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COMMISSION STAFF WORKING DOCUMENT

ECONOMIC REFORM PROGRAMME

OF

ALBANIA
(2024-2026)

COMMISSION ASSESSMENT

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1. EXECUTIVE SUMMARY

Following 2 years of strong economic expansion, Albania's real GDP growth moderated but exceeded expectations in 2023, and the economic reform programme (ERP) projects growth to gather pace in 2024-2026. Helped by exceptional performance in the tourism sector and rising investments, the economy expanded by 3.4% in 2023. The labour market registered positive developments with increases in employment and wages, which supported consumption. Helped by the tourism boom, the current account deficit continued to decrease to historically low levels. The ERP projects economic growth to accelerate from 3.7% in 2024 to 4% in 2026 on the back of increasing domestic demand and rising exports led by a further expansion of tourism. Net exports are expected to contribute positively to GDP growth, which might be somewhat optimistic as rising domestic demand might boost imports more than forecast; while the external environment remains challenging with subdued growth in the EU economy. Inflation declined on the back of external factors and also due to the central bank tightening its policy stance. The ERP expects inflation to already meet the 3% target in 2024. A higher labour force participation rate is expected to be the main driver of labour supply growth, while the unemployment rate is projected to decrease gradually to 9.5% in 2026.

Albania's fiscal position improved in 2023, and the ERP aims to continue realising surpluses in the primary balance in the medium term. In 2023, the budget deficit narrowed to 1.4% of GDP, better than expected on the back of strong revenue growth but also due to lower than planned execution of public investments. The primary balance turned positive. The ERP projects the budget deficit to widen to 2.5% of GDP in 2024 on the back of higher spending on public wages, social insurance and interest costs. However, the primary balance is projected to remain in surplus, in line with the fiscal rule. In 2025-2026, a lower expenditure-to-GDP ratio is projected to lower the budget deficit to just above 2% of GDP and further increase the primary surplus. The government debt ratio fell by more than expected in 2023, reflecting a positive primary balance and favorable snowball effect. It is projected to continue its downward path in future, but at a more moderate pace.

The main challenges facing Albania are the following:

- **While revenues as a share of GDP increased in 2023, the ratio remains low compared to other countries in the region.** After a 1 percentage point (pp.) increase in 2023, the ERP projects public revenues to remain constant at 27.8% of GDP over 2024-2026 and tax revenue to increase marginally. The planned fiscal consolidation is important in the face of elevated financing needs and should be better underpinned by increasing the tax revenue ratio, including by implementing an updated medium-term revenue strategy. A higher tax revenue ratio is crucial for supporting investments in both physical and human capital, and for firmly anchoring the downward trend of public debt. There is also scope for increasing the effectiveness of budget spending by continuing to reform public investment management, including public-private partnerships (PPPs).

- **Fiscal risks continue to stem from arrears and state-owned enterprises (SOEs), particulary in the energy sector.** Arrears continued to accumulate throughout 2023 (1.2% of total expenditure at the end of the year). Reducing their stock and preventing their re-emergence remains a challenge. Contingent liabilities stem from SOEs, PPPs and ongoing court cases. The state-owned energy utilities are reliant on government support either via guarantees or loans, which is a source of fiscal risks. Increased transparency and higher managerial accountability would increase SOEs' fiscal performance and, in turn, reduce their reliance on budget support. While the Ministry of Finance has stepped up fiscal risk monitoring, further progress in this area remains important.

- **Other key challenges are linked to addressing the informal economy, labour shortages and skills, and improving connectivity and energy security.** Informality remains widespread, while the business environment needs further improvements. Informality impacts many sides of the Albanian economy, affecting the business climate and fair competition as well as reducing the tax base and hindering economic growth overall. Given its pervasiveness, tackling informality requires a multifaceted approach. Furthermore, fighting informality and improving the business environment should help stem the tide of emigration. Steady emigration flows over the past few years are shrinking the workforce. While the labour market registered positive developments with increases in employment and wages, the continued brain drain and labour shortages pose issues. Albania has a very high rate of low-skilled adults and high rates of early school leaving. Furthermore, it needs to address the infrastructure gaps and improve connectivity. The energy sector is volatile, with hydro-electricity production dependent on rainfall and reliant on budget support. These challenges are expected to be addressed through key structural reforms identified in the country's reform agenda under the new Growth Plan for the Western Balkans.

Implementation of the policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2023 has been partial. Fiscal consolidation accelerated and a positive primary balance was achieved, as envisaged. Two budget revisions have been undertaken via normative acts, which is not in line with the policy guidance. The end-of-year target for the stock of arrears was achieved (because of budget amendments that reallocated spending for arrears clearance), but throughout 2023 arrears continued to accumulate above the quarterly targets. To increase tax revenues, a new law on income tax was adopted. Albania established a national single project pipeline, but PPPs still need to be integrated into it. Expenditure on education, health and social protection increased in nominal terms while the methodology for data collection and processing on public expenses dedicated to R&D was not finalised. The Bank of Albania continued tightening monetary policy, while the regulation on collecting data from banks on their exposures to the real estate sector has entered into force. The Albanian power exchange ALPEX went live in April 2023, and a new law on renewables was adopted. The piloting of the Youth Guarantee scheme was launched in October 2023 in three regions (Tirana, Shkodra and Vlora). An indexation mechanism of the economic aid scheme still needs to be put in place.

2. ECONOMIC OUTLOOK AND RISKS

Albania's economic growth was robust in 2023, exceeding the projections of the previous ERP. The economy grew by 3.3% year-on-year in the first three quarters of 2023, and by an estimated 3.4% in the year as a whole, undepinned by strong domestic demand and exceptional performance by the tourism sector, which reached new heights with over 10 million foreign arrivals in 2023 (which is well above the pre-pandemic level). Consumption, investments and net exports all made positive contributions to growth. Public consumption growth was supported by higher wages in the public sector (due to public sector wage reform). Private consumption grew slower than in the previous year, while investment witnessed a substantial increase, spurred by private investments. Exports have been supported by a surge in service exports, which offset the decline in goods exports. On the production side, services and construction were the main drivers of growth, while the industrial sector suffered somewhat in 2023 due to a mix of factors, including the appreciation of the exchange rate. While the real GDP growth rate moderated in 2023 compared to 2022, it exceeded expectations and the projections of the previous ERP.

The ERP projects GDP growth to accelerate to 3.7% in 2024 and increase to almost 4% in 2025-2026. In the baseline scenario, domestic demand is expected to be the key driver of growth, with positive contributions from private and public consumption as well as investments. Further support for GDP growth is projected to come from net exports, mainly tourism services. Exports of goods and services are forecast to have robust performance, with average real growth of 5.2% per year in 2024-2026, while imports of goods and services are projected to expand at a slower pace (3.7% on average). Investments are expected to continue growing but at slower pace in 2024-2025, before accelerating in 2026. Their GDP growth contribution is projected to average 0.8 percentage points (pps) per year. From the supply side, all major economic sectors are expected to expand. Employment is expected to rise by an average of 0.3% per year in 2024-2026, gradually reducing the unemployment rate to 9.5% in 2026. A higher labour force participation rate is expected to remain the main driver of labour supply, given the shrinking population (caused by high emigration and low fertility rates). The ERP estimates a zero output gap in 2024 and a slightly negative output gap (-0.1%) in 2025-2026. The plan contains an alternative downside scenario, which assumes that real GDP growth is 1.5 pps lower each year compared to the baseline projections.

