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COMMISSION STAFF WORKING DOCUMENT

ECONOMIC REFORM PROGRAMME

OF

ALBANIA
(2016-2018)

COMMISSION ASSESSMENT

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Contents

1. EXECUTIVE SUMMARY

Albania is experiencing a gradual economic upturn that is expected to continue in 2017-2019. The economic reform programme (ERP) projects GDP growth to strengthen to more than 4 % in 2018 on the back of rising domestic demand and improving net exports. Two large foreign direct investments in the energy sector are major drivers for expansion in the near term. Consumer spending is also expected to pick up further supported by rising employment, higher wages and record-low interest rates. Robust export growth is expected, based on the assumption that the oil price will stabilise and last year's growth in foreign tourism will continue. Stronger-than-projected import growth seems to be the main downside risk to the programme's forecast of real GDP growth.

Sustaining the ongoing economic recovery requires further reform efforts and the tackling of macroeconomic weaknesses in relation to public finances and the financial sector. Under its three-year International Monetary Fund (IMF) programme, completed in February, the country has made great strides in consolidating its public finances, while an accommodative monetary policy has supported the economy's cyclical recovery. Albania has also started to implement substantial business-relevant reforms, such as the comprehensive overhaul of the justice system. Nevertheless, enduring macroeconomic weaknesses and structural obstacles to growth call for sustained efforts to address the following main challenges:

- **While debt stabilisation has been achieved, high public debt remains a major source of macroeconomic vulnerability.** Public debt (including guarantees) still exceeds 70 % of GDP, and is associated with significant rollover and exchange rate risks. The country's fiscal adjustment plans are markedly less ambitious than in last year's programme and aim mainly at locking-in the recently achieved consolidation gains. The expected continuing fall of the debt ratio relies mainly on improving growth prospects and on modest expenditure restraint. While the pace of debt reduction envisaged is appropriate, there are non-negligible downside risks to it, mainly from lower-than-expected nominal GDP growth and from contingent liabilities. There is significant scope for raising more revenue by improving tax compliance and enlarging the tax base.

- **The overhang of non-performing loans still burdens banks' balance sheets and impedes credit recovery.** Banks are well capitalised and highly liquid, and household credit has been rising. However, despite multi-pronged efforts to address the problem, the non-performing loan ratio remains high and constrains business-sector lending. Furthermore, despite an ongoing gradual shift towards lending in lek, the proportion of loans issued in euros remains high and poses challenges both to the stability of the banking system and to the conduct of monetary policy.

- **Inefficiencies in the energy sector, including insufficient security of supply, continue to weigh on Albania's competitiveness.** The ERP recognises this and includes measures to further unbundle and liberalise the energy market following the adoption of the required legal base. Albania has started to diversify its energy sources through its gasification project. In terms of improving the sustainability of the energy sector, some progress has been made in bills collection, but tariff reforms are still awaited.

- **The lack of clarity around land ownership is among the key constraints on Albania's economic development, affecting a number of sectors including infrastructure and industrial development, agriculture, the property market and access to finance.** Progress towards establishing a comprehensive cadastre has been slow. The ERP maintains a narrow view of the issue, prioritising only agricultural land. An agricultural land consolidation strategy was adopted at the end of 2016, but implementation has yet to begin. There has been limited progress in establishing the legal basis for the creation of the much-needed e-cadastre. However, an e-procedure for buildings permits has been introduced.
- **High structural unemployment and inactivity and a widespread skills mismatch are the main challenges for the labour market.** Low quality of education at all levels is a general concern, and education outcomes do not meet labour market needs. Modernisation of curricula focuses on vocational education, but is progressing slowly and with insufficient involvement of the employers. While spending on active labour market policies (ALMPs) has increased, their effectiveness and coverage remain very low. Widespread engagement in informal work remains a challenge and there is no strategic approach to increasing formal employment. Ongoing activities to improve financial social assistance need to be complemented by strengthening the links between social assistance and measures to find work. Inability to address these challenges affects people's employment and social prospects of the population, in particular young people, women and the unemployed.

The policy guidance jointly adopted at the Economic and Financial Dialogue of 25 May 2016 has been partially implemented. Fiscal consolidation has advanced with the deficit narrowing more than planned. The fiscal framework has improved with the adoption of a fiscal rule, even though it does not provide a particularly strong anchor. Important steps have been taken towards liberalising the energy market, but the unbundling of state owned transmission and distribution companies has not been finalised. No progress has been made on setting up the e-cadastre, but steps have been taken to improve property registration. An e-procedure for building permits has become operational. Budgetary allocations for active labour market measures have increased, but the coverage of such measures remains very low and work on linking them with social protection support has not yet started. No progress has been made in reducing undeclared work or setting up a comprehensive approach to do so. The structural reform measures planned to be completed in 2016 in last year's ERP were only partially implemented.

Overall, the programme's macro-fiscal framework is plausible even though on the optimistic side, while the reconfirmed commitment to lowering debt-related vulnerabilities is in line with the priorities identified by the Commission in previous years. The fiscal framework also allocates resources to the implementation of important reform priorities, such as those related to the justice system, public administration and local governments. Structural obstacles to competitiveness and the reform measures, as presented in the ERP, largely match bottlenecks and reform needs identified by the Commission. However, the quality of the analysis varies largely among sectors. It focuses on relevant issues related to access to finance, contract enforcement, the informal economy, business regulation, the skills gap and the overall quality of education. The mix of structural reform measures is overall relevant, while the focus of some measures, especially in the field of employment, skills and social inclusion, is not clear.

2. ECONOMIC OUTLOOK AND RISKS

Albania's economic reform programme (ERP) projects an acceleration of economic activity based on continuing expansion of domestic demand and improving net exports. Private investment is set to be the main driver of growth in the near term fuelled by strong foreign direct investment planned in the energy sector. Consumer spending has strengthened recently in the context of record-low interest rates and an improving labour market. A steady increase in employment and wages is expected to continue supporting private consumption. Government consumption is projected to increase at a robust rate before being reined in in the last year of the programme period. In spite of relatively strong export growth, overall foreign trade (net exports) is still expected to subtract from GDP growth in 2017 due to large import-intensive investments. In subsequent years, however, import growth is projected to slow, while export growth is projected to remain robust. As a result, net exports are set to move gradually towards contributing positively to GDP growth. Seen from the production side, the ERP projects all economic sectors to contribute positively to growth in 2017-2019. The largest contributions are expected to come from agriculture, mining and quarrying, manufacturing, construction, and wholesale and retail trade. The highest growth rates are expected for mining and quarrying, as the industry is seen as recovering from the severe contraction linked to weak commodity prices. All in all, the ERP projects that economic growth will accelerate from 3.4 % in 2016 to 4.2 % in 2019.

