ukraine. The **Economic and Investment Plan** for the Western Balkans (EIP) and the further development of a **Common Regional Market** will help boost the economy's competitiveness, backed by the digital and green transition.

**Reform measure 11: Reducing environmental pollution and promoting the decarbonisation of energy-intensive industries**

This measure is carried over from 2022-2024 ERP. Although updating legislation to lower emissions of fluorinated greenhouse gases is important, there are several other measures that could have been included under measure 11. Albania has endorsed the Green Agenda for the Western Balkans, but besides the measure to lower F-gases, the 2023-25 ERP does not address these issues or increase the capacity in the environmental sector. It is give the size of the business sector that is affected by the measure. There are also other new measures and programmes that have been initiated or been implemented, that have not been reported under measure 11, despite falling under the Green Transition. These include a EUR 240 million donor loan for a budget support programme called 'Support for Nature', which will focus on green development, waste management and protected areas. Also, for the first time, Albania launched a financial support scheme in 2022 to cover up to 70% of the cost of water-heating solar panels. The first call of this scheme, through the Agency for Energy Efficiency, supported around 2 000 families. However, neither of these measures are included in the ERP.

**Reform measure 14: Energy security through the promotion of renewable energy sources and energy efficiency improvements**

This measure on diversifying energy sources was also carried over from the three previous ERPs, (although they had differing names). Although it includes promoting the use of renewable energy sources besides hydropower, it also includes the construction of the Skavica hydro power plant. However the Energy Treaty Secretariat expressed a concern and insisted that this major project would need an environmental and social impact assessment (ESIA) study in line with Energy Community Treaty rules. The study would identify the environmental and social implications of the project and put forward suitable mitigation measures to be carried out in due course. Therefore, preparation of the ESIA study should have been one of the actions under this measure.

Activities promoting other renewable energy sources to generation electricity are essential to reduce the country`s dependency on energy imports, and ultimately aim to reduce the cost of energy for businesses and households. Such energy efficiency activities might only to produce results in the long term rather than in the short term. However, no energy audits are planned, although feasibility studies are underway for both the Skavica hydro power plant (in 2023) and interconnections with Greece. A combination of energy audits and feasibility studies would make the energy efficiency projects more technically mature and speed up their financing and implementation. The activities planned in 2023, 2024, 2025 would need to be reviewed and updated with regards to Skavica, Karavasta PV Power Plant and the Offshore Wind Auction.

***Key structural challenge 3: Increase competitiveness, in particular by improving business support services, funding research and innovation, continuing to address the informal economy and implementing reforms to facilitate the digital transition***

**Albania's micro- and small- businesses still often struggle to access finance due to a lack of business know-how and skills and low financial inclusion and literacy.** They continue to account for a far higher level of employment and added-value than the EU average - yet many SMEs still do not have bank accounts and cannot prepare financial reports to obtain funding. Several steps have been made to tackle informality, including the authorities' fiscalisation programme, along with measures to encourage online banking, is expected to increase financial inclusion and level the playing field in the medium term. Despite some progress, diversification of production and exports is still low. Albania could improve competitiveness by addressing some of the weaknesses identified in the 2022 OECD SME policy index. These include digital skills, infrastructure performance, collateral execution and property titles. Skills investment in particular is key, as described under key structural challenge 1, as firms' readiness to innovate is closely linked to the availability of staff with the right skills. AIDA has launched a new digital platform aimed at informing firms of the available financing opportunities. (https://e-albania.al/). The country should also develop insolvency prevention policy measures, including a fully-fledged early warning system, and stimulate digitalisation and the adoption of e-commerce.

**On research and innovation funding**, budget increases have been planned until 2025. However, there was little progress in 2022 and the target remains very optimistic. Further sustainable efforts to increase public funding of research and Innovation (R&I) are needed, alongside incentives for businesses to increase their R&I expenditure and to cooperate with universities. Reliable statistics and data on science and technology are welcomed, as is a clear methodology to define the indicator on gross domestic expenditure on Research and Innovation are planned for 2023. Albania has also made good use of its participation in the Horizon programme, where 2022 marked the best year of Albania's participation in EU Research and Innovation Framework Programmes. However, on the European Research Area, Albania should improve its linkage with European partners to engage in international cooperative research. There was good progress in 2022 on innovation new Start-ups Law and public funds for start-ups financing for up to 10 EUR million over the following 4 years, however there is no mention of smart specialisation (S3) in the 2023-2025 ERP.

**The informal economy is seen as an obstacle to business development and competition, which make Albania's business environment challenging**. The introduction of fiscalisation has helped to combat this, in particular by comparing VAT data against profit and employment data. Furthermore, informal activity often occurs due to exclusion factors, where those with lower skills and education in less productive sectors rely on subsistence income, notably in agriculture and sectors where enforcement is weaker. The 2023-2025 ERP includes a useful analysis of the impact of measures used to date to tackle the informal economy, although it does not include a sectoral analysis. Such a sectoral analysis could have been useful in order to set out more targeted, sector level, anti-informality actions in the ERP, and justify why they are needed. Also, continued efforts to decrease the cash in the economy should continue as a way of fighting the informal economy.

Contracting authorities need to continue to build capacity to manage public procurement processes in line with the new law on this, by training more officials. While businesses with an annual turnover up to ALL 30 million benefit from simplified bookkeeping rules, some policy measures may be a barrier to formalisation. In Albania SMEs that want to voluntarily register for VAT face restrictions that could increase compliance costs, resulting in a very high tax burden for low-income entrepreneurs. Nevertheless, the 2023-2025 ERP includes useful measures to continue and expand the fight against the informal economy.

**Albania scores below the regional weighted average in the 2022 OECD SME policy index for its legal frameworks for survival and bankruptcy procedure regulations**. The country has made marginal progress since the OECD's 2019 SME policy index, despite Commission recommendations for transparent and well-defined legislation in line with EU and UN requirements. Like all other Western Balkan economies, Albania does not provide any training to bankruptcy administrators, bankruptcy judges, appraisers or creditor associations. It also collects very little bankruptcy data, which hinders effective and regular monitoring of how insolvency measures are implementation.

**Some business services have improved.** According to the OECD, Albania (with Serbia) made more progress than any other economy in the region on adopting and implementing policy measures to ease SMEs' access to public procurement. The business investment and development strategy (2021-2027) is now being implemented. It includes specific support measures for SMEs to develop a dynamic and sustainable entrepreneurship environment, and communication to SMEs on what support is available to them has improved. However, the 2023-2025 ERP seems to have postponed the plans for the establishment of a training sector for SMEs at AIDA, as envisaged in the BIDS 2021-2027. Business licensing practices are quite advanced as applications for all business licences can be made on a portal, whose operator receives business licences and submits them to the relevant authorities as needed. Albania is the only economy in the Western Balkans that has introduced electronic distribution and nomination of licensing officers. However, Albania's skill levels remain below the regional average in the OECD SME policy index for entrepreneurial learning (it had the second-lowest score).

**Albania's legal and regulatory framework on access to finance is weaker than other regional counterparts**, according to the OECD. The financial literacy of Albanian SMEs also remains low. To help address these challenges, an access to finance portal, a one-stop shop to assist SMEs to expand and develop their businesses, was launched in 2021 and had 965 registered users by the time of the publication of the OECD 2022 SME policy index. Nevertheless, the 2022 business barometer shows that businesses still see access to finance as a problem when trying to scale up.