The baseline GDP growth scenario is subject to external and domestic risks, with projections for net exports on the optimistic side. Compared to the previous year, the ERP revises GDP growth downwards by 0.1 pps for 2024, while the estimated growth for 2025 remains unchanged. Nevertheless, the baseline scenario for 2024 is more positive than the Commission's autumn forecast and above international ones. The divergence narrows for 2025, and the estimates are broadly in line. The key difference for both years stems from net exports' contributions to growth, which exceed historical averages in the ERP. In the Commission forecast, net exports are projected to subtract from GDP growth mainly because of decreasing goods exports, which are affected by large currency appreciation, base effects and falling external demand for construction materials. Furthermore, the external environment is challenging, with increased uncertainty amid geopolitical tensions and subdued growth in the EU economy. The ERP baseline scenario also assumes a deceleration in import growth over 2024-2026, which may turn out to be more modest than expected given the projected consumption and investment dynamics.[1] This in turn may lead to smaller than expected net exports. On the production side, the ERP expects the contribution of agriculture, forestry and fishing to growth to exceed

[1] The ERP does not provide details on the impact of disposable income growth and tourism growth on imports of goods and services.

historical averages (following an insignificant contribution in 2023), although it fails to present the underlying factors. When presenting the downside scenario, the ERP mentions domestic and external risks: negative developments linked to the lending to the economy, eurozone economic performance with subsequent effects on exports of goods and services, remittances, various foreign capital flows, changes in exchange rates and interest rates, and slower implementation of planned structural reforms.

Table 1:

Albania - comparison of macroeconomic developments and forecasts

	2022		2023		2024		2025		2026	
	COM	**ERP**	COM	**ERP**	COM	**ERP**	COM	**ERP**	COM	**ERP**
Real GDP (% change)	4.8	**4.9**	3.5	**3.5**	3.1	**3.7**	3.7	**3.9**	n.a.	**4.0**
Contributions:										
- final domestic demand	6.5	**6.5**	4.3	**3.2**	3.3	**3.5**	3.8	**3.6**	n.a.	**4.0**
- change in inventories	1.8	**1.9**	0.0	**0.0**	0.0	**0.0**	0.0	**0.0**	n.a.	**0.0**
- external balance of goods and services	-3.5	**-3.5**	-0.8	**0.2**	-0.2	**0.3**	-0.1	**0.3**	n.a.	**0.1**
Employment (% change)	4.8	**4.8**	2.4	**2.4**	1.8	**0.5**	2.0	**0.3**	n.a.	**0.2**
Unemployment rate (%)	11.3	**11.3**	10.5	**10.6**	10.2	**10.2**	9.9	**9.8**	n.a.	**9.5**
GDP deflator (% change)	9.7	**9.9**	6.2	**4.5**	3.1	**1.5**	2.8	**1.1**	n.a.	**1.1**
CPI inflation (%)	6.7	**6.7**	4.6	**4.8**	3.5	**3.0**	2.9	**3.0**	n.a.	**3.0**
Current account balance (% of GDP)	-6.0	**-6.0**	-4.9	**-4.7**	-5.1	**-4.8**	-4.9	**-4.5**	n.a.	**-4.3**
General government balance (% of GDP)	-3.7	**-3.7**	-2.2	**-2.2**	-2.2	**-2.5**	-2.3	**-2.1**	n.a.	**-2.1**
Government gross debt (% of GDP)	64.6	**64.5**	62.5	**61.5**	61.2	**59.8**	60.9	**59.3**	n.a.	**58.9**

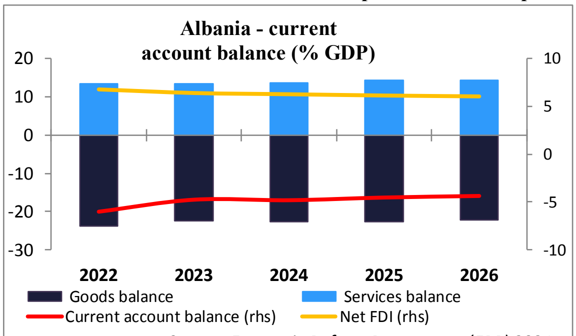
Sources: Economic Reform Programme (ERP) 2024, Commission Autumn 2023 forecast.

Inflation eased in 2023 and is projected to decline further in 2024-2026. The average annual inflation rate eased from 6.7% in 2022 to 4.8% in 2023. Inflationary pressures have receded on the back of falling energy and food prices in international markets as well as the sizeable appreciation of the domestic currency (10.6% year-on-year in December 2023 against the euro), which helped cushion the impact of foreign price pressures. Domestic inflationary pressures have remained elevated in the second half of 2023 as a result of expanding domestic demand, tight labour market and increased production costs due to higher wages, with the latter also boosted by sizeable public sector wage increases. The Bank of Albania continued tightening its monetary policy stance in order to anchor inflation expectations and lower inflation. The main policy rate was raised in 2 steps in 2023: to 3% in March, and further to 3.25% in November 2023. The ERP expects inflation to gradually decline towards the Bank of Albania's target of 3% in 2024. Inflation is projected to remain on a downward path on the back of moderated foreign inflationary pressures, currency appreciation, monetary tightening and a decreasing trend of medium-term inflation expectations. Recent price developments were benign, with inflation already falling below the target in February 2024 (2.6%). However, domestic price pressures may resurface.

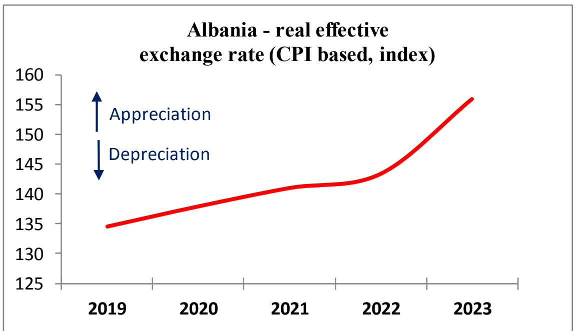
The current account deficit continued to decrease in 2023, and the ERP projects further improvements in the coming years. In the first three quarters of 2023, the current account posted a surplus, outperforming the results of the same period in the previous year. Performance in the fourth quarter was weaker, with the full-year balance turning negative. Nevertheless, reflecting higher inflows from tourism and remittances, the overall 2023 current account deficit is expected to be at a historically low level (4.7% of GDP according to the ERP), continuing the positive trend of recent years. After a small increase in 2024, the current account deficit is projected to follow a downward path from 4.8% of GDP in 2024 to 4.3% of GDP in 2026. This improvement is based on an increasing services surplus led by tourism-related services, and a slight narrowing of the goods trade deficit (as a share of GDP). Overall, the current account developments are more optimistic than in last year's ERP, which assumed higher current account deficits for both 2024 and 2025 (5.6% of GDP and 5.1% of GDP respectively). The difference in the scenarios is driven by this year ERP's higher assumed surpluses in the services balance and narrower deficits in the trade balance (both as a share of GDP).

Net foreign direct investment (FDI) inflows are set to decrease somewhat as a share of GDP, but still fully cover the current account deficit in 2024-2026. Net FDI increased by 6.8% year-on-year in January-September 2023, whereas gross FDI inflows increased by 10.6%. The financial sector was the main contributor to FDI growth in those three quarters. Portfolio investment flows reflected a growth in liabilities of non-residents, namely in the second quarter of 2023 when a Eurobond was issued. As a share of GDP, net FDI decreased from 6.7% in 2022 to 5.9% in 2023, and is expected to gradually decline to 6% of GDP in 2026. Generally, FDI inflows are linked to the construction sector and tourism-related investment projects. As tourism is expected to continue expanding in the medium term, capital inflows are set to remain steady. FDI inflows are projected to cover the current account deficit in 2024-2026. Albania's net international investment position was negative at -45.4% of GDP in 2023, narrowing from -49.5% of GDP in 2022. External debt is estimated to have dropped to about 47.7% of GDP in 2023 on the back of nominal GDP growth and the appreciation of the lek against the euro. The Bank of Albania's risk analysis shows that the external debt ratio is sensitive to currency depreciation and to rising interest rates. These risks are mitigated by ample international reserves, which came to EUR 5.8 billion (or about 28% of GDP) at the end of 2023, 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) 2024.



Source: Economic Reform Programme (ERP) 2024.