Table 1:

Macroeconomic developments and forecasts

	2015		2016		2017		2018		2019	
	COM	**ERP**	COM	**ERP**	COM	**ERP**	COM	**ERP**	COM	**ERP**
Real GDP (% change)	2.6	**2.6**	3.3	**3.4**	3.5	**3.8**	3.6	**4.1**	n.a.	**4.2**
Contributions:										
- Final domestic demand	3.2	**3.2**	4.5	**4.8**	5.2	**5.3**	4.2	**4.1**	n.a.	**3.6**
- Change in inventories	0.2	**0.2**	0.0	**0.0**	0.0	**0.0**	0.0	**0.0**	n.a.	**0.0**
- External balance of goods and services	1.8	**1.8**	-1.4	**-1.4**	-1.7	**-1.5**	-0.7	**0.0**	n.a.	**0.7**
Employment (% change)	4.9	**4.9**	4.4	**3.7**	2.6	**3.9**	2.7	**3.0**	n.a.	**2.6**
Unemployment rate (%)	17.5	**17.5**	15.3	**15.7**	14.5	**14.4**	13.4	**13.3**	n.a.	**12.5**
GDP deflator (% change)	0.3	**0.3**	0.4	**1.3**	1.7	**2.4**	2.3	**2.7**	n.a.	**3.0**
CPI inflation (%)	0.2	**0.2**	1.3	**1.3**	2.2	**2.3**	2.6	**2.8**	n.a.	**3.0**
Current account balance (% of GDP)	-11.2	**-11.2**	-11.8	**-12.1**	-13.1	**-12.6**	-12.8	**-12.0**	n.a.	**-10.7**

Sources: Economic Reform Programme (ERP) 2017, Commission 2017 winter Forecast (COM).

The ERP's projected trajectory for GDP growth appears somewhat optimistic and exceeds the Commission's winter forecast. In the ERP, private consumption is expected to accelerate gradually from 2.3 % growth in 2017 to 3.4 % in 2019, supported by a steady rise in employment, wages and household borrowing. Public consumption is expected to surge in 2017 following a decline in 2016. The estimate for 2016 appears unrealistic considering that the actual growth rate of public consumption in the first three quarters of the year amounted to 1.4 % year-on-year. Growth in capital formation is projected to slow (from 9.9 % in 2017 to 2.6 % in 2019), which appears plausible in view of the implementation schedule for the two large investment projects in the energy sector[1]. Exports are forecast to expand at an average annual rate of close to 6 % over the programme period, based on the assumption that the oil price will stabilise and then edge upwards. The export of tourism services expanded significantly in 2016 from a relatively low base and is expected to continue performing well. Imports are projected to slow from 6.1 % in 2017 to 2.3 % in 2019. As with investment, some decline in import growth is likely as a consequence of the planned schedule for the energy projects, which entail large imports of capital goods. The magnitude of the decline may, however, be smaller than projected in the ERP considering the robust rise in both private consumption and exports. Given the projected divergence for export and import growth in the ERP, net exports' contribution to GDP growth is expected to turn from negative (-1.5 pps.) in 2017 to neutral in 2018 and positive (+0.7 pp.) in 2019. This is the main difference between the ERP's macroeconomic scenario and the Commission's February 2017 forecast, in which the drag on growth from net exports is projected to decline more moderately, i.e. from -1.7 pps. in 2017 to -0.7 pp. in 2018. Overall, the ERP's macroeconomic scenario is relatively plausible although somewhat optimistic. The major risk to projected GDP growth in the baseline scenario is that import growth will exert a stronger-than-expected drag.

Inflation remains below target and the central bank intends to keep monetary policy on an accommodative course. The annual average of the consumer price index rose by 1.3 % in 2016. Annual inflation has now run at below the central bank's 3 % target for four consecutive years, which reflects the absence of upward price pressures from a domestic economy that is still operating below potential in combination with disinflationary impacts from the external environment. In this context, the central bank reduced its key policy rate by half a percentage points in two instalments in April and May 2016, to a new historic low of 1.25 %. The central bank expects average inflation to rise to 2.3 % in 2017 and to return to target in 2018 as economic growth strengthens further. In this scenario, the central bank intends to maintain an accommodative monetary policy stance, but to remain flexible regarding the intensity of monetary stimulus. Specifically, it has signaled that it will not reduce the monetary stimulus before the fourth quarter of 2017. The recent monetary easing has reduced interest rates for private borrowers, thereby supporting consumer spending and private investment. Despite the narrowing of the lek-euro interest-rate differential, the lek appreciated 1.7 % against the euro in 2016 (average annual value) within Albania's floating exchange rate system. The lek's nominal and real effective exchange rates were up by 3.2 % and 4.1 % respectively year-on-year in the fourth quarter of 2016. For 2017-2019, the ERP assumes a constant nominal exchange rate against the euro.

The current account deficit is expected to widen in 2017 as a result of strong growth in import-intensive investments, before declining in the following two years. Albania has a relatively narrow production base resulting in a large structural deficit in the balance of trade for goods. This is partially offset by revenues from foreign tourism and the export of manufacturing services for foreign-owned products. In addition to the surplus on the balance of trade for services, the current account benefits from a large volume of remittances sent by Albanians abroad. Nevertheless, the current account has shown a deficit in excess of 10 % of GDP in each year between 2007 and 2015. In 2016

[1] The Trans-Adriatic Pipeline (TAP) and the Statkraft/Devoll hydropower project.

however, it narrowed by 1.2 pps. to 9.6 % of GDP mainly due to a rising surplus on the balance of primary incomes and current transfers. Goods imports are projected to increase relatively strongly during the final phase of TAP construction in 2017, and expanding domestic demand will be accompanied by rising imports throughout the programme period. Therefore, the import slowdown projected for 2018-2019 is less plausible than the projected rise in exports. The latter is seen to be based on slightly rising commodity prices, relatively low unit labour costs, and continued growth of tourism, even though growth in Albania's main export markets is expected to be tepid. Overall, the ERP projects that the current account deficit will widen to 12.6 % of GDP in 2017 before import deceleration reduces it by about 2 pps. over the following two years. In terms of the saving-investment balance, rising investment relative to GDP is projected to outstrip the expected increase in the domestic saving rate in 2017. This development is expected to be reversed in the next two years mainly as a result of strong growth in the ratio of domestic saving to GDP, while investment as a proportion of GDP is projected to fall slightly in the period 2017-2019. Overall, the assumed path for the current account balance appears somewhat optimistic.

