

# ALBANIA DEVELOPMENT FINANCE ASSESSMENT



JOINT SDG FUND





# ALBANIA

## DEVELOPMENT FINANCE ASSESSMENT



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*\*At the time of writing, the Ministry of Finance and Economy had not yet been separated into the Ministry of Finance, and Ministry of Economy, Culture and Innovation. As such, the report makes reference to the Ministry of Finance and Economy.*

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# LIST OF ACRONYMS

<b>AASF</b>	Albanian Agribusiness Support Facility
<b>AFISaR</b>	Albanian Financial Instrument Settlement and Registration
<b>AFIU</b>	Albanian Financial Intelligence Unit
<b>AFMIS</b>	Albanian Financial Management Information System
<b>AFSA</b>	Albanian Financial Supervisory Authority
<b>AGFIS</b>	Albanian Government Financial Information System
<b>AIC</b>	Albanian Investment Corporation
<b>AIDA</b>	Albanian Investment Development Agency
<b>AIF</b>	Alternative Investment Fund
<b>AIPS</b>	Albanian Interbank Payment System
<b>ALL</b>	Albanian Lek
<b>ALREG</b>	Albanian Securities Register
<b>ALSE</b>	Albanian Securities Exchange
<b>AMA</b>	Albanian Microfinance Association
<b>AMSHC</b>	State Agency for the Support of Civil Society
<b>BFI</b>	Non-Bank Financial Institutions
<b>BIDS</b>	Business and Development Strategy
<b>BoA</b>	Bank of Albania
<b>BOT</b>	Build-Operate-Transfer
<b>BPO</b>	Business Process Outsourcing
<b>CAR</b>	Capital Adequacy Ratio
<b>CEB</b>	Council of Europe Development Bank
<b>CG</b>	Central Government
<b>CIT</b>	Corporate Income Tax
<b>CIU</b>	Collective Investment Undertakings
<b>COFOG</b>	Classification on the functions of government
<b>CoM</b>	Council of Ministers
<b>CRAR</b>	Capital to Risk (Weighted) Assets Ratio
<b>CSD</b>	Central Securities Depository
<b>CTD</b>	Credit-to-Deposit
<b>DFA</b>	Albania Development Finance Assessment
<b>DFI</b>	Development Finance Institutions of EU Member States
<b>DLT</b>	Distributed Ledger Technology
<b>DRM</b>	Disaster Risk Management
<b>DSO</b>	Distribution System Operator
<b>EAMIS</b>	External Assistance Management Information System
<b>EBRD</b>	European Bank for Reconstruction and Development
<b>EC</b>	European Commission
<b>EIB</b>	European Investment Bank
<b>EIP</b>	Economic and Investment Plan
<b>ERP</b>	Economic Reform Program
<b>EU</b>	European Union
<b>FDI</b>	Foreign Direct Investments
<b>FP</b>	Fiscal Policies
<b>FRU</b>	Fiscal Risk Unit
<b>FSA</b>	Financial Supervisory Authority

<b>FSI</b>	Financial Soundness Indicators
<b>FY</b>	Fiscal Year
<b>GDP</b>	Gross Domestic Product
<b>GDT</b>	General Directory of Taxation
<b>GFS</b>	Government Finance Statistics
<b>GGF</b>	Green for Growth Fund
<b>GoA</b>	Government of Albania
<b>GWP</b>	Gross Written Premium
<b>HDI</b>	Human Development Index
<b>IBRD</b>	International Bank for Reconstruction and Development
<b>ICOs</b>	Initial Coin Offerings
<b>ICT</b>	Information and Communication Technology
<b>IDA</b>	International Development Association
<b>IFFs</b>	Illicit financial flows
<b>IFIs</b>	Financial Institutions
<b>ILO</b>	International Labour Organization
<b>IMF</b>	International Monetary Fund
<b>INFF</b>	Integrated National Financing Framework
<b>INSTAT</b>	Institute of Statistics
<b>IPS</b>	Integrated Planning System
<b>IPSIS</b>	Integrated Planning System Management Information System
<b>KESH</b>	Albanian Power Corporation
<b>KfW</b>	Credit Institute for Reconstruction (Kreditanstalt für Wiederaufbau)
<b>KPI</b>	Key Performance Indicators
<b>LG</b>	Local Government
<b>LGUs</b>	Local Government Unit
<b>LTD</b>	Loan-to-Deposit ratio
<b>MDB</b>	Multilateral Development Banks
<b>MFI</b>	Micro Finance Institutions
<b>MIE</b>	Ministry of Infrastructure and Energy
<b>MFE</b>	Ministry of Finance and Economy
<b>MFF</b>	Macro-Fiscal Framework
<b>MHSP</b>	Ministry of Health and Social Protection
<b>MSE</b>	Macedonian Stock Exchange
<b>MSME</b>	Micro, Small and medium sized enterprises
<b>MTBP</b>	Medium Term Budget Planning
<b>MTDMS</b>	Medium Term Debt Management Strategy
<b>MTRS</b>	Mid-Term Revenue Strategy
<b>NA</b>	Normative Act
<b>NAIS</b>	National Agency for Information Society
<b>NBFI</b>	Non-Bank Financial Institutions
<b>NE</b>	Ndihma Ekonomike
<b>NEET</b>	Not in Education, Employment, or Training
<b>NGO</b>	Non-Governmental Organization
<b>NPEI</b>	National Plan for European Integration
<b>NPL</b>	Non-performing loans
<b>NSDI</b>	National Strategy for Development and Integration
<b>NSDEI</b>	National Strategy for Development and European Integration 2023-2030
<b>NSPP</b>	National Single Project Pipeline
<b>OBL</b>	Organic Budget Law
<b>ODA</b>	Official Development Assistance
<b>OECD</b>	Organization for Economic Co-operation and Development



<b>OOF</b>	Other Official Flows
<b>OSHEE</b>	Electric Energy Distribution Operator
<b>OST</b>	Transmission System Operator
<b>OTC</b>	Over-the-Counter
<b>OTF</b>	Organized Trading Facility
<b>PAR</b>	Portfolio at RISK
<b>PDNA</b>	Post Disaster Needs Assessment
<b>PFM</b>	Public Finance Management
<b>PIM</b>	Public Investment Management
<b>PIT</b>	Personal Income Tax
<b>PPPs</b>	Public Private Partnership
<b>QRA</b>	Share Registration Centre
<b>ROA</b>	Return on Assets
<b>RoE</b>	Return on Equity
<b>RSC</b>	Register of Security Charges
<b>RTGS</b>	Real Time Gross Settlement
<b>SAA</b>	Stabilization and Association Agreement
<b>SASPAC</b>	State Agency for Strategic Planning and Aid Coordination
<b>SDG</b>	Sustainable Development Goals
<b>SELDI</b>	Southeast Europe Leadership for Development and Integrity
<b>SIC</b>	Strategic Investment Committee
<b>SII</b>	Social Insurance Institution
<b>SILC</b>	Statistics on Income and Living Conditions
<b>SLA</b>	Savings Loans Associations
<b>SME</b>	Small and medium-sized enterprises
<b>SoE</b>	State-Owned Enterprises
<b>SPC</b>	Strategic Planning Committee
<b>STO</b>	Security Token Offerings
<b>TA</b>	Technical Assistance
<b>TAP</b>	Trans Adriatic Gas Pipeline
<b>TEDA</b>	Technology and Economic Development Area
<b>TO</b>	Tax Office
<b>TSA</b>	Treasury Single Account
<b>TSE</b>	Tirana Stock Exchange
<b>TSO</b>	Transmission System Operator
<b>UCITS</b>	Undertakings for Collective Investment in Transferable Securities
<b>UN</b>	United Nations
<b>UNDP</b>	United Nations Development Program
<b>UNOPS</b>	United Nations Office for Project Services
<b>USAID</b>	United States Agency for International Development
<b>VASP</b>	Virtual Assets Service Providers
<b>VAT</b>	Value Added Tax
<b>WB</b>	World Bank
<b>WB6</b>	Western Balkans (6 economies)
<b>WB EDIF</b>	Western Balkans Enterprise Development and Innovation Facility
<b>WBIF</b>	Western Balkans Investment Framework
<b>WSS</b>	Water Supply System
<b>WTO</b>	World Trade Organization

# EXECUTIVE SUMMARY

The DFA is a comprehensive review of a country's financial landscape, which helps identify strengths and weaknesses in the financial system and how they affect its development objectives as well as its progress towards achievement of the SDGs. This report explores financing instruments and mechanisms, policies, institutions, and capacities in place in Albania, with the aim of highlighting: existing resources, policies, institutions, capacities, and monitoring tools; emerging initiatives to strengthen resource mobilization, policies, institutions, capacities, and monitoring; and future opportunities to further strengthen policies, institutions, capacities, and monitoring to aim for a more integrated approach to development financing.

## Albania's Development Financing Needs

Albania is a small economy and highly vulnerable to regional and international trends. In recent years, the economic and political developments in neighbouring countries such as Greece and the wider EU economies, the Covid-19 pandemic, the war in Ukraine, and the rise in global energy and fuel prices have had substantial implications for economic growth and macroeconomic trends in the country. Despite its growth, the productivity of the Albanian economy remains well below the EU average. The services sector is the largest contributor (45%) to the GDP during 2005-2021, followed by agriculture (18.4%), construction, and industry. Despite employing 33.8% of the population, the agriculture sector offers the lowest wages. Public sector wages in general remain 30% higher than private sector. The labour market displays an unemployment rate of 11.8%, with substantially higher youth unemployment (27.1%), and a systemic gender gap. **EU acces-**

**sion is a long-held aspiration for the country and sits at the heart of the country's vision for development and democratization reforms.** The National Strategy or Development and European Integration 2023-2030 (NSDEI) and the National Plan for European Integration (NPEI) are the foundations that orient the planning and financial programming of the sectorial and cross-sectorial strategic framework. Yet, despite efforts at successfully completing the costing exercise for all policy and strategy documents, no clear financial analysis of their implementation, including funding gaps and resource mobilization challenges and risks, has been included due to lack of sufficient data. As such, it is hard to link NSDEI and NPEI strategic measures to the country's Medium-Term Budgeting Program (MTBP).

**The four sectorial priorities defined in NSDEI are agriculture and rural development, tourism, energy and natural resources, and digitalization.** The initial post-1991 focus on economic and structural reforms, the establishment of a market economy, and strengthening of administrative capacities of public institutions have, in subsequent decades, been replaced with sectorial and infrastructure development. Access to energy has a profound impact on Albania's economy, with energy shortages and price spikes disrupting production and raising costs for consumers. Therefore, investing in energy infrastructure and technologies that promote efficiency, sustainability, and affordability is essential for economic growth. NSDEI dedicates a special chapter to the Agenda on Sustainable Economic Development, Connectivity and Green Growth.

**The National Single Project Pipeline (NSPP) is an important instrument for operationalizing**

**the NSDEI, sectorial strategies and government priorities, and transforming the latter into concrete projects.** The NSPP is a strategic medium- and long-term prioritization instrument established in 2015, which defines the list of the strategic projects in the country, orients foreign and domestic sources of funding towards priorities, and connects long-term priorities with MTBP. There are 145 strategic projects in the pipeline for the period 2024-2026, the majority of which partially matured and non-matured. The EIP for the WB 2021-2027 notes that out of 227 projects, 29 are funder implementation with 100% of the financing guaranteed. The financial gap amounts 89% of EIP total financing needs.

**Despite the growing significance of crisis- and development-driven public investments over the last two decades as the primary driver of economic development, Public Investment Management (PIM) systems need further improvements** to address compliance with guidelines for the selection and approval of new investment projects as part of the budgeting process, guaranteeing value for money considerations during the PPP selection procedures and integration of shocks response related expenditures in the budgetary processes.

**Within the Western Balkans, Albania recorded a more moderate contraction in economic growth in 2020 and is rated among the countries with the highest growth in 2021.** Albania ranked second in the region in terms of GDP growth for 2022. Albania has lower GDP per capita than the WB6 regional average. It ranks with the second lowest level of unemployment rate in the region, and, together with Serbia, the lowest level of regional youth unemployment rate (although it stands at double the EU average). The 2021 and 2022 inflation rate for Albania remains lower than in other Balkan countries, partly due to subsidized energy prices which has also negatively influenced the debt stock. Albania ranks third in the Western Balkan region in terms of FDI as a percentage of GDP, although the effective number of FDI source countries and companies and the FDI target sectors remain very limited. The country also ranks the second lowest regionally in terms of 'Doing Business'.

**Public tax revenues as a percentage of GDP in Albania are low (29.1%) compared to the EU (42%) and the WB average (35%).** Despite having similar or higher tax rates compared to the peer countries, Albania has shown lower

revenue generation over the years due to informal economy, a narrow tax base, and efficiency problems in tax administration and collection – something that has resulted in low VAT productivity. Like other Western Balkan countries, Albania projects a return to the fiscal consolidation path in the upcoming medium-term period as lower fiscal stimulus is expected to be required compared to the recent three years. Albania's debt level is the second highest among the Western Balkan countries, currently facing relatively high, but controlled rollover risks, yet public debt is expected to gradually decline in the upcoming medium-term period, despised the increased interest rates.

**The COVID-19 pandemic highlighted the importance of proactive investment to build comprehensive and resilient social protection systems.** With a registered population of just over 2.8 million people and a shrinking demographics, Albania continues to face poverty and inequality are challenges even despite improvements in its Human Development Index in recent years. Although the country's means-tested social assistance program, Ndihma Ekonomike (NE), provides support to families and individuals in need, active social protection policies such as the economic reintegration of the working age beneficiaries into labour market remain a priority and a challenge. Despite boasting the highest life expectancy in the region, Albania needs to increase both the level and efficiency of education, health, and social protection expenditures to match the levels of investment in human capital in peer countries including the WB6 and the STEE7 countries.

#### **Landscape of current development finance flows**

In Albania, tax revenues are the main contributor to public revenues, with grants and non-tax revenues, including ODA and budget support, representing an insignificant share of total public revenues by comparison. Direct income taxes are a weak contributor to the budget revenues, representing around 18-20% of tax revenues, with indirect taxes generating almost twice the budget revenues in comparison, implying a weak redistributive impact. The three largest contributors to tax revenues are social insurance, VAT, and excise taxes, though VAT remains the primary source of tax revenues (35.4% of in FY2022). The VAT threshold in Albania is low compared to the region, and although its reduction was aimed at fighting informality, the tax

administration still lacks the capacity to achieve the expected results from this policy. Only 54% of total VAT revenues are collected compared to the set benchmarks (EU average 61%). As such, the relationship between tax revenue growth and GDP growth has become more irregular in recent years. According to MTRS, increasing tax revenue to 2.3-3.0% of GDP is necessary to finance additional public spending and support reform measures in the coming years.

**The effectiveness of a progressive tax scheme, introduced in 2014 as part of a fiscal reform program aimed at reducing societal inequalities and disparities, has been hindered by the under-declaration and under-reporting of taxable income.** The country is estimated to have lost around 5.6% of its GDP due to indirect tax exemptions, including VAT compliance gaps and tax evasion. The VAT compliance gap was nearly twice the EU average in 2015. It is estimated that reducing tax exemptions, including VAT, could result in an additional 0.2% of GDP in annual tax revenues. Other measures to raise public revenues could include introduction of intermediate tax brackets and an increase in the highest threshold for personal income tax, bringing self-employment under the labour income taxation scheme, reducing VAT/excises/national taxes exemptions, and increasing property taxes. Given that VAT is the main contributor to budget revenues, a robust and stable VAT is of considerable importance. Although social security contributions account for 6% of GDP, bringing the ratio of direct taxes closer to that of indirect taxes, their significance still fall behind that of tax revenues. Contributory revenues are only able to cover 60% of the total social protection expenditures, indicating a significant gap in the system's ability to provide adequate social protection for citizens, resulting in only a 9% share of social protection expenditures in GDP.

**Limited access to reliable data undermines public revenue and expenditure projections and planning.** On the public revenue side, differences exist between the revenue values indicators from their initial planning to their revision and actual execution. Such unrealistic forecasting has rendered planning based on forecast budget figures more challenging. On the public expenditure side, the published budget provides information on current and capital expenditures by program but does not include details on the total costs of projects. There are also substantial differences between projected

and actual public expenditure values, with the discrepancies growing in recent years, partly in response to consecutive shocks that have further undermined budget forecasting. Deviations from the originally planned levels of budget expenditure primarily reflect ongoing weaknesses in public finance management rather than an inability to meet revenue targets.

**Over the years, social protection has consistently been the primary beneficiary (25-30%) of public expenditures, although social protection spending remains significantly lower than the EU average.** Around 82.4% of social protection spending is allocated to pensions. Several challenges continue to face the public pension scheme in Albania, including low participation rates of the working-age population as contributors, high levels of informality, and low participation rates in the pension contribution scheme among farmers, youth emigration, and an anticipated increase in the number of beneficiaries in the coming years. As a result, the social insurance scheme is largely subsidized by the government, thus contributing to high fiscal deficit. After pensions, general public services, such as housing and community amenities, economic affairs, health, and education, are the second-highest beneficiary of public expenditures. Both domestic and foreign interest expenditures are increasing due to growing public debt, macroeconomic risks, and global developments.

**Consecutive shocks in recent years (including the 2019 earthquake, the Covid-19 pandemic, and the war in Ukraine) raised the need for expansionary fiscal policy to bolster the economy, resulting in an upturn in capital expenditure since 2021.** This took the form of wage subsidies, increased social spending, and two credit guarantees through commercial banks to ease salary payments and release financing for private sector capital and investment needs. Subsidies constitute an insignificant component of current expenditures in relation to GDP while tax exemptions are used more frequently to supporting target groups or provide incentives to various sectors of the economy. Similar to the other Western Balkan economies, Albania struggles to control current expenditures on public wages and pensions, challenging the fiscal consolidation efforts. In this context, enhancing the sustainability of the public administration and pensions systems and better targeting of social transfers are important priorities.

**The crises-induced expansionary fiscal policy**

**coupled with a sharp economic slowdown have widened the fiscal deficit and increased public debt despite the preceding years' fiscal consolidation efforts.** The country's fiscal deficit reached 3.7% of GDP at the end of 2022, showing a decreasing trend after the increase of 2020. The fiscal deficit is financed through domestic funds, including privatization receipts, domestic borrowing, change in the liquidity stock of the Treasure Single Account (TSA), as well as through foreign funds, including long-term loans and budget support. Public debt stood at 64.6% of GDP at the end of FY2022, which is still higher than the regional average of 59%.

**Although the public debt ratio is high, it remains sustainable and can be serviced, repaid, refinanced, and restructured in an orderly manner.** Public debt is vulnerable to potential growth-related shocks such as economic downturns, interest rate increases, and exchange rate fluctuations. The country's foreign debt is more sensitive to currency depreciation than to interest rate increases. Foreign exchange reserves can play a crucial role in mitigating this risk. Nevertheless, Albania is expected to face high gross financing needs during 2022-2026, equivalent to an average annual level of 23% of GDP. Revenue mobilization, together with the improved assessment of fiscal risks (including particularly the State-Owned Enterprises [SoEs] arrears and the Public-Private Partnership payments and guarantees obligations) are crucial for maintaining a stable fiscal position and reducing potential risks to debt sustainability.

**Public-Private Partnerships (PPPs) have been used in recent years for attracting capital investments in strategic public sectors, aiming to ease the budgetary burden and to create fiscal space.** Lack of comprehensive analysis of the value for money and fiscal risks associated with PPPs/concessions indicates the government failure to regularly monitor the PPP contracts. The energy sector has attracted the most awarded concessionary contracts, followed by transport. Despite this, the Albanian energy sector is not financially self-sustainable, with many SoEs also engaged in this sector. Governance of SoEs in the energy sector is deemed weak, and the country has been cautioned about the high contingent liabilities associated with SoEs, that could adversely impact the debt ratio and fiscal risks. Subsidized electricity prices for households and SMEs discourage energy efficiency measures and strain fiscal accounts.

**Although private investment levels have grown substantially since the late 1990s compared to public finance, they play a much smaller role in financing economic development in Albania.** This to some extent stems from the country's relatively recent and challenging process of privatization in the post-1991 phase (including the disastrous collapse of the pyramid schemes in 1997) – which implied that a large portion of privatization over the last three decades has been in the form of a transition of ownership from SoEs to private sector entities, rather than an entry of new private investments into the market. This has also implied a slow and weak growth of the financial instruments, products, and markets to support private investments.

**Albania's financial system suffers from low levels of development and is dominated by banks, holding 90% of the financial sector's assets and the primary source of lending to the public and private sectors.** The full privatization of the state-owned shares in the banking sector was achieved in 2009, with 12 banks operating in the country in 2022. An estimated 75% of the country's financial market is owned by five banks. The relatively recent history of privatization in Albania together with the disastrous collapse of the pyramid schemes in 1997, further explains the relatively weak private investment landscape, trends, and instruments in the country. The nominal value of bank lending rose from 10% of GDP in 1998 to 33.4% in 2022, with the largest weight of lending (72%) to private non-financial corporations, particularly wholesale and retail trade, followed by construction, manufacturing, and electricity and gas supply. The rate of banks' Non-Performing Loans (NPL) has declined from 25% in 2014 to 5% in September 2023, demonstrating a major improvement in banks' management of loans. Banks' lending to the central and local government reached its highest level in 2021 showing the sector's important role in supporting financing for public investments and government interventions at times of crisis. Banks remain the main debtholder in the country, holding more than 63% of Albania's total burden of the sovereign debt in 2022.

**The Tirana Stock Exchange (TSE), established in 1996 as an attempt at developing the Albanian capital market and facilitating the mass privatizations at the time, was suspended in 2022.** The malfunctioning of the TSE and the

eventual suspension of its license are considered to be a result of a number of factors, including the interruption of the mass privatization and the collapse in investor confidence in financial institutions after the 1997 pyramid schemes crisis, lack of adequate and efficient market infrastructure for issuing, trading, clearing and settlement, and lack of crucial institutions for effective functioning of a capital market resulted in. Established in 2014, the Albanian Securities Exchange (ALSE) is the country's first licensed private institution for securities exchange. ALSE initially traded only in government securities, until the establishment of a Central Securities Depository (CSD) for non-governmental securities, named the Albanian Securities Register (ALREG) in 2019. Although ALSE and ALREG provide the complete technical infrastructure for listing and trading the corporate securities in LEK, no Albanian companies are yet listed, and as such, do not yet fulfil the mission to mobilize financing for the Albanian companies which continue to fully rely on bank credits. Approval of the 2020 Law on Capital Markets has been a crucially important development in terms of increasing investors' trust in financial markets and offering better protection of their interests.

**The government securities market and the private placement bond market constitute the most active segments of the Albanian securities market, while equities, corporate bonds with public offering and derivatives market are still absent.** The banks and institutional investors are the largest buyers of government bonds and bills in the primary market on their account and on behalf of their clients, while households still own only a small percentage of government securities as their investments take the traditional form of bank deposits. Currently the Albanian Government remains the sole issuer of government securities. The Primary Dealer System, implemented in Albania since 2018, intends to develop the government securities market and encourage the secondary market and liquidity increase, though no evidence exists yet on its impact on the development of the secondary market. The increase in the number of issues of corporate bonds has remained very limited given the number of participating investors. This is because the Albanian capital market lacks brokers, investment companies and intermediate institutions, which normally should be the banks themselves. Since September 2023 "Eurizon Capital" is authorized as an investment fund under the Inte-

sa SanPaolo Group to create opportunities for Albanian investors to have a direct access to European Markets for investments in collective mutual funds within the EU.

**Despite its very small share in financial intermediation (4%), micro-finance plays a crucial role in serving individuals, farmers and small businesses that do not have access to the banking system.** The Albanian microfinance sector is composed of Non-Bank Financial Institutions (NBFI), providing microcredit and other types of lending such as financial leasing or factoring, and Savings Loans Associations (SLA). About 45% of the loan portfolio granted by NBFI is to individuals, with the rest to the business sector. Most of Albania's Micro-Finance Institutions (MFI) follow a socially responsible policy targeting financially excluded individuals and disadvantaged areas. The sector has evolved in line with the socio-economic developments of the country and the growing market demands, offering products and services that raise living standards for individuals and support free enterprise for micro-businesses but also ensuring sustainability in quality of life and consolidation of local business activity, especially family businesses. MFIs' development and strategic repositioning over time means that they now represent a diversified set of actors, shareholders, and clients.

**Small and Medium-sized Enterprises (SMEs) constitute 99.8% of all enterprises and 81.6% of employment in Albania yet struggle to access finance.** Despite the Law on SMEs that provides the legal framework for various forms of financial support to SMEs, limited access to finance, especially bank loans, remains a major challenge. This is mainly due to high informality (especially in agriculture), limited availability of collateral and low levels of financial capacity. Due to the specifics of the admission criteria, the participation rates in donor-financed SME financing schemes remain low. Enhancing SMEs' access to finance, through increasing the effectiveness of existing grant schemes and introducing and promoting new financial tools and instruments can contribute to strengthening the competitiveness of SMEs.

**The first investment fund in Albania was established in 2011.** The number of such funds increased to 12 funds by 2022, with combined net assets amounting to 4% of GDP and 4% of financial sector assets. The sector's growth has been driven by inflows from (mainly retail) inves-



tors as well as positive returns on assets (mainly domestic sovereign bonds). The sector is highly concentrated, with the largest fund accounting for 62% of total investment funds' assets and the three largest investment funds accounting for 95% of the sector's assets. The first private pension fund was approved in 2010, following the licensing of the management company of voluntary pension funds, with 4 management companies, 4 pension funds and 6 depositories currently operating in the Albanian voluntary pension funds market. The growth of the net assets of the voluntary pension funds market, as well as their investment value and membership have grown substantially over the period 2012-2022.