Banking sector capitalisation remains above the regulatory minimum, while profitability improved significantly. At the same time, vulnerabilities are linked to credit risk, the sovereign-bank nexus and cybersecurity risks. At aggregate level, banks had a capital adequacy ratio of 19.4% in December 2023, which is well above the Albanian minimum requirement of 12%. Banks' profitability improved significantly in 2023 driven by higher net interest income. The return on assets came to 2.2% in December 2023, up from 1.4% a year earlier, while the return to equity increased to 17.3% from 12.3%. On the back of rising interest rates and given the high share of variable rate loans (about 75% of the banks' loan portfolio), credit risks need to be closely monitored. As a mitigating factor, the appreciation of the lek supported strong performance in foreign debt repayments, offsetting the effect of interest rate rises. The ratio of non-performing loans to total loans (NPL ratio) declined from 5% in 2022 to

4.7% at the end of 2023 – the lowest level recorded since the beginning of the global financial crisis in 2008. Another source of vulnerability is banks' exposure to sovereign risk given the high share of government securities among their assets. The increase in the stock of loans decelerated in 2023 mainly due to an exchange rate-driven contraction in foreign currency loans. Credit growth in lek accelerated strongly (driven by real estate loans and mortgage loans). Foreign deposits grew in the banking sector, partly reflecting high inflows from tourism and FDI. The Bank of Albania continued to work on strengthening the bank resolution framework. Furthermore, to monitor banks' exposures to the real estate sector, the Bank of Albania approved an act in October 2023 that regulates data reporting from the banking sector [2]. Overall, within the financial system the banking sector continues to dominate, with almost 91% of total assets.

[2] From 2024, banks will report on a quarterly basis on lending for residential housing, and annually on exposures to commercial real estate.

Table 2:

Albania - financial sector indicators

	2019	2020	2021	2022	2023
Total assets of the banking system (EUR million)	12 380	13 156	14 980	16 426	19 427
Foreign ownership of banking system (%) *	78.4	69.4	68.8	66.2	64.7**
Credit growth (%, average)	3.0	6.1	6.9	11.2	2.6
Deposit growth (%, average)	2.5	5.8	8.5	8.0	1.9
Loan-to-deposit ratio (end of period)	55.6	54.7	54.8	56.1	56.5
Financial soundness indicators (%, end of period)					
- non-performing loans to total loans	8.4	8.1	5.7	5.0	4.7
- regulatory capital to risk-weighted assets	18.3	18.3	18.0	18.1	19.4
- liquid assets to total assets	15.1	13.6	13.3	11.0	30.1
- return on equity	13.5	10.7	12.9	12.3	17.3
- foreign exchange loans to total loans	50.1	48.5	48.8	49.3	44.2

* foreign equity ownership of total banks' equity.

** September 2023, latest month reporting data.

Sources: Economic Reform Programme (ERP) 2024, IMF, Bank of Albania.

3. PUBLIC FINANCE

Fiscal performance improved in 2023, with the budget deficit falling to 1.4% of GDP. The deficit was lower than in 2022 (3.7% of GDP), reflecting a better performance of government revenues, a higher GDP denominator and a small increase in expenditures. According to budget implementation data, budgetary revenues increased by 12.3% in 2023, driven by strong tax revenue growth (10.6% year-on-year). All tax categories registered increases except national taxes. Profit tax and personal income tax saw exceptional rises of 35.4% and 28.7% respectively, while VAT revenues were only slightly above the previous year's level (0.5% increase). This is because the strong appreciation of the lek reduced the VAT calculation base for imported goods, which in turn dampened revenues from VAT on imports. Total expenditures increased by much less than total revenues (3.6%). Spending on wages increased significantly, by 19.2%, on the back of public wage reform [3]. Interest expenditures jumped by 20.1%, while capital expenditures registered subdued growth of only 6% [4]. Overall, total revenues as a share of GDP were up from 26.8% in 2022 to 27.8% in 2023. The revenue ratio was slightly lower than what the ERP projected [5] (28% in 2023). Total expenditure as a share of GDP was also lower than expected, at 29.2% (down from 30.4% in 2022).

The 2023 fiscal outturn was better than planned in the revised budget, but mainly on the back of lower public investments. In 2023, the government introduced two

[3] Public sector reform aims to increase public sector wages in several phases, starting in 2023. The salary increase policy will cost the state budget ALL 39.1 billion, an effect that will be fully felt from 2025 onwards.

[4] Capital expenditures represent 17.6% of total expenditures, while current expenditures make up 81% of total expenditures.

[5] The budget law requires Albania to use a projected nominal GDP not higher than the latest available IMF forecast for fiscal purposes. The ERP expected nominal GDP to be ALL 2311.7 billion in 2023, some 6.2% higher than the original estimate used for the budget preparation (of ALL 2176.1 billion).

budget amendments outside of the regular revision process (facilitated through normative acts) that were not triggered by unexpected events. The initial budget revision took place in October 2023. It involved the reallocation of unexecuted capital expenditure funds between programmes and clearing a large part of the arrears stock. The second revision in mid-December introduced a number of changes but kept the budget deficit unchanged from the original target, at 2.4% of GDP [6]. The fiscal outturn was better than expected, with a budget deficit of 1.4% of GDP and a primary surplus of 0.7% of GDP. Total revenues came to 99% of planned budget revenues, while the execution rate of total spending was 96% of the annual plan. Nevertheless, the overall better performance reflects under-execution in capital expenditures [7].

While fiscal consolidation remains a priority, the ERP projects a widening budget deficit in 2024, followed by an improvement in 2025-2026. Following exceptional increases in revenues in the last 2 years, the ERP projects public revenues as a share of GDP to remain constant at 27.8% over 2024-2026, with a gradually increasing tax revenue ratio (0.1-0.2 pps of GDP per year) offset by falling non-tax revenues and grants as a share of GDP. VAT revenues, personal income tax, excise tax and profit tax are key categories of budget revenues, accounting for about 59% of total revenues in 2024-2026. They are all expected to remain stable as a share of GDP over 2024-2026, at 8.7%, 2.7%, 2.6% and 2.2% of GDP respectively. Social and health contributions are set to remain flat at 6.5% of GDP for this period, and at 23% of total revenues. On government spending, the ERP projects total expenditures as a share of GDP to increase marginally to 30.3% in 2024, while in 2025-2026 they are projected to fall to 29.8% and to 29.9% respectively, underpinning the improvement in the budget balance over 2025-2026. In particular, the narrowing of the deficit from 2.5% in 2024 to 2.1% in 2025-2026 is mainly driven by a decrease in capital expenditure (by 0.5 pps of GDP) and lower spending on operations and maintenance as a share of GDP. The primary balance is forecast to be positive in 2024 (in line with the fiscal rule) and increase gradually over 2025-2026. While this path is in line with last year's programme, the primary balance projections are lower than in the previous ERP. The general government debt ratio is expected to decline gradually from 59.8% of GDP in 2024 to 58.9% in 2026.

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[6] In particular, the amended budget reallocated unspent funds of around 0.9% of GDP (ALL 20 billion). It provided support to vulnerable people; it distributed unconditional grants to municipalities (0.1% of GDP or nominally ALL 2 billion) to pay off arrears and it allocated ALL 250 million to 1144 public employees involved in the EU screening and negotiation process.

[7] At the end of 2023, the execution rate of capital expenditures was 88%. In November 2023, the execution rate of capital expenditures was even lower at 54%, while current expenditures had an execution rate of 87%. The overall underspending prompted a budget revision in mid-December, which facilitated reallocations.

Table 3:

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

	2022	2023	2024	2025	2026	Change: 2023-26
Revenues	26.8	28.0	27.8	27.8	27.8	-0.2
- Taxes and social security contributions	22.2	23.0	23.2	23.4	23.5	0.5
- Other (residual)	4.6	5.0	4.6	4.4	4.3	-0.7
Expenditure	30.4	30.2	30.3	29.8	29.9	-0.3
- Primary expenditure*	28.6	28.0	27.6	27.0	26.9	-1.1
of which:						
Gross fixed capital formation	6.2	6.8	6.3	5.8	5.7	-1.1
Consumption	8.3	8.6	8.9	8.7	8.7	0.2
Transfers & subsidies	11.6	11.1	11.6	11.6	11.5	0.4
Other (residual)	2.5	1.5	0.8	0.9	0.9	-0.5
- Interest payments	1.9	2.2	2.7	2.8	3.1	0.9
Budget balance	-3.7	-2.2	-2.5	-2.1	-2.1	0.1
- Cyclically adjusted	-3.8	-2.3	-2.5	-2.0	-2.1	0.2
Primary balance	-1.8	0.0	0.2	0.8	0.9	0.9
- Cyclically adjusted	-2.0	-0.1	0.2	0.8	1.0	1.0
Gross debt level	64.5	61.5	59.8	59.3	58.9	-2.5

* Excluding arrears clearance.