Foreign direct investment is expected to remain the largest source for financing the current account deficit. In the past 10 years, net inflows of foreign direct investment (FDI) have financed close to two-thirds of the current account deficit. Net FDI inflows are projected to rise gradually to cover more than 80 % of the current account deficit by 2019. However, renewed decline in international commodity prices is a downside risk to this outlook since it would dampen FDI in the extractive industries. Albania's relative success in attracting foreign investment in recent years has been heavily concentrated in non-tradable and natural resource-based industries. Attracting FDI to higher value-added activities would integrate the economy better into global supply chains, boost productivity and create more and better jobs throughout the economy. This, however, would require wide-ranging structural reform to bring about substantial improvements in the investment environment. Gross external debt stood at 71.8 % of GDP at the end of 2016, down by 1.5 pps. from the preceding year. About 80% of the external debt is long-term. More than half of the long-term debt is owed by the government and most of the rest consists of intercompany lending between direct investors and subsidiaries. Although sizeable, the composition of the external debt means that it does not give rise to immediate concerns. Foreign exchange reserves totalled EUR 2.9 billion (26.3 % of GDP) at the end of 2016 and are expected to rise by more than 20 % over the next three years. Currently, the reserves cover about 7 months' worth of imports of goods and services, providing an adequate safeguard against adverse shocks.

Non-performing loans continue to impair bank balance sheets and hamper a revival in lending, even though banks are well capitalised and highly liquid. The ratio of non-performing loans (NPL) to total gross loans trended higher for most of 2016 before reversing and finishing at 18.3 % in December. The central bank attributes the declining NPL ratio in the final months of 2016 to the improving economic situation, credit restructuring and loan write-offs. It is still difficult to assess the effectiveness of the NPL action plan of September 2015, which involves legislative and regulatory measures and was expected to speed up NPL resolution and credit recovery. The high NPL ratio is a major factor behind strict lending standards which, in turn, explains much of the weak lending growth to the business sector. Private credit in Albania grew by only 2.8 % in 2016 (adjusted for the impact of loan write-offs). Monetary easing has led to a decrease in the lek-euro interest rate spread and has supported a gradual shift towards lending in lek. As a result, the share of foreign exchange loans in total loans fell by 2.2 percentage points to 58.6 % in 2016. Unhedged foreign exchange loans, which are associated with the risk of lek depreciation, constituted about 26 % of total private-sector credit in mid-2016. Overall, the banking system maintains adequate buffers to absorb shocks as capital adequacy and liquidity ratios exceed regulatory requirements and profitability has been improving. Banks are also not reliant on foreign-based parent banks for funding because the loan-deposit ratio is low (51.8 % at the end of 2016). However, the preponderance of short-term deposits among funding sources leads to maturity mismatches and hinders long-term financing by banks. On the asset side, government securities account for around 25 %, exposing banks to sovereign risk. The banking sector is relatively concentrated and two of the major banks do not have overseas parents and are therefore not covered by an international supervisor.

Table 2:

Financial sector indicators

	2012	2013	2014	2015	2016
Total assets of the banking system, mEUR	8,503	8,803	9,234	9,773	10,407
Foreign ownership of banking system by asset, %	89.8	88.6	87.1	84.1	82.6
Private credit growth*, %	1.4	-1.4	2.0	2.2	2.8
Deposit growth, %	9.4	3.7	1.5	1.9	5.0
Loan to deposit ratio	60.7	58.4	57.7	56.8	51.8
Financial soundness indicators, %					
- non-performing loans to total loans	22.8	23.2	22.8	17.7	18.3
- core capital to risk weighted assets	14.6	14.9	13.8	13.5	13.8
- liquid to total assets	29.4	27.6	31.9	32.3	31.3
- return on equity	3.8	6.4	10.5	13.2	7.2
- forex loans to total loans	64.5	63.0	62.4	60.8	58.6

**: Adjusted for loan write-offs*

Sources: Economic Reform Programme (ERP) 2017, Bank of Albania, ECFIN CCEQ.

3. PUBLIC FINANCE

In 2016, the fiscal deficit was significantly smaller than planned due to broad-based under-execution of expenditure. Total revenue increased by 6.8 % year-on-year driven by higher tax revenue in most categories. The ratio of revenue to GDP increased from 26.4 % in 2015 to 27.0 % in 2016, which was less than the planned increase to 27.4 %. Compared to the budget as revised in December 2016, total revenue was 2.3 % below target. This was caused by lower-than-expected prices for oil and minerals, lower inflation, higher-than-expected value-added-tax (VAT) refunds and a shortfall of dividends from state-owned companies. These factors were partly offset by higher revenue from profit taxes which, according to the ERP, was a result of the government's campaign to reduce informal economic activity. Total expenditure fell by 1.4 % year-on-year, much helped by the end of payments to clear central government arrears in 2016[2]. The ratio of expenditure to GDP fell from 30.5 % in 2015 to 28.7 % in 2016, which is significantly more than the planned decrease to 29.6 %. Compared to the budget as

[2] Excluding the clearance of arrears, expenditure increased by 2.7 % in 2016, which is still less than nominal GDP growth of 3.2 % (GDP data released on 3 April 2017).

revised in December 2016, total expenditure was 4.2 % below target. Although the under-execution of expenditure was broad-based, it particularly reflected: (1) lower-than-expected inflation reducing social insurance outlays; (2) lower interest rates reducing interest payments; and (3) the recent reorganisation of local government units, which caused delays in local spending. Public-sector investment, as defined in the ERP[3], surged by 23 % year-on-year, much more than projected in last year's ERP. While public investment is crucial to address large gaps in infrastructure, a recurrent failure to adhere to spending targets (which more often takes the form of serious under-execution of the capital budget) indicates ongoing weaknesses in public investment management. All in all, the headline budget deficit narrowed from 4.1 % of GDP in 2015 to 1.7 % in 2016[4], which is significantly lower than in the original budget (2.2 %) and in the revised budget (2.4 %). The primary balance of general government moved from a deficit of 1.4 % of GDP in 2015 to a surplus of 0.7 % in 2016.

For the programme period, the ERP projects budgetary stabilisation and a gradually declining debt-to-GDP ratio. The overall fiscal deficit is projected to rise to 2.0 % of GDP in 2017 before declining to 1.8 % in 2018 and 1.0 % in 2019. The primary surplus is set to rise to 1.8 % of GDP by 2019. This is a markedly less ambitious fiscal plan than in the previous ERP, which targeted an overall fiscal deficit of 0.5 % of GDP and a primary surplus of 2.4 % in 2018. Essentially, the current programme foresees the budget stabilising in 2017 and 2018, with the deficit set to fall only in 2019. For 2017, the rising deficit has to be seen against the background of under-execution of expenditure in 2016. Following last year's drop, the ratio of expenditure to GDP is projected to rise by 0.6 pp. to 29.3 % in 2017. This would still be a 0.3 pp. decline compared to the original target for 2016. Over the following two years, the expenditure ratio is projected to fall by a combined 1.1 pps. to 28.2 %. The ratio of total revenue to GDP is projected to rise by 0.3 pp. in 2017 and to remain at this level in the following two years. This means that the projected narrowing of the fiscal deficit is expected to be largely achieved through a cutback in expenditure relative to GDP. This cutback is, however, more modest than in last year's ERP, which projected an expenditure-to-GDP ratio of 27.8 % as early as 2018. The projected paths for the fiscal deficit and for nominal GDP growth (around 7 %) would allow the debt-to-GDP ratio (including state guarantees) to decline gradually by 8 pps. to 63 % over the three years to the end of 2019. Overall, the government's planned fiscal stance is sufficiently strict to reduce the debt ratio further.