**International foreign aid has lent crucial support to Albania's development needs, its preparation for EU membership, and its crisis response over the last three decades.**

Sectorial foreign aid priorities have evolved over time: whereas in the 1990s aid focused on sectors such as transport and communication, agriculture, and private enterprise development, the 2000s instead prioritized energy, water, social development, and rule of law, and the 2010s allocate more aid towards governance, energy, and financial services. Aid allocation towards critical economic sectors such as water and agriculture, and social sectors such as health and education has declined significantly over time. The EU has been Albania's largest donor, providing 100% grant assistance within the framework of the EU financing Instrument for Pre-Accession (IPA). IPA II that covered the period 2013-2020 was disbursed through various instruments such as conditional budget support focusing on policy areas such as Democracy and Governance, Rule of Law, Economic Governance, Competitiveness, and Growth. Currently, there is under implementation IPA III covering the period 2021-2027. The growing dominance of Other Official Flows (OOF), most of which accompanies non-concessional interest rates, over Official Development Assistance (ODA) as the dominant aid modality has increased Albania's debt levels and pressured domestic budget. While the 1990s was dominated by ODA flows (grants and soft loans) towards humanitarian and balance of payment support, the 2000s witnessed a growing use of OOF. Given the pressure to reduce the debt to GDP ratio, capital investments (which are typically covered by OOF) could be subject to suspension, further impacting the budgeting process, the realization of investment projects, and potentially disrupting the implementation of gov-

ernment policies. Therefore, reorienting aid flows towards ODA loans remains very important for the years to come. Greater alignment between aid allocation and strategic NSDEI pillars is also vital for maximizing aid efficiency and effectiveness.

**Remittances have been a major source of foreign exchange inflows to Albania, constituting a larger share of GDP than FDIs and export revenues, and contributing to financing trade deficit and poverty reduction.**

Currently, there are 1.4 million Albanian emigrants living in countries such as Greece, Italy, United States and Germany. Remittance inflows constitute 15-20% of GDP during the period 1996-2006, dropping to around an average of 9.5% in the period 2007-2022, mainly due to the increased GDP size. Given their resilience to internal shocks and their quick recovery in the face of crisis, remittance inflows have been not only a stable source of revenue for the economy but also a crucial financial resource for crisis response. As a major source of foreign exchange inflows, they also play a crucial role in financing the country's trade deficit, covering about 38.8% of it in 2022 and, therefore, of great importance to macroeconomic stability of the country. In the context of the country's weak social protection schemes, remittances continue to be an important form of social protection and poverty alleviation. Around 23-26% of households receive remittances, and the latter constitute the only source of household income for 24.4% of remittance-receiving households, and for the rest they account for 14-23% of their income.

**Despite the introduction of relevant Foreign Direct Investment (FDI) and privatization laws in the 1990s, high risks associated with political and social instability, low levels of economic diversification and a weak financial system have hampered FDI flows to Albania.**

The pyramid scheme crisis of 1997 was a blow to the country's efforts at creating a conducive foreign investment environment. FDI net inflows reached a low of around 1% of GDP by 1999 before starting a steady recovery, reaching over 11% of GDP by 2009 just before the onset of the Global Financial Crisis. Since then, FDI net inflows and the overall FDI stock have followed a declining trend as a percentage of GDP. Albania's vulnerability to external shocks, regional and global volatilities, ranging from the Eurozone crisis to the Covid-19 pandemic, have further undermined FDI flows to the country.

**Most FDIs since 2000 have been brownfield investments stemming from the privatization of**

**strategic State-Owned Enterprises (SoEs), with only a minor FDI share in the form of green-field investments.** Institutional and regulatory reforms, capacity improvements and economic developments since the early 2000s have aimed at enhancing the country's green-field investment climate, though the latter has never managed to surpass the brownfield investments. During the first 25 years of transition, energy, mining, infrastructure, manufacturing, agriculture, and food processing were the priority FDI sectors in Albania. Energy and power generation sectors have continued to attract the majority of green-field investments to date. In 2022, The FDI equalled 6.7% of GDP. Given the growing investor interest in the energy sector, it is important to ensure sufficient foreign investments are also drawn to other strategically important economic sectors.

**Illicit Financial Flows (IFFs) constitute a significant challenge to Albania, particularly in terms of their drain on potential private financial resources, their integration into official financial system, their large associated informal economies and associated cash flows, and their undermining of the state, state institutions and democratic cultures.** According to 2020 estimates, IFF in Albania represents around one fifth of the economy. Key reasons for the prevalence of illicit financial activity are the lack of institutional capacities, integrity, and development to keep up with the scale of trade. Progress has been made in establishing appropriate legal, regulatory, and enforcement mechanisms to counter IFFs in Albania, although the country still lacks formal procedures to measure and assess the extent and activities of the illegal economy and the criminal activities and products in circulation.

#### Key challenges in mobilizing development finance within an INFF framework

Albania is expected to see a steady economic growth and a gradual fiscal consolidation starting from 2023; however, a narrow focus on GDP growth will not address the country's development challenges. Investing in people, increasing firm productivity, building a more sustainable growth model, and strengthening public finances should be components of a stronger and more sustainable development strategy. Growth needs to become more green, more resilient, and more protective towards vulnerable groups, rendering financing more difficult but more sustainable. In addition, the fiscal space should be increased through revenue

mobilization through the deployment of extra fiscal resources, including foreign capital flows and mobilization of the domestic private capital inside and outside the financial institutions.

**Albania remains as one of the most risk-exposed countries in the region, yet there is a lack of clear measurement of the risks, inhibiting relevant policy responses.** Over the last decades, the country has experienced several risks such as macroeconomic shocks (1991), financial sector crisis (1997), natural disasters such as floods, fires as well as earthquakes (the most severe being the 2019 earthquake), the Covid-19 pandemic, and most recently the ramifications of the war in Ukraine – all of which have created important fiscal challenges for the economy. The Government of Albania lags in monitoring, reporting and managing such fiscal risks and suffers from a large insurance protection gap (both for public and private assets) and no sovereign insurance to provide budget support during emergencies. This explains the government's substantial funding gap in response to the multiple crises of the last years and the use of an ex-post policy approach in the form of budget cuts and reallocations, borrowing, or donor aid, which are costly and disruptive despite their rapidness. These measures have widened the country's fiscal deficit and debt burden (74.5% of GDP in 2021). Under the limited ex-ante sources of funds, public expenditures were reallocated through normative acts and crowding out important planned expenditures, presenting an opportunity cost in terms of forgone or delayed returns.

**Shadow economy in Albania is large and informal economic activity accounts for about 27% of GDP, with one-third of the country's workers are in the informal sector (over half in the agriculture sector is included).** In general, informality is driven by a weak institutional and regulatory environment, insufficient enforcement capacity of public authorities, corruption, and low awareness of its negative social implications. Widespread informality undermines competition, hinders efficient allocation of state and private resources, and reduces tax revenues and funding of social security systems. Reducing informal employment and a redesign of the relevant tax policies could help increase social contributions and income tax revenues in addition to raising employment and minimum wages. The fiscalization process that started in 2021 is expected to improve the avail-



ability of real-time information about economic activity. At the time of writing, no cross-cutting strategy to tackle informality has been drafted or adopted.

**Albania is experiencing a rapidly shrinking population due to emigration and declining birth rates, pressuring both the pension system and the labour market.** The share of pensioners to the total population has increased from 19% in 2010 to 22.6% in 2022. Although the contribution revenues have increased over the last decade, the 2022 level of deficit in the pension system is twice the deficit level in 2010. Underreporting of wages in the private sector impacts the pension contribution rates. The size of the 15–29-year-old age group has decreased by 30% over the period 1989-2020. The brain drain continues to be a highly costly phenomenon particularly for occupations that are difficult to fill in the labour market. Although the number of immigrants from other countries to Albania and returned emigrants have increased, this is insufficient to compensate the emigration numbers.

**Albania's existing social protection program (NE) has a limited impact on reducing poverty risk.** Around 21.8% of the population are at risk-of-poverty, but only 9% of the Albanian population are beneficiaries of the NE program – 95% of which is provided in the form of cash transfers. Local governments are responsible for social care provision, yet their fiscal space is insufficient to substantially increase social protection funding at the local level. While about one-third of public expenditure is allocated to social protection, this is still not comparable to the EU27 average, with ongoing problems persisting in terms of the targeting and adequacy, increased deficit in the public social insurance system, increased number of beneficiaries versus contributors due to the aging population, and the slight increase in the replacement rate for old age pensions.

**Significant financial resources are required to address strategic development and sectorial priorities.** The country's numerous strategic documents highlight the indicative cost of achieving the objectives set out in national development plans, however no complete financial scenarios are provided in terms of resource gaps and required fund mobilization strategies, or the impact of the financing gaps on the implementation of the strategy. A crucially import-

ant instrument to operationalize the NSDEI, sectorial strategies and government priorities in concrete national and regional megaprojects/projects is the National Single Project Pipeline (NSPP), which as of 2022 has listed 145 strategic projects the majority of which in non-matured and partially matured stage. Based on indicative budgets the financing needs are over 16 billion EUR.

### Recommendations for the INFF

This report offers a set of recommendations to inform the development of an integrated financing strategy to underpin Albania's sustainable development vision. The recommendations are organized into three main groups:

1. Overall financing strategy recommendations;
2. Recommendations specific to the financing of thematic priorities;
3. Recommendations to improve governance, monitoring, and reporting mechanisms for an INFF. Key strategies include reforming tax policies and administration, streamlining tax incentives, boosting public and private investment in sustainable development, and fostering a conducive environment for domestic and international finance.

The report emphasizes the critical role of coherent policies, institutional reforms, and strategic partnerships in achieving sustainable development goals, underscoring the necessity for Albania to adopt a multi-faceted approach to finance strategy that aligns with its long-term development vision and priorities.

# Chapter I.

## INTRODUCTION

### 1.1. The Integrated National Financing Framework

In 2015, with the adoption of the 2030 Agenda for Sustainable Development and the Sustainable Development Goals (SDGs) that are at its heart, world leaders also recognized the critical role of financing for making meaningful progress towards their achievement. To that end, they agreed to the [Addis Ababa Action Agenda \(AAAA\)](#), which stipulates a new global framework for financing sustainable development by aligning all financing flows and policies with economic, social, and environmental priorities. This Agenda calls for the SDGs to be implemented through cohesive, nationally owned sustainable development strategies, supported by Integrated National Financing Frameworks (INFF).

An INFF is a comprehensive strategy that a country uses to mobilize, allocate, and manage its financial resources to achieve its development goals. It involves creating a coordinated approach that brings together various sources of financing, including government budgets, domestic and international private investments, and development assistance from multilateral organizations.

The framework aims to ensure that financial resources are effectively and efficiently used to address the country's development challenges, such as sustainable economic growth, job creation and poverty reduction. The integrated national financing framework considers the country's macroeconomic conditions, fiscal policy, financial sector development, and public financial management to create a sustainable and inclusive financial system that supports the country's long-term development objectives.

#### Every INFF complies with the following core principles:

- It is a country-led and country-owned process governed by an oversight body composed of national decision-makers, such as ministries and representatives of other sectors.
- It is aligned with and anchored around existing processes, policies, and institutional investment programs, as well as the work of the SDG reporting and SDG acceleration fund.
- It is evidence-based: the INFF is underpinned by an assessment of the financing landscape and ecosystem, with recommendations being derived through scrutiny and analysis of primary and secondary data sources.
- It is based on multi-stakeholder dialogue between governmental actors, as well as with non-governmental organizations, civil society, public and private investors, and sub-national authorities, allowing the outcome of the exercise to be co-created.
- It is practical and action oriented: the INFF road map, its recommendations and financing strategy build from the existing and emerging financing systems and provide pragmatic, practical, and action-oriented measures that can be integrated into the SDG financing ecosystem.

The process of formulating an INFF is structured around four basic building blocks, as outlined in Table 1 below. Each building block represents a critical component in building national capacity to strategically plan, mobilize, and manage the financing needed for national sustainable development objectives.

Table 1. INFF Building Blocks

BB 1: Assessment and Diagnostics	BB 2: Financing Strategy
<ul style="list-style-type: none"> <li>Quantify financing landscaping volumes and players,</li> <li>Establish initial estimates of financing needs,</li> <li>Identify emerging financing trends,</li> <li>Outline key financing challenges and opportunities,</li> <li>Understand risk landscape,</li> <li>Identify primary impediments to effective financing of national development priorities</li> </ul>	<ul style="list-style-type: none"> <li>Review existing budgeting processes and consider catalytic potential,</li> <li>Evaluate role of international development community,</li> <li>Identify ways to integrate sustainability into private sector decision making,</li> <li>Consider primary financing constraints,</li> <li>Identify possible financing policy solutions for inclusion in INFF Roadmap</li> </ul>
BB 3: Monitoring and Evaluation	BB 4: Governance and Coordination
<ul style="list-style-type: none"> <li>Review national capacity to track financing trends,</li> <li>Review national data and statistical systems,</li> <li>Encourage / support sustainability reporting,</li> <li>Identify potential for SDG/Gender/Climate budget tagging,</li> <li>Identify opportunities to improve monitoring capacity</li> </ul>	<ul style="list-style-type: none"> <li>Identify INFF Ownership Arrangements within Government,</li> <li>Finalize INFF roles and responsibilities,</li> <li>Review existing Public-Private dialogue platforms,</li> <li>Identify preferred oversight, dialogue, coordination, transparency, and accountability structures to overcome silos and enhance integration across stakeholders, sectors, and financing policy areas</li> </ul>

### 1.1.1. Building Block 1: Assessment and Diagnostics

This report provides a summary of the assessment conducted in fulfilment of the first INFF building block. It represents the first holistic mapping of Albania's entire financing ecosystem. The assessment was conducted based on the UNDP's [Development Finance Assessment \(DFA\) guidelines](#)<sup>1</sup>.

The DFA is a comprehensive review of a country's financial landscape, which helps identify strengths and weaknesses in the financial system and how they affect its development objectives as well as its progress towards achievement of the SDGs. The assessment looks at different sources of financing available (i.e., public and private, domestic and international), and identifies trends, gaps, constraints in the financial system and the policies and regulations governing resource allocation and mobilization. Based on these findings, subsequent building blocks of the INFF process will formulate a strategy to address the identified challenges for achieving the country's development goals by aligning financial resources with the country's development priorities.

Thus, in this report, we explore financing instruments and mechanisms, policies, institutions, and capacities in place in Albania, with the aim of highlighting:

- Existing resources, policies, institutions, capacities, and monitoring tools,
- Emerging initiatives to strengthen resource mobilization, policies, institutions, capacities, and monitoring,
- Future opportunities to further strengthen policies, institutions, capacities, and monitoring to aim for a more integrated approach to development financing.

In doing the above, the analysis maps out Albania's existing and emerging development financing landscape and identifies critical gaps and opportunities. The recommendations from this analysis can then be addressed by the INFF Financing Strategy. It is important to note that the results presented here combine analytical and diagnostic work based on secondary data, as well as findings from rounds of multi-stakeholder dialogue conducted over the study period.

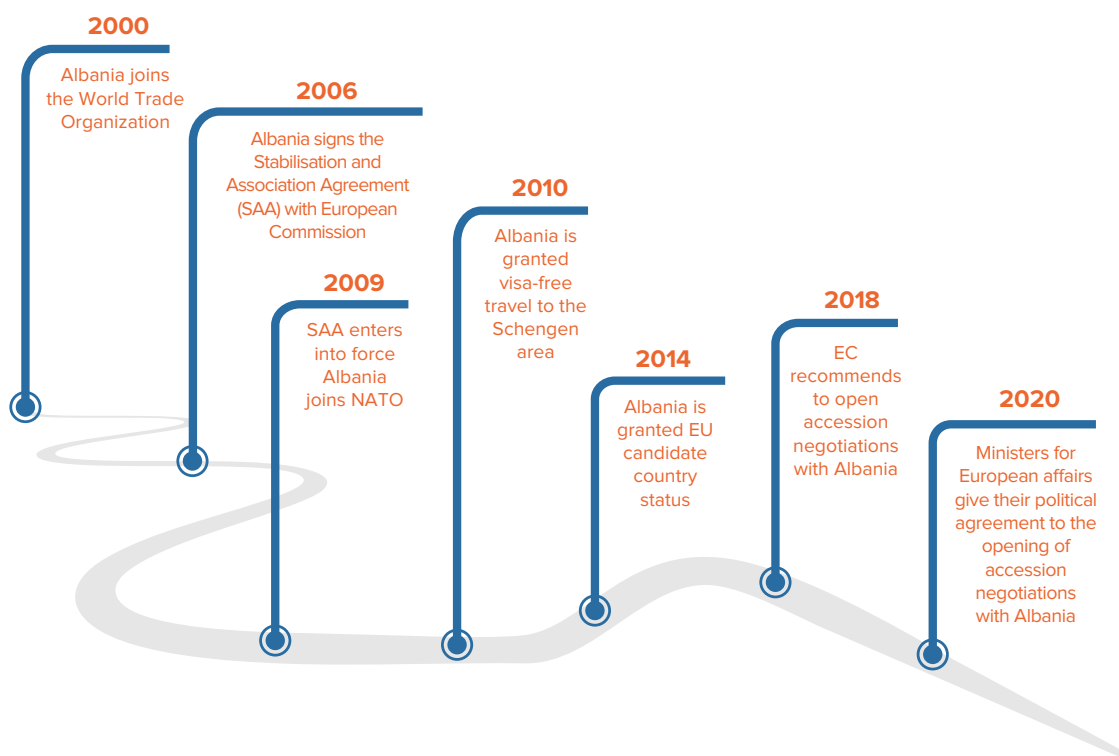
1. See UNDP Development Finance Assessment [Guidebook](#).

# Chapter II.

## COUNTRY CONTEXT

### 2.1. Albania and its vision for development

Figure 1. A timeline of Albania's accession into different organizations



Albania opened up to the world after the fall of the communist regime and has made concerted efforts to join international platforms and organizations ever since. EU accession is a long-held aspiration for the country and the

overarching driving force behind its democratization reforms. In addition to the strong policy alignment, EU accession enjoys also unwavering popular support. A February 2020 poll showed that 97% of Albanians were in favour of

EU accession.<sup>2</sup> The latter is, in fact, at the very heart of the country's vision for development, as outlined in the National Strategy for Development and European Integration 2023-2030 (NSDEI).<sup>3</sup>

*“[a] dynamic economy, part of EU and WB region, with equal opportunities for all Albanian citizens based on a functional democracy and that guarantees the human rights and freedom”.*

NSDEI, aimed mainly at European Integration, is based on three pillars: (i) Democracy and strengthening of institutions and good governance; (ii) Sustainable economic development, connectivity, and green growth; and (iii) Social cohesion. Other NSDEI objectives that address sustainable development include strengthening the financial system and monetary policy, strengthening the public finances and fiscal stability, business development, competitiveness and promotion of foreign investments, agriculture and rural development, blue economy, tourism development, digital economy and society, energy and natural resources, sustainable environment etc.

The link between each NSDEI strategic objective with the related EU Acquis Communautaire and SDG targets and indicators is made explicit. Financial considerations for NSDEI are based on economic growth predictions, while the implementation risks are linked with the potential future impact of events like the war in Ukraine and related inflationary pressures. Nevertheless, no estimates or scenarios are presented to quantify these considerations.

In 2014, EU member states, led by Germany, initiated an intergovernmental cooperation initiative aimed at providing new momentum to the EU accession of the Western Balkan (WB) countries, which is known as the Berlin Process.<sup>4</sup>

This Process has launched a number of projects and platforms to improve the integration of WB countries with one another, as well as their alignment with the EU. Some of the bodies emerging from the Berlin Process include the Economic and Investment Plan (sustainable transport, clean energy and digital connectivity implemented through the Western Balkans Investment Framework), the Green Agenda and the Common Regional Market for the WB. Albania is not only an active participant and beneficiary of the Berlin Process, but it has also been a promoter of the “Open Balkan” initiative<sup>5</sup> to further enhance and accelerate regional cooperation (beyond the above mentioned Common Regional Market, Digital Agenda, Connectivity, WB Green Agenda, Green Corridors).

Currently, the country has started its EU accession negotiation process, which began in July 2022 with the first Intergovernmental Conference. The very demanding process of screening Albania's preparedness for negotiations is guided by the National Plan for European Integration 2022-2024<sup>6</sup>, which coordinates Albania's approximation of legislation to the Acquis.

## 2.2. Albania and the 2030 Agenda for Sustainable Development

The Government of Albania is strongly committed to the [2030 Agenda for Sustainable Development](#), which it endorsed on 25 September 2015. The 17 Sustainable Development Goals (SDGs), at the heart of the 2030 Agenda, have been embedded in the country's National Strategy for Development and Integration 2015-2020 (NSDI II) and the EU integration agenda. To support national efforts to meet the requirements of sustainable development, in 2017 Albania's Parliament approved a resolution<sup>7</sup> confirming the country's commitment to Agen-

2. European Parliament. (2022, May). At a glance - 2021 report on Albania. (PDF). Retrieved from: [https://www.europarl.europa.eu/RegData/etudes/ATAG/2022/729418/EPRS\\_ATA\(2022\)729418\\_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/ATAG/2022/729418/EPRS_ATA(2022)729418_EN.pdf), on 17 August 2022.

3. NSDEI 2030 is the overarching document outlining Albania's vision for development. All other sectorial policies and strategies needs to be harmonized with NSDEI.

4. An intergovernmental cooperation initiative started at the 2014 Berlin Conference with the support of German Government, under the leadership of former Chancellor, Angela Merkel, and followed by several other Summits, which aims revitalizing the multilateral ties between the Western Balkans and selected EU member states, and at improving regional cooperation in the Western Balkans on the issues of infrastructure and economic development.

5. Albania, North Macedonia, Serbia, and Montenegro are currently cooperating under this initiative. The platform remains open for other countries to join. It aims to increase trade and cooperation as well as improve bilateral relations of the participant countries.

6. The National Plan for the Implementation of the SAA (NPISAA) 2007–2012 is the first drafted. Since 2014, the Plan is drafted for a five-year period and is updated on annual basis.

7. Albania's Parliament <https://www.un.org.al/news/members-albanian-parliament-commit-play-active-role-support-imple->

da 2030 and establishing an ad hoc Subcommittee on SDG nested under the Parliamentary Committee on Economy and Finance. In the executive branch, the coordination and leadership for the 2030 Agenda is within the mandate of the Inter-Ministerial Committee on the SDGs,<sup>8</sup> chaired by the Deputy Prime Minister and comprising key government institutions, as well as other stakeholders from the business community, civil society, academia, and international organizations.

The development agencies and partners in cooperation with the governmental agencies and institutions are currently implementing 220 activities focusing on important SDG areas such as quality education, industry, innovation and infrastructure, decent jobs and economic growth, climate actions, good health and well-being, sustainable cities and communities, and gender equality. The UN is the leading partner, mobilizing in 2022 around USD 94 million<sup>9</sup> to support the SDG 2030 agenda as a complimentary effort to Albania's EU accession goal.

Monitoring of progress in meeting the SDGs has been recorded through a Baseline Report<sup>10</sup> (2017) and a Voluntary National Review<sup>11</sup> (2018), which Albania presented at the UN High Level Political Forum on sustainable development. These analyses mostly focused on SDG alignment and harmonization with the national policy framework since the Albanian National Strategy for Development and Integration 2015-2020 (NSDI) and most sectorial strategies were already in place at the time the global SDG Agenda 2030 was approved. In addition, the Ministry of Finance and Economy, with UN support, has prepared two further analyses of the state

budget versus the SDGs – namely SDG Budget Analysis 2015-2017,<sup>12</sup> and SDG Budget Analysis 2015-2019.<sup>13</sup>

Quantitative progress in SDG achievement is tracked by the national statistical agency, INSTAT, through a dedicated dashboard.<sup>14</sup> Albania produces regular data on 83 out of the 244 global indicators in the SDG monitoring framework (34%), while for 56 other indicators (23%) information is either partially available or additional calculations are needed as part of the existing methodology.<sup>15</sup> In addition, there are two important international monitoring platforms, the SDG Global annual Report<sup>16</sup> and the Global SDG Data Platform<sup>17</sup> with indicators' status for 192 countries including Albania.<sup>18</sup> The 2022 Sustainable Development Report<sup>19</sup> ranks Albania 61 out of 163 countries (with a score of 71.63<sup>20</sup>).

### 2.3. The 2030 Agenda and the EU

Sustainable development is also at the heart of European policy and embedded in the EU Treaties.<sup>21</sup> Similarly, the EU and its Member States are strongly committed to deliver on the 2030 Agenda and SDGs, placing them at the core of EU international cooperation.<sup>22</sup> Some of the examples of how the EU has integrated SDGs in its policy framework include:

- The European Green Deal, the EU's flagship policy aimed at making Europe climate-neutral by 2050, fostering a resilient future. This is aligned with SDG 7 (Affordable and Clean Energy), SDG 12 (Responsible Consumption and Production), and SDG 13 (Climate Action).

mentation-agenda-2030-and

8. Order of the Prime Minister No. 63, dated 12.05.2017. Amended by Order No.249, dated 28.12.2017.

9. <https://albania.un.org/en/sdgs>

10. Can be accessed at [https://info.undp.org/docs/pdc/Documents/ALB/SDG\\_baseline\\_report\\_final.docx](https://info.undp.org/docs/pdc/Documents/ALB/SDG_baseline_report_final.docx)

11. Can be accessed at [https://sustainabledevelopment.un.org/content/documents/20257ALBANIA\\_VNR\\_2018\\_FINAL2.pdf](https://sustainabledevelopment.un.org/content/documents/20257ALBANIA_VNR_2018_FINAL2.pdf)

12. Can be accessed at <https://albania.un.org/sites/default/files/2020-05/no.20- Budget Analysis of SDG Related Spending in Albania 2015 - 2017.pdf>

13. Can be accessed [https://albania.un.org/sites/default/files/2021-06/UN\\_2021\\_SDG\\_Spending\\_Albania\\_Final.docx.pdf](https://albania.un.org/sites/default/files/2021-06/UN_2021_SDG_Spending_Albania_Final.docx.pdf)

14. INSTAT SDG Dashboard: <https://www.instat.gov.al/en/sdgs/>

15. The SDG Baseline Report.

16. <https://unstats.un.org/sdgs/>

17. <https://unstats.un.org/sdgs/dataportal>

18. The global indicator framework includes 231 unique indicators (updated on 21<sup>st</sup> May 2021), but the total number of indicators listed in the global indicator framework of SDGs is 248, because thirteen indicators repeat under two or three different targets.