**Albania has made some progress on the digital agenda strategy and e-government.** Driven by the COVID-19 pandemic, e-learning, digital training services and, to some extent, e-commerce has become more prevalent in businesses. However, as mentioned above, Albania still needs to create an environment that supports SME digitalisation and e-commerce adoption as the country lags behind regional peers in these areas. While Albania has a solid and well-designed e-commerce policy framework, despite the fact that the actual use of e-commerce is rather limited compared to neighbouring economies. Low use of credit and debit cards and high use of cash, as well as low capacity of telecommunication operators and Internet providers, are among the reasons why e-commerce has not bloomed even during the COVID-19 pandemic. More public and financial services are being made available online, and the government aims to offer 95% of public services online. However, there is a risk that this rapid shift could be made at the expense of delivery, accessibility, and there may also be cybersecurity risks.

**There has been mixed progress on digitalisation**. In June 2022, the government adopted a digital agenda with a corresponding action plan for 2022 – 2026. Digital infrastructure continued to improve and the share of businesses with faster network connections (>10MB/s) increased from 79.8 % in 2020 to 90.5 % in 2021. However, there has been only a small rise in internet use and business websites. Fixed broadband penetration also remains an issue, notably in rural areas where 40 % of the population live but which have four times fewer subscribers connected to fixed broadband than urban areas. Investment in digital infrastructure is also needed in schools - many lack computers and have poor internet connections; currently there are about 0.2 computers per pupil, and this remains an obstacle to using digital technologies in schools and beyond.

As part of its new regulatory framework, in January 2021, Albania strengthened the guidelines for reporting, monitoring and evaluation of public-private consultations (PPCs) conducted by line ministries. The overall PPC process is monitored by the Council of Ministers. However, the lack of meaningful a public consultation on the 2022 ERP, signals that businesses are not consulted enough on government initiatives and are not yet ready to do so purely online (the consultation was only carried out online through a platform that civil society was unaware of at the time). The public consultation on the mid-term revenue strategy was also suspended in early 2022.

**In the ERP, the analysis of the main obstacles to digital transformation and a digital economy is rather complete.** It underlines the importance of the issue, updates the data on broadband usage, and notes the discrepancy between urban and rural areas. It highlights a lack of investment in rural areas due to a lack of or low return on investment. The ERP also goes on to note that the development of digital and broadband infrastructure requires large investments, synergies between infrastructure projects and digitalisation projects at central and local levels. Furthermore it points out that affordability of both fixed and mobile broadband remains an issue especially in rural and low-income areas.

**Reform measure 03: Improving institutional, financial and human capacities for research and innovation**

This measure is carried over from the 2021 and 2022 ERPs. It remains relevant and could help Albania strengthen its innovation and research capacities. The measure was initially ambitious, providing for R&D to be doubled as a percentage of GDP in 3 years (from 0.1% in 2022 to 0.2% in 2024). However, there have clearly been delays, as the 2023 ERP pushes the first benchmark to 2023 and now sets the 0.2% target for 2025, not 2024. In addition, the measure also no longer mentions the completion and implementation of the smart specialisation strategy (S3). However, it does provide for legal and support initiatives to be put in place over 2023-2025, including a legal framework for science, innovation and technology.

Some progress on this measure was made in 2022 with the establishment of the Interinstitutional Working Group for monitoring the implementation of the 2017–2022 national strategy for scientific research, technology and innovation. However, very limited progress was made in the implementation of the important ongoing smart specialisation strategy (S3) process, leading to a backlog of tasks. In January 2023, the political responsibility for S3 was moved from the Ministry of education to the Deputy Prime Minister’s Office. Cooperation across ministries and governmental bodies will need to be strengthened to ensure that the Albanian S3 is drafted and adopted by mid-2024 as planned.

Budget increases are planned in these areas until 2025; however, the possibility of meeting the target increase in % of GDP is remote. Further sustainable efforts to increase public research and Innovation (R&I) funding are necessary, as well as incentives for businesses to increase their R&I expenditure and cooperate with universities. The EU therefore welcomes that reliable statistics and data on science and technology and a clear methodology to set an indicator on gross domestic R&I expenditure are both planned for 2023.

The EU welcomes that Albania has joined and participates in the EU's Horizon Europe programme and notes that in 2022 the country had its participation highest rate in EU R&I framework programmes. However, Albania should try to increase private sector participation in Horizon Europe. The country should also improve its links with European partners in the European Research Area (ERA) to become more involved in international cooperative research, as it has not joined any of the 20 ERA actions so far. As this aspect is not properly addressed in this ERP, Albania should rapidly identify the ERA actions most relevant to it and then actively itself engage in them.

**Reform measure 06: Strengthening the fight against informality**

This is a worthwhile measure that builds on the work already done in 2022. However, in the description of the measure, it would have helped to assess the extent of the informal economy and the sectors in which it is most prevalent. It would also have been useful to include more information on the measures planned in the MTRS to tackle the informal economy (the MTRS was still a draft document at the time of writing despite its adoption being part of the 2022 policy guidance). The creation of a cross-sectoral anti-informality unit is welcomed; however, further reporting on the unit's action plan would have been useful. The measure should also have contained a summary of the monitoring reports prepared by the unit's secretariat. This would have shown the added value of the new anti-informality structures even more clearly.

**Reform measure 07: Developing a legal framework to support innovative start-ups**

The description of this measure, which is carried over from the last ERP, focuses heavily on the drafting of the law on start-ups. However, this law has now been adopted, making parts of the text mostly historical. Furthermore, it does not explain why there was a need to amend the law (is it, for example to add elements to the legal framework on the digital nomad and legal instruments of financing of start-ups (for example venture capital, business angel investments)). The text also neglects to mention that the government has already set up a fund (equivalent to EUR 10 million) over 4 years to provide free advice to start-ups. This operational information is arguably more important than the legal issues on which the text focuses. Furthermore, the result indicators need to be revised.

**Reform measure 08: Support measures to MSMEs**

This is a potentially useful measure, however, in the description part of the information on the overall amount of assistance provided for the sector is missing. Only fragmented information about two donor-funded programmes is provided, which does not provide a complete picture of the full amount of assistance available or planned for MSMEs. The description of the measure would need further elaboration, in order to see a gradual matching with the planned activities. Although an export strategy is very much needed, the process of its drafting could be better explained, perhaps as component of BIDS, and followed up in the list of activities. Furthermore, in the result indicators, there is no mentioning of the export strategy, export promotion actions, or agreements signed between companies.

**Reform measure 12: Development of the broadband infrastructure for digital economy**

This measure is carried over from the last three ERPs. The information on the reform has been updated, supplemented with new developments in the sector, and it highlights the European Green Deal. In addition, the measure is analysed in light of the green transition. The reform seems well-prepared, it will have a clear impact on the economy, and it is in line with the EU strategy for the digital agenda in the Western Balkans. Albania has patchy broadband penetration, particularly in rural areas, and the proposed measure clearly addresses this. The text also links the measure to reform measure 8 (access to finance), which includes digitalisation and ICT access for SMEs. It also flags that the measure on digital skills is also relevant (though this is under education and reform section). That measure is specifically aimed at the development and empowerment of teachers' digital skills.