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3 Including grants to the Regional Development Fund administered by local governments, amounting to about 0.6 % of GDP.

4 On the basis of GDP data released on 3 April 2017, the budget deficit amounted to 1.8 % of GDP in 2016.

Table 3: Composition of the budgetary adjustment (% of GDP)	2015	2016	2017	2018	2019	Change: 2016-19
Revenue	26.4	27.0	27.3	27.3	27.3	0.3
- Taxes and social security contributions	21.0	21.5	21.7	21.7	21.7	0.2
- Other (residual)	5.4	5.5	5.6	5.6	5.6	0.1
Expenditure	30.5	28.7	29.3	29.1	28.2	-0.5
- Primary expenditure*	27.8	26.3	26.7	26.3	25.5	-0.8
of which:						
Gross fixed capital formation	5.3	6.2	6.0	5.9	5.6	-0.6
Consumption	9.4	8.7	8.9	8.7	8.4	-0.3
Transfers & subsidies	11.4	11.8	11.7	11.5	11.2	-0.6
Other (residual)	1.7	-0.4	0.1	0.2	0.3	0.7
- Interest payments	2.7	2.4	2.6	2.8	2.7	0.3
Budget balance	-4.1	-1.7	-2.0	-1.8	-0.9	0.8
- Cyclically adjusted	-3.9	-1.6	-1.9	-1.8	-1.0	0.6
Primary balance*	-1.4	0.7	0.6	1.0	1.8	1.1
Gross debt level	72.7	71.0	68.9	66.3	62.8	-8.2

**: Excluding arrears clearance*
Sources: Economic Reform Programme (ERP) 2017, ECFIN calculations

The 2017 budget seeks to lock in the gains from fiscal consolidation achieved in the previous three years during the IMF's economic programme for Albania[5]. Parliament adopted the 2017 budget law on 15 December 2016. Compared to the budget outcome for 2016, it projects total revenue to rise by 7.7 %. Oil-related revenues are projected to strengthen significantly, on the assumption of a 21 %-rise in the annual average price for oil. Tax revenues are also expected to benefit from the 10 % wage hike in large parts of the public sector, which was implemented in March following a three-year wage freeze. Revenue-generating measures include broadening the base of a tax on luxury cars and improvements in revenue administration. Total expenditure is projected to increase by 8.4 % year-on-year, which allows scope for increases in public wages and pensions while containing the wage bill at the 2016 level as a percentage of GDP. Budget expenditure also covers the cost of structural reforms, such as strengthening the water utilities sector and implementing judicial reform. It provides for property restitution claims related to the communist era and additional resources for decentralisation. Following the surge in 2016, public investment spending is projected to increase at the relatively modest rate of 2.9 %, which reduces its share of GDP to 6.0 %. Fiscal plans assume that nominal GDP will grow by 6.3 % in 2017, which is one percentage point more than projected in the Commission's winter forecast. The budget deficit of 2.0 % of GDP is lower than the original and revised budget deficit targets for 2016 (2.2 % and 2.4 %, respectively), but higher than the realised deficit of 1.7 %. It is also higher than the 1.4 % deficit projected for 2017 in last year's ERP. In this perspective, a budget deficit of 2 % of GDP suggests that there is less ambition for fiscal consolidation, which might also be explained by the election cycle.

[5] The IMF's three-year economic programme for Albania (an Extended Fund Facility equivalent to about EUR 377.3 million) was completed in February 2017.

Beyond 2017, plans for fiscal consolidation rely on spending restraint, but the underlying measures are unclear. The ERP does not provide information about fiscal measures or analytical support for the budget projections, which are presented as tables. Total expenditure relative to GDP is projected to decline by 1.1 pps. between 2017 and 2019, with all the major spending categories increasing clearly at rates below the projected growth for nominal GDP. Interest expenditure, however, is projected to rise, reflecting an expectation of increasing interest rates in domestic and foreign markets. Social insurance outlays, the biggest expenditure item, are now linked to the annual rate of inflation, and social transfers' share of GDP is expected to decline by half a percentage point to 11.1 % in 2019. Improving the efficiency of public administration and better targeting social assistance schemes may create savings, but the ERP has no details. Total public investment is projected to continue to fall as a share of GDP, to 5.6 % in 2019. In the light of Albania's successful fiscal adjustment under the IMF programme in 2014-2016, the major downside risk regarding the ERP's expenditure targets seems to be the loss of the disciplinary anchor provided by the IMF programme. Another risk is posed by the outcome of the parliamentary elections in June 2017, which might lead to changes in political priorities. On the revenue side, risks stem mainly from the possibility that nominal GDP growth will fall short of the projection. In addition, without further revenue measures, meeting the target of keeping the revenue-to-GDP ratio stable will require sustained efforts to improve revenue collection, for which there is ample scope given the large informal economy.

The ERP's medium-term budgetary projections entail a number of additional risks which have not been fully evaluated in the programme. Apart from risks inherent in the implementation of fiscal discipline under conditions of uncertainty, Albania's budget position may be affected by financial obligations for which the government can ultimately be held responsible. Public guarantees represent one such source of risk, even if they are fully accounted for in the public debt and were reported to amount to 3.6 % of GDP at the end of 2016. There are also continuing fiscal risks associated with the electricity sector, which is expected to start repaying subsidies received in previous years. A further long-standing risk to the budget outlook is posed by the obligation, confirmed by international court rulings, to provide compensation to former owners of property expropriated in the communist era. The budget line dedicated to such compensation payments may be insufficient to cover the totality of eventual claims. There are plans to increase the use of public-private partnerships and concession contracts, which might entail fiscal risks in the form of contingent liabilities for the state budget. However, the ongoing tightening of the government's control of these arrangements, if implemented properly, might mitigate such risks. Finally, there are continuing risks entailed in financial management by local governments; their expenditure represents 3.2 % of GDP in 2017. However, in this area too the central government is in the process of improving public finance management, partly by drafting a new law on local finance.

Box: Debt dynamics

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

Table 4:

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

	2015	2016	2017	2018	2019
Gross debt ratio [1]	**72.7**	**71.0**	**68.9**	**66.3**	**62.8**
Change in the ratio	2.9	-1.7	-2.0	-2.6	-3.5
Contributions [2]:					
1. Primary balance	**1.4**	**-0.7**	**-0.7**	**-1.0**	**-1.8**
2. "Snowball" effect	**0.7**	**-0.8**	**-1.5**	**-1.6**	**-1.7**
Of which:					
Interest expenditure	2.7	2.4	2.6	2.8	2.7
Growth effect	-1.7	-2.4	-2.5	-2.6	-2.6
Inflation effect	-0.2	-0.9	-1.6	-1.7	-1.9
3. Stock-flow	**0.8**	**-0.2**	**0.2**	**0.0**	**0.0**

Notes:

[1] End of period.