Sources: Economic Reform Programme (ERP) 2024, Commission calculations.

The 2024 budget targeted a primary surplus of 0.2% of GDP, while the revised budget commits Albania to slightly better performance with a 0.4% surplus. The budget plan aims to increase tax revenues (including social contributions) by about 6%, or as a share of GDP by 0.2 pps compared to 2023 budgeted figures. The ERP [8] states that the projected revenues from taxes, customs and insurance contributions take into account the effects of economic growth, new fiscal policies as well as the effects of improving the tax and customs administration. This is accompanied by legal changes that aim to increase the level of voluntary compliance of taxpayers with the law. All main categories (except profit tax and property tax) were projected to increase compared to the 2023 budgeted figures: a 5.6% increase in VAT revenues, 7.8% in excise tax, 16.4% in personal income tax, 8% in national taxes and other taxes, 2.5% in customs tax and 9.2% in social and health insurance contributions. The substantial increase in personal income tax revenues is mainly driven by the wage reform in the public sector, the increase in the number of employees and higher average salaries in the private sector.[9] Nevertheless, total revenue as a share of GDP was set to remain unchanged compared to the 2023 outcome at 27.8% as the small increase in the tax revenue is offset by a fall in grant revenue compared to 2023 when the one-off EU energy budget support was disbursed. In the budget, total expenditure was planned at 30.3% of GDP in 2024, which is 1.1 pps higher than the 2023 outcome. This rise is driven by personal expenditures that were set to increase by 0.6 pps to 4.9% of GDP. This reflects the second phase of the public sector

[8] The ERP figures were in line with the budget plan adopted in December 2023.

[9] Other relevant factors specified to be taken into account for the projected increase in the personal income tax are: i) increase in income from tax on dividends, tax on leasing, tax on professional services; ii) increase in income from the inclusion in the scheme of taxing income from tourism and accommodation of entities that are not registered and declared as accommodation units.

wage increase planned in July 2024, and driven by interest payments that were projected to reach 2.7% of GDP (from 2.1% of GDP in 2023), including a reserve to mitigate potential risks from interest rate and exchange rate fluctuations. Capital spending was planned at 5.3% of GDP, which is in line with the level of capital expenditure realised in 2023. Overall, the original 2024 budget targeted a deficit of 2.5% of GDP, while the primary balance was set to reach a small surplus of 0.2% of GDP. Nevertheless, the budget was revised in February 2024 via a normative act, increasing the level of ambition with respect to the surplus of the primary balance, which is now set to reach 0.4% of GDP, while the revised deficit target is slightly lower at 2.4%.[10]

The 2024 budget and the revised budget

* On 7 December 2023, Parliament adopted the 2024 budget law, targeting a deficit of 2.5% of projected GDP and a positive primary balance of 0.2% of GDP.
* On 21 February 2024, the Council of Ministers approved a normative act amending the 2024 budget. The revised budget targets a slightly lower budget deficit of 2.4% of projected GDP and a slightly higher primary balance surplus of 0.4% of GDP.
* Revenues for 2024 were revised upwards, to about ALL 687 billion or 28.2% of GDP (from 27.8% in the original budget), while total expenditures were also revised upwards but the increase was smaller, to ALL 744 billion or 30.6% of GDP (from 30.3% in the original budget).
* The normative act also included a new State Guarantee Instrument of ALL 4 billion to support the Cut, Make & Trim garment industry, which was affected by exchange rate strengthening. This instrument helps businesses secure the necessary financing from banks via state guarantees.

Table: Main measures in the budget for 2024

Revenue measures*	Expenditure measures**
• Taxation on self-employed professionals, excises indexation, increasing of excise duty for cigarettes, gambling law *(overall estimated impact: ALL 7 billion, or 0.3% of GDP)*	• Salary increase for employees in health, education and public administration *(estimated impact: ALL 11 bn, or 0.5% of GDP, permanent measure)*

* Estimated impact on general government revenues.
** Estimated impact on general government expenditure.

Source: ERP

[10] The early budget revision was motivated by the need to allocate funds for the newly established ministries, such as the Ministry of Economy, Culture, and Innovation. The upward revision in tax revenues reflects the better-than-expected performance of these revenues up to the point of the revision, leading to higher annual revenue forecast for 2024 compared to the autumn projections underlying the original budget, the macro-fiscal framework, and the ERP.

General government debt fell by more than expected in 2023 and is projected to continue its downward path, but at a much slower pace. On the back of a primary balance surplus and high nominal GDP growth in 2023, the public debt ratio fell by 5.3 pps to 59.2% of GDP in 2023, which is below the ERP projection of 61.5%. Furthermore, general government debt also decreased slightly in nominal terms (from ALL 1378 billion in 2022 to ALL 1369 billion in 2023). Domestic debt accounts for about 54% of the total debt stock, while foreign debt amounts to 46% (September 2023). Assuming a higher initial level at the end of 2023, the ERP projected the public debt ratio to decrease by a cumulative 2.5 pps in 2024-2026, reaching 58.9% of GDP at the end of 2026. Guaranteed debt, which is fully accounted for in the public debt stock, decreased from 2.4% of GDP in 2022 to 1.8% of GDP in 2023.

The public debt maturity structure improved slightly in 2023, but risks linked to refinancing short-term debt and interest rates remain. Short term debt – with maturity of less than 1 year – decreased slightly in 2023 but remains elevated at about 17% of total debt. Furthermore, within the domestic debt stock, the share of debt maturing within 1 year is about 32%, while the share of debt falling due within 5 years is 36%. In this context, the tightening of financing conditions and the shallow domestic market for government securities pose risks. Meanwhile, foreign debt consists mainly of long-term loans and long-term bonds (5-, 7- and 10-year Eurobonds issued in international markets). While this mitigates refinancing risks, external debt poses exchange rate risk. 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 as a reserve to offset the fiscal impact of exchange rate fluctuations. In June 2023, Albania tapped international markets and issued its sixth Eurobond worth EUR 600 million, with a 5-year maturity, 5.9% coupon and a primary yield of 6.125%. The bond generated strong demand with an order book of over EUR 1.3 billion. The bond's proceeds will be used to cover part of the government's financing needs in 2023 and 2024, which remain elevated. The cost of debt increased on the back of rising interest rates. In particular, the average cost for domestic debt reached 4.62% at the end of September 2023, increasing by 57 basis points compared to the end of 2022. As regards the foreign debt portfolio, due to the increase in international market interest rates, the average cost was expected to be 3.4% in 2023, increasing by 100 basis points compared to the end of 2022.

Albania Composition of changes in the debt ratio (% of GDP)	2022	2023	2024	2025	2026
Gross debt ratio [1]	64.5	61.5	59.8	59.3	58.9
Change in the ratio	-10.0	-3.0	-1.7	-0.5	-0.4
Contributions [2]:					
1. Primary balance	**1.8**	**0.0**	**-0.2**	**-0.8**	**-0.9**
2. 'Snowball effect'	**-7.7**	**-2.5**	**-0.3**	**0.0**	**0.2**
Of which:					
Interest expenditure	1.9	2.2	2.7	2.8	3.1
Growth effect	-3.1	-2.1	-2.2	-2.2	-2.3
Inflation effect	-6.4	-2.7	-0.9	-0.6	-0.6
3. Stock-flow adjustment	**-4.2**	**-0.5**	**-1.2**	**0.3**	**0.4**

[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) 2024, Commission calculations.

Debt dynamics

The debt ratio fell in 2023, driven by a strong snowball effect due to still high inflation and robust GDP growth. Furthermore, a negative stock flow adjustment related to the use of cash reserves helped reduce the debt stock. In future, primary surpluses are set to support a continued reduction in the debt ratio, while the snowball effect is expected to moderate as inflation abates and interest costs rise. The table is based on the values provided in the ERP. However, due to the much larger than expected debt reduction in 2023, the debt path is expected to shift to a lower level.