## 5. Overview of the implementation of the policy guidance adopted at the Economic and Financial Dialogue in 2022

*Every year since 2015, the Economic and Financial Dialogue between the EU and the Western Balkans and Türkiye has adopted targeted policy guidance for all partners in the region. The guidance represents the participants' shared view on the policy measures that should be implemented to address macro-fiscal vulnerabilities and structural obstacles to growth. The underlying rationale of the policy guidance is similar to that of the country-specific recommendations usually adopted under the European Semester for EU Member States. Implementation of the policy guidance is evaluated by the Commission in the following year's ERP assessments. The following table accordingly presents the Commission's assessment of the implementation of the 2022 policy guidance jointly adopted by the EU and the Western Balkans and Türkiye at their Economic and Financial Dialogue at Ministerial level on 24 May 2022.*

| **Overall: Partial implementation (47.2 %)**[9] | |
|---|---|
| **2022 policy guidance (PG)** | **Summary assessment** |
| **PG 1:**<br><br>If needed, use the available fiscal space in the 2022 budget to cushion the potential adverse shocks through targeted support to vulnerable households and firms provided the economic recovery is well entrenched, plan in the MTBF a gradual reduction of the public debt ratio and a return to a positive primary balance by 2024 while lowering general government arrears below 2.5% of total expenditure in 2022 | **There was partial implementation of PG 1:**<br><br>1) **Substantial implementation:** According to the ERP, ALL 20 billion or 1% of GDP was allocated to support households and companies to cushion the impact of inflation and energy prices. This support was targeted to a large extent at vulnerable households (around ALL 14 billion or 0.7% of GDP), but the figure also includes general fiscal policies that are unrelated to the price shock. In addition, 1.4% of GDP (ALL 28 billion) went to the state-owned energy companies so they could keep electricity prices stable for all households and SMEs, but not in a targeted way.<br><br>In 2022, public debt is expected to have been reduced to about 68.8% of GDP from 73.2% in 2021. It looks set to further decline to around 67.5% in 2023. Under the ERP's baseline scenario, public debt is expected to fall to about 64.2% in 2026 and about 54.9% by 2031. The ERP expects the primary budget balance to turn positive already in 2023.<br><br>By November 2022, arrears had accumulated to 3.7% of total expenditure but were reduced to 2.2% of GDP in December. The one-off clearance of a part of the arrears via reallocation in the end -of -year budget amendment is not the spirit of the PG. This is because arrears still increased in the second half of the year, and no systematic approach has been observed that |

(9) 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. This is available at https://ec.europa.eu/info/publications/economy-finance/2017-economic-reform-programmes-commissions-overview-and-country-assessments_en

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| | sustainably prevents arrears that do not arise due to a lack of funds. |
| Restrict budget revisions to the regular revision process set out in the Budget Law and use the regular legislative process should an amendment of the Budget Law become necessary. | 2) **No implementation:** In 2022, four normative acts (two less than in 2021) to amend the budget were adopted with no regular amendment process. There was no amendment to the budget law. Unexpected circumstances could possibly have justified the use of normative acts for two of the amendments, but not the amendment of 27 December. The fact that the regular revision process was not used at all cannot be justified either. |
| Assess the fiscal risks from state owned enterprise and develop proposals for their mitigation | 3) **Substantial implementation:** The Fiscal Risk Unit (FRU) in the Ministry of Finance and Economy extended its monitoring of state-owned enterprises. It also proposed additional financing in form of budget support to public electricity providers in 2022 and 2023 to mitigate risks from international price increases. In addition, the FRU issued an order that requires all public bodies to report on their fiscal risks and include proposals for their mitigation. |
| **PG 2:** | **There was limited implementation of PG 2:** |
| Implement the activities outlined in reform measure 10 of the ERP on Public Strategic Investments and in the PFM strategy to improve the management of public investments including PPPs | 1) **Partial implementation:** Since 1 January 2023, a new Decision of the Council of Ministers (DCM) has been in force requiring all investment project proposals of a certain volume to be included in the strengthened National Single Project Pipeline and to be subject to an improved appraisal process, regardless of their source of financing, that is including PPP proposals. The principles for the identification, proposal, prioritisation and evaluation of investment projects have been improved. However, the DCM still needs to be operationalised, and additional legal amendments are necessary to fully integrate PPPs into the process. |
| Adopt the medium-term revenue strategy following an intensive public consultation, and complement it with a budgeted, operational implementation plan to guide tax policies in the coming years | 2) **No implementation::** The public consultation of the draft MTRS was suspended, earlier comments were not taken into account, and there appears to be no budgeted operational plan for its implementation. The formal adoption also seems to have been abandoned. Selected measures proposed in a preparatory International Monetary Fund technical assistance report for the MTRS were included in the 2021, 2022 and 2023 fiscal packages but not to the proposed extent and without a meaningful public consultation. |
| Continue to increase the shares of spending on education, health, social protection and R&D in total expenditure | 3) **Limited implementation:** The shares of spending on education and health in total expenditure are not planned to increase in the coming 2 years (in 2025, 10% to 11% on education). However, social protection expenditure is expected to increase its share from 28% to 32% in 2025. Public expenditure on R&D has not been reported. |

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| **PG 3:**<br><br>Carefully assess and analyse price developments and stand ready to tighten monetary policy, if needed, to preserve price stability in the medium term.<br><br>Ensure a transparent and accurate reporting of asset quality and adequate provisioning, further reduce remaining obstacles to NPL resolution, particularly by resolving the bailiff deadlock, and reduce data gaps in particular as regards the real estate sector<br><br>Foster the implementation of measures aimed at promoting saving and borrowing in national currency and at limiting the use of foreign currency in the real economy, including through measures in the remit of the government in line with the Memorandum of Cooperation. | **There was partial implementation of PG 3:**<br><br>1) **Full implementation:** The Bank of Albania began normalising monetary policy, ending the provision of unlimited liquidity to banks and raising the policy rate. The Bank of Albania has continually communicated that the policy rate will continue to increase in the future, while the normalisation pace will be data dependent.<br><br>2) **Substantial implementation:** The Bank of Albania made efforts to ensure a transparent and accurate reporting of asset quality but has not conducted an asset quality review of the five major systemic banks as previously recommended. There was progress on the resolution of the bailiff impasse with the ruling of the supreme court at the end of 2022. The Bank of Albania has prepared a draft regulation to improve data collection on the exposure of the banking system to the real estate sector, and this is currently under consultation.<br><br>3) **No implementation:** While the Bank of Albania implemented measures taken in line with the Memorandum of Cooperation earlier, the government made no progress and has no plans to introduce measures to increase the use of the national currency. |
| **PG 4:**<br><br>Provide enhanced business support services to improve access to finance and entrepreneurial know-how.<br><br>Assess the effectiveness of the consultation mechanism and then revise it with input from businesses and social partners in order to make the process more comprehensive, practical and transparent.<br><br>Design a strategic and coordinated action plan for implementing anti-informality policies, based on, | **There was partial implementation of PG 4:**<br><br>1) **Substantial implementation**: There has been good progress in: i) adopting legislation on micro, small and medium-sized enterprises and its by-laws, ii) in developing an e-commerce guide and a self-assessment tool for e-commerce and iii) continuing business support services by AIDA. The 'access to finance' platform has been upgraded and new functionalities were introduced for grants, other financial schemes, and consultants. Calls on innovation, technology and education have generated higher interest from SMEs. Further efforts are needed in developing AIDA's training capacity<br><br>2) **Limited implementation:** No assessment on the effectiveness of the consultation mechanism has been reported on. Although not mentioned in the document, the Investment Council, led by the Minister of Finance and Economy, held a dedicated meeting on business consultation At this meeting participants addressed concerns related to the consultation process with social partners and business associations. It was confirmed that such consultations need a different approach than the one currently used by state institutions. This is why the publication of certain draft laws and strategic documents on the online platform konsultimipublik.gov.al has not yielded any relevant comments.<br><br>3) **Partial implementation**: Efforts have been made to address the informal economy in a coordinated way |