[2] The snowball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and

Source: Economic Reform Programme (ERP) 2017, ECFIN calculations

The public debt ratio has started to decline from a high level, but public debt continues to entail risks. At the end of 2016, Albania's public debt (including public guarantees) stood at 71.0 % of GDP.[6] This was 1.5 pps. below the long-term peak at the end of 2015 and was the first decline in the debt ratio in seven years. Almost all of the public debt is owed by central government**.** In a benign interest rate environment, the debt generated interest payments worth 2.4 % of GDP, down from 2.7 % in 2015. Efforts to lengthen the maturity profile of the debt produced some results, but domestic refinancing needs still amount to about 21 % of GDP annually. With a narrow investor base consisting mainly of domestic banks, Albania is vulnerable to changes in market sentiment or host country regulatory requirements that could influence debt holders' willingness to hold Albanian securities. Foreign debt increased slightly to 47.3 % of total public debt in the course of 2016, which represents 33.6 % of GDP. Two thirds of the foreign debt is denominated in euros and most of the remainder in US dollars. The foreign currency debt exposes the government to exchange rate risk, especially to a potential depreciation of the lek against the euro. The envisaged fiscal consolidation is therefore essential to mitigate debt-related vulnerabilities and rebuild room for policy manoeuvre.

The reintroduction of a fiscal rule may support the achievement of debt sustainability over the medium term. Parliament amended the Organic Budget Law in June 2016, reintroducing a fiscal rule which mandates a long-term debt ceiling of 45 % of GDP and annual budget balances that ensure a falling debt ratio until the target is reached. However, the rule does not set a deadline for the target to be reached or require an independent body to monitor compliance. Whether the rule is sufficiently strict to ensure budgetary discipline and medium-term debt sustainability has to be proved in the programme period and beyond. In principle, the rule is likely to be helpful. Among other amendments to improve debt sustainability was the introduction of an annual budgetary

6 On the basis of GDP data released on 3 April 2017, the debt-to-GDP ratio stood at 72.0 % of GDP at the end of 2016.

reserve of 0.7 % of total expenditure to cover risks to public debt from adverse exchange rates and interest rate fluctuations.

4. STRUCTURAL REFORMS

The improvement in the quality of the structural reform part of the ERP compared to last year's programme is limited. The key obstacles to growth and competitiveness are properly identified. The ERP outlines a number of relevant measures to address these obstacles. Most of the proposed measures have been carried over from the previous ERP. In most areas, reform measures have been prioritised in line with the diagnostic section of the ERP and the expected impact on competitiveness is relevant. The Commission's assessment of last year's ERP has been partially taken into account. In many cases the evaluation of the measures' expected outcomes is not realistic enough or is not clearly analysed.

The proposed reform measures cover nine different areas reflecting the overall challenges to the competitiveness of the Albanian economy. The focus is mainly on the area of energy, transport and telecommunications markets with five measures included, while the other sectors are more evenly covered. This is broadly justified by the severity of the problems and/or the sector's potential. There is a good mix of legislative, administrative and infrastructure reforms without overemphasising infrastructure, but rather looking at genuine structural reforms. Contributions from the national budget are planned in most of the measures, showing a strong commitment of the government to the content of the reforms. However, the cost estimates, the respective budget impact and links between sectors and measures given are not comprehensive which makes this element more difficult to assess. Also, the infrastructure-related measures depend on co-financing by international financial institutions or donors, which raises questions about whether they will prove sustainable when maintenance funding is needed.

Further efforts in the implementation of comprehensive structural reforms in key areas such as transport, energy, telecommunications, business environment and education are needed to ensure sustainable economic growth. The business environment remains hampered by regulatory issues, weak contract enforcement and the lack of clarity of land ownership. The quality of education needs to be raised at all levels to better equip people with skills in line with the labour market needs. Last year's policy guidance covered these three areas specifically, but has unfortunately only been implemented partially. Implementation of judicial reform is beyond the scope of the ERP; nevertheless it is a key cross-cutting item needed for significant and sustained improvement of the business environment.

Public finance management

The ambitious public finance management (PFM) reform which the government is implementing could have a positive impact on competitiveness. However, the ERP fails to analyse this impact. The ERP only very briefly points out the constraints to competitiveness in the PFM field. In the ERP, it would be appropriate to select a few measures which could have a positive impact on competitiveness, for example public procurement reform or other measures increasing the efficiency of public spending, such as reform of local finances. The budgetary impact of the PFM reform strategy remains unexplored.

Transport, energy and telecommunications markets

Main obstacles to competitiveness in the transport, energy and telecommunications markets include the lack of efficient rail transport and the inefficient or inadequate capacity and operational structure of maritime infrastructure. The ERP diagnostic recognises this. While the low quality of transport infrastructure can be an impediment to integration in regional and global supply chains, the ERP should focus more on proper structural reform of network markets, i.e. the connectivity reform measures of the connectivity agenda (some of which are ongoing in Albania) in order to contribute most efficiently to improving competitiveness.

Four out of the five measures included in this area are rolled over from the previous ERP and are therefore well covered by the analysis (although less so on diversification/gasification). The two measures in the energy sector are highly relevant, but cover mainly the supply side, while the demand side is discussed less. Energy demand management, including measures to stimulate investment in energy efficiency, can also contribute positively to the competitiveness of the economy and to energy security.

The measure to further liberalise the energy market is needed and is in line with the obligations under the Third Energy Package and Albania's own strategies. However, the assessment of the specific contribution of this measure to competitiveness is weak. The measure is not imbedded in the overall framework of accompanying actions, like strengthening of the regulatory body, demand management, energy efficiency, or the need for price reforms. The price and tariff reform will require further efforts, while bill collection rates have improved significantly.

The measure connecting the country to the international gas network to create conditions for gasification in line with the development of the TAP project will promote energy diversification. The analysis of the state of play and of the challenges to competitiveness in this field is weak. If efficiently implemented, the measure is expected to have a positive impact on competitiveness, but risks should be considered. The measure has not been taken further since last year's ERP and only includes activities in 2017-2018, although the gasification project will go on into 2019 and beyond. The costs of implementing the measures have not been properly accounted for and the list of activities for 2017 seems unrealistic; more information on further plans should be provided.

With regard to transport, the two foreseen measures are in line with the TEN-T core network extension priorities, but do not address regulatory and structural needs related to the connectivity agenda, the so-called connectivity reform measures, which would have a more direct impact on competitiveness. In view of the shortcoming of infrastructure in Albania, the feasibility study for the extension of the Adriatic-Ionian corridor appears appropriate, but the project is at a very preliminary stage and can hardly be considered a structural reform even if it does address a structural need. The expected impact on competitiveness is presented in broad terms without figures for the expected passenger or freight traffic increase. Related issues, like the maintenance budget, have not been discussed.