19. See more <https://dashboards.sdgindex.org/map>

20. A score of 100 indicates that all SDGs have been achieved.

21. Articles 3 and 21 of the Treaty on European Union.

22. See 2030 Strategy.

- The EU's Circular Economy Action Plan, aimed at promoting a circular economy, where resources are used in a more sustainable way. The plan is aligned with SDG 8 (Decent Work and Economic Growth), SDG 12 (Responsible Consumption and Production), and SDG 13 (Climate Action).
- The Just Transition Mechanism, a policy aimed at supporting regions and communities that are heavily reliant on fossil fuels to transition to a more sustainable future, ensuring “transition [...] happens in a fair way, leaving no one behind”<sup>23</sup>. The policy is aligned with SDG 8 (Decent Work and Economic Growth), SDG 10 (Reduced Inequalities), and SDG 13 (Climate Action).
- The EU provides development assistance to partner countries to support their efforts to achieve the SDGs, promoting sustainable development, reduction of poverty, and upholding human rights.

EU also monitors SDG indicators: in collaboration with various stakeholders, the EU has developed a set of around 100 indicators structured along the 17 SDGs that are relevant from an EU perspective. These indicators are monitored annually by EUROSTAT,<sup>24</sup> and there are 38 indicators included in the EU SDG indicators list that include Albania,<sup>25</sup> EU member states, and other Western Balkan countries.

## 2.4. EU Sustainable Finance Strategy

As noted previously, the EU faces a sustainability challenge for the next decade as it strives to decouple economic growth from environmental degradation and address social inequalities. As such, climate policy has become a top priority, with the ambitious aim of reducing greenhouse gas emissions by 55% by 2030 and achieving complete climate neutrality by 2050. The European Commission (EC) released a sustainable finance plan to help achieve these goals by promoting green investment and integrating economic and environmental policies. This so-called EU Sustainable Finance Strategy is launched as part of the European Green Deal. The related action plan includes ten key actions under three main pillars: (i) Reorienting

capital flows towards sustainability, such as creating green bond standards and sustainability benchmarks; (ii) Mainstreaming sustainability into risk management, including better integrating sustainability in ratings and market research and clarifying institutional investors' and asset managers' duties; (iii) Fostering transparency and long-termism, which involves strengthening sustainability disclosure and accounting rule-making, promoting sustainable corporate governance, and attenuating short-termism in capital markets.

To facilitate green investment, the EU published the EU Taxonomy in June 2020. This classification system identifies six environmental objectives, including protection of ecosystems, climate change mitigation, climate change adaptation, protection of water and marine resources, transition to circular economy, and pollution control. The taxonomy applies to EU public interest companies with over 500 employees and spans various sectors such as agriculture, manufacturing, transportation, energy, construction, and communication. Additionally, there are various established platforms, such as the European Commission's technical expert group on sustainable finance, the EC high level expert group on sustainable finance, the EU member states expert group on sustainable finance, and the international platform on sustainable finance (IMF/the World Bank), that support sustainable finance initiatives.

23. Retrieved from: [https://commission.europa.eu/strategy-and-policy/priorities-2019-2024/european-green-deal/finance-and-green-deal/just-transition-mechanism\\_en](https://commission.europa.eu/strategy-and-policy/priorities-2019-2024/european-green-deal/finance-and-green-deal/just-transition-mechanism_en)

24. See: <https://ec.europa.eu/eurostat/web/sdi/database>

25. See: <https://eu-dashboards.sdgindex.org/profiles/albania> and [https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Enlargement\\_countries\\_-\\_indicators\\_for\\_Sustainable\\_Development\\_Goals](https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Enlargement_countries_-_indicators_for_Sustainable_Development_Goals)



# Chapter III.

## SOCIO-ECONOMIC CONTEXT

### 3.1. Social Context

Albania is a country of almost 2.8 million people,<sup>26</sup> yet population decline due to increased migration and falling birth rates continues to be a major demographic challenge facing the country. During 2011-2022, the population of Albania shrunk by 3.9%, equal to an annual average of -0.4%. Similar to other countries, the crude birth rate in 2021 was lower than the crude death rate, resulting in a natural population decrease, also due to the impact of Covid-19 pandemic. For Albania, the natural population decrease was -1.2 in 2021, down from an increase of 4.9 in 2011. The fertility rate in 2021 was 1.31, falling consistently after 2018 (1.37 children per woman). In 2010-2011 fertility rates were respectively 1.63 and 1.65 per woman. The average age at childbirth is currently 29.2 years, compared to the EU average of 31.1 years in 2021. Albania experienced substantially falling life expectancies between 2013-2021, with a decrease of 2.4 years for both men and women. Life expectancy in Albania fell from 76.0 in 2013 to 73.6 in 2021 for men (compared to 77.2 years in the EU) and from 80.1 to 77.7 for women (compared to 82.9 years in the EU). In 2019, the life expectancy for men was 77.6 years (compared to 78.5 years in the EU), and for women, it was 80.7 years (compared to 84.0 years in the EU). In Albania, the life expectancy gender gap was 4.1 in 2021 (compared to 5.7 years in the EU).<sup>27</sup> Furthermore, the number of Albanians who obtained EU citizenship increased from 24.6 thou-

sand in 2011 to 32.4 thousand in 2021<sup>28</sup>. Albania ranked 67<sup>th</sup> out of 191 countries and territories on the Human Development Index in 2021, with an index value of 0.796<sup>29</sup>, thus belonging to the high human development category, along with some of the world's wealthiest countries and most EU member states. This is an improvement from 2019, when Albania ranked 69<sup>th</sup>. Albania did particularly well in the Gender Inequality Index – which reflects gender-based inequalities in three dimensions (reproductive health, empowerment, and labour market) – with Albania ranking 39<sup>th</sup> out of 170 countries.

Nevertheless, poverty and inequality are challenges that Albania still needs to address. In 2021, the ratio of at-risk of poverty population equalled to 22%, slightly higher than in 2020 when it was 21.8%. This remains at the same level as the EU 27 average (21.7% of the EU population in 2021). There are welfare programs in place in the country to support population groups in need, most note-worthy of which in this context is Ndhma Ekonomike (NE), a means-tested social assistance program providing support, cash or in kind, to families and individuals in need. The NE benefit increased by 57% over the period 2018-2022. In 2022, 64,000 families received NE benefits, amounting to 224,000 individual beneficiaries of, equivalent to 9% of the total Albanian population. Economic reintegration of the working age

26. A population of 2,761,785 reported by INSTAT for January 2023; Results from Cens 2023 are still not available.

27. Eurostat. Enlargement countries - population statistics: [https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Enlargement\\_countries\\_-\\_population\\_statistics#Population\\_and\\_age\\_structure](https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Enlargement_countries_-_population_statistics#Population_and_age_structure)

28. [https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Enlargement\\_countries\\_-\\_statistics\\_on\\_migration,\\_residence\\_permits,\\_citizenship\\_and\\_asylum&oldid=485831](https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Enlargement_countries_-_statistics_on_migration,_residence_permits,_citizenship_and_asylum&oldid=485831)

29. Read the report here: <https://www.undp.org/albania/publications/human-development-report-2021-22>



NE beneficiaries into labour market remains an ambitious target for the Albanian government. Yet, according to SILC 2021,<sup>30</sup> the NE program covers 36% of individuals under the at-risk-of poverty threshold and 80% of families in the two lowest quintiles of population income, resulting in a limited poverty-reducing impact of the program. The COVID-19 pandemic highlighted the importance of proactive investment to build comprehensive and resilient social protection systems that can respond quickly and effectively to shocks when they emerge. Cash transfers constitute about 95% of the social protection sector's overall budget. Local governments are responsible for the budgeting and delivery of social care services; however, many local governments are unable to generate sufficient own resources to finance these services and remain heavily dependent on the transfers from the state budget. To address this, an additional financing mechanism called Social Fund was established in 2016 but activated in 2019, for ensuring adequate funding to implement Social Care Plans and provide social services for the communities. This fund aims to support local government units (LGU) to be able to establish their own Local Social Funds (similarly to the Social Fund of the Ministry), as a sustainable instrument to raise resources through central and local financing, donors' support, private sector contribution, etc. During 2019-2023, the Fund disbursed ALL 800 million in total (equivalent to USD 8.5 million) supporting the establishment of 54 social services (out of which 39 local services and 15 specialized services) for around 26,000 beneficiaries.

## 3.2. Macroeconomic context

### 3.2.1. A fast growing, but vulnerable GDP

Albania began its transition to a market economy at a time when the country was experiencing the shock of a deep crisis (communism economic failure) that worsened over 1980s.

In 1990, a 10% Gross Domestic Product (GDP) contraction was reported, deteriorating by a further 27.7% in 1991, followed by another 9.7% contraction in 1992. While a comprehensive IMF-led program of domestic macroeconomic and structural adjustment (1993-1996) was under implementation<sup>31</sup>, the first financial pyramid scheme<sup>32</sup> collapsed in late 1996, followed by the collapse of all other pyramid schemes, causing unprecedented economic and social consequences. According to the International Monetary Fund (IMF) and the World Bank (WB), Albanians' subsequent lost deposits equalled USD 1.2 billion, equivalent to half of the country's GDP for 1996 or 40 times more than the total amount of the Foreign Direct Investments (FDI) during 1991-1996 (USD 31 million)<sup>33</sup>. The 1997 crisis slowed economic activity, increased inflation, devaluated the domestic currency and widened the fiscal deficit. The implementation of the IMF macroeconomic stabilization policies resulted in rapid economic recovery, with a GDP growth rate of 8.8% in 1998. This positive economic growth continued for the subsequent years, albeit at a different pace.

Albania's growth rate during 2005-2021 averaged at 3.6 percent. Between 2005 and 2008 Albania's GDP experienced a period of growth fuelled by construction, industry credit expansion, and remittances, with growth peaking at 7.5% in 2008 due to infrastructure investments including a one-billion-Euro highway to Kosovo. However, an EBRD Report in 2007 warned of the importance of addressing the power crisis and the challenges facing the energy sector in order to facilitate the country's long-term development<sup>34</sup>.

During 2009-2015, Albania's GDP growth declined, hitting a low of 1% in 2013 due to weak services and agriculture performance, a construction contraction, and a decline in remittances due to the Great Recession.<sup>35</sup> Public debt reached an unprecedented level of 72% in 2014,<sup>36</sup> compared to 57.5% in 2004 (including accumulated unpaid bills and arrears), while the banks reported increased non-performing

30. <https://www.instat.gov.al/en/themes/social-condition/income-and-living-conditions-in-albania/publication/2022/income-and-living-conditions-in-albania-2021/>

31. A 3-year arrangement under the Enhanced Structural Adjustment Facility (ESAF) of IMF

32. For more information, see here: <https://www.imf.org/external/pubs/ft/fandd/2000/03/jarvis.htm>

33. UNDP, Human Development report for Albania, 1998.

34. EBRD, Transition Report 2007.

35. A large portion of remittances came from the Albanian diaspora in Italy and Greece, two countries that were severely under strain in the late 2000s.

36. See: <https://financa.gov.al/te-dhena-historike/>

loans and decreased investor confidence. In 2014 and 2015, Albania gradually implemented fiscal consolidation to gain macroeconomic stability and growth. Positive factors contributing to growth in 2015 included a strong pick-up in tourism and electricity production due to exceptional rainfall, while negative factors included floods, decline in oil production due to low prices, and financial turmoil in neighbouring Greece. The country continued to experience economic growth in 2016 (3.3%) and 2017 (3.8%), driven by private consumption and investment in hydroelectric power plants in Devoll and the Trans-Adriatic Gas Pipeline (TAP), respectively. In 2018, the country experienced 4% growth driven by industry, including energy production fuelled by heavy rainfall, contributing to almost half of the value added. However, weak power generation led to a decreased growth rate in 2019. In addition, the aftermath of the November 2019 earthquake and the onset of the 2020 Covid-19 pandemic brought about a growth contraction of -3.48%.

Despite the challenges posed by the pandemic, Albania's GDP grew in 2021 with an economic growth rate of 8.54%, driven primarily by stronger investment growth as well as increased domestic demand from both private and public consumption and investments. Pri-

vate and public investments grew by 20.2%, including the post-earthquake reconstruction expenditures. Fiscal and monetary policy measures helped to contain the pandemic's effects. A healthy recovery in exports of construction materials, metals, mineral products, textile, and footwear also contributed to the 2021 growth rebound. However, household consumption has been slower to recover. Government support for pandemic-related expenditures (including health and other support services), continued demand for goods exports, and the easing of international travel restrictions were the main drivers of increased consumption. The fastest-recovering sectors after the pandemic were construction, mining, manufacturing, and electricity generation, while agricultural production has been sluggish. Tourism has also recovered and reached pre-pandemic levels from 2019. Despite a rebound, in 2021 Albania was hit by a wave of shocks starting with an energy crisis that had a major impact on households and the budget, followed by the war in Ukraine, which affected the country through higher commodity prices, including wheat<sup>37</sup> and fertilizers. Higher energy prices drove up prices in transport, leading to second-round effects on other consumer goods. Inflation was expected to increase to 5.5% in 2022 from a pre-conflict scenario of 3%. With higher import costs, the current account

Figure 2. Real GDP annual growth during 2005-2023<sup>39</sup>



Source: INSTAT (2023)

37. Around one third of Albania's wheat imports traditionally come from Ukraine and Russia. Wheat itself accounts for 30% of the population average calorie intake.

deficit is likely to grow to 7.9% of GDP. As higher costs reduce household purchasing power and raise the costs of businesses, growth prospects are expected to be lower,<sup>38</sup> at around 4% on average from 2023 to 2028. The medium-term economic growth of Albania is forecasted to be 4.86% in 2022, 3.9% in 2023, and 4% in 2024. In the medium term, growth is expected to be generated mainly by domestic demand, both consumption and investment, while net foreign demand is expected to have a moderate net effect.

According to estimates, Albania's annual GDP at current prices was expected to reach approximately EUR 15,894 million in 2022, up from EUR 15,152 million in 2021 and EUR 13,307 million in 2020. Similarly, GDP per capita was projected to increase from EUR 4,752 in 2020 to EUR 5,411 in 2021 and to EUR 5,676 in 2022, continuing a trend of growth in both metrics since 2005.<sup>40</sup>

However, despite this growth, the productivity of the Albanian economy remains low. Over the last decade, the average productivity of each employed person in the Albanian economy, as measured by the contribution to GDP in USD constant PPP, was only 31.2% of the EU average in 2012, and while this figure has increased to 34.7% in 2021, it still lags behind other countries in the region, which have remained at a constant level of 51.3%.<sup>41</sup>

When looking at sectorial contribution to GDP, the services sector continues to be the largest contributor, accounting for 45% of the total over the period of 2005-2022, followed by agriculture at 18.4%, construction at 12%, and industry at 11%. The relative contribution of each sector to GDP has remained relatively stable since 2005, with a modest increase of 4% in the services sector's contribution. The construction sector has fluctuated over the years, peaking at around 15% in the mid-2000s before steadily decreasing to an estimated 9.5% in 2021. Energy makes a minimal contribution to GDP, and there have been no major changes in this sector over the years, aside from variations in production due to weather effects. The water supply and waste management sector have the least contribution to GDP. The growth rate of

4.86% in 2022 was generated by an increase of 7% in private consumption and of 7.14% in fix capital formation. Main contributors to annual growth have been sectors of construction (1.95 pp) and trade, transport, accommodation, and food (1.55 pp).

### 3.2.2. Inflation and interest rates

Inflation has been stable below the targeted level of 2% since 2011,<sup>42</sup> but there was an increase in the average inflation rate for 2021 to 2.0%, 0.4 p.p. higher than the previous year. Inflation rapidly increased from 0.9% in Q1 to 1.8% in Q2, and from 2.4% in Q3 to 3.1% in Q4. However, since the beginning of 2022, there has been a significant increase in inflationary pressure because of global events linked to the war in Ukraine.

Inflation reached rate of 6.7% in 2022. By December 2022, the average inflation rate was 7.4%, with the prices of food and transportation showing sharp increases of 14.2% and 6%, respectively. The Bank of Albania (BoA) has confirmed that this upward trend is spreading across an increasing range of goods and services. The BoA has also raised interest rates from 0.25% to 2.25% in October 2022 due to supply issues (for the first time, after a long period of applying low interest rates). The increase in the interest rate may hamper the country's post-pandemic economic recovery. However, even though it has warned that, according to its forecasts, the inflation rate has not yet peaked, data reported during 2023 reflect lower than expected inflation rates.

### 3.2.3. Private sector development

Good progress has been made in terms of private sector development over the last decade. The number of active businesses in 2021 reached 181,549 (including farmers), which is 74% more than in 2012. This was the result of new businesses entering the market, as well as the formalization of existing businesses, particularly unregistered farmers. In a decade, medium-sized enterprises (10-49 employees) in 2021 increased by 76%, while the number of

38. World Bank, Country Partnership Framework for Albania, June 2022.

39. Preliminary data is reported for 2022 and 2023

40. See: <https://www.instat.gov.al/al/temat/ekonomi-dhe-financ%C3%AB/llogarit%C3%AB-komb%C3%ABtare-gdp/>

41. National Strategy for Employment and Skills 2023-2030 based on World Development Indicators database, 2022

42. See: <https://www.instat.gov.al/al/temat/%C3%A7mimet/indeksi-i-%C3%A7mimeve-t%C3%AB-konsumit/#tab2>

large companies (over 50 employees) doubled. The development of the private sector and the reduction of informality have had a positive effect on the number of the social insurance contributors, which increased from 482,000 in 2014 to 703,000 in 2021 (74% are from the private sector). The EBRD Transition Report 2022-2023 highlights that in order to promote private sector development, Albania should enhance the business environment by giving priority to simplifying tax system, enhancing support for micro-, small- and medium-sized enterprises, ensuring the security of e-government services, and increasing the public-private dialogue.

### 3.2.4. Labour force participation and productivity - the path to welfare

The labour market in Albania is shaped by demographic and migratory trends. Over the period 1989-2020, the 15-29 age group segment of the population declined by 30%.<sup>43</sup> On the other hand, in the last two decades, around 25% of the country's total population emigrated, equivalent to about 35% of the active population<sup>44</sup>. Also, there is noted an increase in the number of immigrants, with 15,000 foreign citizens obtaining resident permits in Albania in 2021<sup>45</sup>, combined with a rise in the number of returning migrants. However, emigration numbers still exceed the numbers of both immigrants and returning migrants.

In 2022, the labour force participation rate was 73.2%,<sup>46</sup> with a systemic gender gap observed in which the labour force participation rate stood at 66.7% for females and 80% (13.3 percentage points higher) for males. The service and agricultural sectors have the highest share of employed with respectively 44.2% and 33.9% of the total employment. However, agriculture proved to be the sector most vulnerable to pandemic-related shocks that led to a 5.3% decrease in employment.

In 2022, the unemployment rate was at 10.9%, its lowest level since 2005 and significantly lower than the 17.3% peak in 2014. However, the unemployment rate is still higher for individuals with basic education, those living in small cities and rural areas, and vulnerable populations. Youth unemployment remains high, with a rate of 24.9% in 2022, almost twice as high as the EU rate (13.9%), indicating that young people have difficulty finding work that meets their skills and expectations. The NEET rate (Not in Education, Employment, or Training) for youths aged 15-29 was 25.2% in 2022, which, although improved from 34.5% in 2014, remains high.

Medium-term growth projections suggest that employment is expected to grow by an average of 1.3% per year over the period 2022-2024. Sectors with the highest employment rates in recent years include Information Communication Technology (ICT), accommodation, health, automobile sale and repair.

The average wage at the end of Q4 2022 was EUR 529, which is almost twice the minimum wage of EUR 341. The low levels of productivity in the economy are reflected in the relatively low average wages compared to other regional countries. A degree of underreporting of wages in the private sector is also assumed to push down the average national wage level. The average wage is 30% higher in the public sector compared to the private sector. Wages grew by 8.23% compared to level of 2021.

This reflects the increase in the minimum wage by 15.1% since beginning of 2021, as well as reduction in under-reported wages.<sup>47</sup> The highest average wages are in the ICT and Financial Insurance Activities sectors, while wages in agriculture remain the lowest. Compared to the previous year, in 2022 there is an increase of the gender pay gap by 1.7 percentage points.

43. See: [https://databaza.instat.gov.al:8083/pxweb/sg/DST/START\\_ED\\_REG/REG03/](https://databaza.instat.gov.al:8083/pxweb/sg/DST/START_ED_REG/REG03/)

44. See: <https://punetejashtme.gov.al/en/shqiptaret-ne-bote/>

45. See: <https://www.instat.gov.al/media/10428/foreigners-in-albania-2021.pdf>

46. INSTAT, 2022, Labor Market and Labor Force Survey 2022

47. A leak of salary data of about 630,000 citizens in 2021 enabled a recently established special anti-informality unit of the government to target the widespread practice of under reporting salaries on individual business level.

# Chapter IV.

## ALBANIA'S STRATEGIC AND INVESTMENT PRIORITIES

### 4.1. Priority sectors for growth and development

Albania's sectorial development priorities have changed over the years. The first post-communist decade focused on the implementation of economic and structural reforms, the establishment of a market economy, and strengthening of administrative capacities of public institutions. The strategic frameworks for sectorial priorities of the economy evolved in the subsequent decades. The National Strategy for Social and Economic Development 2001-2004 and 2004-2007 prioritized the development of the transport, construction, and services sectors, whereas for the period 2008-2014,<sup>48</sup> the focus shifted to infrastructure and energy with the aim of increasing energy supplies through electrical energy, discovery of new deposits of oil and gas, and increase in production and electrical transmission capacities. The National Strategy for Development and Integration 2015-2020 (NSDI) focused on the following priorities: agriculture and rural development; the development of a sustainable and integrated tourism model; improving ICT infrastructure, development of e-governance and interactive delivery of public services through internet for citizens and businesses; energy (hydro, renewable energy, oil, and gas); and enhancing transport infrastructure. The most recent National Strategy for Development and European Integration 2023-2030 (NSDEI) dedicates a special chapter to the Agenda on Sustainable Economic Development, Connectivity and Green Growth. There are four sectorial priorities, which include agriculture and rural development; tourism; energy and natural resources; and digitalization. Globally, the start of the war in Ukraine in Feb-

ruary 2022, has put a spotlight on energy transition and possible avenues for its financing. These considerations are salient in Albania as well. Supply-side constraints and elevated prices have a significant impact on energy consumption and costs for all income groups, particularly the poor. However, energy is also critical for production particularly in manufacturing and industrial processes. While the government has protected energy prices from rising sharply through subsidizing energy prices, Albania still needs to make a fundamental shift towards conventional and alternative energy generation to meet EU integration and Paris Agreement goals. The availability of, and access to energy has a profound impact on Albania's economy, and energy shortages and price spikes can disrupt production and lead to higher costs for consumers. Therefore, investing in energy infrastructure and technologies that promote efficiency, sustainability, and affordability is essential for economic growth.

### 4.2. The strategic framework and resource planning

The National Strategy for Development and European Integration (on a 7-year basis) and the National Plan for European Integration (NPEI, on a 3-year basis) are the foundations that orient the planning and financial programming of the sectorial and cross-sectorial strategic framework. Each sectorial and cross-sectorial policy document is associated with an indicative cost of achieving the objectives, the required finan-

48. National Strategy for Development and European Integration, 2008-2014

cial sources, and the existing financial gaps. Despite the efforts at successfully completing the costing exercise for all policy and strategy documents, the review of several such documents shows that no complete financial chapter has been produced, also due to lack of detailed data from several sources, including donors financing statistics. This is due to the high complexity of the costing template, which requires detailed data from several sources that are not always available. In addition, it is challenging to link each strategic measure included in a policy document to the Medium-Term Budgeting Program (MTBP<sup>49</sup>). Furthermore, strategic documents lack envisaged actions on funds mobilization and identification of financing resources to fill the financing gaps. Finally, midterm review documents are focused on the progress achieved on objectives, measures, and indicators, with no analysis provided of the financial aspects of the implementation of the national strategy, such as funding gaps and resource mobilization challenges. Also, the most recent NSDEI lacks clear financial analysis and risks scenarios for its implementation.

### 4.3. Public investments

The process of public investment in Albania involves six phases: identification; assessment and preparation; approval; implementation; monitoring and reporting; and evaluation and auditing.<sup>50</sup> The line ministry carries out the first three phases, which include identifying potential projects and selecting the most efficient ones based on their impact. Details of approved projects are then forwarded to the Ministry of Finance and Economy (MFE), which, together with the State Agency for Strategic Planning and Coordination (SASPAC), evaluates the proposals based on the country's priorities, feasibility, return on investment, and environmental impact, and decides on their priority level. Existing projects receive the highest priority for financing under the public budget ceilings, while funding of new projects depends on the outstanding budget, investment budget requirements (PPP vs. budget financing), macro-fiscal indicators, and public debt risks. Big investment

projects that are of strategic importance for the country's social and economic development or address emergency situations are sent to the MFE and approved by the Strategic Planning Committee (SPC). However, currently public investment management procedures are under revision by the MFE and SASPAC. In the past two years, public investments have expanded in response to the 2019 earthquake damages and the government's emphasis on investment projects as the primary driver of economic development.

To reduce public debt, capital expenditures have decreased annually since 2014, reaching 4.4% of GDP in 2019. However, after 2019, the planned capital expenditures increased to an average of 6% of GDP, which is higher than the annual average level over 1993-2019. The government's decision to bypass the budget process and MTBP by using Normative Acts for existing and new projects' financing<sup>51</sup> has increased the budget deficit, which has been disagreed by the International Monetary Fund (IMF).

The Public Investment Management (PIM) system has certain weaknesses, including non-compliance with guidelines for the selection and approval of new investment projects; expansion of fiscal space regardless of value for money considerations due to PPP selection; bypassing of MFE's procedures when decisions are made on investment projects entering the budgeting process; and, an inadequate integration of post-earthquake reconstruction and Covid-19-related expenditures in the budgetary processes.

### 4.4. Strategic investments

Albania's strategic investments priorities play a special role in supporting the sectorial economic priorities. The approval and support of strategic investments follows special procedures,<sup>52</sup> implemented by the Strategic Investment Committee (SIC), an Advisory Committee to the Prime Minister. The technical secretariat for SIC is the Albanian Investment Development Agen-

49. Produced by the Ministry of Finance and Economy, with data from all line ministries

50. CMD no. 185 dated 29.03.2018, "on Public Investments Management"

51. The financed projects are in the sector of transport (roads), water supply and regional development, while the large majority of the allocations for the water supply projects were quickly disbursed following the approval of the Normative Act by the Parliament, as these expenditures went to cover payment arrears for works already completed.