Fiscal risks stem from public guarantees to state-owned enterprises (SOEs) such as hydroelectricity providers, from onlending and from arrears. Over 75% of the state guarantee stock belongs to the energy sector. The state-owned energy utilities' dependence on regular government support (either guarantees or loans) is a source of fiscal risks. While public guarantees to SOEs are fully included in the stock of public debt at the date of issuance – an approach that mitigates risks to the budget – this has implications for government debt.[11] Budgetary support to energy SOEs increased in 2022 as adverse weather conditions caused a decline in domestic electricity production and import costs surged. Albania's reliance on hydropower exposes it to fluctuations in rainfall and to increasing climate risks for which mitigation measures still need to be developed. The governance system of SOEs has gaps with respect to international standards, reflected also in the weak financial viability of some of these companies.[12] Better transparency[13] and greater managerial accountability would increase the financial performance of SOEs and in turn reduce their reliance on budget support. [14] The government also faces fiscal risks from on-lending as a result of gaps in its risk assessment. The recurring accumulation of public sector arrears remains a challenge. Despite reductions in the overall stock, arrears persist, particularly related to investment projects and court cases. Meanwhile, there are also contingent liabilities related to PPPs,

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[11] As such, public debt increases with the issuance of public guarantees.

[12] In line with OECD findings. See Competitiveness Outlook 2024 (forthcoming).

[13] There is limited transparency with respect to the financial performance of SOEs. Furthermore, SOEs benefit from direct subsidies from their line ministries, with limited transparency regarding what activities these subsidies are expected to finance.

[14] Currently there is no central overview of the state's portfolio of SOEs, with information on their size, employment or financial returns.

but they are not measured in a comprehensive manner and as such are neither properly assessed nor adequately monitored.

Sensitivity analysis

The ERP presents the dynamics of fiscal key indicators over 2024-2026 under three different scenarios: baseline, optimistic and pessimistic.

The alternative scenarios are constructed with varied economic growth assumptions for each year. In particular, the real GDP growth rates that underpin the optimistic and pessimistic scenarios deviate by +0.5 pps and -1.5 pps respectively from the baseline growth scenario of 3.7% in 2024 and its average rate of 3.9% in 2025-2026.

In the optimistic scenario, total revenues as a share of GDP are identical to the baseline scenario. Capital spending as a share of GDP is expected to remain very close to the baseline (0.1-0.2 pps higher than the baseline), while current spending as a share of GDP is gradually being reduced (ultimately 0.5 pps lower than in the baseline in 2026). The fiscal deficit is smaller in the optimistic scenario only in 2025 and 2026. The ERP explains that generally, there is an expectation of a more robust fiscal consolidation in the optimistic scenario and a fiscal deficit relaxation in the pessimistic scenario, reflecting a countercyclical response to different assumed dynamics of the economic cycle.

Nevertheless, in the pessimistic scenario fiscal policy easing, compared to the baseline, would be implemented to the extent that key public finance parameters (such as the debt-to-GDP ratio and primary balance) simultaneously adhere to the fiscal rules in the Organic Budget Law. In the pessimistic scenario, the revenue ratio is assumed to be 0.5 pps below the baseline. Capital spending in 2024-2026 is reduced compared to the baseline by 0.7 percent of GDP on average each year, while current expenditure is about 0.1 pps above the baseline. Interest expenditure (in nominal terms and also as a share of GDP) is assumed to be lower in the pessimistic scenario compared to the other scenarios in 2025-2026. The fiscal deficit is set to be higher (0.1-0.2 pps) than in the baseline scenario, except in 2025 when it is lower.

The public debt ratio is set to decrease in all three scenarios, including in the pessimistic one, although the reduction is marginal (0.1 pps). Furthermore, the primary balance is non-negative in all scenarios.

The government is working on a new public finance management (PFM) strategy, which is expected to be adopted in the first half of 2024. This would be the third PFM strategy, following the 2014-2020 PFM and the one in 2019-2022. According to the ERP, PFM reforms need to be continued in order to increase the effectiveness of budget spending and create a more productive environment for expenditure in the medium- and long term. Nevertheless, in the ERP there are no details on its content and no indication on the starting date for implementation. A first draft of the PFM strategy document was expected to be finalised in December 2023. In the last stage following consultations, the document is to be approved by the Council of Ministers, which is expected in the first half of 2024. Progress has been made to reform public investment management as the national single project pipeline (NSPP) list has been prepared, updated and approved by the Decision of the Council of Ministers in July 2023. To facilitate medium-term budget planning, a ranking of these projects based on their strategic importance, maturity and financing is yet to be completed. The necessary legal amendments to integrate public-private partnerships into the NSPP and into the regular public investment management cycle are also outstanding. The authorities are working on publishing a fiscal risk statement as a stand-alone document. They also plan to set up a separate department within the Ministry of Finance tasked with fiscal risk monitoring.

The ERP envisages an incremental increase in the tax revenue ratio over 2025-2026, but better outcomes could be achieved with more decisive revenue-enhancing reforms and a broader tax base. The medium-term revenue strategy (MTRS), drafted in 2021, has not been officially adopted yet and the authorities have asked the IMF for help in updating the existing plan, also taking into account recent developments such as the growing importance of the tourism sector. Good progress was made in recent years on adopting tax policy measures in line with the MTRS, but some measures, such as a review of the property tax, remain outstanding. However, the main focus of the authorities in the upcoming period will be on improving tax administration, including improved information exchange, the use of IT tools and capacity increase. The initial aim of the MTRS was to increase the tax revenue ratio by 2.5 pps compared to its 2019 level. Of this, 1.5 pps is yet to be achieved according to the authorities' own calculations. Raising more revenue is all the more important as Albania needs to invest more in physical and human capital to accelerate its convergence with EU income levels. However, according to the ERP projections the improvement of the fiscal balance over 2025-2026 is set to be achieved mainly through a reduction of the expenditure ratio driven by a decrease in capital spending and in spending on operation and maintenance as a share of GDP.

ERP medium-term fiscal planning is in line with the fiscal rules. Overall, the assumed fiscal path of a widening deficit in 2024 and an improvement in subsequent years would ensure continuing surpluses in the primary balance and a decreasing debt-to-GDP ratio, in compliance with the fiscal rules set by law. Compliance with the primary balance rule was achieved in 2023, a year ahead of the legal obligation entering into force. The importance of this rule is reflected in the fact that the primary surplus is projected to play an increasing role in ensuring continued debt reduction in 2024-2026.

4. MAIN MACRO-RELEVANT STRUCTURAL CHALLENGES

In November 2023, the Commission proposed a New Growth Plan for the Western Balkans[15] with the aim of supporting the region's economic convergence and accelerating the accession process. The plan involves a Reform and Growth Facility (EUR 2 billion in grants, EUR 4 billion in loans) that is to be disbursed in 2024-2027 as investment[16] and budget support in exchange for implementing reforms that are to be set out in reform agendas prepared by the Western Balkan partners. The New Growth Plan is therefore an important tool to increase reform incentives to boost growth and convergence. In this context, with a view to ensuring an integrated surveillance of

[15] https://neighbourhood-enlargement.ec.europa.eu/enlargement-policy/new-growth-plan-western-balkans_en.

[16] Infrastructure investments need to comply with the EU environmental acquis, national and international nature protection and water management obligations, ensure public participation and consultation, and guarantee high quality environmental impact assessment reports that include cumulative impacts on nature and biodiversity.

Albania's economy, this chapter briefly outlines the main structural challenges facing the country.

The informal economy is sizeable in Albania and the level of informality in employment is also high. Latest studies [17] show that the informal economy amounted to 27.2% of GDP in 2019. The International Labour Organization estimates that as much as 56.7% of total employment may be informal in Albania [18]. At the same time, the Albanian State Statistics Institute estimates that the informal employment accounts for 29.4%, excluding the agricultural sector.[19] Informal employment takes different forms such as undeclared work, envelope wages and lower official reported wages with remaining wages paid in cash. Among the economic sectors, agriculture is the sector with the highest level of informal employment, followed by wholesale and retail trade, and then construction. With the expansion of tourism supported by better access to global booking channels, hospitality is a fertile ground for the informal market as there is a large share of accommodation not registered.