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| but not limited to, the medium-term revenue strategy. | through establishment of the '*special anti-informality unit for revenues from employment and services'*. The unit is made up of representatives from the Ministry of Finance and Economy, the General Directorate of Taxation, General Directorate of State Police, the General Directorate of Prevention of Money Laundering, the State Cadastre Agency, and the State Labour Inspectorate. The unit operates based on an action plan. Progress in fiscalisation is noted. Further analysis of the results of cross-checking data from the fiscalisation process would have helped to assess the implementation of this PG. A recommendation would be to continue coordinated actions in tackling fiscal evasion and the informal economy, as well as the ongoing widespread usage of cash in the economy. The use of fiscalisation data in risk management and by inspectors needs to be improved. |
| **PG 5:**<br><br>Finalise, in co-operation with all relevant ministries, their agencies and stakeholders, a Youth Guarantee Implementation Plan, adopt it and initiate its implementation<br><br>Conduct the regional labour market analysis in all regions, institutionalise the national skills needs analysis and utilise these tools together with the Labour Market Observatory to improve the labour market relevance of initial and continuous vocational education and training for young people and adults and to target the use of active labour market measures.<br><br>Encourage cooperation between innovative businesses and academia as foreseen in the Strategy on Business and Investment Development 2021-2027, by continuing to increase science and research funding, and by creating the conditions for the development of business incubation programmes | **There was partial implementation of PG 5:**<br><br>1) **Partial implementation**: The Youth Guarantee plan has been drafted with a wide consultative process and in alignment with the new 2023-2030 national strategy on employment and skills. The national implementation plan for the Youth Guarantee scheme has been adopted in March 2023 as part of the 2023-2030 national strategy on employment and skills. .<br><br>2) **Partial implementation**: A Labour Market Information Observatory has been developed, as the primary mechanism for fetching and disseminating labour market information and intelligence. The labour market analysis was completed for two regions: Elbasan and Durres. A recommendation would be to complete the labour market analysis for the other regions and consolidate capacities for regular publication of datasets and findings as well as use them in policy making, particularly education, training and ALMPs planning.<br><br>3) **Partial implementation:** As reported in the previous PG, spending on science and research remains limited. Albania has made good progress in boosting its participation in EU Horizon Europe programme, in which it has absorbed more than 65% of funds compared to the previous year. Nevertheless, further efforts are needed in this area |
| **PG 6:**<br><br>Finalise the assessment of adequacy of 'Economic Aid' benefits, increase their adequacy as of 2023, and establish a mechanism for their annual indexation. | **There was partial implementation of PG 6:**<br><br>1) **Limited implementation:** Ad hoc increases of funds for economic aid benefits occurred in several stages during 2022, partly as a result of the two energy crisis resilience packages that the government adopted. However, a permanent mechanism of annual indexation is needec. It should be based on an impact assessment of the adequacy of the current benefits, and on benchmarks that take into account the cost of living. |

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| Increase allocation to the National Social Fund to ensure coverage, provide additional support to municipalities with limited resources, and improve the sustainability of newly established social services through continued contribution beyond the third year under a condition that municipalities establish a Local Social Fund with sufficient budget. | 2) **Partial implementation:** There has been some positive progress on the Social Fund, in particular the continuation of financial support of social services beyond the third year after their establishment. However, the mechanism requires further consolidation and improvement to ensure the sustainability of services, equity in distribution and procurement of services to third parties. Furthermore, municipalities need to start increasing their local budget allocation to fund social services at the local level. The EU is providing technical assistance to improve the overall operational arrangements of the Social Fund. |
| Redesign reimbursement policy for outpatient medicine to reduce financial hardship, particularly among persons with disabilities and chronic disease, poor households, people aged 65 and over, and minorities. | 3) **Substantial implementation:** Significant steps have been taken to ensure higher reimbursement rates and free treatment for patients with chronic diseases and cancer patients. New medicines have been added to the 'reimbursement medicines list'. A new measure was adopted to start reimbursing costs of medical devices. It is limited to diabetes strips for now, but it is important to expanded it. Other packages for treatment and care have been expanded. |

## ANNEX A: ASSESSMENT OF OTHER AREAS AND STRUCTURAL REFORM MEASURES INCLUDED IN THE 2023-2025 ERP

The 2023-2025 ERP analyses areas where Albania has identified the biggest obstacles to its economic development. These areas include the business environment, education and skills, labour and employment, the informal economy, and research and development. It also continues to address the negative impact of the COVID-19 pandemic and Russia's war of aggression against Ukraine. It provides a general assessment of the current reforms towards formalisation of the economy, while acknowledging that informal economic activity remains a significant concern, as illustrated by the high number of cash transactions and non-declared workers. However, the analysis of the sectors where informal activity is most prevalent is largely missing, as are the challenges encountered when trying to tackle the issue. The text describes the challenges in the education system and the reform measures proposed, in particular inclusiveness of education, investment in teacher training, reform of pre-university curricula to match labour market and investment in ICT skills for teachers and students. However, there is no analysis of the problems leading to low educational attainment and results.

Although there is now a good analysis of some green transition challenges, related waste and water issues were not included in this analysis. The low level of business digitalisation, innovation, and research and innovation capacities, which generate the increased demand for both new services and improved infrastructure and knowhow, were also largely absent in the analysis, even though the ERP includes reform measures to address these obstacles. The level of foreign direct investment, product diversification, and exports all affect the country's competitiveness and growth and its ability to create jobs, but these are also not analysed. Furthermore, issues with the rule of law, corruption, unclear property titles and the proper functioning of the judiciary system still hinder businesses and reduce Albania's attractiveness for foreign investments.

***Public financial management (PFM):***

The analysis of this area is short and focuses almost exclusively on managerial accountability. However, PFM is far wider than this specific topic. Furthermore, a comprehensive approach to managerial accountability is incomplete if it is not linked to the delegation of decision making, internal control and external auditing. The analysis should have covered the al the obstacles on PFM, as many were already identified and some were addressed under Albania's 2019-2022 PFM Action Plan. The risk analysis is also incomplete as most of the mitigating measures are missing.