52. Law no. 55/2015 "on Strategic Investments in the Republic of Albania"



cy (AIDA). The current strategic investment sectors are: (i) energy and minerals (at least EUR 30 million for the status of assisted procedures, at least EUR 50 million for the status of special procedure); (ii) transport, infrastructure, electronic communication, and urban wastes (at least EUR 30 million for the status of assisted procedures, at least 50 million EUR for the status of special procedure); (iii) tourism (at least EUR 5 million and 80 new jobs for the status of assisted procedures, at least EUR 50 million for the status of special procedure); (iv) agriculture and fishing (at least EUR 3 million and 50 new jobs for the status of assisted procedures, at least EUR 50 million for the status of special procedure); (v) economic development and technology (at least EUR 5 million for the status of assisted procedures, at least EUR 50 million for the status of special procedure); (vi) development priority areas (at least EUR 1 million and 150 new jobs for the status of assisted procedures, at least EUR 10 million and 600 new jobs for the status of special procedure).<sup>53</sup> Albanian or foreign legal entities willing to invest in a project of more than EUR 100 million can benefit from the “strategic status” to which special procedures are applied.

A crucially important instrument for operationalizing the NSDEI, sectorial strategies, and government priorities and transform them into concrete projects is the so-called National Single Project Pipeline (NSPP) – a component of the Integrated Planning System (IPS).

The NSPP is a strategic medium- and long-term prioritization instrument established in 2015, which defines the unique list of the strategic projects in the country, orients foreign and domestic sources of funding (domestic, foreign, credits, grants, PPPs) towards priorities, and connects long-term priorities with Medium Term Budget Planning (MTBP). The NSPP 2024-2026 includes 145 projects, classified as matured (60 projects), partially matured (36 projects) and non-matured (49 projects)<sup>54</sup> with an indicative total amount of EUR 16.1 billion. The NSPP 2024-2026 provides figures regarding indicative cost for each project at each stage, but no figures are provided regarding financial commitment and the related gap. However, indicative financing needs can be perceived by looking at the Economic Investment Plan 2021-2027 for the WB, which is structured around 6 key areas of intervention (transport, energy, digital, environment, private sector/economic development, and human capital development/social) corresponding with NSPP priority areas for Albania. The EIP 2021-2027 includes 227 projects for Albania with a total financing of EUR 18.245 billion, out of which 29 are under implementation with 100% of financing guaranteed. The financing needs for the rest of projects equals 89% of total financing (EUR 16.28 billion).

53. See: <https://www.aida.gov.al/sq/investimet-strategjike/kriteret-e-perzqjedhjes/sektoret-dhe-nensektoret>. A new law on investments is currently under the drafting process.

54. Matured projects are those considered feasible based on a finalized feasibility study, and for which the preparation of technical documents is at an advanced stage.

Partially matured projects are those for which a feasibility study is initiated, and the preparation of technical documents is in process.

Non-matured projects are those at the initial concept note stage.

# Chapter V.

## ASSESSMENT AND DIAGNOSTICS

### 5.1. Domestic Public Finance

#### Section summary

In Albania, tax revenues are the main contributor to public revenues, accounting for around 25-27% of GDP, with grants and non-tax revenues (including ODA and budget support) representing an insignificant share of total public revenues by comparison. However, several significant challenges undermine the government's ability to maximize its tax revenues and the latter's redistributive potential. Such challenges include the existence of a large informal economy (27% of GDP), substantial under-reporting of incomes and revenues, large financial (cash-based) flows taking place outside the formal banking system, and the government's weak tax administration and collection capacities. Direct income taxes are a weak contributor to the budget revenues, representing around 18-20% of tax revenues, with indirect taxes generating almost twice the budget revenues in comparison. The three largest contributors to tax revenues are VAT, excise taxes, and social insurance, with VAT remaining the primary source of tax revenues, contributing to 35.4% of the total tax collection in FY2021.

The government has introduced a number of policies aimed at tackling the obstacles to a more efficient and productive tax system, given the latter's importance to public revenues. However, low tax administration capacities have obstructed some of these

efforts; for example, the effectiveness of a progressive tax scheme, introduced in 2014 as part of a fiscal reform program aimed at reducing societal inequalities and disparities, has been hindered by the under-declaration and under-reporting of taxable incomes.

With the help of international partners Albania has also embarked on a fiscal consolidation program to improve revenue collection through anti-evasion efforts and increases in excise taxes, as well as expenditure-side measures. Yet, other measures, such as recent tax policy reforms have allowed for more exemptions and hence a narrowing of the tax base, further complicating tax administration and revenue collection. The country is estimated to have lost around 5.6% of its GDP due to indirect tax exemptions, including VAT compliance gaps and tax evasion. The VAT threshold in Albania has been kept low compared to the regional economies in order to fight informality, yet this has failed to produce the expected results. Informality and the narrow tax base resulting from exemptions, together with low capacity of the tax administration, imply that only 54% of total VAT revenues are collected compared to the set benchmarks. Despite the recent improvements in tax administration, the stock of tax arrears is high (equivalent to 68% of



total revenue collection) and increasing. Given that VAT is the main contributor and as such it drives variability in the overall tax revenue growth, maintaining a robust and stable VAT is of considerable importance. According to the Mid-Term Revenue Strategy (MTRS), increasing tax revenues to 2.3-3.0% of GDP is necessary to finance additional public spending and support reform measures in the coming years. Reducing tax exemptions, including VAT, could result in an additional 0.2% of GDP in annual tax revenues, according to the World Bank. Additional measures such as bringing self-employment under the labour income taxation scheme and increasing property taxes could help raise public revenues. With the aim of mobilizing public revenues, it is important for GoA to reduce inefficiencies both in the tax policy formulation (increasing tax compliance and/or addressing tax loopholes) and in the tax administration (strengthening control and reducing arrears). This would be an important step is the implementation of the fiscal reforms that started in 2021.

In terms of public expenditure, social protection has consistently been the primary beneficiary (25-30%). Accounting for approximately 10% of GDP, social protection expenditure is significantly lower than the EU-27 average of 19.3%. Around 82.4% of social protection spending is allocated to the public pension scheme, which faces the challenges of low participation rates of the working-age population as contributors, high levels of informality, emigration of youth, and an anticipated increase in the number of beneficiaries in the coming years. Although social security contributions account for 6% of GDP, bringing the ratio of direct taxes closer to that of indirect taxes, their significance still fall behind that of tax revenues. Contributory revenues are only able to cover 60% of the total social protection expenditures, indicating a significant gap in the system's ability to provide adequate social protection for citizens. Hence, the social insurance scheme remains largely subsidized by the government, contributing to large fiscal deficit. After pensions, general public services (housing and community

amenities, economic affairs, health, and education) constitute the main beneficiary of public expenditures. Enhancing the sustainability of the public administration and pensions systems and better targeting of social transfers are crucial in reducing the government's public expenditure burden. Despite recent years' fiscal consolidation efforts that have enabled a larger fiscal space and successful commercial borrowing at low interest rates, crises-induced expansionary fiscal policy coupled with a sharp economic slowdown, has significantly widened the fiscal deficit, and increased public debt. In the face of consecutive domestic and international shocks, expansionary fiscal policy has been deployed to protect the vulnerable and bolster the economy through instruments such as wage subsidies, increased social spending, and tax exemptions and credit guarantees through commercial banks to ease salary payments and release financing for private sector capital and investment needs. This policy direction has contributed to a large fiscal deficit, estimated at 5.4% of GDP for 2022, financed through domestic funds, including privatization receipts, domestic borrowing, change in the liquidity stock of the Treasure Single Account (TSA), as well as through foreign funds, including long-term loans and budget support. Both domestic and foreign interest expenditures are increasing due to growing public debt, macroeconomic risks, and global developments. Public investments by the central government are expected to remain relatively high during 2023-2025, averaging at around 5.3% of GDP annually.

At the end of FY2022, public debt stood at 64.6% of GDP (still higher than the regional average of 59%), after its peak level FY2021 due to the shock effect of 2019 and 2020. Public debt is vulnerable to potential growth-related shocks such as economic downturns, interest rate increases, and exchange rate fluctuations, and Albania is expected to face high gross financing needs during 2022-2026, equivalent to an average annual level of 23% of GDP. Revenue mobilization, together with an improved assessment of fiscal risks

(particularly the State-Owned Enterprises arrears and the Public-Private Partnership (PPP) payments and guarantees obligations) are crucial for maintaining a stable fiscal position and reducing potential risks to debt sustainability. Although PPPs have been used in recent years largely to raise capital investment in strategic public sectors and ease the budgetary burden by creating fiscal space, there is a lack of comprehensive analysis and understanding of the value for money and fiscal risks associated with them, indicating government's irregular monitoring of the PPP contracts. The energy sector has attracted the most awarded concessionary contracts, with many State-owned Enterprises (SoEs) engaged in the sector but is not financially self-sustainable. Governance of SoEs in the energy sector is deemed weak, with serious risks of high contingent liabilities associated with SoEs adversely affecting the debt ratio and fiscal risks.

The foreign debt portfolio continues to exhibit lower risks due to its composition, primarily consisting of longer-term instruments. Fixed-rate borrowing represents 63.4% of the foreign debt portfolio, and loans sourced from bilateral and multilateral creditors, primarily directed towards developmental projects, continue to hold the largest share. Project-related loans account for approximately 40.1% of gross foreign debt and budget support constitutes the rest. Debt sustainability analysis indicates that Albania will face high gross financing needs during 2022-2026, with an average annual level of 23% of GDP. The overall debt management objectives are first, to meet the government's financing needs and debt service requirements for both the state debt and guaranteed state debt at the lowest possible cost. This is achieved

by prioritizing instruments with favourable cost and risk exposure, while maintaining a prudent level of risk exposure. The second objective is to foster the development of the primary and secondary markets for government securities, promoting liquidity and efficiency in these markets. These objectives are aimed at enhancing the overall management of debt and ensuring optimal financial resources for the government. Revenue mobilization, together with the improved assessment of fiscal risks (here including particularly the SoE arrears and PPP payments and guarantees obligations) are also crucial for maintaining a stable fiscal position and reducing potential risks to debt sustainability.

Limited access to reliable data undermines public revenue and expenditure projections and planning in Albania. On the public revenue side, differences exist between the revenue values indicators from their initial planning to their revision and actual execution. Such unrealistic forecasting has rendered planning based on forecast budget figures more challenging. On the public expenditure side, the budget published provides information on current and capital expenditures by program but does not include details on the total costs of projects. There are also substantial differences between projected and actual public expenditure values, with the discrepancies growing in recent years, partly in response to consecutive shocks that have further undermined budget forecasting. Deviations from the originally planned levels of budget expenditure primarily reflect ongoing weaknesses in public finance management rather than an inability to meet revenue targets.

### 5.1.1. Public revenue trends and sources of financing

Albania has in place a modern tax system that combines direct and indirect taxes to achieve the country's revenues needs. Over the years, changes have been made to the tax system instruments, rates, brackets, thresholds, and exemptions. From 2007 to 2013, Albania implemented a flat direct tax rate for both personal income tax (PIT) and corporate income tax (CIT). However, in 2014, this was replaced with a progressive tax scheme as part of a fiscal reform aimed at reducing societal inequalities and disparities. Unfortunately, the effectiveness of this reform has been hindered by the under-declaration and under-reporting of taxable income. To address this issue, since 2014, Albania has implemented a fiscal consolidation program with support from international partners. The program includes measures to improve revenue collection through anti-evasion efforts and increases in excise taxes, as well as expenditure-side measures.

Recent tax policy reforms have resulted in a narrower tax base, with more exemptions, and sector-specific incentives, which have further complicated tax administration and increased compliance costs. However, the frequent exemptions from indirect taxes have undermined their efficiency of revenue collection. The country was estimated to have lost around 5.6% of its GDP due to indirect tax exemptions, including the policy, compliance gaps, and tax evasion, with most of it coming from VAT.<sup>55</sup> In 2015, the VAT compliance gap was nearly twice the EU average,<sup>56</sup> estimated at around 28%. According to the World Bank<sup>57</sup> (2021), reducing tax exemptions, including VAT, could result in an additional 0.2% of GDP in annual tax revenues.

According to the approved Mid-Term Revenue Strategy (MTRS),<sup>58</sup> increasing tax revenue to 2.3-3.0% of GDP would be necessary to finance additional public spending and support reform measures over the next 5 years. While the IMF supported this increase, its implementation was

postponed starting only after FY2021. Although the postponement of the MTRS is understandable given the crisis, some experts argue that prioritizing domestic revenue mobilization and reducing tax expenditures would create more resources for targeted spending programs. According to the ILO (2019), tax evasion alone was responsible for a 30% reduction in current tax collection, equivalent to roughly 8% of GDP.<sup>59</sup> Additionally, MFE estimated that tax expenditures amount to over 5% of GDP, primarily in the form of VAT exemptions.<sup>60</sup> One recently proposed solution is a fiscal amnesty, which would impose taxes on declared amounts, but its revenue potentials are uncertain.

With the aim of mobilizing public revenue, it is important for GoA to reduce inefficiencies both in the tax policy formulation (increasing tax compliance and/or addressing tax loopholes) and in the tax administration (strengthening control and reducing arrears). This would be an important step in the implementation of the fiscal reforms that started in 2021. It is expected that it will improve VAT collection by an estimated 10-15%.<sup>61</sup>

To help raise public revenues, the World Bank<sup>62</sup> has provided the Government of Albania with several policy options, including the introduction of intermediate tax brackets and an increase in the highest threshold for personal income tax, bringing self-employment under the labour income taxation scheme, reducing VAT/excises/national taxes exemptions, and increasing property taxes. The World Bank estimates that widening the labour taxation base, reducing VAT exemptions, and increasing local government resources could generate an additional 1.5% of GDP in public revenue.

55. IMF. (2020, Feb). Technical Assistance for the Tax Policy Reform Options for the MTRS

56. IMF. (2022, May). Technical Assistance Report for the MTRS administration reform options

57. World Bank. (2021). Albania: The impact of Covid19-related budget reallocations

58. IMF. (2022, Apr). Technical Assistance Report for Enhancing Tax Administration Capacity During Challenging Times

59. ILO. (2019). Fiscal Space for Financing Social Protection in Albania

60. Ministry of Finance and Economy. (2022, Jun), Mid-Year Report on the implementation of the Annual Budget and the Macro economic and Fiscal situation

61. Ibid

62. World Bank. (2021). Country Economic Memorandum 2021 for Albania - Strengthening the Sustainability of Albania's Growth Model

### AN OVERVIEW OF PUBLIC REVENUES

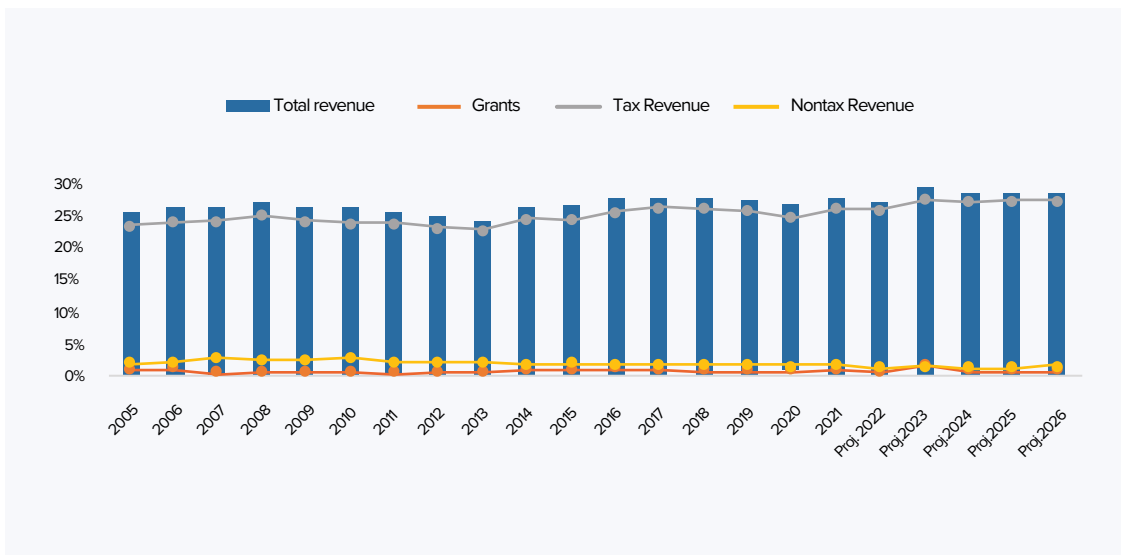
**Total Revenues.** Total public revenues consist of: (1) Tax revenues (revenues from tax offices and customs, local government revenues and revenues from special funds/social insurance contribution); (2) Grants (budget support, post-earthquake reconstruction and project-specific investments); and (3) Non-tax revenues (profit tax from BoA, dividend from the SoE, income of budgetary institutions, service fees and other revenues such as selling licenses, 3G, etc.).

Analysing the total revenues, one can notice a slight rising trend after 2013 stemming primarily from rising tax revenues. With some fluctuations over the years, total public revenues have averaged 26-29% of GDP. Tax revenues are the major contributor to public revenues, accounting for around 25-27% of GDP, and have slightly increased over time. Both grants and non-tax revenues represent an insignificant share of the total public revenues. Non-tax revenues have been around 1% of GDP, with declining trends. Similarly, grants (ODA) account for 1-2% of GDP, with a declining trend and narrowed targeted sectors. Budget support represents around 0.2% of GDP.

In 2021, total public revenue amounted to EUR 4,169 million, of which EUR 3,833 million came from tax revenues, EUR 182 million from non-tax revenues, and the remaining EUR 103 million from grants. The increase was the result of an increase in tax revenues due to a satisfactory economic growth of 8% and a widening of economic activity in line with fiscal forecasts. In 2022, total public revenue amounted to EUR 4,675 million, of which EUR 4,419 million came from tax revenues, EUR 179 million from non-tax revenues, and the remaining EUR 78 million from grants. The mid-term report of the MFE (2022) expected a good performance in public revenue outturn until the end of 2022 thanks to continuing economic recovery, improvement of imports, and progress with fiscalization.<sup>63</sup> The implementation of the MTRS was expected to improve the revenue ratio starting from 2023 (EC, 2022).<sup>64</sup>

According to the Normative Act (NA) of budget 2023,<sup>65</sup> public revenues were expected to reach 29.9% of GDP with a tax-revenues-to-GDP ratio of 27.4%. Based on the 2024-2026 Macro Fiscal Framework (MFF), total budget revenues are expected to increase in the upcoming medium-term period with an average year-on-year growth of around 5%.

Figure 3. Public revenues (in % to GDP)



Source: MFE (2023)

63. The adoption of fiscal laws to combat informality in the retail sector.

64. European Commission. (2022, Jun). Economic Reform Programs of WB and Turkey, the Commissions' overview and country assessments. [Institutional Paper 180]

65. Normative Act no.5 dated 18.10.2023.

The graph below (Figure 4) shows the historical trends of the key fiscal indicators of public revenues that finance the state budget, from its initial planning to its revision and actual execution. It is evident that significant differences exist between the revenue values' indicators and the values of budget projections and budget revisions over the years (complete data are available until FY2021). On average, over the last 10 years, actual tax revenues have been approximately 1.5% lower as a proportion of GDP compared to the budget forecasts.<sup>66</sup> This is due to two main reasons: unrealistic forecasting and inefficient tax administration and control. These are also the primary reasons why the Medium-Term Revenue Strategy (MTRS) was requested by the GoA, even though revenue performance improved in the years before the pandemic (FY2014 and FY2016).

Not surprisingly, revenue shortfalls seem to correlate with the electoral fiscal years, such as in FY2013 and FY2015. In 2015, a significant underperformance in excise and PIT tax revenues was registered. Due to the 2019 earthquake and the Covid-19 pandemic shocks, a sharp fall in revenues was recorded in 2020, 16% lower than the original forecast.

The relationship between tax revenue growth and GDP growth has become more irregular in recent years.

**Tax revenues.** The three tax revenues categories show an increasing trend as a share of GDP. Tax revenues from Tax Office (TO) and Customs totalled EUR 3,190 million or 18.3% of GDP in 2022. They are expected to increase further in the medium-term (starting from a value of 19.5% of GDP in FY2023). The local government revenue to GDP ratio has been at approximately 1.5-2% (totalling EUR 225 million in 2022), while social insurance contributions have amounted to around 5.8% of GDP (EUR 1,002 million in 2022).

If we examine the contribution of each tax revenue source to the total budget revenue, we can see that the three largest contributors are social insurance, VAT, and excise taxes, accounting for around 65% of total revenue. Of this amount, approximately one third is generated from VAT, which is equivalent to around 9% of GDP. Social contributions make up 19% of total revenue, equivalent to 5.8% of GDP, while the remaining 12% is generated from excise taxes, equivalent to 2.5% of GDP.

**Direct vs. Indirect taxes.** Direct taxes include of PIT, CIT, and national taxes (the latter is not included in the calculation of the direct income taxes). Indirect taxes consist of VAT, excise taxes, and other custom duties.

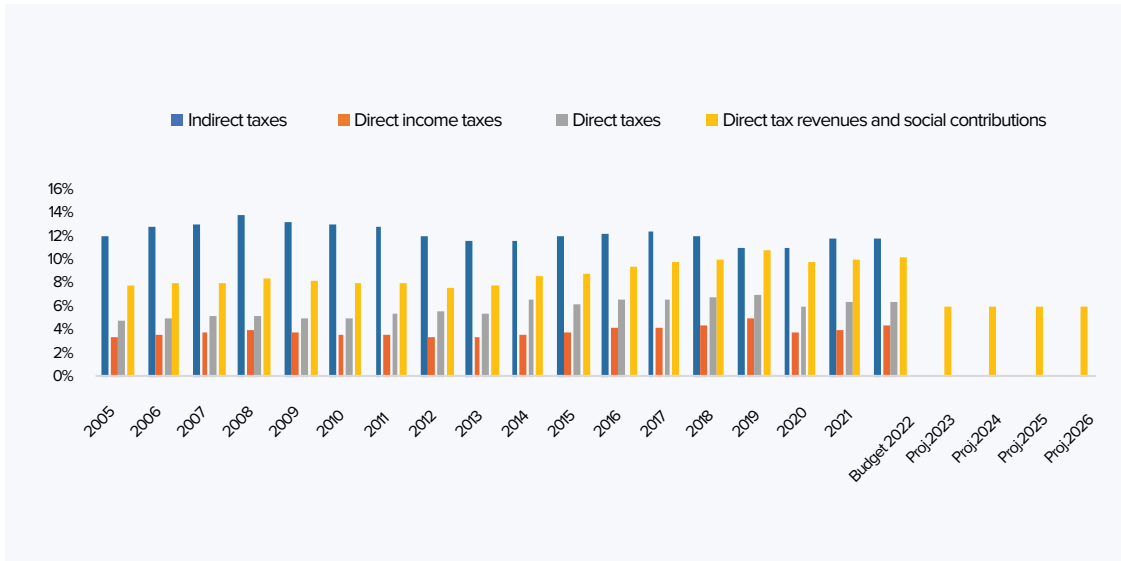
Figure 4. Public revenues (in EUR million)



\* Complete data are available until FY2021  
Source: MFE (2022)

66. IMF. (2022, May). Technical Assistance Report for the MTRS administration reform options

Figure 5. Direct and indirect taxes (in % to GDP)



Source: MFE (2023)

Direct income taxes are a weak contributor to the budget revenues in Albania representing around 18-20% of tax revenues (4% of GDP). In fact, indirect taxes generate almost twice the budget revenues compared to direct taxes. This implies that the current taxation system in Albania has a weak redistributive impact. Although social security contributions account for 6% of GDP, bringing the ratio of direct taxes closer to that of indirect taxes, they still fall behind. This is highlighted by the fact that social protection expenditures in Albania represent 9% of GDP, meaning that direct taxes and social security contributions combined are not enough to cover these expenditures. In fact, contributory revenues are only able to cover 60% of the total social protection expenditures, indicating a significant gap in the system’s ability to provide adequate social protection for citizens. (Figure 5)

Unlike other Western Balkan countries (WB6), self-employed individuals are not considered as PIT income subjects in Albania. It is estimated that by applying a progressive PIT to self-employment income more than EUR 8 million in revenues could be generated. The General Directory of Taxation (GDT) collects on average 62% of total tax revenues (80% if social security contributions are included) or 83% of tax revenues from the Tax Offices (TO) and the Customs.

**Property tax (under revenues from local government).** The ratio of local revenue to the total tax revenue has remained consistently low, at less than 5%, while revenues from special funds such as social insurance contributions account for approximately 25% of total tax revenues. (Figure 6)

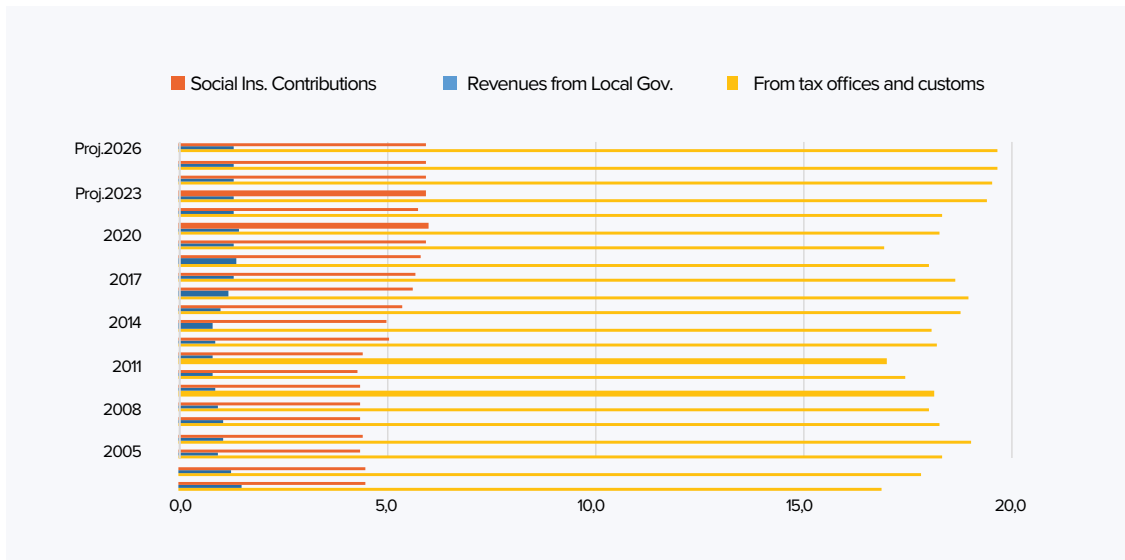
Local revenues are generated from local taxes and tariffs, property taxes, and the simplified profit tax for small businesses. Currently, the average revenue generated from property tax is around 0.3% of GDP, which is relatively low compared to the average of 0.8% of GDP in comparable countries.<sup>67</sup> According to the IMF, increasing the property tax rate could generate additional revenues of 0.3-0.5% of GDP, but this would require a fully developed fiscal cadastre to be feasible and effective. The law on property tax was amended in 2017 to introduce a valuation system based on the market value of the property. The IMF also suggests that similar amounts of revenues could be raised through the application of environmental taxes.