Informality impedes fair competition among businesses, reduces the tax base and hinders economic growth. Informality penalises companies that are tax-compliant, reducing fair market competition. The process of fiscalisation as a major reform undertaken by the tax administration has enabled the declaration and real-time tracking of sales and purchase transactions carried out by taxpayers. This process has helped increase the correct declaration by the businesses that make real financial declarations of their economic activity, but informality still remains a challenge, as some businesses will continue with informal invoicing and under-declaration, remaining part of the grey economy. Furthermore, informal activity often occurs due to exclusion factors, where those with lower skills and education in less productive sectors rely on subsistence income, specifically in agriculture and other sectors where enforcement is weak. High informality is reflected in the low tax base and revenue-to-GDP. Compared to other Balkan countries, Albania has been lagging behind in the tax revenue-to-GDP ratio. Low revenues to the state affect the provision of public goods such as infrastructure, education and health. In the ERP, the government included a measure on strengthening the fight against informality. It aims to reduce the compliance gap linked to VAT, reduce undeclared work and under-declaration of wages, and reduce tax fraud. While details are missing on the concrete efforts that are to be undertaken towards these objectives, among the measures that were put forward for 2024 were the integration and use of data from different tax administration systems and the campaign of registration for VAT purposes.

The business environment needs further improvement, including through reforms on the rule of law, better public procurement, digitalisation of cadastre services, better consumer protection and more electronic payments. Progress has been made in improving the business climate. For example, surveys shows that businesses' satisfaction with public services improved in 2021 and 2022, supported by a higher level of digitalisation. A new 'council of enterprises', composed of public and private sector

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[17] IMF Albania 2022 Article IV Staff Report.

[18] Based on the Labor Force Survey of 2020– 2021.

[19] Informality is very high in agriculture and thus estimates are significantly higher when accounting for this sector.

representatives, has been set up to improve consultation of small and medium-sized enterprises (SMEs). To reduce informality and support fair competition, cash limits were introduced for business-to-business transactions. Nevertheless, inefficiencies and delays in dealings with the administration persist. The regulatory framework is excessively complex and subject to changes, while dealing with the tax administration is perceived as burdensome. Irregularities in public procurement procedures are still perceived as an obstacle for businesses. Digitalising the cadastre still needs to be completed and there are discrepancies in the information on property deeds. Businesses in Albania see corruption as the biggest factor in the existence of the hidden economy. Key enablers of a favourable business climate include the strengthening of the implementation of the justice and anticorruption reform measures as they have considerable potential to trigger economic transformation, reducing the informal economy and corruption. Other crucial elements include the adoption of the unified investment law (which is delayed), putting in place adequate consumer protection laws and reducing cash payments.

While the labour market situation has improved, brain drain and labour shortages pose problems. The labour market registered positive developments with increases in employment and wages in 2023. The employment rate for the population aged 15 to 64 was 67.7% in Q3-2023, reflecting an increase compared to 2022. The labour force participation rate continued to increase, peaking at 76.1% in Q3-2023. Nevertheless, the unemployment rate (15-64 years) remained elevated at 11% in Q3-2023 despite improvements, while youth unemployment was 22% in Q3-2023. These figures are much higher than the EU-27 averages. The gender gap in labour force participation remains significant, despite improvements. Steady emigration flows since 2015 are shrinking the workforce. Since the pandemic, Albania has lost an estimated 20 000 inhabitants per year, and the trend is likely to continue [20]. This is causing a continual brain drain, particularly in the case of young people that have been leaving for higher-paid jobs in the EU. Businesses have increasing concerns about labour shortages and report that finding skilled labour is challenging, particularly in remote areas of the country.

Albania has a very high rate of low-skilled adults and high rates of early school leaving. There are significant rural-urban and socio-economic differences in access to education, and the early school leaving rate remains the highest among candidate countries and potential candidates after Türkiye, amounting to 17.5% in 2021 (vs 9.6% in the EU in 2022). Participation in adult learning over the past 12 months has been very low compared to the EU. The overall level of digital skills (23.80% in 2021) is the lowest among all candidate countries and far below the EU average (53.92%). Worryingly, about 27% of young people are not in education, employment or training, which is almost double the EU average. The quality of education and training is still low, as illustrated by the latest OECD PISA results in 2022[21]: a significant number of students in Albania are not acquiring the basic skills in reading, mathematics and science needed to

[20] IMF Albania 2022 Article IV Staff Report.

[21] Albania had the second lowest score of the five Western Balkan economies that participated in the PISA 2022.

fully engage in a knowledge-based society after completing compulsory education. In this sense, Albania needs to scale up its efforts to improve student performance, especially among those from disadvantaged families, those living in rural areas, and those belonging to ethnic minorities. Furthermore, reorienting young people to better match market needs would improve the employability of the workforce. The authorities undertook a number of efforts in supporting vocational education and training (VET), but further progress is required. The number of people attending VET schools is still low compared to other countries in the region and in the EU. The main goal and the most complex challenge of the VET system is still to update, expand and adapt the VET offer to the needs of the labour market in order to reduce the skills mismatch. Furthermore, despite efforts the engagement of the private sector in the VET system is still in its infancy.

Risks of poverty and social exclusion are very high, and the capacity of the social protection system to reduce them is low. Albania has the highest rate of poverty and social exclusion (46.2% in 2020) among all EU Member States and candidate countries for which data are available. Although there is a social assistance scheme, the allowances have low adequacy. 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, mainly informal workers, do not have health insurance.

Albania needs to address the infrastructure gaps and improve connectivity. Public investments have been mainly focused on road infrastructure rather than other modes of transport. Nevertheless, work is ongoing to build and rehabilitate railways, including train stations.[22] Improving physical transport infrastructure, especially along the main connectivity corridors, remains essential as this will translate into significant improvements on safety and reduced journey times for exported goods. Main interventions will occur in key trans-European transport network (TEN-T) corridors, such as Corridor VIII and the Mediterranean Corridor, which are vital for the transit of goods and passengers between Albania, the EU and other Western Balkan countries. Digital interconnectivity infrastructure is another area of investment, with the government aiming to complete investments for connecting regional networks with European broadband networks.

Albania continues to be hampered by inefficiencies in the energy sector, including insufficient security of supply. While electricity in Albania is produced 100% from renewables, the energy sector is volatile and its hydro-electricity production is dependent on rainfall. The majority of the total net domestic production is generated from the plants owned by the state-owned company KESH, while the other part is generated by independent and priority generation plants. The energy SOEs are dependent on budget support (subsidies, on-lending and guarantees), while some energy infrastructure needs upgrading. Overall, Albania remains a net importer of electricity. Besides better efficiency in energy use, the deployment of solar and wind resources will improve Albania's energy security and reduce its vulnerability to climate change impacts.

[22] Investment in rail infrastructure increased significantly from 2019 to 2022 but it is still outweighed by investment into road infrastructure.

Furthermore, better governance of energy SOEs would help improve financial performance and strengthen the resilience of the energy system.

ANNEX 1: OVERVIEW OF THE IMPLEMENTATION OF THE POLICY GUIDANCE ADOPTED AT THE ECONOMIC AND FINANCIAL DIALOGUE IN 2023

Every year since 2015, the Economic and Financial Dialogue between the EU and the Western Balkans and Turkey 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 guidance is similar to that of the country-specific recommendations usually adopted under the European Semester for EU Member States. Implementation of the guidance is evaluated by the Commission in the following year's ERP assessments.

The following table presents the Commission's assessment of the implementation of the 2023 policy guidance jointly adopted by the EU and the Western Balkans and Turkey at their Economic and Financial Dialogue at ministerial level on 16 May 2023.