**Reform measure 09: Public Strategic Investments**

This measure is carried over from the previous ERP. The actions planned for 2023 are relevant as they focus on implementing the single project pipeline, which are useful and necessary. The assessment of obstacles and challenges in public investment management is realistic and is based on the International Monetary Fund's (IMF) 2016Public Investment Management Assessment (PIMA) findings. The proposed measure, implementing the public investment management process, continues to address PG recommendations on assessing and approving all investments that involve public funds and PPPs through the same approval process. The measures could be more specific since the DCM on the National Single Project Pipeline has now been adopted. The adoption of the PPP law in 2023 could also have been included in the list of activities.

**Reform measure 10: Strengthening managerial accountability in general government units**

This measure is welcome as this is an important issue. However, the list of activities requires further development as they are just repeated for each of the 3 years of this ERP. The measure lacks specific verifiable targets on the expansion of managerial accountability. While it is clearly desirable to strengthen managerial accountability in public services, the focus of this measure seems to focus on making managers accountable. It does not look at the wider internal control processes linked to public service standards, internal control and internal audit. Albania should ensure that this reform takes all these aspects of internal control into account. The country should also follow the principles of public administration reform for the Western Balkans, as laid down by OECD/SIGMA[10], which it has agreed to. The targets set for this measure are only outputs and do not show the results, which somewhat obscures the potential added value.

***Economic integration reforms***

The analysis in the ERP is largely a list and short summary of public policies fostering trade integration of the country at regional, EU and global levels. While the text lists many measures and provides updates on the state of play, it does not analyse the issues and potential benefits. While this is to some extent informative, overall it is not analytical. However, there is a short analysis on conformity assessment, the export of animal by-products and trade relations with Kosovo. Even then, this analysis is undeveloped or missing for many other areas that this section should cover.

**Reform measure 13: Deepening economic integration**

This measure is rolled over from the previous years. Its description could explain in more detail why this specific measure has been drawn up and what is the expected impact in the medium term, rather than just describing the activities. The government should focus on aligning national legislation with EU *acquis* under Chapter 29. One activity planned in 2023, a possible customs union with Kosovo, seems optimistic as the parties are still assessing its feasibility, which will then be followed by negotiations. This measure is relevant to Albania's active involvement in regional trade integration, particularly through the Central European Free Trade Agreement (CEFTA), and the text provides most of the relevant information. Albania continues to take steps to open its market and to ensure deepening economic integration within the region. The follow-up of CEFTA work, such as the process of mutual recognition of authorised economic operators, are actions that will support Albania's EU integration process. However, some activities described in the measure are not well defined. For 2023-2025, this measure focuses on four actions: a possible customs union between Albania and Kosovo, CEFTA actions, the

(10) See Master doc - Principles of Public Administration (sigmaweb.org)

Open Balkan initiative, and cross-border trade projects. A possible customs union between Albania and Kosovo is mentioned for the first time in an ERP, and it only seems to cover a feasibility study of the scenario - the text does not go into detail about what it might cover. The rest of the measure is largely a continuation of existing actions

***Transport market reforms***

The analysis is well developed in identifying the main obstacles facing the transport sector. It states that further reforms are necessary in this area; Albanian companies in the World Bank 2019 Enterprise Survey identified transport as one of the main obstacles to improving the business environment. The 2021-2025 National Transport strategy, which includes building the intermodal railway connection linking the new Port of Durrës in Porto Romano with the energy park, in line with the national transport plan. This transport strategy is now ongoing in principle though this is not mentioned in the ERP. The ERP admits that work has been sluggish so far, but expects that it will now pick up pace. The text states that impediments, notably land expropriation, have been identified and are being resolved.

**Reform measure 15: Rehabilitation and construction of the railway segment Durrës-TIA-Tirana**

This measure has been rolled over from several previous ERPs. Upgrading and extending the Durrës-Airport-Tirana railway will increase intermodal transport, and should double the speed of passenger and freight transport between Tirana and Durrës, boosting traffic and reducing road congestion. A contract for upgrading the Tirana-Durrës railway was signed in February 2021. This strategic investment also benefits from EU funding under the European Economic and Investment plan. It forms part of Rail Route 2, linking the capital of Albania, Tirana with the capital of Montenegro, Podgorica, and is extended to the port of Durrës. This is a key project for the region. Project-level indicators are used and need to be further developed to better measure the implementation of reform, which includes information on electrifying the railway line, although there is little indication on when this will take place. New information has been added about the link between investment and the revised national transport plan.

There has been little progress on this measure and the proposed activities were all postponed by a year. Most of the comments in the previous ERP assessment are still valid. Progress has been slower than expected. The document admits that delays have been caused by several factors: (i) a lack of *ex-ante* evaluation of possible environmental effect of the disputes; (ii) (a lack of) experience with the technologies; (iii) issues with the expropriation of land, and (iv) difficulties with the implementing legislation in the transition phases and legal provisions for the setting-up of the relevant structures and agencies. The risks and mitigating measures are well presented, as is the impact on job creation (including the impact on the gender balance) and the environmental and energy efficiency considerations.

The ERP also flags that this measure should enable Albania's rail system to move toward alignment with the EU rail system and that it will be relevant to the green agenda. As mentioned above, unlike the previous ERP, the 2023 ERP mentions urban planning and land acquisition and the potential risk of land expropriation. This issue was introduced in this ERP, and it is elaborated upon. However, the ERP does not include the reasons preventing it from being fully addressed. The issue has resulted in all dependent activities being delayed. Furthermore, the measure should reflect the impact of the planned relocation of cargo activities from the Port of Durrës to a new port which is to be constructed near Porto Romano. The timeline of the activities for 2023 and beyond need to be revised taking into consideration delays in the project so far.

***Agriculture, industry and services***

The analysis of the main obstacles in the 2023-2025 ERP focuses almost entirely on the agriculture and tourism sectors (as did the previous ERP). It largely fails to address obstacles in the industrial sector or in other service sectors, apart from a list of issues (without any analysis) at the end of the section. This limits the ERP's usefulness as a document for economic policy coordination and prioritisation, and the consistency of economic policies is not ensured.

The Albanian agriculture sector is not very competitive compared to EU-27. Land fragmentation and small agricultural holdings discourage investments in mechanisation and automation and prevent any economies of scale. The main obstacle in addressing land fragmentation is the lack of property reform, such as an integrated land management policy and how it would subsequently be enforcement. Furthermore, the availability of cheap, skilled labour is the main factor that contributes positively to the sector's competitiveness is. However, this is under pressure, and statistical trends suggest that fewer workers are available. This is mainly due to internal migration from rural areas to urban areas and to external migration. Moreover; the educational system (in particular vocational education) continues to be disconnected from the industry needs of the and fails to equip the young generation with the skills demanded by the market. The analysis of the agricultural sector is long but incomplete as it fails to mention the impact of EU IPARD support. The analysis in the previous ERP on this area seemed more realistic. The sector remains prone to structural problems such as land consolidation, land fragmentation, and property ownership issues, some of which are mentioned in the ERP. Another issue poor access to finance for economic operators in the sector. Despite agriculture making up 18 % of GDP in 2021, banks' lending to the agricultural sector made up just 1.4 % of all lending to the private sector in Albania in 2022, as the sector is seen as risky by banks, land is highly fragmented, and producers often lack the collateral necessary

Besides the issues listed as obstacles in the 2023-2025ERP, Albania should also consider the following: i) consolidating the food-safety system following an integrated approach by ensuring cross-compliance along the entire food chain; i) exploring new market opportunities related to food product exports ; iii) enforcement of registration and approval of establishments operating with products of animal origin; and iv) the classification and upgrading of existing operating establishments in line with EU requirements.