The measure aiming at rehabilitating and extending the Durres-Airport-Tirana railway will allow the development of intermodal transport, but its estimated competitiveness impact appears over-optimistic. Some of the main risks are outlined, but no mitigating measures are proposed. The adoption of the Railway Law at the beginning of 2017, aiming to align the legislation with the requirements of the EU *acquis*, is an important step encouraging the development of the railway sector as a whole. There was progress in implementing the activities planned for 2016 under the previous ERP, especially the reconstruction of the port of Durres, but delays were reported for many of them.

The telecommunications measure to adopt the legal and regulatory framework for the construction of broadband infrastructure sets out the approach to ensuring broadband development in Albania well. A clear action for the coming two years is presented, without adding activities for 2019. The analysis of its impact on competitiveness goes far beyond the scope of the measure itself, as it can only be considered a very first step towards enabling synergy effects during the construction and roll-out of the physical infrastructure. In 2016, a law on the development of a high-speed electronic communications network was adopted, but the work on the development of spectrum policy continues. The measure is not expected to have any additional budgetary impact, apart from the administrative cost of the public staff involved (covered by the state budget), which is probably true for the legislation part. However, rolling out broadband requires broadband infrastructure investment, maybe even incentives, and this is not taken into account.

Sector development

Agricultural sector development

The small average size of agricultural holdings, low levels of co-operation between farmers, the absence of a comprehensive land register and low levels of investment in the sector are serious obstacles to the development of the sector. The diagnostic section correctly points to these challenges, but fails to flag up other problematic areas such as for instance phytosanitary issues and veterinary capacity. In view of agriculture's significant economic contribution to both GDP and employment in Albania, the consolidation and defragmentation of agricultural holdings remains a major priority, which should allow the development of a more efficient agriculture sector.

The rolled-over measure on consolidation and defragmentation of agricultural land focuses mostly on capacity development and public awareness-raising, without taking into consideration the creation of the technical conditions for the land consolidation process. Progress in its implementation in 2016 was limited to the adoption of the strategy on land consolidation. At the same time, efforts should be made to clarify property rights and develop a comprehensive land cadastre. Adopting a land consolidation strategy is an important step, but could be more ambitious and linked to cadastre development in general. Some risks are described, but others, such as delays due to property rights disputes, should also be considered.

Industry sector development

In general, the industrial sector is weak and exports are concentrated in a few product groups of low sophistication and level of processing. The 2017-2019 ERP is the first programme to examine the development potential of the industrial sector. However, the analysis focuses only on processing of different raw materials available in the country.

The measure introducing a strategy for the development of non-food industry outlines some preparatory actions towards a more strategic policy approach, in particular in the processing industry. The measure consists only of a number of feasibility studies, without a clear objective or impact on competitiveness, which calls its effectiveness into question. The considerable risks and uncertainties on the results of the studies are also not assessed.

Services sector development

The services sector contributes 70% of the gross value added and has an important export potential. The tourism sector in particular has significant development potential, but is impeded by a number of challenges linked to the lack of skills of tourism professionals, low accessibility of tourism services, the absence of a sustainable natural and cultural offer, etc. The ERP diagnostic of the services sector is not sector-wide; however, in terms of tourism development the main challenges are highlighted.

The measure to standardise the tourism sector, if implemented successfully, could be a driving factor for competitiveness. However, it should be implemented in the broader context of other challenges to the sector, like the lack of qualified staff, poor accessibility and unclear land ownership, etc., which may inhibit the development of the sector, in spite of the efforts outlined. More ambitious measures should be considered to keep pace with the steadily increasing popularity of Albania as a tourist destination. Information on the implementation of the measure in 2016 is not presented in Table 12 of the Annex to the ERP. The risks are well described and some mitigating measures, like awareness-raising, financial incentives and capacity-building, are considered.

Business environment and reduction of the informal economy

Insufficient clarity of land ownership, weak contract enforcement, poor access to finance and a large informal economy are the key weaknesses of the business environment. The diagnostic section of the ERP recognises all of these key challenges; in addition, it focuses on the need to further support female entrepreneurs. This gender-sensitive perspective is welcome. More could have been said about the need for significant streamlining of business regulations, including better impact assessments of legislative proposals and better stakeholders' consultations. There is no clear reporting on implementation of the policy guidance from last year on the development of an e-cadastre. Actions to reduce the informal economy are not specified as a measure, but they are described in the programme and should contribute to improving the business environment.

The measure to reduce the regulatory burden on businesses by expanding and improving the activity of the National Business Centre could have a major impact on the business environment and thus on the competitiveness of the economy, but it needs to be implemented in the broader context of tackling the other challenges identified in the sector. The same is true of the measure on improving access to finance by tackling the high number of non-performing loans. Implementation of the relevant reform measures in 2016 went well, in particular with the introduction of the system for e-construction permits, and the adoption of the new bankruptcy law.

Research and innovation

Research and innovation capacities in Albania are very low with no positive effects on the competitiveness of the economy. A policy and specifically an implementation framework for research and innovation is still lacking and is not provided by the ERP. The state of play and the challenges to competitiveness in the Research Development and Innovation (RDI) sector are also not comprehensively examined. The strategic documents quoted are outdated, and it is not clear if they are still relevant. Engaging the Albanian diaspora, increasing funding and a more focused RDI strategy in a number of specific sectors (e.g. in energy, the agri-food sector and sustainable tourism) could improve overall research and innovation capacity. Improving the governance of the R&I policy making process and reforming the public science base to increase quality and impact would also make a big difference.

The implementation of the measure aiming to support the development of innovation policies has been hampered by delays in approving the action plan based on the triple helix model. The plans for the creation of the innovation hub and the incubator for the ICT start-ups are welcome. The capacity development strategy for agencies providing innovation support services should be drafted earlier than in 2019 so that the agencies can start delivering in their policy fields. The cost per activity is stated, but the source of funding is not.

The measure on setting up basic structures for R&I governance addresses an essential weakness, but the activities lack ambition. The proposed budget is limited and the actions remain modest, focusing on developing institutional capacity, rather than implementing specific measures in the field. This means the expected impact on competitiveness is more long-term, which is not sufficient in view of the current challenges. Some risks are identified and devising a strategic framework for the sector is considered as a mitigating measure. The absence of indicators, baselines and statistics makes it very difficult to assess the potential impact of the two measures in this area.

External trade and investment facilitation

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

The trade facilitation measure is highly relevant and in line with national priorities and regional initiatives, such as the connectivity agenda agreed in the Berlin Process and the Central European Free Trade Agreement (CEFTA) Trade Facilitation protocol. It includes references to exchange of information with neighbours through the EU-financed system for the electronic exchange of data (SEED) maintenance project and to the efforts to establish an authorised economic operator (AEO) programme in Albania that is aligned with the EU's *acquis* in this area and that will facilitate trade for Albanian AEO's within the CEFTA region. To have a bigger impact on competitiveness, this measure needs to be combined with efforts to expand the country's industrial base (these are still underdeveloped in ERP) in order to diversify tradable goods.