**Taxes from tax offices and customs.** VAT<sup>68</sup> remains the primary source of tax revenue in the country, contributing to 35.4% (EUR 1,562 million) of the total tax collection in FY2022, or 49% of the revenues collected by the TO and Customs. A slight increase in VAT collection was expected for FY2023, starting from a level of 9.2% of GDP.

67. IMF. (2020, Feb). Technical Assistance for the Tax Policy Reform Options for the MTRS

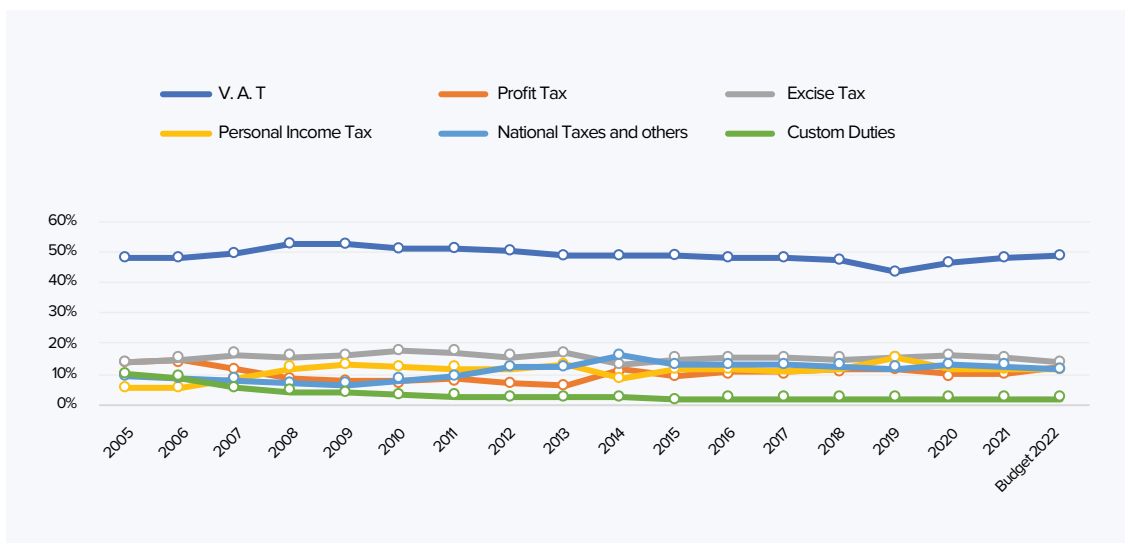
68. In place since 1995 and in line with the EU 6<sup>th</sup> Council Directive.

Figure 6. Tax revenues as % of GDP



Source: MFE (2023)

Figure 7. Tax revenues from the TO and Customs (as % of tax revenues)



Source: MFE (2023)

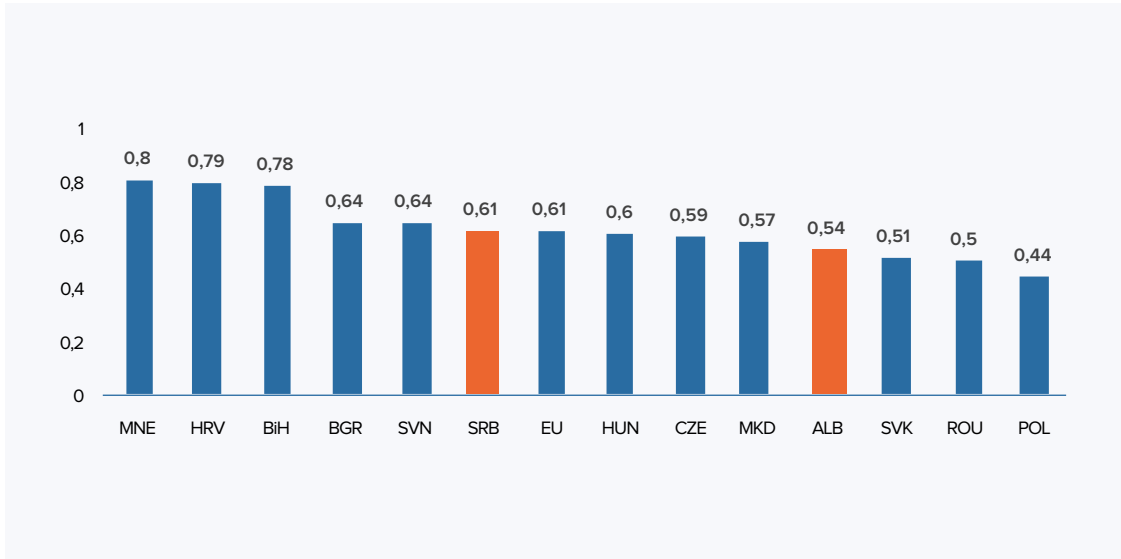
Excise taxes are the second highest, comprising 13.7% (EUR 437 million) of the total tax revenues from TO and Customs, and accounting for 9.8% of the total tax revenues in FY 2022. However, it is worth noting that if no exemptions were made, the estimated amount could have been an additional 4.4% of the excise revenues or 0.08% of GDP.<sup>69</sup> Small national taxes, which comprise 11 different taxes, account for 11.4%

(EUR 366 million) of the revenues from TO and Customs, followed by PIT and CIT with 11.4% (EUR 367 million) and 12% (EUR 389 million), respectively. Other revenues from customs duties represent only 2% of the revenues from TO and Customs and have decreased over time.

The standard rate of VAT in Albania is relatively high at 20%, but the implementation of VAT is

69. IMF. (2020, Feb). Technical Assistance for the Tax Policy Reform Options for the MTRS

Figure 8. VAT C-efficiency ratio (1/...)



Source: Authors' calculations based on IMF data (2020)

not yet efficient compared to other countries in the region.<sup>70</sup> The VAT threshold in Albania is low compared to the region, and although its reduction was aimed at fighting informality, the tax administration still lacks the capacity to achieve the expected results from this policy. Due to informality and the narrow tax base resulting from exemptions, VAT productivity is low at 54%, which is below the EU average of 61%. This indicates that Albania collects only 54% of total VAT revenues compared to the set benchmarks. (Figure 8)

The stock of tax arrears was high and increasing, registering a level of EUR 995 million by the end of 2020 (equal to 68% of total revenue collection), of which 70% are overdue by more than 2 years – a trend which is also on the rise.<sup>71</sup> It is worth mentioning that almost 68% of the total stock of tax arrears was estimated to be uncollectable in practice, with a critical need to write it off. Referring to the Customs and Excise arrears, the stock was about 16.6% of total revenues collected by the GDC at the end of FY2020. With regards to the VAT refund stock of arrears, the GDT aimed for target of zero by the end of 2021 and for sustaining this target in the medium-term period (as confirmed in the Mid-Year Reports on the implementation of the Annual Budget and the Macro economic and Fiscal situation for the subsequent fiscal years

of 2022, 2023). Given that VAT is the main contributor and as such it drives variability in the overall tax revenue growth, maintaining a robust and stable VAT is of considerable importance.

### 5.1.2. Expenditure trends and composition

Based on the economic classification, total public expenditures are grouped into five main categories in the fiscal account tables accompanying the annual budget: (1) current expenditures; (2) reserve fund; (3) capital expenditures (including the reconstruction fund); (4) other transfers (both temporary and those related to the energy sector, encompassing domestic financing and budget support); and (5) the expropriation fund.

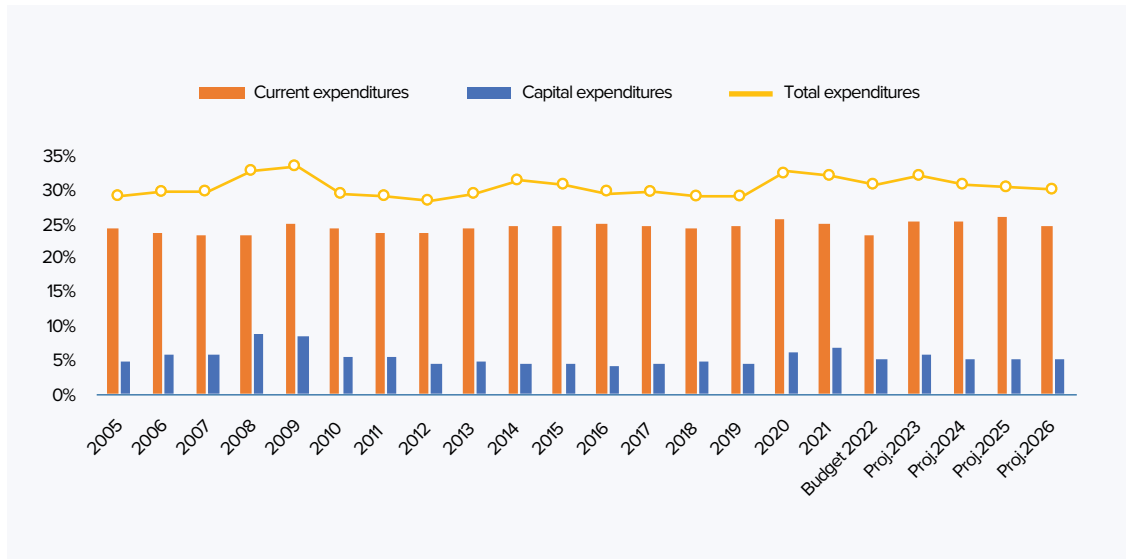
The budget published provides information on current and capital expenditures by program but does not include details on the total costs of projects. Although the Organic Budget Law (OBL) mandates that the budget should present comprehensive data on capital projects, including investment value, expenditure incurred to date, budget allocations for the current year, and sources of financing, this information is currently lacking in the budget documentation.

70. Ibid

71. IMF. (2022, Apr). Technical Assistance Report for Enhancing Tax Administration Capacity During Challenging Times



Figure 9. Public expenditures (in % of GDP)



Source: MFE (2023)

This lack of transparency regarding total investment project costs is further exacerbated by the large number of ongoing projects, which imposes a burden on the budget. Current expenditures encompass various sub-categories, including (a) personnel/staff costs; (b) interest expenditures (including provisions for debt-related risks); (c) operational and maintenance costs; (d) subsidies (covering lump-sum costs, including financing of state-owned enterprises in need of financial support); (e) social insurance outlays; (f) local budget expenditures; and (g) other expenditures (which incorporate social protection spending excluding pensions).

Since 2010, capital expenditures, which are essential for driving economic growth through investment projects, have remained low relative to GDP, hovering at around 5% (amounted to 5.3% of GDP in 2022 and expected to reach a level of 6.3% of GDP by the end of 2023). They have been primarily financed through domestic sources (accounting for approximately 3% of GDP in 2022 and 4% of GDP by the end of 2023) rather than foreign financing (0.9% of GDP in 2022 and 1.5% of GDP by the end of 2023). (Figure 9).

There is noticed an upturn in capital expenditure since 2021 due to the need for expansive fiscal policy to bolster the economy after consecutive

shocks.<sup>72</sup> For instance, in response to the energy crisis, the GoA implemented a socially targeted expenditure policy, including loan guarantees, price surveillance, and direct transfers to state-owned enterprises in the energy sector. Building on the utilization of sovereign guarantees for Covid-19 support in 2020, the GoA has planned to employ similar instruments to facilitate access to finance for in the agriculture sector, manufacturing, and innovation.<sup>73</sup> This resulted in a deviation from the initial plans in terms of actual capital expenditures. In 2021, domestically financed projects exceeded expectations by reaching 94.1% of the planned amount (actual vs. planned capital expenditures) and the foreign-financed projects reaching 82.8% of the planned amount.

This higher-than-expected financing amounts were facilitated by new debt and higher revenue collection. Subsequently, due to multiple budget reallocations in 2021<sup>74</sup> capital expenditures declined, leading to the suspension or postponement of many investment projects. The situation would have been even more severe without the Eurobond issued in 2021.<sup>75</sup> Given the expectation that high crisis-level fiscal stimulus and support will not be required in the near future, lower levels of capital expenditures are projected for the coming years.

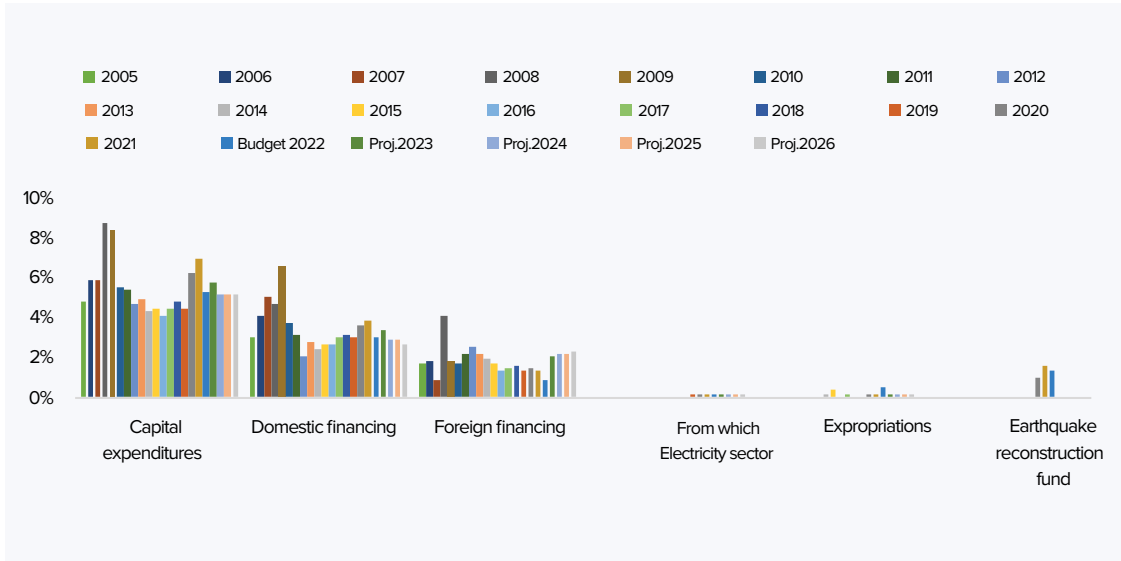
72. November 2019 earthquake, Covid-19 pandemic, energy crisis

73. European Commission. (2022, Jun). Economic Reform Programs of WB and Turkey, the Commissions' overview and country assessments. [Institutional Paper 180]

74. In total, 5 budget revisions took place during 2021, with frequent reallocation of budget funds.

75. World Bank. (2022). Western Balkans Regular Economic Report for Albania, Spring 2022

Figure 10. Components of capital expenditures (in % of GDP)



Source: MFE (2023)

Current expenditures have consistently accounted for around 25% of GDP with minimal fluctuations over time. These expenditures increased after 2020, driven by higher spending on social security, maintenance, and public wages. They decreased to 23.4% in 2022 but are expected to increase by the end of 2023 and for the mid-term period (starting from 25.4% of GDP by the end of 2023), primarily due to the rise in the interests' expenditures, as shown in the figure 11.

Social insurance outlays constitute a significant component of current expenditures, accounting for approximately 10.1% of GDP for the FY2022 and 10.4% of GDP by the end of 2023. They are followed by personnel expenditures, which represent around 4% of GDP having exhibited a decreasing trend over time. Interest expenditures and those related to operations and maintenance account on average for 3% of GDP, with the former showing an increase in recent years and in the forecasted medium-term period. A substantial rise in interest expenditures, reaching around 2.6% of GDP by the end of 2023 and more than 3% for the mid-term period. It is worth noting that both domestic and foreign interest expenditures are increasing due to growing public debt, macroeconomic risks, and global developments. Although public debt is deemed sustainable, it remains high (64.6% in

2022), and there is a significant need for gross financing.

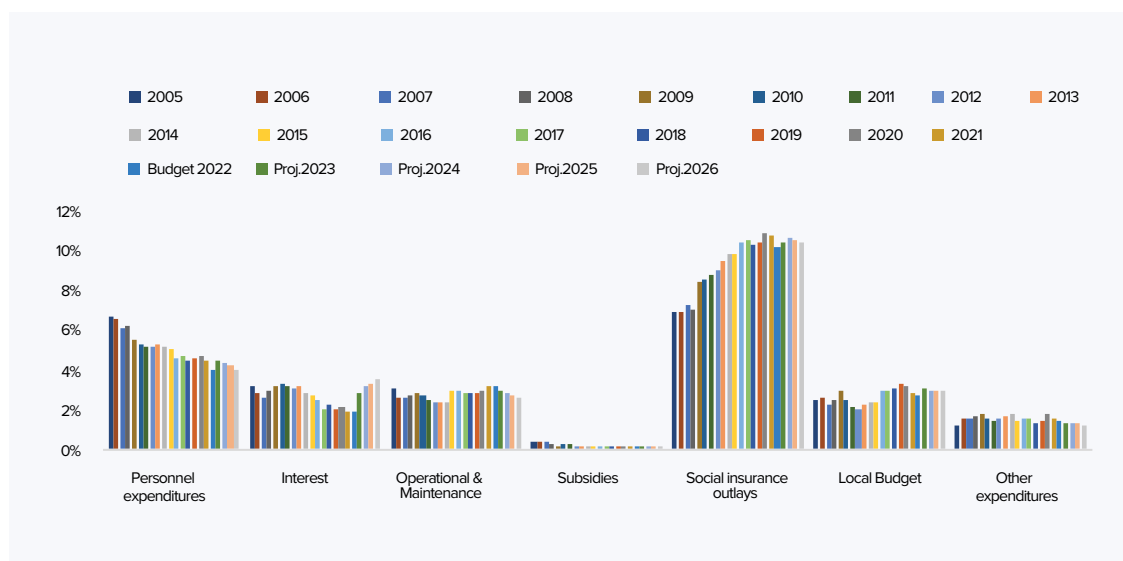
Similar to other WB6 countries, Albania has struggled to control current expenditures on public wages and pensions.<sup>76</sup> This trend is expected to continue in the near future, posing challenges to fiscal adjustment efforts. It is crucial to enhance the fairness and sustainability of the public administration and pensions system, while also improving the targeting of social transfers.

Subsidies have consistently constituted an insignificant component of current expenditures in relation to GDP, amounting to 0.1% in 2022. This confirms that subsidies are not considered a major instrument for supporting target groups or incentivizing various sectors of the economy. Instead, tax exemptions are used more frequently for this purpose – a trend that has been growing over time. Social protection expenditure excluding pensions represents, on average, 2% of GDP. These expenditures finance unemployment insurance benefits, social assistance and disability programs, compensation for ex-political prisoners, as well as the baby bonus.

Public expenditures at the local level in Albania are typically low. On average, local govern-

76. European Commission. (2022, Jun). Economic Reform Programs of WB and Turkey, the Commissions' overview and country assessments. [Institutional Paper 180]

Figure 11. Components of current expenditures (as % of GDP)



Source: MFE (2023)

ment expenditures account for 3% of GDP (2.7% in 2022). Local government transfers from the central government (CG) amount to approximately 1.4% of GDP and are classified as unconditional or conditional. Unconditional transfers follow a formula applied since 2016, based on cost equalization and fiscal capacity equalization principles. Conditional transfers are specific to functions that have been devolved<sup>77</sup> to local government units (LGUs) or competitive financing for local infrastructure, economic development, and digitalization (with less rule-based criteria). In practice, unconditional and conditional/specific grants constitute 60% of total transfers to LGUs.

The three remaining categories of public expenditure consistently hold a negligible (0%-1%) weight in GDP. The Mid-Term Macro-Fiscal framework 2024-2026 of the MFE projects a gradual increase in the reserve fund/contingency-to-GDP ratio<sup>78</sup> in the medium term, with a planned share of 0.7% of GDP for 2023. This allocation includes the reserve fund and the anti-crisis contingency, specifically the social resistance package/social aid for Covid-19. The expropriation fund exhibits high fluctuations in budget expenditures but remains relatively low as a share of GDP since 2014.

Normative Act No3/2022 provided a budget support of approximately EUR 163 million (1.1% of GDP) to the energy sector, in addition to domestic borrowing for the energy sector at a value of around 0.4% of GDP.

**Expenditures by functional classification.** Public expenditures are also classified along a functional classification,<sup>79</sup> which also includes the so-called reserve fund, contingencies for debt risks, and borrowing for the energy sector. The reserve fund and contingencies have gained importance as ex-ante instruments for financial resilience and addressing fiscal risks amid shocks and abnormal economic developments. Although the public expenditure-to-GDP ratio in the last three years has remained relatively stable at around 32% of GDP, there have been significant disparities in the allocation of public expenditures by function. The largest share of expenditures, accounting for approximately 10% of GDP, is directed towards social protection.

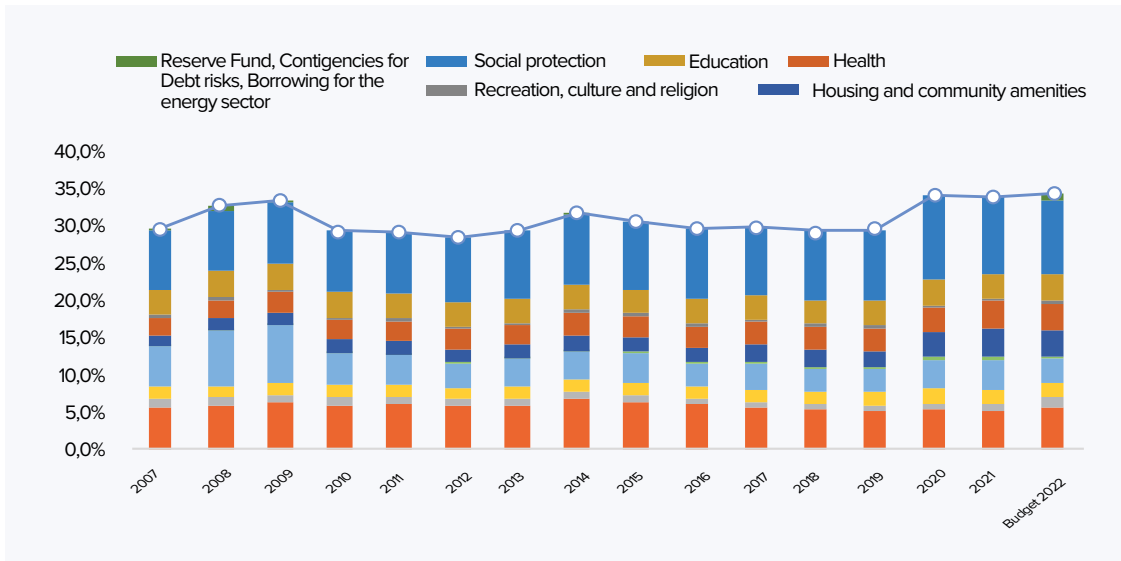
This is significantly lower than the EU-27 average of 19.3%. Over the years, social protection has consistently been the primary beneficiary of total public expenditures, consistently maintaining a share of 25-30%, with a peak of 33% in 2020 due to pandemic response measures.

77. Pre-university education, social services, fire protection services, rural roads, management of forests, irrigation and drainage.

78. It proved to be practically insufficient for the emergency needs.

79. COFOG – OECD classification on the functions of government

Figure 12. Expenditures by functions (as % to GDP)



Source: MFE (2022)

The allocation of social protection spending in Albania can be categorized under: (a) pensions (82.4% of total social protection expenditure), (b) non-contributory cash assistance programs for individuals with disabilities and those at risk of poverty (13.7%), (c) the baby bonus scheme (1.5%), (d) passive and active employment policies (1.1%), and (e) social services and administrative costs associated with social protection at the central and municipal levels (1.3%).

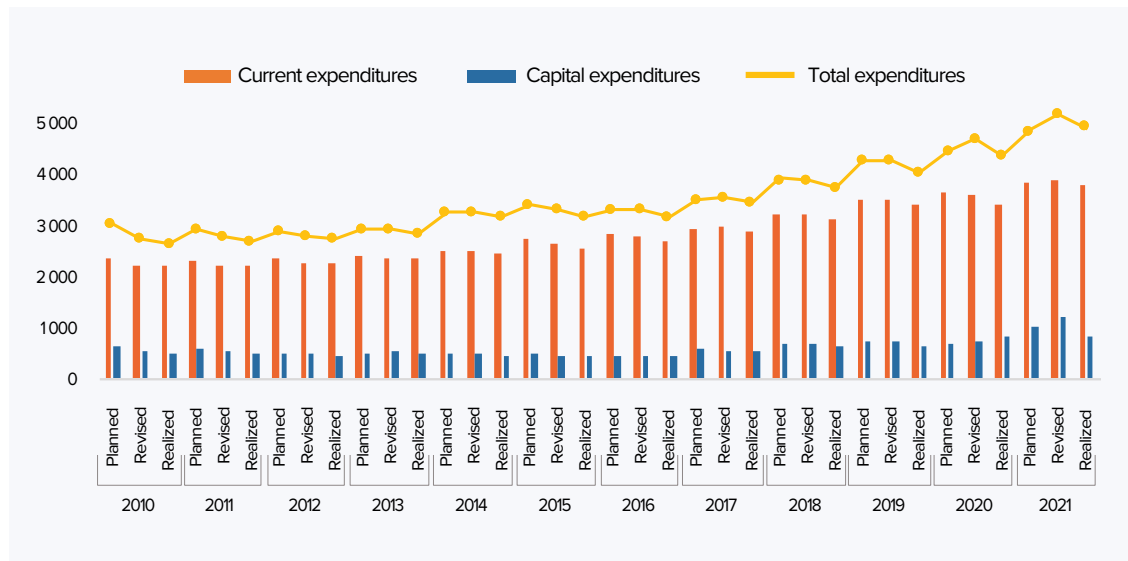
The second-highest beneficiary of public expenditures, at 5.5% of GDP, is general public services. Expenditures related to housing and community amenities, economic affairs, health, and education each receive approximately 3.5% of public expenditures in GDP terms. However, the allocations for health and education fall significantly below the recommended EU levels of 8% and 5% of GDP, respectively. On the other hand, categories such as ‘Recreation, culture, and religion’, and ‘Reserve Fund, Contingencies<sup>80</sup> for Debt Risks, and Borrowing for the Energy Sector’ have the lowest share in expenditures to GDP ratio, representing only 0.4% and 0.9% (FY2022), respectively. Expenditure on the so-called ‘Reserve Fund, Contingencies for Debt Risks, and Borrowing for the Energy Sector’ category has been negligible over the

years but is projected to increase to around 0.8% of GDP in 2022, equivalent to 2-3% of total public expenditures, as this category is gaining more attention as an ex-ante instrument for enhancing financial resilience and addressing fiscal risks amid shocks and abnormal economic developments. The reconstruction fund, established in 2020, is included in two key categories of the COFOG classification of government functions: (a) housing and community amenities, and (b) education, which includes expenditures for the reconstruction of schools. Interest expenditures for the public debt are included in the category of general public services, along with the special fund of wages and local government unit expenditures.