Obstacles and opportunities regarding maritime tourism are well defined, highlighting some potential for expansion. However, apart from that there is almost nothing is mentioned of other services, even though this is a major economic sector.

As regards industry, this ERP does not provide any analysis for this significant sector, as was the case in the last two ERPs. This is a significant shortcoming.

**Reform measure 16: Better marine and maritime governance and services**

This was a new measure in the 2021 ERP. The same comments then and in 2022 apply – the reform is small in scale and seems to be an isolated initiative, based on some legal reforms. The measure should ideally have been treated as part of a larger reform, where relevant policies/plans regarding marinas/ports should be also considered. The description of the measure has clear references to strategic policy documents, and other sectoral reforms, such as those related to the blue economy and the financial approach to incentivise maritime tourism. Within these constraints the activities are well planned and detailed. They seem feasible and are relevant to the proposed measure, however, some baselines are still not included.

Reforms in the tourism sector are welcome, as it is an sector with high untapped potential for economic development. However, this measure does not seem to be integrated into the overall sectoral development policies and plans. Furthermore, although the text presents the legal framework for marinas (and legal clarity is certainly really important for such investments), the text does not examine the environmental effects of building and running them The overall description of the measure has improved from last year, and concrete results are reported. However, the activities are very generalised and repeated for each of the next three years, which will make their monitoring very difficult.

***Education and skills***

Skills, VET and reform measure 1 are analysed in section 4 of this document, under key structural challenge 1.

Investment in education continues to be lower than in the EU – 3.1% in 2021 compared to 4.8% in the EU. This is reflected in the quality of education and lower results and levels of attainment: a significant proportion of 15-year-olds still lack basic reading and numeracy skills. The share of early leavers from education and training (17.4% in 2021) is also much higher than in the EU (9.7%).

University education in Albania is of low quality and largely disconnected from the labour market. In a list of 400 higher education institutions (HEIs) (QS – World University Ranking 2021), the University of Tirana is ranked 351-400, behind its regional peers. There are 40 HEIs in Albania, with more than 1 300 study programmes. These programmes are often multiplied across different HEIs , which is a clear indicator of the lack of structural planning and education development strategies. This results in poor content and a lack of alignment with labour market needs. There is a theory-practice gap, with limited internships opportunities, mostly in the public administration. Even EQF level 5 professional programmes are mostly theoretical and lack practical content. Inter-disciplinary study programmes are also not promoted. The 2021-2026 national strategy for education plans to partly address this issue through increasing the offer of professional programmes, promoting career offices, and interdisciplinary and Science, technology, engineering, and mathematics (STEM) programmes. However, cooperation with the private sector is still very weak, and this needs to be strengthened to prioritise the provision of programmes based on labour market demand. The ERP does not include any reform measure to tackle issues in higher education.

The ERP presents a good overview of the measures taken in the area of pre-university education. However, an analysis of the problems that result in these low levels of attainment and comparatively low performances in international assessments would have been useful.

**Reform measure 17: Support the implementation of pre-university curricular reform and teacher training**

The measure is carried over from the previous ERP and focuses on a reform of the curricula to align them with labour market needs (one of the most crucial areas in the pre-university education area). and investment in teacher training. If implemented ompletely, the measure has the potential to significantly improve the development of skills in the education system and the quality of investments in human capital.

A particular emphasis is placed on teacher training and a professional network to empower and encourage teachers. This serves as a mechanism to support the professional development of teachers and improves the quality of the curriculum implemented in schools. This reform measure is supported closely by the EU Programme on Social Inclusion.

The reform measure contains many activities needed to improve the education system, but their effectiveness depends on the quality of implementation. In particular, planning international assessments is welcome; however, these assessments should not just be carried out: it is even more important that their results are used to inform further policy decisions. The teacher training plan could have been much more ambitious considering the number of teachers in the country. In the estimated cost of activities, teacher training is also noticeably under-prioritised. In addition, teachers are already required to have 3 days of a training every year, which is insufficient to adapt their teaching methods and content fully to the changes in curricula.

**Reform measure 18: Inclusiveness and equality in education**

This reform measure is carried over from the previous two ERPs and is a priority in the country's education strategy. It aims to: (i) ensure inclusive education for all vulnerable groups by providing free textbooks and transport; (ii) further increase the number of assistant teachers for children with disabilities in mainstream public schools; (iii) support deinstitutionalisation; and (iv) set up resource centres to offer daily support for persons with disabilities. The planned budget increase from 2023 to 2025presents a good foundation for the success of the measure. This increase demonstrates the government's commitment in addition to the support from the EU programme on Social Inclusion and other development partners.

Albania has made progress in setting up a professional network of assistant teachers and training heads of the network and assistant teachers. However, it is necessary to put in place an integrated approach that combines the investments in physical environment and accessibility, curriculum and assistive technologies, as well as more training of general teachers.

The planned action t transform special education schools and institutions into resource centres is a comprehensive investment that goes through several stages. It brings changes to the structure, management, teaching,specialised staff, curriculum, and infrastructure. However, it is also crucial to ensure that these new centres do not prevent children with disabilities from attending mainstream education if it is possible. As mentioned above, this requires a continued comprehensive investment in all aspects of the education environment.

The continued support to students from Roma and Egyptian minorities, such as scholarships, free transport and textbooks, are positive. However, educational outcomes of Roma and Egyptian students remain among the lowest in Albania, and their school dropout rates are close to 50%. This shows that a further analysis of the barriers is needed, together with corresponding support measures.

The measure sets indicators on the number of assistant teachers and psychological services staff. However, would have benefited by including an indicator on the number of children with disabilities who are integrated in the mainstream schools.

**Reform measure 19: Development and empowerment of digital competency of teachers**

This reform measure is carried over from the previous ERP and is a positive stepto tackle and adapt to new labour market developments. Focusing on ICT skills as a key part of the digital transition – it not only supports the EU priorities in that direction but also reflects a reference to EU and international competency frameworks for teachers. The measure also includes investment in infrastructure and equipment, which is essential for it success. Ensuring that everyone has access to a high-quality internet connection should also be one of theprerequisites so that digital skills become part of everyday schoolwork.

***Employment***

The employment of vulnerable groups and reform measure 2 are analysed in Section 4 of this document, under key structural challenge 1.

**Wages** are not featured in the 2023-2025 ERP. However, they are asignificant factor in the country’s economic situation. Wages are closely related to other issues, such as the informal economy, social protection contributions, the number of people living in poverty and social exclusion, and brain drain. Wage growth has continued increasing, with the average wage having increased by 5.8% between Q1-2021 and Q1-2022, although that increase does not match current inflation. In addition, there is no mechanism for revising and updating the minimum wage. And even though minimum wage increases should usually be discussed and approved by the National Labour Council, there was no proper consultations on the two increases adopted in 2022.

Albania has taken steps to improve **social dialogue**, and the National Labour Council is finally operational. However, the Council does not meet frequently enough (only two meetings in 2022), which does not allow for meaningful discussion and participation. Updating the trade unions law would also strengthen collective bargaining. It is essential to develop stronger cooperation on and discussion of policies, including the draft budget, at the highest level with both employers and employees. This is crucial for ensuring a strong link between economic and labour market development. Furthermore, stronger social dialogue is necessary to help ensure healthy and safe working conditions, adequate minimum wages and decent work.