Overall: Partial implementation (47.2%)[23]	
2023 policy guidance (PG)	**Summary assessment**
PG 1: Achieve as envisaged a non-negative primary balance in 2023 while providing targeted support to vulnerable households and firms if needed to cushion the impact of high energy prices and, thereafter, implement the medium-term budgetary plan aiming to reduce the public debt ratio and increase the primary surplus while using the regular revision process for budget amendments.	There was **partial implementation** of PG 1: 1) **Substantial implementation:** In 2023, the primary balance achieved a positive outcome. Support to vulnerable households and firms was limited compared to 2022 as the energy sector performed better. Furthermore, according to the ERP there were no untargeted subsidies allocated to state-owned electricity enterprises. The public debt as a share of GDP declined to59.2% in 2023, from 64.5% in 2022. In October 2023 the budget was revised through a normative act and not through the regular revision process for budget amendments – this is not in line with the PG. The revision addressed arrears accumulated throughout 2023 and reallocated unexecuted capital expenditure funds. Furthermore, there was another budget revision in December 2023, also via a normative act.
Keep general government arrears in each quarter of 2023 at maximum 2.5% of total expenditure and below 2.4% of total expenditure at end-2023.	2) **Partial implementation:** The stock of arrears amounted to 1.83% at the end of Q1-2023, 2.67% at the end of Q2-2023, 2.91% in Q3-2023 and 1.16% in Q4-2023. Thus, the annual target of '2.4% of total expenditure at end-2023' was met. While this is progress, the accumulation of arrears throughout 2023

[23] 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:https://ec.europa.eu/info/publications/economy-finance/2017-economic-reform programmes-commissions-overview-and-country-assessments_en

	above the set quarterly targets, and their clearance in October and December 2023 via budget amendments, are not in line with the agreed PG. Overall, there seems to be no systematic approach to prevent arrears from building up.
Inform decisions about new state guarantees and on-lending to public entities by a systematic risk assessment.	3) **Limited implementation:** The Ministry of Finance envisages strengthening the analysis and evaluation of the risks and budget impacts stemming from guarantees and on-lending to public entities. In this respect, it intends to collaborate with the World Bank, to receive assistance through the Government Debt and Risk Management Program, for developing a comprehensive framework for providing guarantees and on-lending, underpinned by a formalised assessment methodology focused on the risk management of existing and potential future portfolio. Discussions with the World Bank have been initiated. The Ministry of Finance made legal changes for setting-up a unit specialized in collecting back unpaid obligations of borrowing entities stemming from on-lending operations and guaranteed loans. The unit is expected to be set-up in 2024.
PG 2: Continue measures to increase tax revenue as share in GDP in a growth-friendly way while taking into account the results of a broad public consultation on tax policies.	There was **partial implementation** of PG 2. 1) **Partial implementation:** Tax revenues, as a share of GDP increased in 2023. At the beginning of 2023, a new law 'On Income Tax' was discussed and approved in Parliament. It contains a series of measures from the medium-term revenue strategy (MTRS), linked to the field of direct taxes. Furthermore, a new law 'On property tax' was drafted but it is not envisaged to be adopted sometime soon. Overall, in the last years the government made progress in implementing measures from the MTRS and currently it plans to review the strategy.
Complete procedures to fully establish the national single project pipeline (NSPP) and advance the necessary legal amendments to fully integrate PPPs into the NSPP.	2) **Substantial implementation:** In February 2023, the Instruction of the Minister of Finance No. 4 determined the financial limit (threshold) above which projects are eligible to enter the NSPP. Projects classified as non-strategic and have a total value below the threshold are submitted for evaluation and approval only to the Ministry of Finance. These projects are not part of the NSPP list and the procedures followed for these investment projects on identification, preparation and approval are simpler. Projects classified as strategic require in-depth analyses for the processes of identification of the project, preparation, submission of documents and evaluation until the final approval. These projects are submitted for evaluation to the Ministry of Finance and to the State Agency for Strategic Programming and Aid Coordination. For these projects, full feasibility studies are required. The final approval of the new investment projects that are to be financed is done by the Ministry of Finance within the framework of the Medium-Term Budgeting Programme. Regarding the form of financing, if

Increase spending on education, social protection and health as a percent of total expenditure and issue instructions for data collection on public expenditure on R&D.	private-public partnership (PPP) is an option, a justification should be provided by comparing this option with the financing standards. Regarding the content of the feasibility study, all financing options should be presented and detailed. The NSPP list has been prepared, updated and approved by the Decision of the Council of Ministers on 26.07.2023. The Ministry of Finance and Economy started to work on a new law to replace Law No. 125/2013 'On Concessions and Private Public Partnership PPP'. The development of a methodology for the evaluation of new concessions/PPPs will be part of the new law. 3) **Limited implementation:** In 2023, expenditure on education, and social protection increased in nominal terms. Due to the wage reform, there has been increases in the salaries of employees in public administration. In 2024 the average salaries of teachers and medical staff are foreseen to increase significantly on the back of the second stage of the public wage reform. Nevertheless, the budget on education, health and social protection remains in line with the average levels of previous years. In the 2024 budget, health expenditures as a share of total expenditure comes to 9.3% (higher than 8.6% in 2023, but lower than 9.6% in 2022). Social protection as a share of total expenditure is foreseen to increase to 29% in 2024 from about 28% in 2023, while education increases by 0.4 pps year-on-year to 7.5% in 2024. No progress on data collection on R&D public expenditure. Work is still underway on designing the methodology for data collection and processing on public expenses dedicated to R&D.
PG 3: Continue to carefully assess and analyse price developments, including by publishing additional indicators of underlying price pressures, and ensure a sufficiently tight monetary policy stance to preserve price stability in the medium term, including by further tightening monetary policy, if needed. Strengthen further the reporting and risk management frameworks across the banking system to ensure an accurate reporting of asset quality, to further reduce obstacles to NPL resolution and to reduce data gaps in particular as regards the real estate sector. Continue the implementation of measures aimed at promoting saving and borrowing in domestic	There was **partial implementation** of PG 3. 1) **Partial implementation:** The Bank of Albania has not started to publish additional indicators of underlying price pressures yet. It continued to normalise monetary policy but slowed the pace of tightening despite persistent inflationary pressures, rising risks and accelerating credit growth in lek. Nevertheless, it consistently communicated its readiness to tighten further in a data-dependent manner and in line with the fiscal stance and exchange rate developments. 2) **Substantial implementation:** A guideline for reporting in line with European Banking Authority standards is under consultation. The Regulation to improve data collection on the exposures of the banking system to the real estate sector has entered into force. Significant progress was made in the resolution of the bailiff impasse, although problems remain with its operationalisation. The introduction of IFRS 9 standards, planned for 2023, has been postponed. 3) **No implementation:** While the Bank of Albania implemented measures taken in line with the Memorandum of Cooperation earlier, the government

currency, limit unhedged lending and the use of foreign currency in the real economy, with all signatories of the Memorandum of Cooperation taking appropriate action.	made no progress and has no plans to introduce measures to increase the use of the national currency.
PG 4: Develop business support services to create a business environment to nurture SMEs' greening transition, further accelerate SME digitalisation and e-commerce, offer robust insolvency prevention policies to SMEs at risk, and ensure a coherent and predictable application of the property law. Enhance energy resilience and diversification towards green energy transition to implement the Green Agenda, notably the electricity, energy efficiency and climate acquis. Implement within 2024 the adopted climate and energy targets based on the National Energy and Climate Change Plans, (NECP) as part of the 2030 decarbonisation roadmap, and ensure that the Renewable Energy Operator is operational by end 2023, in line with the renewables law that was adopted on 23/3/2023.	There was **limited implementation** of PG 4. 1) **Limited implementation:** Further efforts are needed to improve business support services, for SME on the green transition and digitalisation, including e-commerce. Albania has completed an analysis of the green economy, identifying areas such as renewable energy and the Cut, Make & Trim (i.e. clothing) manufacturing as sectors with potential for action on the green economy. More efforts from the institutions and support to the private sector are needed. Uncertainty remains on property titles, hampering investments.. 2) **Partial implementation:** The Albanian power exchange ALPEX established by the transmission system operators of Albania and Kosovo went live on 12 April 2023. The new Renewables Law adopted in March, brings a series of innovations to the electricity sector. A transition to net billing for self-consumed renewables was scheduled to start on 1 January 2024. Progress has been made in the implementation of the national renewable energy action plan through implementation of PV plants (240 MW, Karavasta and Spitalla). Progress has been achieved with the auction on PV plants and wind farms. The government has imposed obligatory measures, requiring a 15% reduction in electricity consumption. Nominated energy managers are responsible for monitoring progress and reporting. There is not yet a dedicated funding mechanism for energy efficiency, and a long-term building renovation strategy has not yet been adopted. 3) **Limited implementation:** The 2030 climate targets are yet to be defined in national legislation, but these have been defined in the NECP. The updated NECP, including the new targets, is expected to be enacted by 2024. The Renewable Energy Operator has not yet been established.
PG 5: Encourage cooperation between innovative businesses research organisations, 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. **1) Partial implementation:** Albania adopted the National Strategy for Research, Science and Innovation 2023-2030 in September 2023. In 2023, the National Agency for Science, Research and Innovation opened the first call for joint academia-business projects in the field of innovation and 10 joint projects were awarded. Albania was included for a second consecutive year in the European