It is important to highlight that the earthquake reconstruction fund and Covid-19 expenditures are still not fully integrated in the budget process. This lack of integration undermines the transparency and efficiency of the budgetary framework. In addition, data on the stock of arrears for the general government (central and local) is also absent, which poses challenges to assessing the overall fiscal situation. Furthermore, the absence of program expenditure plans within the Medium-Term Budget Plan (MTBP) for the settlement of arrears beyond 2022 raises concerns about the macro-fiscal credibility of the budget.

80. There is a fiscal rule in place referring to contingencies. Specifically, each planned budget year includes a specific contingency of no less than 0.7% of total budget expenditure, to compensate potential risks from fluctuation of exchange rates or interest rates, affecting the debt level.

Figure 13. Public expenditures (in EUR million)



\* Complete data are available until FY2021  
Source: MFE (2022)

**Budgetary planning vs. execution.** Figure 13 illustrates the dynamics of key fiscal indicators of public expenditures, from initial planning to revision and actual execution. It is evident that over the years, there have been substantial differences between projected and actual public expenditure values, with actual expenditures consistently falling short of budget projections. These discrepancies have become more pronounced in recent years, exacerbated by the urgent necessity arising from the three consecutive shocks,<sup>81</sup> thereby amplifying inefficiencies in budget forecasting.

In 2021, overall expenditures as a percentage of GDP were slightly lower than initially planned, primarily due to underspending on capital expenditures,<sup>82</sup> which saw a 3% decrease compared to 2020. For FY2022, total public expenditures were initially planned to be at 33.4% of GDP, with current expenditures comprising 27% and capital expenditures comprising 6%. The maintenance of retrenchment of capital expenditures was expected to contribute to improvements in public finance indicators such as fiscal deficit and sustainability of public debt. The

expenditure ratio was projected to drop below 32% of GDP in 2024, coinciding with the implementation of the fiscal rule requiring a positive primary balance. Additionally, there are plans to reduce general government arrears (both central and local) to below 2.5% of total expenditures starting from 2022.

Deviations from the originally planned levels of budget expenditures primarily reflect ongoing weaknesses in public finance management (despite slight recent improvements) rather than an inability to meet revenue targets. It is notable that a significant portion of capital expenditures is concentrated in the last quarter of the year. Over the last three fiscal years, the aggregate expenditure outturn has been approximately 94% of the approved budget. Changes in expenditure outturn by function exhibit substantial variance, often attributable to factors such as the clearance of historical arrears, unanticipated costs associated with implementing large investment projects, and underperformance in revenue collection targets.<sup>83</sup> Furthermore, the allocation and execution of public expenditures

81. November 2019 earthquake, Covid-19 pandemic, pressures arising from the war in Ukraine

82. Spending by line ministries was ALL 40.8 billion higher than the 2020 estimates (without the pandemic), but there were large areas of underspending. In total, 57% of budget programs experienced a net underspending – 43% related to the line ministries of defense, education. Total underspending amounted to ALL 177 billion (of which ALL 9.9 billion intended for viable expenditures – considered as successful ones, with positive return, had funding been available), equivalent to 93% of Covid-19 expenditures in 2020, or 5% of total spending in 2020, or 16% of additional net public debt taken in 2020 (WB, 2021).

83. International Bank for Reconstruction and Development / World Bank. (2018). Performance Assessment Report Albania, Report No. 123426 – AL

suffer from inefficiencies due to gaps in an unreliable Medium-Term Budget Framework, weak linkages between the framework and annual budget planning, and inadequate and irregular monitoring of public expenditures, including the management of arrears.<sup>84</sup>

The EU policy guidance for 2022 recommendations emphasize the utilization of available fiscal space to mitigate the social impact of shocks by providing targeted support to vulnerable groups and restricting the budget revisions to the regular revision process set out in the Organic Budget Law (OBL).<sup>85</sup>

The significant variance in the functional composition of expenditures, discussed in the previous section, undermines fiscal discipline and the credibility of the budgetary process.<sup>86</sup> Although updated forecasts are prepared based on an updated macro-fiscal framework, any variations between fiscal forecasts and the approved budget are not separately identified, explained, or published as part of the budget process. Furthermore, public expenditure reprioritization seems to be a potential financing source only for sectors that receive fewer funds at the moment.

Fiscal consolidation. Since 2014, with the support of international partners, Albania deployed a fiscal consolidation program,<sup>87</sup> including measures on both revenue and expenditure sides. GoA also went through structural reforms to address historic vulnerabilities and concerns, such as restructuring and clearing arrears in the energy sector (with state owned enterprises representing a large fiscal deficit), as well as reforming the pension system. Another important measure has been the repayment of the accumulated stock of arrears, particularly to the private sector.

The GoA temporarily shifted away from its fiscal consolidation agenda over the last three years due to the need for significant fiscal stimulus to address various economic shocks.<sup>88</sup> To allevi-

ate the impact of these shocks on poverty, the GoA increased public expenditures on social services and earthquake reconstruction, including wage subsidies, increased social spending, and two credit guarantees through commercial banks to ease salary payments and release financing for private sector capital and investment needs.<sup>89</sup>

While these instruments were crucial in supporting and boosting the economy during the crisis, public expenditures increased by around 4.6% for FY2020 (from 29.3% of GDP in FY2019 to 33.9% of GDP in FY2020), which has been sustained in FY2021. However, the Medium-Term Macro Fiscal Framework 2023-2025 recognized that lower public expenditures to GDP ratio would be necessary to support the economy over the period 2023-2025, indicating a return to the fiscal consolidation path and a declining trend of public expenditures.

After the 2020 increase, public expenditures to GDP ratio decreased to 30.5% in 2022 and are expected to reach 30.1% of GDP by the end of 2026 (as foreseen in the Macro-Fiscal Framework 2024-2026 of the MFE). According to the recent Macro-Fiscal Frameworks, fiscal policy will again be oriented towards fiscal consolidation. However, public investments by the central government are expected to remain relatively high, averaging at around 5.3% of GDP annually.

### 5.1.3. Budget deficit and public debt Fiscal deficit and its financing

Albania has persistently had a relatively high level of fiscal deficit. In the last two decades the fiscal deficit has exceeded the optimal/targeted value of the EU convergence criteria. Positive achievements from the fiscal consolidation approach deployed after 2014 were reversed by the shocks-driven higher spending and borrowing since 2020.

Fiscal deficit equalled 6.7% of GDP at the end of 2020; it had more than quadrupled compared

84. World Bank. (2021). Country Economic Memorandum 2021 for Albania - Strengthening the Sustainability of Albania's Growth Model

85. European Commission. (2022, Jun). Economic Reform Programs of WB and Turkey, the Commissions' overview and country assessments. [Institutional Paper 180]

86. International Bank for Reconstruction and Development / World Bank. (2018). Performance Assessment Report Albania, Report No. 123426 – AL

87. Active program with the IMF; Budget Support and Technical Assistance from the multiple development partners, here including the IMF, WB, EU, SECO, SIDA, etc.

88. Impacts of the November 2019 earthquake, Covid-19 pandemic, and inflationary pressures of the war in Ukraine

89. World Bank. (2021). Albania: The impact of Covid19-related budget reallocations

to the 2018 level of 1.6% of GDP. It decreased in 2021, particularly due to the large increase in public revenues, reaching 4.6% of GDP, and it reached at 3.7% of GDP by the end of 2022. It is expected to follow a decreasing trend in the medium-term period.

It is important to note that there are two fiscal rules associated with the expenditure side of the state budget and that affect the fiscal deficit:

- i. The budget deficit for each year cannot exceed the annual amount allocated for capital expenditures as approved in the budget law.
- ii. Income generated from privatization is not included in the MTBP. However, in cases where privatization proceeds are collected, no less than 50% of the amount should be used to reduce public debt, with the remaining amount allocated to public investments.

As foreseen in the medium-term Macro-Fiscal Framework, in accordance with this rule/provision, the annual deficit targets for the period 2023-2026, are lower than the capital expenditures planned in the annual budget (respectively, 2.6% and 5.7% of GDP for 2023 and 1.7% and 5.1% of GDP for 2026).

The primary balance<sup>90</sup> has exhibited considerable fluctuations over time. After experiencing a surplus for several years, it deteriorated to -4.6% of GDP in 2020. In response to this concerning trend, Albania has implemented a new fiscal rule that aims to achieve a non-negative primary balance, equivalent to 0.3% of GDP, by 2024.<sup>91</sup> Based on the medium-term macro fiscal framework, implementation of MTRS, economic growth recovery and current retrenchment of capital expenditures are projected to support compliance with this fiscal rule.

Overall, the financing of the fiscal deficit has been characterized by significant fluctuations, particularly in terms of the sources of financing (domestic or foreign). This volatility can be attributed to the government's efforts to utilize both domestic borrowing funds and tap into the foreign market for deficit financing purposes. The domestic sources of financing fiscal deficit include privatization receipts, domestic borrowing, and change in the liquidity stock of the Treasury Single Account (TSA). The foreign sources of financing include long-term loans and budget support. The share of privatization receipts and changes in the liquidity stock of TSA in financing the fiscal deficit is quite low compared to domestic borrowing – with large fluctuations over time and an expected declining trend.

**Figure 14. Overall fiscal deficit and primary balance (in % of GDP)**

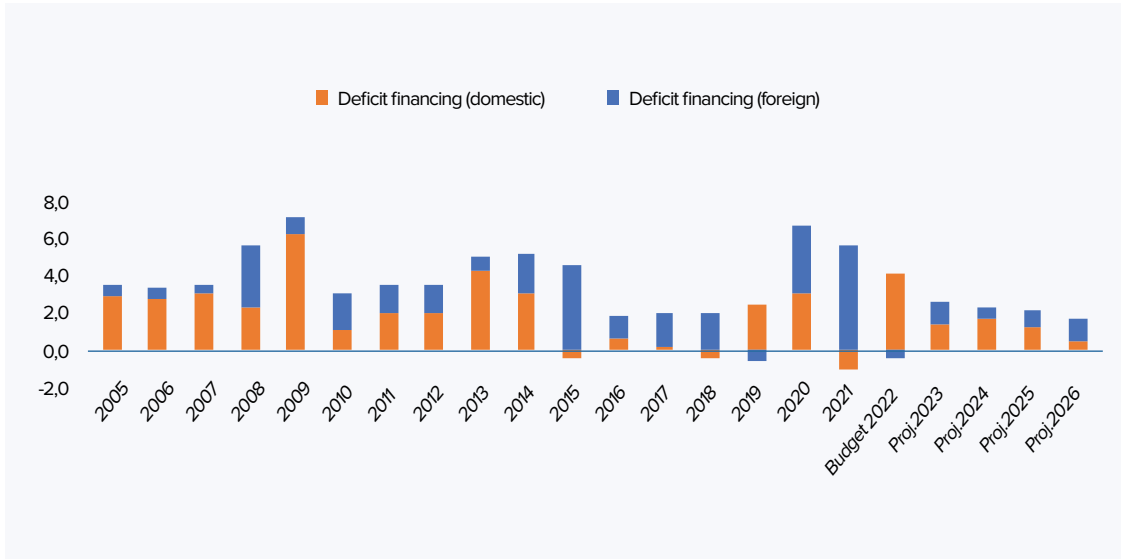


Source: MFE (2023)

90. The fiscal balance excluding net interest payment on public debt

91. Introduced in 2020 to take effect in 2023. Recently, postponed through a Normative Act for 2024.

Figure 15. Overall deficit financing (as % of GDP)



Source: MFE (2023)

Foreign loans are classified as (a) project-based loans,<sup>92</sup> (b) earthquake reconstruction loans, (c) Eurobond, and (d) local government lending/on-lending. The financing of the fiscal deficit in Albania through investment-related long-term loans has experienced significant fluctuations over the past two decades. It is worth noting that the integration of the earthquake reconstruction fund into the budgetary processes has not been fully realized, and lending by local governments remains relatively low, making it insignificant as a ratio of GDP (around 0% over the years). Albania has issued a total of five Eurobonds, in 2010, 2015, 2018, 2020, and 2021, respectively. The macro-fiscal framework includes projections regarding the utilization of these Eurobonds in the upcoming medium-term period.

Despite securing project-based funds from multilateral and bilateral creditors, GoA also received budget support amounting to EUR 270 million in 2021, as reported in the Economic Reform Program (ERP, 2022). This included:

- USD 80 million in budget support from the World Bank aimed at fostering fiscal sustainability and promoting economic growth,
- EUR 90 million in budget support from the European Union focusing on macro fiscal assistance, and
- EUR 100 million in budget support from the German Development Bank (KfW) aimed at energy sector reforms.

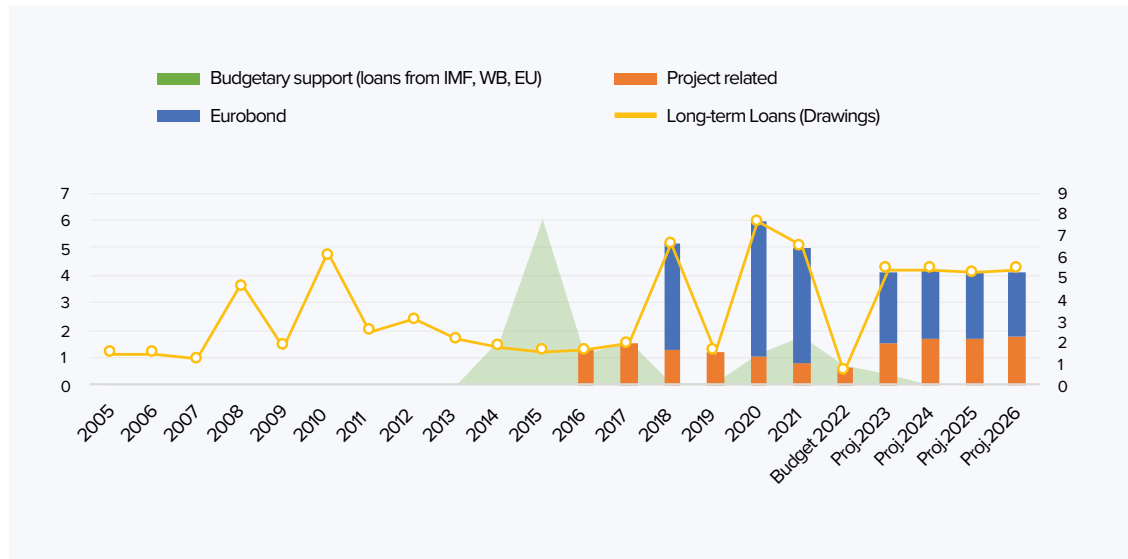
While these budget support inflows have been significant, it is anticipated that disbursements in the upcoming period will be lower compared to the 2021 levels and will amount to approximately 1% of the country's GDP.

**Public debt.** Albania's gross public debt reached 11.2 billion EUR in 2022, equivalent to 64.6% of the GDP, encompassing both domestic and foreign debt. Since 2013, the country has exceeded EU debt targets, primarily due to accumulated arrears in 2013, the 2019 earthquake, Covid-19 pandemic, and recent fluctuations in energy and commodity prices. However, Albania has made progress in recent years by effectively managing its public debt levels, reducing them annually between 2017 and 2019. This consolidation approach has created fiscal space and allowed for successful commercial borrowing at low interest rates between 2018 and 2020, while also supporting the 2020 economic shocks.

Nevertheless, the current public debt remains high and vulnerable to refinancing risks. The implementation of supportive/expansionary fiscal policies, including counter-cyclical fiscal stimulus, coupled with a sharp economic slowdown, has significantly widened the fiscal deficit, and further increased public debt from 65.8% of GDP in 2019 to 74.5% by the end of FY2021, the highest level in two decades. The public debt in

92. Disaggregation by sources of these project-based loans is not available.



**Figure 16. Long-term loans financing the fiscal deficit (in % of GDP, right axis for the budget support)**

Source: MFE (2023)

Note: Missing detailed data for 2005-2015

2022 decreased to 64.6% of GDP which is still higher than the WB6 average of 59%. Despite projections for a decrease in gross public debt in the medium-term, it appears challenging to achieve the EU convergence criteria of 60% by 2026 (expected value at around 64.2% of GDP). Since 2017 Albania applies a fiscal rule that requires the public debt level (debt-to-GDP ratio) to decline in every fiscal year until it reaches 45% of GDP. However, this rule has been violated in recent fiscal years, including its suspension due to emergency circumstances through a Normative Act (NA) in 2021, known as specific exceptional clauses in the current OBL.<sup>93</sup>

Deviation from the fiscal consolidation approach poses risks to the credibility of fiscal policy and public support for future consolidation efforts. Moreover, it increases the refinancing risks associated with the country's public debt, particularly when it remains above targeted levels for an extended period.

The gross public debt stock comprises public debt from the budget and extra-budgetary public debt, with the latter including local government debt stock and guaranteed public debt stock. Public debt from the budget consistently accounts for more than 90% of the gross public

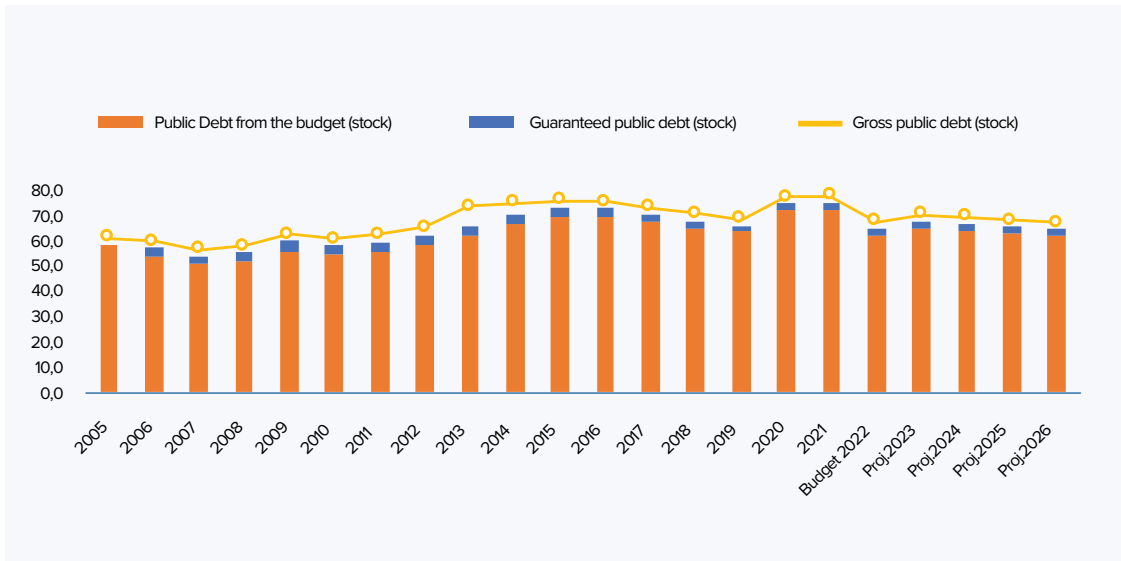
debt. The borrowing-to-GDP ratio of local governments remains insignificant due to their low capacities in absorbing borrowing, while the guaranteed public debt, despite increasing usage, remains low at around 3% of GDP.

To address liquidity constraints stemming from maturing Eurobonds prior to the crisis, GoA has taken measures to ensure short-term liquidity. This includes borrowing from the domestic market through short-term instruments, receiving a concessional loan through the IMF Rapid Financing Instrument, and issuing a Eurobond worth EUR 650 million to pre-finance the overall needs of FY2022, partly paying off maturing debt and partly financing the third revised supplementary budget. The guaranteed debt portfolio represented approximately 2.4% of GDP or 3.7% of the government debt portfolio by the end of FY2022 (expected to remain at an average level of around 3% of GDP in the medium-term up to FY2026). Domestic guarantees make up 30% of the total guaranteed debt stock, mainly consisting of short-term credits issued by national banks to the Albanian power corporation KESH. Foreign guarantees comprise long-term concessional or semi-concessional loans. In response to the Covid-19 shock, GoA issued two state guarantees in 2020,<sup>94</sup>

93. Related to the conditions when fiscal policy needs to respond to large fiscal shocks, temporarily deviating from the fiscal consolidation path.

94. The first Loan Guarantee in the amount of ALL 11 billion, to be allocated by commercial banks to companies that had difficulties in paying employee salaries; The second Loan Guarantee, in the amount of ALL 15 billion, providing loans for working capital and investment for all sectors of the economy.

Figure 17. Components of gross public debt stock (in % of GDP)



Source: MFE (2023)

\* Please note that local government stock of public debt is around 0% over the two decades

which accounted for 21.3% of the total actual guaranteed debt stock. In 2021, a package of Guarantee Agreements was concluded with four banks to support imports in the energy sector. For FY2022 the GoA planned support for securing electricity supply in the form of a sovereign guarantee for the Energy sector in the sum of ALL 8 billion in the form of loans and ALL 20 billion as budget support. While for the FY2023 the government has planned (ALL 12 billion) as budget support for the energy sector.<sup>95</sup>

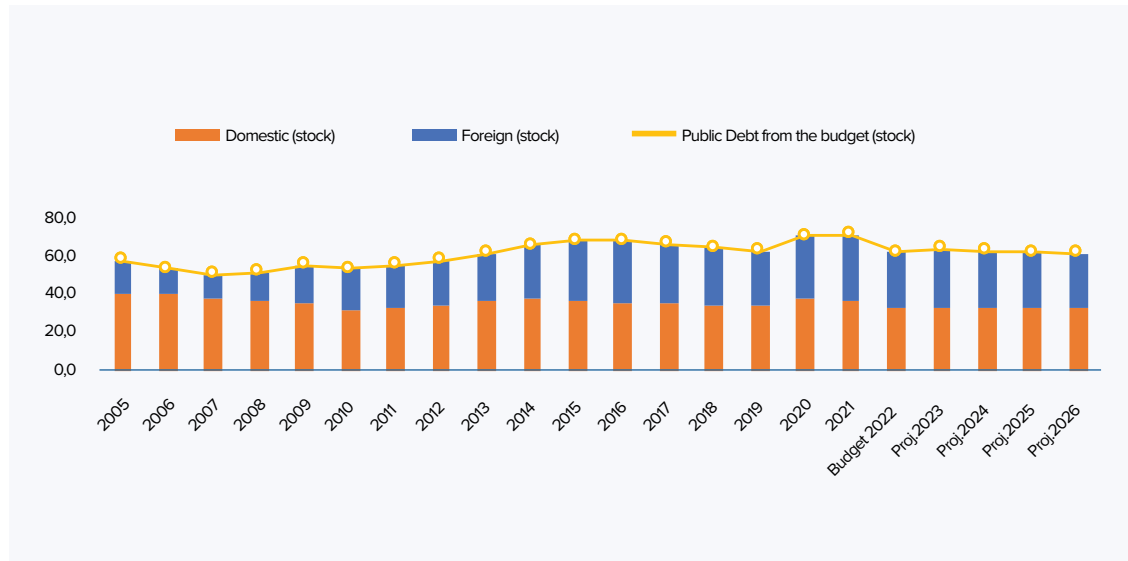
In the medium-term, the level of guaranteed debt is planned to be around 3%, with a projected declining trend. These guarantees primarily aim to support development projects in infrastructure, regional development, environment, as well as to manage existing contingent liabilities in terms of average costs and risks.

Share of foreign public debt from the budget to overall public debt has increased constantly over the years and equaled the value of 28.7% in GDP terms for the FY2022, reflecting a significant decrease from the level of 35% by the end of FY2021 in accordance with the objective set to control the risks with regards to the exchange rates. Domestic debt portfolio is dominated by shorter maturities. To extend the average maturity of domestic debt, the share of long-term

government securities in the domestic debt portfolio composition has increased, with 64.6% of securities having a maturity of more than 1 year. To mitigate interest rate risks, fixed-rate securities make up 98.7% of the total portfolio. The average cost of domestic debt slightly increased in the first months of 2023, reaching a level of 4.43% (from the level of 4.05% in 2022), primarily due to the increase of interest rates for short-term instruments.

Despite the positive developments in the financial system, domestic debt continues to pose a relatively high refinancing and interest rate risk. These are further amplified by the absence of an active secondary market and the narrow investor base. Projections on the medium-term period indicate that domestic borrowing will continue to rely heavily on the banking sector. Short-term securities will be mostly used to refinance the existing maturities to ensure liquidity, while long-term securities will be used to cover the budgetary deficits. The foreign debt portfolio continues to exhibit lower risks due to its composition, primarily consisting of longer-term instruments (approximately 94% of the total portfolio) and the majority of them with fixed interest rates (63.4% of total). A significant portion of the foreign debt carries concessional terms, with 50% of these loans being owned GoA. In terms of diversification, loans sourced from

95. MFE. (2022). Economic Reform Program 2023-2025

**Figure 18. Domestic and foreign public debt from the budget (as % of GDP)**

Source: MFE (2023)

bilateral and multilateral creditors, primarily directed towards developmental projects, continue to hold the largest share. MFE's 2023 mid-year report indicates that gross foreign debt is composed of project-related loans, accounting for approximately 40.1% of the total (with 25.8% allocated to the transport sector<sup>96</sup>), and budget support, constituting around 59.9% of the total.