## ANNEX B: OVERVIEW OF THE MAIN INDICATORS PER AREA/SECTOR OF THE ECONOMY

| Area/Sector | 2017 | 2018 | 2019 | 2020 | 2021 | EU-27 Average (2021 or most recent year) |
|---|---|---|---|---|---|---|
| **Energy** | | | | | | |
| Energy imports dependency (%) | 38.2% | 21.1% | 31.5% | 35.82% | N/A | 55.6% |
| Energy intensity: kilograms of oil equivalent (KGOE) per thousand euro | 219,15 | 209,44 | 204,16 | 196,31 | N/A | 110.35 |
| Share of renewable energy sources (RES) in final energy consumption (%) | 35.90% | 36.84% | 38.04% | 45.02% | 41.39% | 21.7% |
| **Transport** | | | | | | |
| Railway network density (metres of line per km$^2$ of land area) | 11.62 w | 11.62 w | 5.88 w | 7.79 w | 7.80 | N/A |
| Motorisation rate (passenger cars per 1000 inhabitants) | 146.8 w | 159.9 w | 174.1 w | 191.3 w | N/A | N/A |
| **Agriculture** | | | | | | |
| Share of gross value added (agriculture, forestry and fishing) | 21.8% | 21.1% | 21.0% | 22.0% | 20.3% | 1.8% |
| Share of employment (agriculture, forestry and fishing) | 38.2% w | 37.4% w | 36.4% w | N/A | N/A | 4.3% (2020) |
| Utilised agricultural area (% of total land area) | 40.8 w | 40.8 w | 40.8 | 40.5 | N/A | 40.6% (2020) |
| **Industry (except construction)** | | | | | | |
| Share of gross value added | 12.8% | 14.1% | 13.8% | 12.5% | 22.0% | 19.9% |
| Contribution to employment (% of total employment) | 12.5% w | 12.7% w | 14.4% | N/A | N/A | 16.1% |
| **Services** | | | | | | |
| Share of gross value added | 54.9% | 54.5% | 55.4% | 55.3% | 57.7% | 79.2% |
| Contribution to employment (% of total employment) | 42.4% w | 42.9% w | 43.5% w | N/A | N/A% | 70.9% |
| **Research, development and innovation** | | | | | | |
| R&D intensity of GDP (R&D expenditure as % of GDP) | N/A | N/A | N/A | N/A | N/A | 2,26% |
| R&D expenditure – EUR per inhabitant | N/A | N/A | N/A | N/A | N/A | EUR 734,5 |
| **Digital economy** | | | | | | |
| Percentage of households who have internet access at home | N/A | 84% | 85% | 87.2% | 90.9% | 92.5% (2022) |
| Share of total population using internet in the 3 months prior to the survey [NB: population 16-74] | N/A | 62.6% w | 68.6% w | 72.24% | N/A | 90%(2022) |
| **Trade** | | | | | | |
| Export of goods and | | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| services (as % of GDP) | 31.6% | 31.6% | 31.3% | 22.7% | 30.6% | 50.4% |
| Import of goods and services (as % of GDP) | 46.6% | 45.3% | 45.0% | 37.9% | 43.9% | 46.7% |
| Trade balance (as % of GDP) | -22.7% | -20.2% | -20.7% | -20.1% | -22.9% | N/A |
| **Education and Skills** | | | | | | |
| Early leavers from education and training (% of population aged 18-24) | 19.6% w | 17.4% w | 16.3% w | 15.6% w | 17.4% | 9.7% |
| Young people not in employment, in education and training (NEET) (% of population aged 15-24) | 26.9% | 28.9% | 26.5% | 25.5% | 24.0% | 13.1% |
| Children aged less than 3 years in formal childcare (% of under 3-years-olds) | N/A | N/A | N/A | N/A | N/A | 36.2% |
| Individuals who have basic or above basic overall digital skills (% of population 16-74) | N/A | N/A | 21% | N/A | 23.8% | 53.92% |
| **Employment and labour market** | | | | | | |
| Employment rate (% of population aged 20-64) | 63.9% w | 65.6% w | 67.1% w | 66.3% w | 63.3% | 73.1% |
| Unemployment rate (% of labour force aged 15-74) | 13.7% w | 12.3% w | 11.5% w | 11.8% w | 11.6% | 7% |
| Long term unemployment rate (% of labour force aged 15-74) | 8.9%w | 8.3%w | 7.3%w | 7.0% w | N/A | 2.8% |
| Gender employment gap (Percentage point difference between the employment rates of men and women aged 20-64) | 16.5 pps w | 16.5 pps w | 15.0 pps w | 15.2 pps w | 16.3 pps | 10.8 pps |
| Disability employment gap (Percentage points difference in employment rates between people with and without a disability) | 18.1 pps | 16.9 pps | 18.7 pps | 13.3 pps | N/A | 23.1 pps |
| Real gross disposable income of households (Per capita increase, Index = 2008) | N/A | N/A | N/A | N/A | N/A | 110.27 |
| **Social protection system** | | | | | | |
| At-risk-of-poverty or social exclusion rate (AROPE) (% of population) | 58.5% | 53.9% | 50.8% | 46.2% | N/A | 21.7% |
| At-risk-of-poverty or social exclusion rate of children (% of population 0-17) | 62.0% | 57.7% | 53.9% | 51.0% | N/A | 24.4% |
| Impact of social transfers (other than pensions) on poverty reduction | 12.55% | 11.03% | 11.88% | 12.10% | N/A | 37.08% |
| Income inequality - quintile | 7.47 | 6.98 | 6.38 | 5.86 | N/A | 4.97 |

| | | | | | | |
|---|---|---|---|---|---|---|
| share ratio (S80/S20) (Comparison ratio of total income received by the 20% of the population with the highest income to that received by the 20% with the lowest income) | | | | | | |
| Housing cost overburden (% of population) | 9.2% | 6.0% | 5.5% | 3.8% | N/A | 8.3% |
| **Healthcare** | | | | | | |
| Self-reported unmet need for medical care (of people over 16) | 13.1% | 14.8% | 14.6% | 10.6% | N/A | 2.0% |
| Out-of-pocket expenditure on healthcare (% of total health expenditure) | 44.45%[z] | 44.58%[z] | N/A | N/A | N/A | 14.39%(2020) |