	Innovation Scoreboard as an emerging innovator. However, it experienced a decrease in its score. Albania advanced in drafting the Smart Specialisation Strategy, which is expected to be adopted in the first half of 2024. Despite the efforts that the country is making on innovation, Albania needs to substantially increase funding on science and research. The new Law on Science, which will include Open Science, knowledge valorisation, research infrastructure and facilities, and will support a stronger R&I ecosystem aligned with the European Research Area policy agenda priorities, is still to be adopted.
Conduct a Youth Guarantee pilot and analyse its performance, and in parallel review and adjust the functioning and operational structure of the National Agency for Employment and Skills (NAES) to accommodate the service delivery of the Youth Guarantee and develop a set of quality offers.	**2) Substantial implementation:** The National Implementation Plan for the Youth Guarantee Scheme was approved by the Council of Ministers. The piloting of the Youth Guarantee Scheme was launched by October 2023 and its full-scale implementation will take place in three regions – Tirana, Shkodra and Vlora – in 2023-2024. Initial progress states that 120 young people not in education, employment or training have been identified and are receiving services according to their development plan. Public Employment Services (PES) employees were trained in January 2024 through the EU-IPA funded programme. The Youth Guarantee website has been designed but not launched yet. An initial restructuring of the National Agency for Employment and Skills was completed. However, another review and adjustment should be done based on the pilot phase. A further strengthening of the PES offices beyond the pilot regions needs to be implemented to accommodate a service delivery of the Youth Guarantee and quality offers.
Use the outputs of the Labour Market Observatory to improve the labour market relevance of vocational education and training (VET), invest in its quality and ensure cooperation with the private sector; focus on building skills of youth and adults, with a particular focus on digital skills to support the expanding communications and technology sector.	3) **Partial implementation:** The Labour Market Observatory was established and is now operational. It processes and analyses administrative data generated by the General Directorate of Taxes and the National Agency for Employment and Skills, and can display data by occupation, gender and region. Based on the labour market data, the observatory and other instruments such as the tracking of VET graduates/certificates, a new employment promotion programme (ALMP) related to the provision (through outsourcing) of advanced training in the field of ICT (programming) was drafted in 2023. As at Oct 2023, 1 875 unemployed jobseekers had been trained free of charge by public VET centres on the digital curriculum (short-term course with the 5 basic digital competencies according to the EU Digital Competencies Framework 2.0). An inter-institutional working group was established to identify challenges and increase participation in VET programmes, and a regulation was adopted on transferring from universities to vocational education schools and on making the registration process easier. A dedicated website – https://aftesi.al/ – has been created to help all students who wish to receive detailed information

	about VET in Albania. Further efforts are needed to strengthen cooperation with the private sector.
PG 6: By 2024, establish a mechanism for the annual indexation of the 'Economic Aid' benefits to ensure their adequacy based on the assessment carried out. Ensure sustainability of the newly created services and encourage the creation of new services within the increase of the allocation to the National Social Fund, especially in the municipalities offering the least number of social services and with lower resources. Continue the cooperation with NAES on the 'Economic Aid' Exit Strategy to refer beneficiaries to the services offered by NAES, and in particular analyse and address the reasons for refusal to take on offers of employment or training.	There was **partial implementation** of PG 6. 1) **Limited implementation:** Limited progress was made in this regard. However, this remains one of the priorities under the National Strategy on Social Protection 2024-2030, which was adopted in March 2024. The annual indexation mechanism of the Economic Aid scheme is part of the measures under the draft National Strategy on Social Protection 2024-2030. 2) **Partial implementation:** The Social Fund budget for 2023 has increased. However, the full absorption/disbursement of the amount from the municipalities remains a concern, particularly the need for clear sectorial instructions. The Ministry of Health and Social Protection, with support from external technical assistance, is currently reviewing the Social Fund. Subject to the results of this evaluation, the Ministry will consider reviewing the Decision of the Council of Ministers on the Social Fund – particularly on the level of contributions from municipalities and the financial sustainability of services. In certain municipalities, social service provision is still lacking or is very low. 3) **Substantial implementation:** Progress has been made on implementing the exit strategy for recipients of economic aid. A Joint Order[24] between the Minister of Health and Social Protection and the Minister of Finance and Economy was signed in January 2022 for the referral mechanism for employment and social integration of working-age family members benefiting from the economic aid scheme. The order builds on the referral model initially piloted for 3 months in Elbasan. In 2022, a special tripartite commission was established, composed of the Regional Office for Social Services, the Regional Office for National Agency for Employment Skills and the Department for Social Services in Elbasan. This model has been rolled out to the 12 regions, entailing immediate assistance and support from the Ministry in cooperation with the national agencies (SSS and the National Agency for

[24] Joint Order No. 52 of 26.01.2022.

	Employment and Skills). A protocol for referral is now in place, and the regional stakeholders are implementing the profiling of working-age beneficiaries. Social mentoring is part of the individual plans prepared to support the reintegration of economic aid beneficiaries. The reasons for refusing to take on offers of employment or training are also recorded, analysed and addressed through targeted support measures.

ANNEX 2 : COMPLIANCE WITH PROGRAMME REQUIREMENTS

The government of Albania submitted the 2024-2026 ERP to the Commission on 15 January 2024.

Inter-ministerial coordination

The drafting and preparation of the 2024-2026 ERP was coordinated by the Ministry of Finance and Economy, with contributions from various ministries and agencies.

Stakeholder consultation

The 2024-2026 ERP was discussed at the Investment Council on 15 December 2023, whereby representatives from business associations, development partners and other interested stakeholders were present. The Investment Council is chaired by the Minister of Finance and Economy and supported by its Technical Secretariat.

Macroeconomic framework

The programme presents a clear and concise picture of past economic developments and covers relevant data available at the time of submission. The information provided is coherent, concise and well structured. The macroeconomic framework provides a good basis for policy evaluation and discussions. The ERP does not provide an analysis of labour productivity, skills shortages, migration, brain drain or details on key investment projects or the investment environment. Statistical tables were complete.

Fiscal framework

The fiscal framework is detailed, in line with stated policy objectives and consistent with the ERP macroeconomic framework. The information about discretionary measures planned for 2024 and 2025 is rudimentary and fragmented. There is no analysis on the long-term sustainability of public finances (demographic developments, pensions, health expenditure). The ERP lacks details on expenditure plans, in particular for capital expenditure. Fiscal data do not yet meet Euopean System of Accounts (ESA) 2010 requirements. Soon after the ERP was submitted, the budget for 2024 was revised in February 2024, including the fiscal projections for 2025-2026. The revenue projections were revised upwards and are now closer to the optimistic scenario presented under the sensitivity analysis in the ERP.

Structural reforms

The chapter on structural reforms follows the ERP guidance note. The ERP does not make a clear link between the analysis of the challenges facing the economy, the proposed reforms and the corresponding budget allocations. A dedicated section provides information on the implementation of the policy guidance for 2023. Reporting on the progress of 2023 structural reform measures is generally of good quality. There is also a table reporting on the implementation of the structural reform measures from the previous ERP (2023-2025), but information on implementation is missing for some measures.