In 2021, gross external debt increased, driven by the issuance of a 10-year Eurobond worth EUR 650 million (initially yielding 3.75%, comparable to the yield of the 7-year Eurobond issued in 2020), as well as other concessional loans to support the economy. Of the funds raised, EUR 250 million were used to refinance a maturing Eurobond, while macro-financial assistance amounted to EUR 180 million in the form of an EU loan with highly favourable terms. The growth of public debt in the foreign market and currency during 2020-2021 has increased its share to the total public debt stock by nearly 5%, currently accounting for 51% of the total. This surpasses the targeted maximum of 50% stipulated by the Medium-Term Debt Management Strategy (MTDMS). However, the revised medium-term fiscal framework aims to reduce this share to 44.5% of the total debt stock by 2024 and by the end of FY2022, it seems to be well achievable.

### Medium Term Debt Management Strategy 2022-2026

The GoA maintains a robust system for recording and reporting debt and guaranteeing the provision of detailed data. MFE has produced comprehensive MTDMS on an annual basis. The current MTDMS covers the period from 2022 to 2026. The overall debt management objectives have remained consistent across the last three consecutive strategies. The first objective is to meet the government's financing needs and debt service requirements for both the state debt and guaranteed state debt at the lowest possible cost. This is achieved by prioritizing instruments with favourable cost and risk exposure, while maintaining a prudent level of risk exposure. The second objective is to foster the development of the primary and secondary markets for government securities, promoting liquidity and efficiency in these markets. These objectives are aimed at enhancing the overall management of debt and ensuring optimal financial resources for the government.

### The Public Finance Management Strategy 2019-2022:

The current PFM in place extended with its revised Action Plan for 2020-2022 addresses the following strategic pillars: (1) sustainable and prudent fiscal framework; (2) well-integrated and efficient planning and budgeting of public

96. Other sectors financed through project-related loans are as follows: health (7.7%); water (4.4%); energy (1%) and others representing 1.1%.

expenditures; (3) efficient execution of the budget; (4) transparent public financial reporting; (5) effective internal controls; and (6) effective external oversight of public finances.

**Debt servicing**

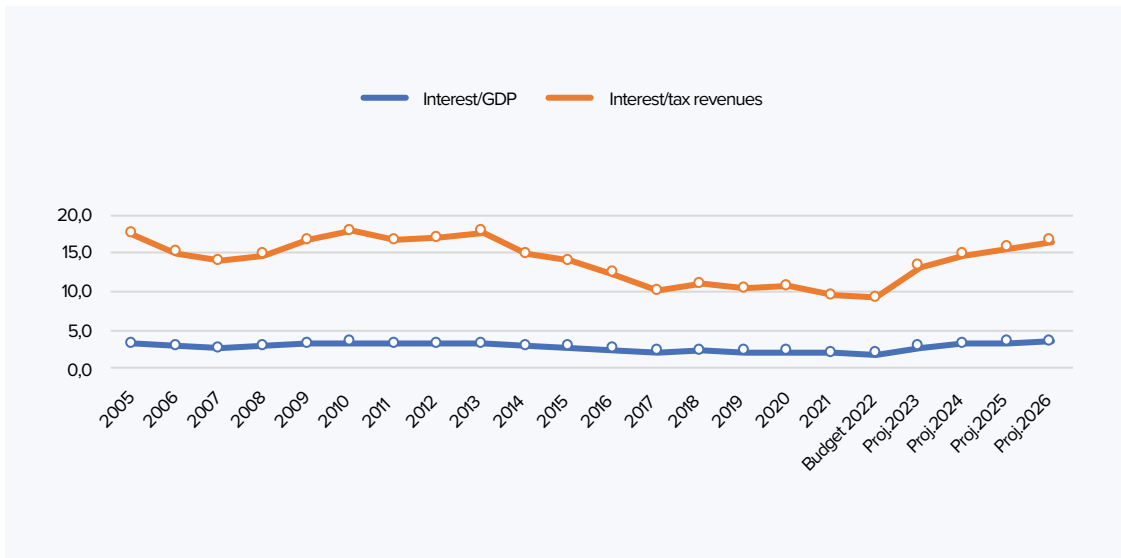
MFE foresees an upward trajectory in debt servicing during the medium-term period, with estimates indicating it will reach around 4.5% of GDP. Interest payments, a key component of debt servicing, reached 1.9% of GDP by the end of FY2022 and are projected to account for approximately 2.8% of GDP in 2023, equivalent to 8.7% of total public expenditures and more than 10% of total tax revenues. The latter is projected to show an increasing trend over the mid-term period.

In the medium-term, an increase is expected in expenditures on debt interest payments in absolute terms, mostly due to the debt stock increase. A gradual increase of interest expenses in relative terms to GDP and tax revenue is also expected. In recent years, interest expenditures have declined due to long-term low interest rates as well as the refinancing of maturing debt with less expensive borrowing terms.

**Debt sustainability**

Although the public debt ratio is high, it remains sustainable and can be serviced, repaid, refinanced, and restructured in an orderly manner.<sup>97</sup> The 2021 evaluations by both Standards & Poor’s and Moody’s rated Albania as B1/stable and B+/stable, respectively, in terms of macroeconomic risk. Despite the increasing financing needs of GoA, interest rates for government securities have decreased, and S&P Global ratings affirmed a B+/stable outlook for the long-term credit rating of Albania’s currency. During 2023, S&P has upgraded its outlook for Albania from “stable” to “positive”. Concurrently, it has reaffirmed Albania’s credit rating at “B+”. Debt sustainability analysis indicated that Albania would face high gross financing needs during 2022-2026, with an average annual level of 23% of GDP.<sup>98</sup> In the baseline scenario, the public debt is still vulnerable to potential growth-related shocks such as economic downturns (based on IMF projections), interest rate increases (stemming from significant recent increases), and exchange rate fluctuations (due to the rising gross foreign debt stock).

Figure 19. Interest expenditures as % of GDP and of tax revenues



Source: MFE (2023)

97. European Commission. (2022, Jun). Economic Reform Programs of WB and Turkey, the Commissions’ overview and country assessments. [Institutional Paper 180]

98. World Bank. (2021). Country Economic Memorandum 2021 for Albania - Strengthening the Sustainability of Albania’s Growth Model

According to BoA (2022) risk analysis confirmed that Albania's external debt is more sensitive to currency depreciation than to interest rate increases. The volatility of foreign prices can put pressure on the currency's value and impact debt sustainability. Foreign exchange reserves can play a crucial role in mitigating this risk. In the Albanian economy, foreign exchange reserves have consistently increased over the years and stood at around EUR 5 billion by the mid of FY2023, adequate to potentially cover 6.8 months of average imports and 409% of short-term foreign debt, surpassing the respective targets of coverage of 3 months of imports and 100% of short-term foreign debt.<sup>99</sup>

Revenue mobilization, together with the improved assessment of fiscal risks (here including particularly the SoE arrears and the Public-Private Partnership [PPP] payments and guarantees obligations) remain crucial for maintaining a stable fiscal position and reducing potential risks to debt sustainability (ERP, 2022).

#### 5.1.4. Other factors influencing the public budget

##### Public-Private Partnerships (PPPs)

In Albania, PPPs have been used in recent years largely for capital investments in strategic public sectors, aiming to ease the budgetary burden and to create fiscal space. By the end of 2021, 228 contracts<sup>100</sup> were listed in the PPPs/concessions registry (with 6 contracts having been signed in that same year), covering sectors of transport, energy, urban development, economic development, fiscal control, environment, and health.

According to MFE,<sup>101</sup> the cumulative invested amount for PPP/concessions projects has shown an increasing trend in GDP terms over

the years, reaching a peak of 34% by the end of FY2020. It decreased to 31% of GDP during FY2021, due to the registered economic growth, as previously expected.

Out of the total number of contracts, 13% have been initiated and concluded as solicited proposals from the contracting authorities, while the rest have resulted as unsolicited proposals provided by private bodies in different sectors, aiming at offering a contractual service through advanced technology. These unsolicited proposals have shown an increasing trend after FY2013. Most contracts (176) have been concluded during 2004-2013 and only 52 (or 70% less) have been concluded after FY2013.

The rising stock of PPPs was expected to reach EUR 6.3 billion at the end of 2022 or around 36% of GDP.<sup>102</sup> The sector with the most awarded concessionary contracts is energy. In 2021, there were 179 concessions contracts awarded in the energy sector<sup>103</sup> under the Build-Operate-Transfer (BOT) model with no public budget mobilized. They account for approximately 66% of total value of concession contracts. The works under 61% of the contracts (under 109 out of 179) are finalized and the energy production has started, 14 works are under construction, while 56 contracts or 31.3% of total have not started yet.

The second largest sector in terms of PPPs/concessionary contracting value is transport. In 2022, new PPPs/concession contracts led to a 26% increase in the total value of PPP contracts. MFE confirms that there are no PPPs/concessionary contracts directly managed by LGUs.

In 2017, GoA launched the EUR 1 billion infrastructure plan, aiming to support the construction of road infrastructure, as well as initiatives in the education and health sectors through a "project financing" mechanism.<sup>104</sup>

99. There are several benchmarks to evaluate whether foreign exchange reserves are in excess, considering the macroeconomic stability of the country. A widely known criteria of the "foreign reserves in months of imports" considers that the optimal stock should represent coverage of imports for at least 3 months. Another criteria/Rule of Greenspan-Giudotti indicates that the foreign reserve should account for 100% of the short-term debt. Two other indicators are those of the ratio of forex to the total foreign debt balance and to the M2 aggregate.

100. Currently, 5 of them are resolved.

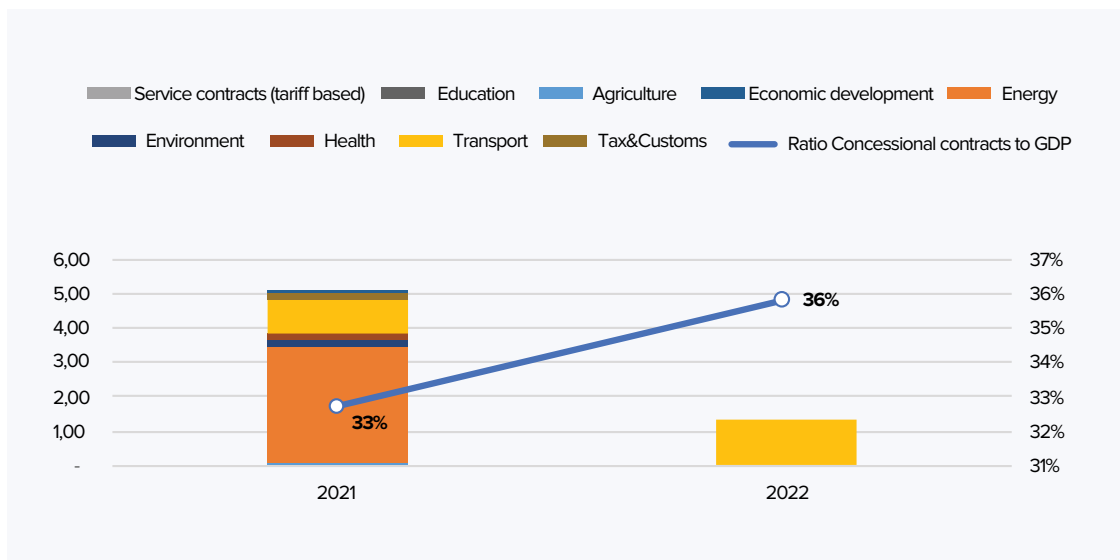
101. Ministry of Finance and Economy. (2022). Annual Report on the Performance of the PPP/concessions contracts in 2021

102. GDP value is the one adjusted by the MFE in April 2023 (Fiscal Accounts update April 2023).

103. Out of the total of 206 contracts signed by the Ministry of Infrastructure and Energy

104. Through public budget participation paying the fee after the construction of the public asset is finalized.

Figure 20. Concession contracts by sector (in billion EUR) and as % of GDP (secondary axis)



Source: MFE (2022)

During and after 2020, the planned funds for PPPs were cut several times in order to create budget space for extraordinary governmental support measures (including cash assistance). MFE’s Fiscal Risk Unit (FRU)<sup>105</sup> made efforts to renegotiate concessionary contracts and postpone their payment deadlines. Latest data from FRU confirmed that there were 14 active PPP/concessionary contracts (6% of total) with budgetary payments in FY2022. For the FY 2022, the planned budget funds for concessionary contracts amount to EUR 99 million (5.6% higher compared to actual payments in the FY2021), of which 37.6% relates to capital expenditures and 62.4% to current expenditures. According to the mid-year report of FY2023,<sup>106</sup> there are currently 11 active PPP/concession contracts requiring budget support.

There are several considerations about the use of PPPs/concessionary contracts to finance the delivery of works and services. Importantly, there is a lack of comprehensive analysis of the

value for money and fiscal risks associated with PPPs/concessions, although MFE does monitor the financial impact of PPPs and ensures that their earmarked budget allocations do not exceed 5% of the previous year’s level of tax revenues, as stipulated by the fiscal rule in the OBL.<sup>107</sup> Direct budgetary liabilities from concessions/PPP have remained stable below 3% of tax revenues (respectively 2.9% for FY2021 and 2.7% for FY2022<sup>108</sup>), and the forecasts indicate a decreasing trend for the years 2023 (between 2.3-2.5%) and 2024.

MFE has expanded its fiscal risk assessment to include SoEs in the water and energy sectors, recognizing the importance of assessing risks beyond the scope of PPPs/concessions. The approval process for PPPs is still separate from the PIM process, which increases risks, creates incorrect incentives for vested interests, and overlooks the principle of value for money. The implementation status of individual PPP contracts for 2021 has been scrutinized by the High

105. MFE has established a Fiscal Risk Unit (FRU) under the Budget Department in charge of fiscal risk assessment and monitoring. The main objective is to understand, monitor and analyze the fiscal risks and to provide recommendations on fiscal risks preventions. There are two risks’ categories under the focus of FRU: explicit risks (macroeconomic shocks, revenues forecast, unforeseen expenditures and public debt) and implicit risks (PPP financial obligations, obligations of the SOE and other risks such as court decisions, natural disasters, international court cases etc.).

106. Ministry of Finance and Economy. (2023, June). Mid-Year Report on the implementation of the Annual Budget and the Macro economic and Fiscal situation

107. However, this does not include PPP related liabilities, which are below the line, e.g. linked to power purchasing agreements and the like (EU Progress Report for Albania, 2022).

108. Ministry of Finance and Economy. (2023, June). Mid-Year Report on the implementation of the Annual Budget and the Macro economic and Fiscal situation

State Control (State Supreme Audit), with their 2022 report highlighting anomalies and violations in several concessionary projects, indicating government failure to regularly monitor PPP contracts.

The IMF<sup>109</sup> and the EU<sup>110</sup> have highlighted the importance of improvement of processes around PPPs/concessions, for which they advise:

- Incorporating PPPs into the strategic planning process of the government, including the State Agency for Strategic Planning and Aid Coordination and MFE's General Budget Directorate.
- Strengthening the PIM functions and enabling better assessment of new investment proposals based on national and sectorial priorities, cost-benefit analysis, value for money considerations, and fiscal risk analysis. The assessment should also explore alternative financing modalities, including budget funding or PPPs. PPP proposals should be included in the Policy Priority Note presented to the Strategic Planning Committee (SPC) at the beginning of each year during the determination of fiscal space (as addressed in ERP 2022-2024).
- MFE's PPP Department should maintain its supervisory and monitoring role for the management of PPP contracts even after the approval process. A fiscal risk statement has started accompanying the budget proposal, and its scope has gradually expanded to cover PPPs as well.
- Further development of technical skills and capacity is necessary to design and assess PPPs/concessions effectively. Investment in human resources and capacity building is required to support the efficient functioning of the institutional structures related to PPPs. Many of these considerations and suggestions are also addressed in the ERP 2022-2024.

### State owned enterprises (SoEs)

The state (public) sector consisted of 167 extra-budgetary units under the central government, including state-owned enterprises (SoEs), as well as local government entities such as water, utilities, and football clubs. Additionally,

there were 26 non-financial public corporations and two public financial corporations.<sup>111</sup> Ownership of SoEs is divided between MFE and various line ministries, with the Ministry of Infrastructure and Energy (MIE) overseeing the most critical ones. In 2021, six SOEs were merged, and preparations are underway to initiate privatization procedures for several others. Continuous efforts are being made to define and monitor public sector corporations, as well as assess their associated fiscal risks.

Albanian Investment Cooperation (AIC) has started to review state assets, formalize partnerships with governmental institutions and to prepare a project pipeline. An assessment of the state's shares in 21 corporations, where the state holds less than 50% of the capital, was initiated in 2022 with the aim of determining the state's voting power in these corporations.

Information is provided below on the two SoE systems/services currently representing the highest fiscal burden for the state budget.

The Albanian Power system is comprised of state-owned companies responsible for electricity generation, transmission, and distribution. Two fully state-owned companies, KESH and Lanabregas HPP, generate the country's electricity supply. This is complemented by the electricity produced by other licensed private entities. Electricity transmission is managed by another state-owned company, the Transmission System Operator (TSO), while distribution is carried out by the also fully state-owned Distribution System Operator (DSO).

Over the past decade, with a few exceptions,<sup>112</sup> Albania has primarily been a net importer of electricity. Approximately 98% of the energy is generated from hydropower, making the country highly dependent on hydrological conditions. Distribution losses have steadily decreased and reached their lowest historical level of 19.7% in 2022. Regulated tariffs below energy costs and liquidity issues have necessitated government support to the energy generation company KESH and other sectorial assistance. Collection rates from energy consumers have significantly improved since 2015, reaching 98% in 2022,

109. IMF. (2021). Article IV of Consultation [Staff Report]

110. European Commission. (2022, Jun). Economic Reform Programs of WB and Turkey, the Commissions' overview and country assessments. [Institutional Paper 180]

111. INSTAT, 2021

112. In 2010, 2016 (small values) and 2020



but overall losses and arrears in the system remain high.<sup>113</sup> In absolute terms, the Albanian energy sector is not financially self-sustainable. The European Commission has cautioned the government about the high contingent liabilities associated with SoEs, which could impact the debt ratio and fiscal risks. Governance of SoEs in the energy sector is also deemed weak. The electricity market is currently closed, with regulated wholesale contracts between state-owned generation and distribution companies. However, the government has taken the steps to establish a Power Exchange. The retail market has gradually opened, excluding users connected to the 35 KW network from regulated prices set by OSHEE as the last-resort supplier.<sup>114</sup>

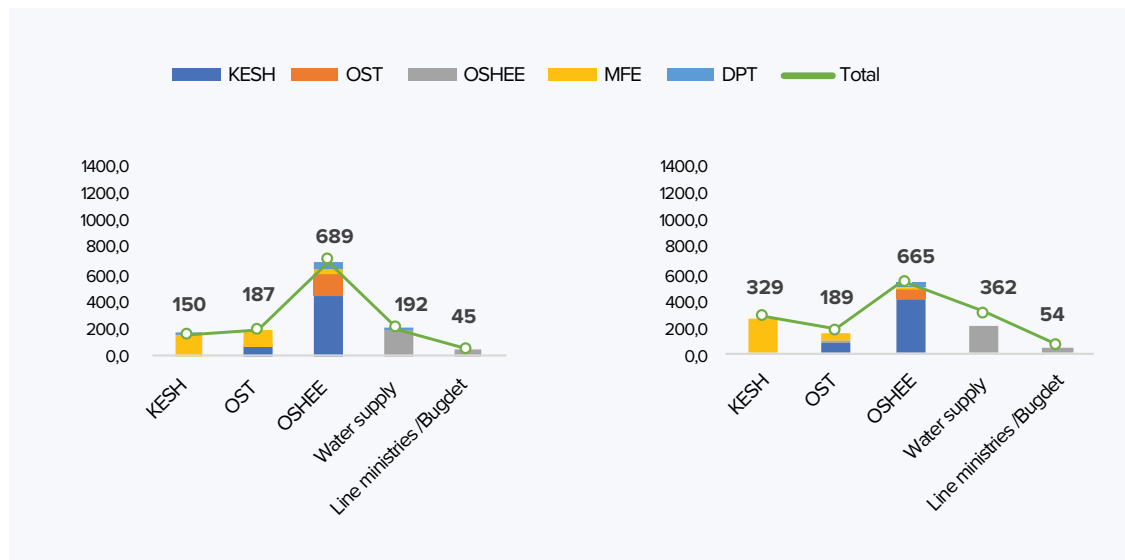
Dependence on hydrological conditions for power generation influences the need for electricity imports to ensure uninterrupted supply, placing a financial burden on state-owned power generation. Subsidized electricity prices for households and SMEs discourage energy efficiency measures and strain fiscal accounts. In October 2021, the government declared an energy supply emergency due to reduced domestic production – a crisis which was further deepened due the international energy crises following the war in Ukraine. Under

this emergency situation, budget support was provided to KESH to compensate for price increases, while prices for households and SMEs remained unchanged. The state budget covers the differences for the state-owned electricity distributor.

To address the high stock of arrears in the energy sector and to facilitate reform and restructuring efforts, a Joint Decision (No. 304) by MFE and MIE was approved in 2020. The arrears include liabilities of energy companies and water supply and sewage companies (including liabilities between them), as well as obligations to third parties, including line ministries/budget institutions and the General Directorate of Taxation (GDT).

In terms of fiscal risks, the sector’s impact on public finances for the FY2022 was estimated to be around EUR 49 million, a 9% increase compared to FY2021. Taking into account the mismatched values between companies, the total stock of arrears and liabilities in the sector amounts to EUR 1,262 million. OSHEE holds 55% of the total accumulated arrears (EUR 689 million), while 39% of arrears are owed to KESH. During May 2022-2023, total arrears in the sector increased by 26.7%, primarily due to an

Figure 21. Reciprocal arrears in the Electricity sector (in million EUR, until May 2022 and until May 2023)



Source: MFE Mid-term Report (2023)

113. ERE, 2022 Annual Report

114. European Commission. Staff Working Document Economic Reform Programme of Albania (2020-2022). Retrieved from <https://data.consilium.europa.eu/doc/document/ST-7468-2020-INIT/en/pdf>.



increase in total liabilities of water supply and sewage to third parties (by 88%) and in total liabilities of KESH to third parties (by 119%).

**Water Supply Services.** Though Albania is a water-rich country, most of its water utilities perform poorly, both technically and financially. The 56 companies that compose the water supply system are unable to extend services to the peri-urban and rural areas in the country and 20% of the rural population has no piped access at home.<sup>115</sup> The number of water supply companies that rely on central government support has increased. Since 2021, 53 out of the 56 supply companies faced a negative financial situation with delays in paying obligations and difficulties in collecting revenues and arrears. The number of companies accumulating losses have increased after the earthquake and the Covid-19 pandemic. The water supply companies face severe problems in collecting bills' payments and high losses in the system, which have created liquidity problems.<sup>116</sup>

Currently, the sector is undergoing a reform process based on the National Strategy for the Water Supply Companies 2020-2030. The aim of the strategy is to organize the 58 water supply companies in 15 central directories, with improved management and organizational and financial performance. In 2021, a study<sup>117</sup> concluded that to address the Water Supply Services (WSS) problems there is a need to increase the efficiency of the energy used, improve the Key Performance Indicators (KPIs) of utilities, apply a new tariff plan for WSS services, and to continue partially or fully subsidizing the utilities from the state budget. The study particularly analysed the problem for 6 WSS utility coverage areas, namely Durrës, Vlorë, Patos, Kavaje, Krujë and Kurbin, which represent about 65% of the total energy debt to OSHEE. Energy costs accounted for about 29% of their operation and maintenance (O&M) costs, second only to labour costs. In 2021, energy costs increased by 8% due to the increase in consumption by KW 12.2 million compared to 2020. The main impact was seen in the case of WSS Durres due to the entry into operation of the

new water supply system from the sources of Milot field in 2021 with a flow of 637 litres per second. The increase in energy prices in 2022 expected to draw in special decisions from the central government regarding energy tariffs for WSS utilities. The government subsidy for the water supply companies was EUR 3.2 million (60% of the subsidy is allocated to 4 water supply companies Durrës, Patos, Vlorë and Elbasan) in 2022. The total need of the sector for subsidies is EUR 13.5 million. For the FY2023, the subsidy is again expected to amount to EUR 3 million.

Currently, the fiscal risks of the main state-owned companies (KESH sha, OSHE sha, OST sha), main water supply companies, stock of arrears of the central and local government institutions, PPPs/concessionary payment obligations, as well as other obligations coming from International Court Decisions are monitored by FRU. At the time of writing this assessment, MFE reports on arrears twice a year, as part of the fiscal risks and contingencies in the implementation report of the annual budget and the macro fiscal situation. Information is provided on the SoEs with particular emphasis on those in the energy, water supply, and sewage sectors.

**State Pension Fund.** The pension reform started in the early 1990s. Three distinct phases of the reform are: (i) 1991-1994: transition reforms that accompanied the country's shift from a centralized to a market economy system; (ii) 1995-2013: focus on increasing the efficiency of the pension system and decreasing its burden on the state budget (seeking cost-containment strategies); (iii) post-2013: retrenchment and expansion of the system (introduction of a social pension).

In 1992, the administration of the pension schemes was entrusted to the Social Insurance Institution (SII),<sup>118</sup> which became responsible for collecting contributions, keeping records, and calculating pensions. In 1993, a new law on social insurance was adopted,<sup>119</sup> which conditioned benefits upon payment of contributions and tightened eligibility criteria of all benefits.

115. World Bank. (2022, May). Albania to Reform and Improve its WSS, with World Bank Support [Press Release]

116. Ministry of Finance and Economy, (2023), Mid-Year Report on the implementation of the Annual Budget and the Macro economic and Fiscal situation, June 2023

117. WRS Albania, Issues of Covering Energy Costs by WSS Utilities, 2021.

118. Approved by the Council of Ministers' executive order no. 249 of 05.06.1992.

119. Law no. 7703 of 11.05.1993 "on Social Insurance in the Republic of Albania".

The adoption of the legislation to support the introduction of the private pension institutions<sup>120</sup> in 1995 was an important development.<sup>121</sup> One of the main difficulties faced by the public pension scheme was the high contribution rate of 31.7%, which demotivated payment of contributions by private companies (both population and companies who also lacked the culture of paying taxes). Informal employment and/or declaration of lower wages in order to minimize the contribution to the pension fund was widespread. As result, the social insurance scheme was largely subsidized by the government, thus contributing to high fiscal deficit.