Setting up a transparent legal framework for investment will be an important step in Albania's effort to attract foreign direct investment. While the measure may contribute to improving investor confidence, the expected impact on increasing investment appears optimistic.

Education and skills

The skills mismatch and a lack of vocational and entrepreneurship skills inhibit competitiveness and social cohesion in Albania. This is recognised by the ERP diagnostic and a number of broadly relevant measures are proposed. The ranking in PISA is low compared to other European countries and the World Bank reports a functional illiteracy rate above 50%. Teacher training is a major issue, partly because most teachers have only secondary education themselves. Furthermore, the lack of cooperation between education institutions and the business sector and employers affects school-to-work transition and timely and accurate adaptation to the labour market needs.

Vocational education and training (VET) is prioritised compared to other components of education, from preschool to higher education. Yet, progress in the field of VET is hindered by the delay in the adoption of the VET Law. Support for basic education is the essential starting point for meaningful reform and a foundation for further education, social and employment prospects. A number of measures implemented under the National Strategy for Employment and Skills can have a positive impact on the quality of VET and increase labour market participation, but the implementation remains weak.

Albania plans to continue with the two measures foreseen already in the 2016 ERP - drafting new competence-based curricula and modernising its VET system. New curricula based on the European Qualifications Framework and teacher training are being implemented for the pre-university education. The measures can help address some of the challenges related to the reform of curricula and a stronger VET system. Sustained, in-depth reforms and investments would be necessary to bring public VET provision in Albania up to the standards. The ERP gives little information on the content of the changes, which prevents the assessment of the relevance of the measure in terms of social and economic outcomes, and none of the measures include monitoring or evaluation mechanisms. The relevance of linkages with the private sector is recognised, but there is no indication of any concrete activities.

Employment and labour markets

High structural unemployment and inactivity remain major labour market challenges in Albania. Progress in linking education with the labour market is slow and the support through active labour market policies (ALMPs) and employment services is insufficient. Half of the registered unemployed only have basic education and their prospects to find regular jobs are minimal. The coverage rate of jobseekers with ALMPs has been very low until now (4.35% in 2016) and training measures are short, which is why - at current funding levels - no sizeable impact on reducing unemployment can be expected.

Low labour market participation particularly affects young people, women and the low-skilled and is linked with widespread informal work. Women have poorer education, employment and social prospects and are over-represented in the agricultural sector and in unpaid family work. The lack of targeted employment measures and weak preschool education further impede their position. Youth unemployment has only started to fall slightly in 2016, but remains at a high 30%, which is significant given the high proportion of youth in the population. Informality remains widespread, particularly in construction and agriculture, the latter being the main employer in the economy. The ERP recognises the challenges, but the design of the proposed measure is weak.

Funding for employment programmes continues to increase, but their outreach remains low. In line with the ERP, some employment programmes have targeted socially vulnerable groups, but the Employment Promotion Law, which should improve the situation, is still awaiting adoption. Similarly, the Law on Crafts was adopted, but the apprenticeship scheme has not been implemented yet.

The implementation of ALMPs and training of employment service staff continue slowly, but the ERP measure covering these activities is weak. Efforts to clear unemployment registers and to modernise employment offices and services are welcome.

However, the budgets and the availability of services are limited. For example, there are no services outside urban centres, which is why a major impact on reducing unemployment cannot be expected. In particular older and the long-term unemployed persons stand little chance of benefiting from any new jobs created due to their low skills. In addition, the vague design of the measures will make them quite difficult to monitor.

Social inclusion, poverty reduction and equal opportunities

Poverty gaps in Albania are influenced by the education structure, geographic location and ethnicity. Labour market vulnerability contributes to aggravating poverty patterns. Unemployed people and workers with low wages are at greater risk of social exclusion. To advance the national agenda on social inclusion and fight against marginalisation and poverty, there is a need for strong commitment to tackle multidimensional aspects of social exclusion and poverty in the country. The diagnostic section of the ERP focuses on the recent efforts of the government rather than identifying the key challenges in the field.

Albania is working to improve outreach and coverage of social protection and has included a measure with this aim in the ERP. The Ministry of Social Welfare and Youth has developed a National Strategy on Social Protection (2015-2020), which aims at providing a holistic approach to social exclusion through establishing a social care system and puts greater emphasis on pinpointing beneficiaries' needs. Yet, its implementation so far has been limited. There is a National Electronic Register for Management of Economic Aid. By 2017, the numerical system is expected to have been introduced in all Albanian municipalities. Successful implementation should increase the efficiency and targeting of cash transfers to beneficiaries, but Albania has not made significant progress so far, as the relevant law was just recently adopted.

Strengthening social protection and social inclusion is better prioritised, but the design of the measure remains weak. Albania lists actions to improve financial assistance schemes, ensuring the sustainability of pensions and extending the national electronic registry to all municipalities by the end of 2017. A stronger design of the measure in terms of prioritising, setting specific targets and action points could contribute to a more comprehensive follow-up on the implementation. The interplay between social assistance and activation needs to be strengthened by extending ALMPs to include social scheme beneficiaries. The measure is relevant and can have a positive social impact if it is properly implemented, which is not guaranteed. The limited capacity of local governments poses a risk to implementation.

ANNEX 1: IMPLEMENTATION OF THE POLICY GUIDANCE ADOPTED AT THE ECONOMIC AND FINANCIAL DIALOGUE IN 2016

2016 policy guidance	Summary assessment
PG 1: Pursue fiscal adjustment by ensuring that revenue and expenditure targets and, by extension, the deficit target, are met. Evaluate and quantify fiscal risks stemming from all active PPP and concession contracts and from local government arrears.	Albania has **partially implemented** PG 1: • The budget deficit was below target in 2016 as a result of a broad-based under-execution of expenditure, while revenue also fell short of the target but to a lesser extent. • In January 2017, a public register of all active PPP projects was launched. It is envisaged to publish summaries of all PPP contracts as well as the contracts themselves. • Amendments passed in June 2016 to the Organic Budget Law (OBL) set a cap on annual budget support for PPPs, integrated PPPs into the budgetary process, and strengthened the MoF's role in their oversight. • MoF estimates local government arrears at 0.7 percent of GDP. The new local government units have developed action plans to gradually clear the arrears. The 2017 budget provides more resources to local governments to support fiscal decentralization. Outright transfers from the budget will be conditioned on the successful clearance of arrears. A draft law on local finances has been prepared that will improve transparency, monitoring, and accountability when adopted. • A new fiscal risk unit at the MoF became fully operational in October 2016. It will periodically monitor and report on fiscal risks related to macroeconomic forecasting; central and local government debt and arrears; central government PPPs; state-owned enterprises and public investments; central government revenue collection; the financial sector; and central government restitution.
PG 2: Underpin fiscal consolidation by improving the fiscal framework; in particular, (i) strengthen medium-term budget plans by empowering the Parliament to approve binding three-year ceilings at programme level and by clearly showing in the MTBP which funds are effectively committed and which are new expenditure under the ceiling; (ii) move decisively towards adopting a fiscal rule which ensures debt sustainability, counter-cyclicality and transparency.	Albania has **substantially implemented** PG 2: • The OBL amendments from June 2016 fully empowered the Parliament to adopt binding medium-term expenditure ceilings at programme level. • Work has started to develop tools and methods for distinguishing existing policies from new policy initiatives in the MTBP. MoF and some line ministries will benefit from technical assistance by SIGMA during the preparation of the MTBP for 2018-2020 in order to better differentiate ongoing and new policy expenditure. The exercise will be extended to comprise all line ministries in the MTBP for 2019-2021. • The OBL amendments re-introduced a fiscal rule which mandates a long-term debt ceiling of 45 % of GDP and annual budget balances that ensure a falling debt ratio until the target is