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

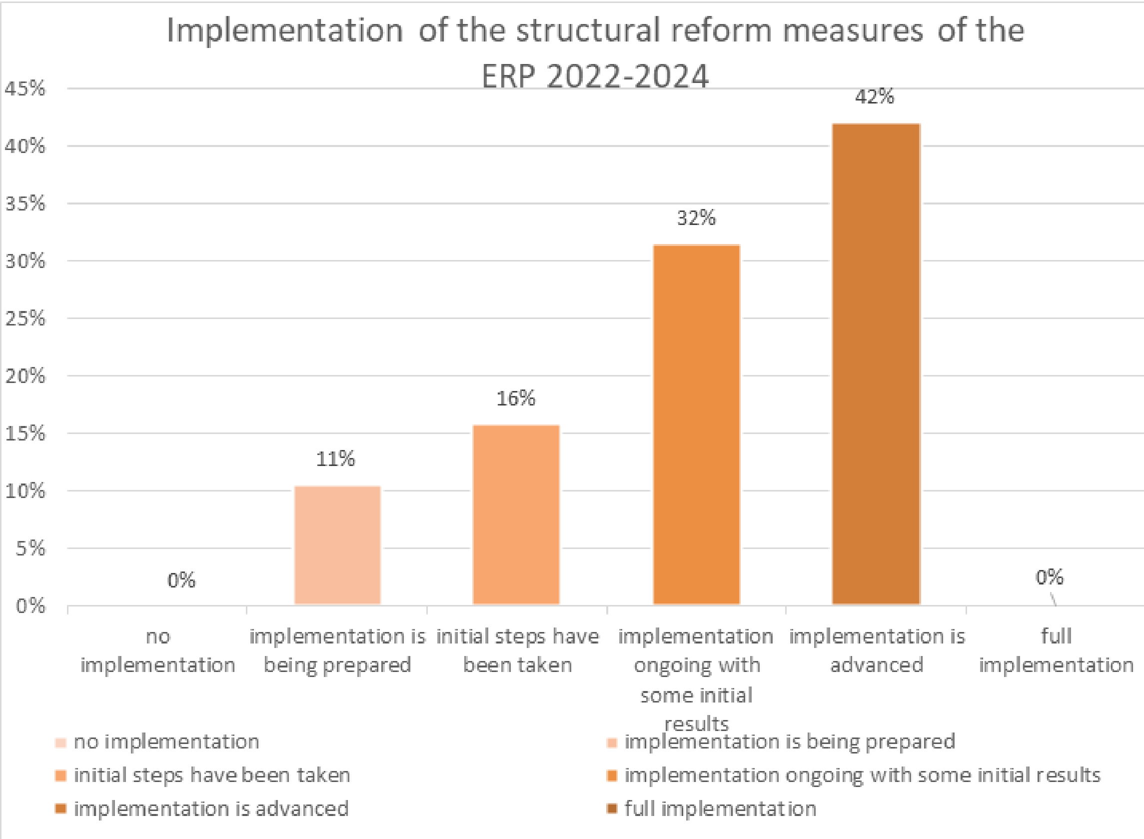
*z: data from the World Health Organization*

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

## ANNEX C: PROGRESS WITH STRUCTURAL REFORM MEASURES FROM ERP 2022-2024

Progress was made in implementing the measures from last year's ERP (average score: 3.3 out of 5). Activity reports provide a fairly accurate description of the level of implementation of the measures that were reported on. However, two measures were not reported on. These were measures on i) the quality and coverage of VET; and ii) access to healthcare. The Commission therefore had to independently evaluate the extent to which these two measures were implemented in the reporting period. The scoring was slightly imprecise for the measures related to addressing the employability of the most vulnerable unemployed jobseekers, improving capacities for research and innovation, increasing social care, support measures to MSMEs, broadband, liberalisation of the energy market, maritime governance, and pre-university curriculum reform. Only text assessment, rather than numerical values, were provided on deepening economic integration. Some of the activities related to broadband and inclusive education were not reported on, so also had to be estimated.

Table 11: Reporting on the implementation of the 2022-2024 ERP's structural reform measures of the structural reform measures



## ANNEX D: COMPLIANCE WITH PROGRAMME REQUIREMENTS

Coordination of Albania's ERP is led by the Ministry of Finance and Economy. In 2022, the overall ERP coordination task was delegated from one deputy minister to another. However, the Ministry of Finance and Economy continued to lead the coordination process.. There was limited consultation with private stakeholders. No consultation with Parliament or with local/regional authorities took place during the drafting process. The document was published for consultation in the government portal www.konsultimipublik.gov.al, and on the Ministry of Finance and Economy's website. No comments were registered there by the social partners/private stakeholders. Only the national Agency on Information Society, the Data Protection Commissioner, and one Embassy provided comments on, the document..

The Ministry made some additional efforts were made this year to draw the attention of business associations to the ERP, by sharing the invitation for comments on the draft document through the Investment Council network. Decide just publishing documents online, the requirement to discuss and engage in dialogue with social partners and business associations on important documents, such as the ERP, needs to be formalised. Some business associations requested additional time for comments, beyond the 6 January deadline. The responses from these bodies are well documented in the Annex to the ERP.

The structure of the section on structural reform priorities follows the guidance note. However, there is room for improvement in the format and content. For example, Section 2 on implementation of the policy guidance (PG) is about 16 pages long, exceeding the four-page limit set in the guidance. In some cases, the reporting on PG implementation was mixed with actions planned for the future, and in two cases (PG 3.2- in part and PG 3.3) the information was missing altogether. While there are 19reform measures, below the limit of 20, the page limit was not observed (it was 20 pages more than the maximum limit).

*Macroeconomic framework*

The programme is in line with the medium-term budgetary framework and the Budget Law of Albania. It was submitted on time on 1 February 2023 and adopted on 1 March 2023. It describes the past economic developments based on the available data and includes an updated medium-term macro-fiscal framework. Both were published on the Ministry of Finance and Economy's website, but no information about the public consultation and its results is included. Projections for growth in 2023 and beyond lack a detailed explanation, particularly projections for the balance of payment. However, overall, the revised projections are more in line with international estimates than in earlier ERPs. Information on the level of implementation of policy guidance 3 is incomplete. The ERP does not provide an analysis of labour productivity, skills shortages, migration, brain drain and the investment environment. There is also no assessment of the impact of the shrinking size of the population on social insurance and growth.

*Fiscal framework*

The data in the ERP and the medium-term macro-fiscal framework are consistent, and the fiscal planning is based on latest outturn data. These are both significant improvements compared to last year's ERP. However, data on central government capital investment in the GDP tables does not tally with the data in the fiscal tables. The information about discretionary measures planned for 2023 and 2024 is still rudimentary and fragmented, and there is still no data on the long-term sustainability of public finances (demographic developments, pensions, health expenditure), including past data. However, there is more information on contingent liabilities / use of sovereign guarantees and discretionary measures. The calculation of functional expenditure still needs to be improved. It is still difficult to link policies mentioned in the ERP with the macro-fiscal and budget tables or make comparisons over time. This is because various expenditures are aggregated under one budget heading, and the use of budget headings for the same kind of expenditure varies from one budget to another. Additionally, new headings are introduced every year, which complicates matters. The headings used to record the treasury's outturn data do not fully correspond to the headings used in the budget and fiscal tables.

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. It lacks details on the expenditure plans, in particular plans for capital expenditure. It remains unclear if policies are sufficiently financed because the structural reforms costs presented in the ERP cannot be linked to the budget. There is only limited information on: (i) contributions to the coverage of social insurance benefits and entitlements; and (ii) the deficit of the social insurance schemes to be covered by the budget. Information is missing on: (i) arrears and repayments from public entities (although it is set out to be included in the fiscal framework tables); and (ii) local-government expenditure. Fiscal data do not yet meet ESA 2010 requirements. Albania regularly sends EDP notifications to Eurostat on a best-effort basis and strives to improve them and align its fiscal statistics with EU requirements (with the support of Eurostat). Government finance statistics are not yet aligned with international standards.

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