	reached. However, the rule does not stipulate a deadline for the target to be reached or an independent body to monitor compliance.
PG 3: Continue to address risks to financial stability and the real economy by following-up on the NPL action plan which has been adopted and developing a medium-term strategy to promote the use of the local currency in the financial system, including all relevant stakeholders. Throughout this process, the central bank's monetary policy stance may remain accommodative insofar as the path of fiscal consolidation remains favourable, but risks related to further policy easing should be carefully assessed.	Albania has **partially implemented** PG 3: • The Parliament has adopted a new Bankruptcy Law as well as amendments to the Law on the Registration of Immovable Properties, the Law on Securing Charges, and the Private Bailiffs Law. These laws aim to strengthen the protection of creditors' rights and collateral enforcement. The adoption of several related bylaws is still outstanding. Measures have been adopted to accelerate NPL resolution through the use of out-of-court debt restructuring. • The Bank of Albania has revised its regulatory framework to facilitate the sale of NPLs to specialized non-bank financial vehicles and improve the management of repossessed collateral. The credit registry has been strengthened to contain information on court procedures, loan restructurings and sold loans. • Work has started on the de-euroisation strategy with discussions in the Financial Stability Advisory Group and the preparation of a draft MoU. The MoU identifies the areas where each of the participating institutions should focus its efforts and also contains indicators to facilitate regular monitoring and reporting. In its area of competence, the BoA has identified possible measures to deal with euroisation in the banking sector. The identified measures, affecting both sides of banks' balance sheet, are expected to be implemented gradually.
PG 4: Fully implement the obligations under the Energy Community Treaty including, in particular, the full unbundling of transmission and distribution activities in the electricity and gas sectors in order to improve energy security and allow market entry of independent operators.	Albania has **partially implemented** PG 4: • Legal framework is adopted but not the secondary legislation and the unbundling has not been finalised. • Market entry of independent operators is allowed by law, however, the conditions for supplier switching have yet to be implemented in practice. The applied distribution network tariffs are not fully cost-reflective relative to voltage level. ERE adopted switching rules as a first step in building the switching platform.
PG 5: Strengthen administrative capacities to ensure smooth legal land registration, the full functioning of the cadastre in general and especially the e-cadastre until 2019. Implement the e-procedure for building permits in order to cut red tape and encourage investments.	Albania has **partially implemented** PG 5: • There was limited progress regarding the functioning of the cadastre through the continued process of property registration; no details have been provided in the ERP; • E-procedure for building permits is in place.
PG 6: Increase the coverage of active labour market policies and improve the activation of unemployed and inactive persons, especially youth, women and long-term unemployed. Step up current efforts to achieve a comprehensive approach to reducing	There has been **limited implementation** of PG 6: • ALMPs are supported through sector budget support under the Instrument for Pre-Accession Assistance. Albania has been increasing budgetary allocation for ALMPs, but coverage

undeclared work.	remains very low (4% of all registered unemployed). • There have been some employment programmes implemented targeting socially vulnerable groups but groups vulnerable on the labour market should be prioritised as well. Employment Promotion Law is still pending adoption. The Law on Crafts has been adopted, but the apprenticeship scheme has not been applied yet. Measures to link ALMPs with social protection support are planned, but have not begun to be implemented yet. • No progress has been made in setting up a strategic/comprehensive approach to reducing undeclared work.

Annex 2: Compliance With Programme Requirements

The economic reform programme 2017-2019 was adopted by the government on 25 January 2017 and submitted to the Commission on 31 January, as required. No components of the ERP are missing and its structure largely follows the guidance note provided by the Commission. However, Annex II on external stakeholders′ contributions contains only a summary instead of written contributions.

Interministerial coordination

The programme was jointly coordinated by the Ministry of Economic Development, Trade, Tourism and Entrepreneurship and the Ministry of Finance. All relevant line ministries were involved and contributed to the drafting exercise. However, the programme suffered from changes in staffing and organisation regarding ERP coordination between the two lead institutions. The ERP was adopted by Council of Ministers Decision No 49 of 25 January 2017 *On the adoption of the economic reform programme (ERP) 2017-2019*.

Stakeholder consultation

A public consultation was held at a suboptimal stage of the adoption process, including a meeting on 28 December with a deadline for written contributions of 7 January. Because of the holiday season, stakeholders could not properly influence priority-setting or the content of reforms. Annex 6 gives an overview of the opinions received from a number of stakeholders, but no original written comments are annexed. Parliamentary committees received the ERP for their consideration.

Macroeconomic framework

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

Fiscal framework

The fiscal framework is detailed and well integrated with the policy objectives. It is also consistent with the macroeconomic framework. Data on the implementation of the 2016 budget cover the first 11 months of the year — an improvement from the previous ERP, which covered only the first 9 months. The factors behind projected revenues are presented clearly, including the expected fiscal impact of economic growth, discretionary measures and better tax administration. However, there is scope for a better description of the planned expenditure measures and their anticipated budgetary impact. Forward-looking plans for debt management are less detailed than in 2016. Fiscal data do not meet ESA2010 requirements as regards the delimitation of general government, the distinction between financial and non-financial transactions, or the recording of accruals. Since November 2014, Albania has submitted regular excessive deficit procedure notifications to Eurostat on a best-effort basis and is expected to gradually align its fiscal statistics with EU requirements.

Structural reforms

The structural reforms sections (4, 5 and 6) broadly follow the guidance note. Section 4 and Table 12 in the Annex give an adequate but not complete overview of the implementation of the structural reform measures from the ERP 2016-2018. The total number of reform measures is limited to 19 and the page limit (40 pages) for section 4 has been met. The overall structure of the reform measures is in line with the guidance note; however, some measures would have benefited from a more comprehensive diagnostic, a more targeted and ambitious approach or a more forward-looking timeline. The description of the impact on competitiveness is not always based on rigorous analysis and baselines and indicators are missing. The quality of estimates of costs and budgetary impact varies greatly across different measures and in general leaves a lot of room for improvement. The identification of risks and mitigating measures is generally underdeveloped. The tables on budgetary impact and on implementation of ERP 2016-2018 measures have only partially been completed.