After 2002, several legislative changes were introduced, affecting the retirement age and the contribution rate, with the latter decreasing from 31.7% to 29.9%<sup>122</sup> (2002), then to 23.9% (2006) and 21.6% (2009). In December 2009, a new law<sup>123</sup> on the pension system was adopted in order to consolidate the legal basis of the private pension market. The new law provided the basis for creation of both voluntary occupational pension schemes – where employers pay contributions on behalf of their employees – and voluntary personal pension schemes – for any individual willing to contribute for supplementary old age pension, disability, and death benefits.

In 2015, another set of changes were introduced to the pension scheme. This came to be known as the ‘social pension’ reform and consisted of: (i) the gradual increase of the retirement age, aimed at reaching 67 years for both sexes in 2056, (ii) the increase of mandatory contribution years from 35 years to 40 by 2025, in order to benefit a full old-age pension income, (iii) the increase in the contribution rate for rural areas, making farmers’ contribution levels equal to those in urban areas by 2018; (iv) the establishment of a means-tested social pension (100% financed from the state budget and equal to the actual partial pension of a person who has worked for 15 years and has paid contributions based on a minimum wage, only for individuals over 70 years old, who have resided in Albania during the past 5 years). The

calculation formula was amended as well: the supplemental pension is calculated as 1% of the average indexed wage over the individual’s entire career for every year of contribution.

The reforms considered gradually phasing out certain special regimes, such as the subsidized rural pension scheme. The State’s supplementary pensions for constitutional functionaries were revised to adjust the balance between contributions and benefits and reduce the State subsidy. For this purpose, amount of contribution increased by 1% for each group by functions set by law and there was introduced an indexation of supplementary pensions excluding reference to the revised wage level. The retirement age for members of parliament and ministers was increased from 55 years to 60 years, with an increase in benefits and modifications to benefit calculations. In addition, the retirement age for underground miners was reduced by five years (from 60 years to 55 years), with an increase in the contribution rate by 5% of the gross wage.

The total number of contributors in the pension system has increased by 15.4% over the period 2010-2022, mostly due to the efforts to formalize the labour market, reaching around 801 thousand contributors in 2022. 92.6 % of the contributors are in the urban areas. There are 687 thousand beneficiaries, 83% of whom benefit from old age pensions (34% more in 2022 than in 2010), and 10% from disability pension (23% more in 2022 than in 2010), while the rest are survivors (22% less over the same period, due to the increase of retirement age after 2015). The increase in the number of contributors has positively influenced the dependency ratio, which decreased particularly after 2013 and reached 82% in 2022.

120. Law no. 7943 of 01.06.1995 “on Supplementary Pensions and Voluntary Pensions’ Institutions”.

121. The first private pension fund was established only a decade later, due to incomplete regulation framework, low solvency rate from beneficiaries and high risk of investments in this domain.

122. Law no. 8889 of 25.04.2002 “on Social Insurance in the Republic of Albania”.

123. Law no. 10197, dated 10.12.2009, “on Voluntary Pension Funds”, was followed by the approval of new bylaws in implementation of this law, during the years 2010, 2011 and 2012 and amendments were made to these bylaws during the following years.

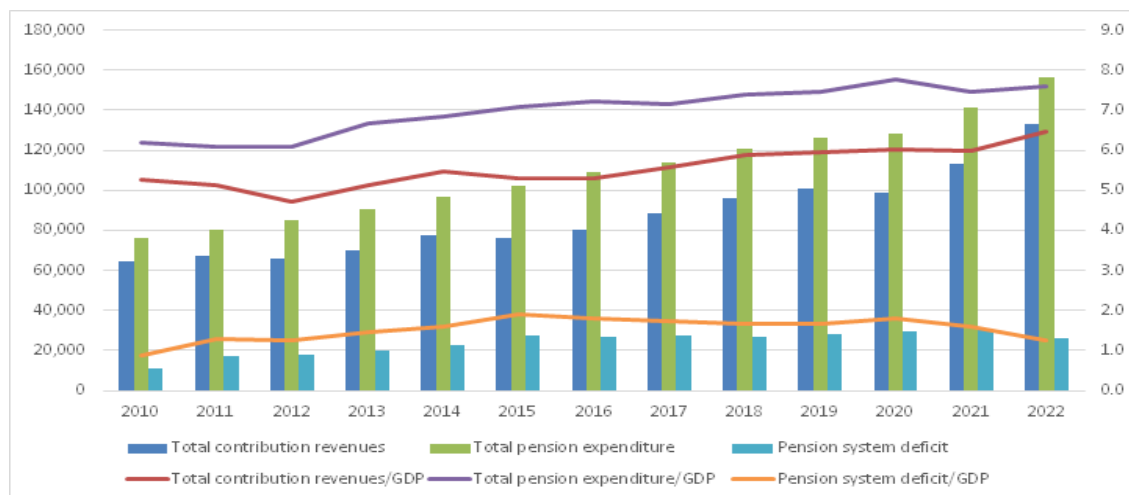
**Table 3. Demographic and financial indicators of the pension system**

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
<b>Number of contributors</b>	<b>694,514</b>	<b>735,448</b>	<b>549,720</b>	<b>561,169</b>	<b>654,563</b>	<b>718,070</b>	<b>718,286</b>	<b>752,383</b>	<b>778,111</b>	<b>781,924</b>	<b>747,872</b>	<b>790,835</b>	<b>801,480</b>
<i>Urban</i>	441,910	474,351	483,100	496,895	526,835	628,543	665,118	693,857	719,171	720,361	701,129	732,744	739,410
<i>Rural</i>	252,604	261,097	66,620	64,274	127,728	89,527	53,168	58,526	58,940	61,563	46,743	58,091	62,070
<b>Number of beneficiaries</b>	<b>543,053</b>	<b>548,675</b>	<b>554,102</b>	<b>570,423</b>	<b>585,483</b>	<b>598,932</b>	<b>611,544</b>	<b>621,186</b>	<b>635,735</b>	<b>651,539</b>	<b>665,863</b>	<b>673,813</b>	<b>686,923</b>
<i>Old age</i>	427,890	429,309	433,847	447,286	460,736	474,475	488,042	498,143	512,507	529,103	544,205	557,017	572,736
<i>Disabled</i>	54,777	58,685	62,098	66,470	68,779	69,864	69,394	69,716	70,175	70,501	69,648	68,179	67,167
<i>Survivors</i>	60,386	60,681	58,157	56,667	55,968	54,593	54,108	53,327	53,053	51,935	52,010	48,617	47,020
<i>Orphans</i>													
<b>System Dependency ratio (%)</b>	<b>1.01</b>	<b>1.35</b>	<b>1.00</b>	<b>1.00</b>	<b>1.13</b>	<b>1.21</b>	<b>1.19</b>	<b>1.22</b>	<b>1.24</b>	<b>1.21</b>	<b>1.14</b>	<b>1.18</b>	<b>1.18</b>
<b>Old age dependency ratio (%)</b>	<b>1.28</b>	<b>1.72</b>	<b>1.27</b>	<b>1.27</b>	<b>1.44</b>	<b>1.54</b>	<b>1.49</b>	<b>1.53</b>	<b>1.54</b>	<b>1.50</b>	<b>1.39</b>	<b>1.44</b>	<b>1.42</b>
<b>Revenues</b>	<b>64,572</b>	<b>67,595</b>	<b>65,771</b>	<b>69,735</b>	<b>77,351</b>	<b>76,414</b>	<b>80,277</b>	<b>88,746</b>	<b>95,955</b>	<b>100,613</b>	<b>98,973</b>	<b>113,127</b>	<b>133,321</b>
<b>Expenditures</b>	<b>76,010</b>	<b>80,428</b>	<b>84,881</b>	<b>90,807</b>	<b>96,791</b>	<b>102,417</b>	<b>109,303</b>	<b>114,148</b>	<b>120,642</b>	<b>126,044</b>	<b>128,041</b>	<b>141,151</b>	<b>156,311</b>

Source: Social Insurance Institute (2023)

The share of pensioners to the total population has increased from 19% in 2010 to 24% in 2022. Long-term forecasts based on birth rate and migration trends indicate that the share of population in pension will increase to 29% by 2031 and 32% by 2080 (SII, 2023).

Total pension expenditures and revenues have almost doubled in 2022 compared to 2010, bringing the pension deficit level to more than twice that of 2010.

**Figure 22. Total pension expenditures, contribution revenues and deficit of the Pension System**

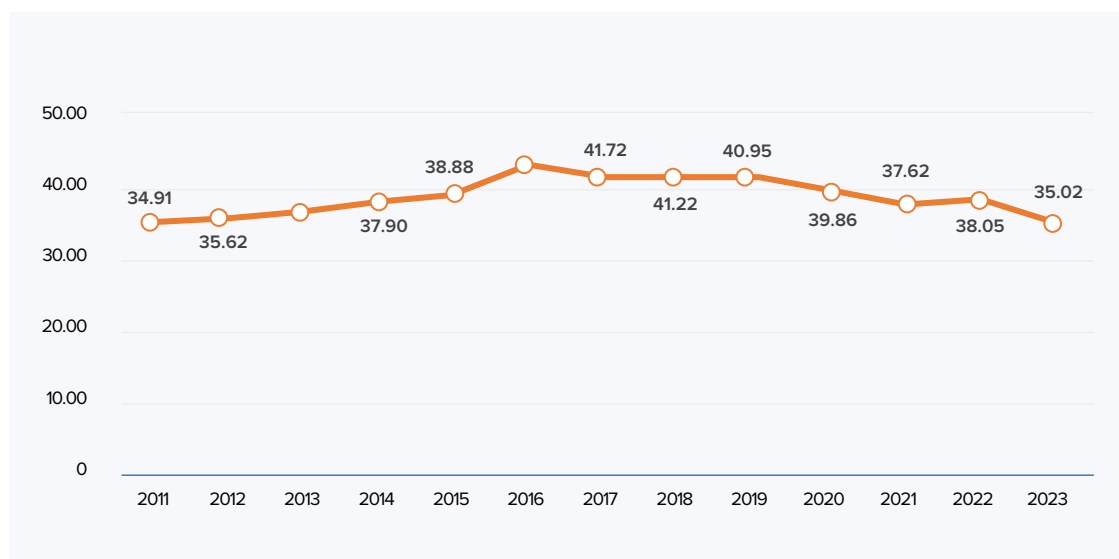
Source: Social Insurance Institute (2023)

Table 4. Overview of pension benefits during 2010-2022

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
<b>Urban pension amount</b>	<b>11,251</b>	<b>11,695</b>	<b>12,280</b>	<b>12,975</b>	<b>13,403</b>	<b>13,508</b>	<b>13,783</b>	<b>14,412</b>	<b>14,793</b>	<b>15,197</b>	<b>14,804</b>	<b>16,254</b>	<b>16,524</b>
<i>Old age</i>	12,153	12,654	13,324	14,076	14,518	14,585	14,873	15,527	15,875	16,254	15,732	17,258	17,350
<i>Disabled</i>	10,985	11,456	11,738	12,181	12,593	12,648	12,803	13,390	13,817	14,258	14,398	15,064	15,939
<i>Survivors</i>	6,341	6,456	6,536	6,785	6,765	6,696	6,613	6,707	6,897	6,888	6,608	7,460	8,118
<i>Orphans</i>													
<b>Rural pension amount</b>	<b>6,283</b>	<b>6,801</b>	<b>7,105</b>	<b>7,135</b>	<b>7,479</b>	<b>7,956</b>	<b>8,150</b>	<b>8,360</b>	<b>8,355</b>	<b>8,794</b>	<b>8,943</b>	<b>9,277</b>	<b>9,910</b>
<i>Old age</i>	6,576	7,139	7,457	7,465	7,825	8,330	8,556	8,808	8,792	9,165	9,295	9,656	10,349
<i>Disabled</i>	5,314	5,582	5,738	5,832	6,113	6,501	6,595	6,451	6,630	7,834	8,239	8,195	8,280
<i>Survivors</i>	2,896	2,957	3,002	3,149	3,252	3,240	2,830	2,478	2,312	2,789	2,904	2,516	2,237
<i>Orphans</i>													
<b>Average wage total</b>	<b>28,012</b>	<b>28,868</b>	<b>34,160</b>	<b>34,961</b>	<b>33,721</b>	<b>32,274</b>	<b>34,615</b>	<b>36,578</b>	<b>37,621</b>	<b>39,587</b>	<b>40,801</b>	<b>44,205</b>	<b>48,175</b>
<b>Replacement rate (average old age pension/average</b>	<b>34.91</b>	<b>35.62</b>	<b>36.54</b>	<b>37.90</b>	<b>38.88</b>	<b>43.18</b>	<b>41.72</b>	<b>41.22</b>	<b>40.95</b>	<b>39.86</b>	<b>37.62</b>	<b>38.05</b>	<b>35.02</b>

Source: Social Insurance Institute (2023)

Figure 23. Average Gross Replacement Rate for Urban Old-age Pensions in Albania



Source: Social Insurance Institute (2023)

The average pension (in ALL) has increased over the years for each single pension category. However, the replacement rate for the old age pension has only slightly increased in 2021 compared to 2010 (from 35% to 38%) in gross terms. During 2022, this ratio decreased to 35% as a result of the higher rates of wage increase compared to that of the pensions and of the increase of the partial pensions.

Several challenges continue to face the public pension scheme in Albania, including low participation rates of the working-age population as contributors, high levels of informality, low participation rates in the pension contribution scheme among farmers, emigration of youth, and an anticipated increase in the number of beneficiaries in the coming years.

## 5.2. Domestic Private Finance

### Section summary

Although private investment levels have grown substantially since the late 1990s, they play a much smaller role in financing economic development in Albania compared to public finance. To some extent, this stems from the country's relatively recent and challenging process of privatization in the post-1991 phase (including the disastrous collapse of the pyramid schemes in 1997) – which implied that a large portion of privatization over the last three decades has been in the form of a transition of ownership from SoEs to private sector entities, rather than an entry of new private investments into the market. This has also implied a slow and weak growth of the financial instruments, products, and markets to support private investments. Reflecting the low productivity and employment potentials of the private sector as well as the economy's high levels of informality, the Albanian economy is characterized with a large dominance of Small and Medium-sized Enterprises (SMEs). Given the latter's significant role in job creation, more resources need to be made available to support the growth and productivity of the SME sector.

Albania's financial system suffers from low levels of development and is dominated by banks, holding 90% of the financial sector's assets. The full privatization of the state-owned shares in the banking sector was achieved in 2009, with 12 banks operating in the country by 2022 – five of which own an estimated 75% of the country's financial market. The banking sector is the primary lending source to the public and private sector, with the nominal value of lending rising from 10% of GDP in 1998 to 33.4% in 2022. Businesses are the economic agents which hold the higher share of loans in the economy (63%), followed by individuals (33%), with the remaining 4% held by the public sector. Nearly 58% of lending is to private non-financial corporations, particularly wholesale and retail trade, followed by construction, manufacturing, and electricity and gas supply. Banks hold more than 60% of Albania's total burden of the sovereign debt. The rate of banks' Non-Performing Loans (NPL) has declined from 25% in 2014 to 5% in September 2023, demonstrating a major improvement

in their management of loans. Along with the banking sector, a number of instruments and markets have been introduced, with varying degrees of success, aimed at supporting private investments. The Tirana Stock Exchange (TSE) which was established in 1996 as an attempt to develop the Albanian capital market and facilitate the mass privatizations of the time, was suspended in 2022. The interruption of the mass privatization and the collapse in investor confidence in financial institutions after the 1997 pyramid schemes crisis, lack of adequate and efficient market infrastructure for issuing, trading, clearing and settlement, and lack of crucial institutions for effective functioning of a capital market resulted in the malfunctioning of the TSE and the eventual suspension of its license. Established in 2014, the Albanian Securities Exchange (ALSE) is the country's first licensed private institution for securities exchange. ALSE initially traded only government securities until the 2019 establishment of a Central Securities Depository (CSD) for non-governmental securities, named the Albanian Securities Register (ALREG). Even though ALSE and ALREG provide the complete technical infrastructure for listing and trading the corporate securities in LEK, no Albanian companies are yet listed, and as such, they do not yet fulfil the mission to mobilize financing for the Albanian companies which continue to fully rely on bank credits. Approval of the 2020 Law on Capital Markets is a crucial development in terms of increasing investors' trust in financial markets and offering better protection of their interests by setting stricter licensing requirements for entities operating in the capital and investment fund markets, setting transparency requirements for issuers and listed companies, setting higher requirement for the market operators, and increasing competition between the market operators and other market participants through clearer operation rules. The first investment fund in Albania was established in 2011. By 2022, 12 such funds have been established, with a combined net assets amounting to 4% of GDP and 4% of financial sector assets. The sector's growth has been driven by inflows from (mainly retail) investors as well as positive returns on assets (mainly domestic sovereign bonds). The sector

is highly concentrated, with the largest fund accounting for 62.7% of total investment funds' assets. Some funds have recently launched investments in foreign sovereign bonds and corporate bonds, as well as in foreign equities, albeit in small amounts. Overall, around 65% of funds' assets are composed of domestic sovereign bonds.

Albania's first private pension fund was approved in 2010, following the licensing of the management company of voluntary pension funds, with 4 management companies, 4 pension funds and 6 depositories currently operating in the Albanian voluntary pension funds market. The investment value and the membership of the voluntary pension funds market grew substantially over the period 2012-2022. Despite this the increase in the number of issues of corporate bonds has remained very limited given the number of participating investors due to the Albanian capital market's lack of brokers, investment companies and intermediate institutions. Government securities market and the private placement bond market together constitute the most active segments of the Albanian securities market, while equities, corporate bonds with public offering and derivatives market are still absent. The banks and institutional investors are the largest buyers of government bonds and bills in the primary market on their account and on behalf of their clients, while households still own only a small percentage of government securities as their investments take the traditional form of bank deposits.

Despite its very small (4.4%) share in financial intermediation, micro-finance plays a crucial role in serving individuals, farmers and small businesses who do not have access to the banking system. Most of Albania's Micro-Finance Institutions (MFI) follow a socially responsible policy targeting financially excluded individuals and disadvantaged areas, with a strong focus on creating jobs, narrowing the gender gap in entrepreneurship, and offering financial solutions in a sustainable manner. The microfinance sector has evolved in line with the socio-economic developments of the country and the growing market demand, offering products and services that raise living standards for individuals and support free enterprise for micro-businesses but also ensuring sustainability in quality of life and consolidation of local business activity, especially family businesses. About 54% of the loan portfolio granted by non-bank MFIs is to individuals, with the rest

to the business sector. The microfinance lending portfolio represented 5.6% of the total lending portfolios to the economy in 2022.

Despite constituting 99.8% of all enterprises in Albania and accounting for 81.6% of all employment in the country, SMEs (1-249 employees) struggle to access finance. The SME sector is characterized by high informality (especially in agriculture), limited availability of collateral and low levels of financial capacity. Despite the Law on SMEs that provides the legal framework for various forms of financial support to them, limited access to finance, especially bank loans, remains a major challenge. Apart from classic grants, no other financial scheme is offered to SMEs in Albania. This highlights the importance of enhancing access to finance through increasing the effectiveness of existing grant schemes and introducing and promoting new financial tools and instruments to strengthen the competitiveness of SMEs. There are some donor-financed SME financing schemes, although due to the specifics of the admission criteria, the participation rates are low. The Business and Development Strategy 2021-2027 defines some strategic milestones, such as redesigning the existing grant scheme for SMEs (raising the maximum amount of grants per project to improve appeal), online grant application and administration, and introduction of additional financial tools and instruments (including loan guarantees). Given their significance in terms of job creation, their relative resistance to external shocks and their potential to contribute to inclusive growth and innovation, SMEs are important potential strategic partners for government in achieving the ambitious development goals set out in both the NSDI and the SDGs.

Given the presence of a large informal economy and low public sector monitoring and enforcement capacities, over 30% of money in Albania is outside the banking system, depriving the country of potentially large volumes of financial resources that could have been used for investments in support of economic development. With the significant growth of M3 aggregate of broad money, money outside depository corporations has almost tripled over the last two decades, reaching ALL 388 billion (around EUR 3 billion) in 2022. Money kept outside depository systems is often used to invest in bonds, real estate, luxury assets, precious metals, or crypto currency.

Albania is among the countries with a low development of the financial system, with a sectorial GDP contribution of below 3%, and a declining economic value added from 2.9% in 2017, to 2.5% in 2019 and 2.1% in 2020.<sup>124</sup> The share of financial sector's assets to GDP has increased from 88% in 2011 to 110% in 2021, indicating a financing potential for the economy. The Albanian financial system includes the banking financial institutions (12 institutions), non-bank financial institutions (35 institutions); Unions and Savings and Loan Associations (1 Union and 16 Associations) and Foreign Exchange Bureaus (556). About 90% of the financial sector's assets in Albania are held by banks, followed by Investment Funds (4.1%), non-bank financial institutions (4%), Insurance companies (2%), Saving Loans Associations (0.7%) and Pension Funds (0.2).<sup>125</sup>

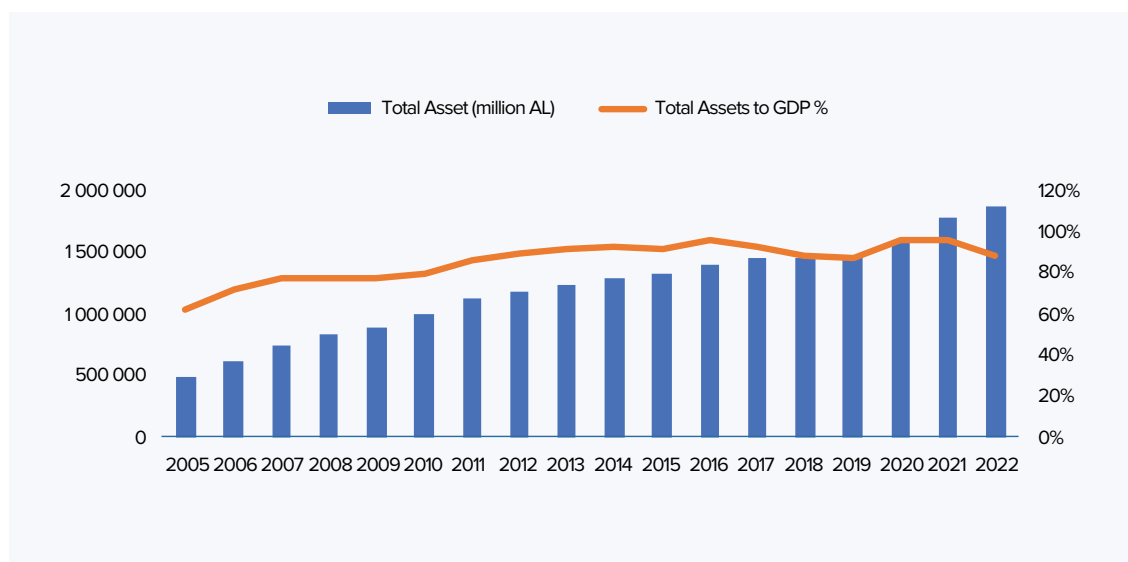
### 5.2.1. Commercial Banking sector

The two-level banking system in Albania was introduced in April 1992.<sup>126</sup> It is comprised by the first level (independent) or National Bank of Albania, and second tier banks or commercial banks. The new legal system allowed the

establishment of banks with private capital, while a major challenge over the first decade of transition was the privatization of the state-owned banks, namely the National Commercial Bank and the Savings Bank, in order to open the path for an efficient banking system. In the 2000s, the shares of the National Commercial Bank were sold to a three-partner consortium of international investors; in 2004 all shares of Savings Bank (Banka e Kursime sh.a.) were sold to the Raiffeisen Zentralbank (Austria); the full privatization of the state-owned shares in the banking sector was achieved in 2009. Alongside the privatization processes, the expansion of the banking sector continued, where the last state shares were transferred to various second level banks. In 2006, there were 17 banks operating in the market, but following a consolidation phase in the banking sector the numbers went down to 12 in 2021. Of these, 7 are banks with foreign ownership and 5 are either domestically owned or with domestic-foreign ownership.

In terms of the value of disposed assets, in 2021 the sector was dominated by the banks with foreign (EU and non-EU) capital. After 2009 there has been an increase of the share of assets owned by banks with mixed domestic-for-

**Figure 24. Total Assets in Banking System (in 000 AL) and Assets to GDP ratio, 2005-2022**



Source: BoA (2023)

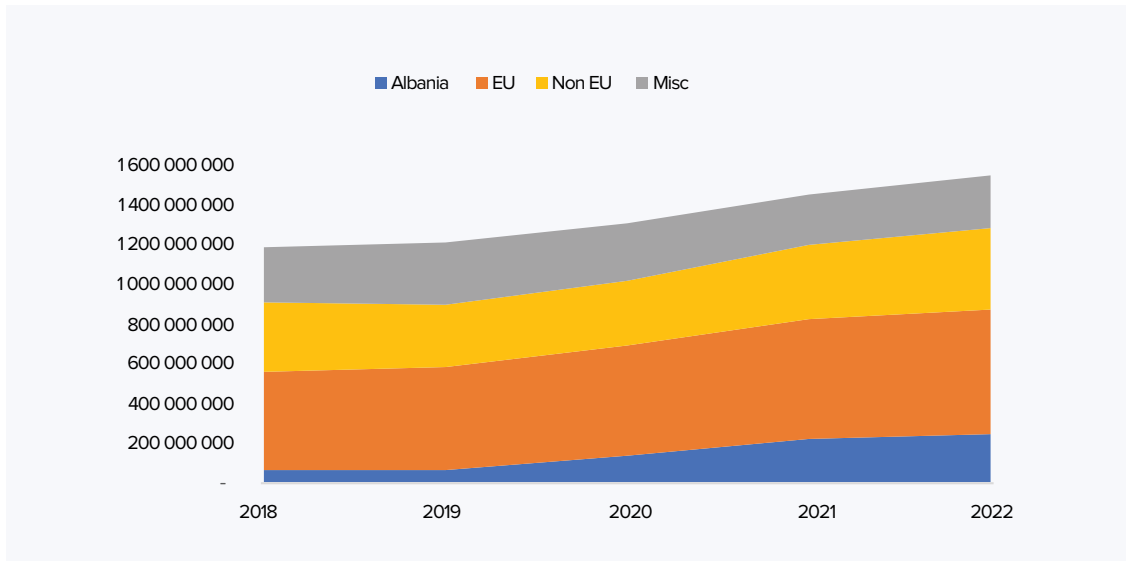
124. INSTAT, 2020 data are semifinal.

125. Bank of Albania, 2022.

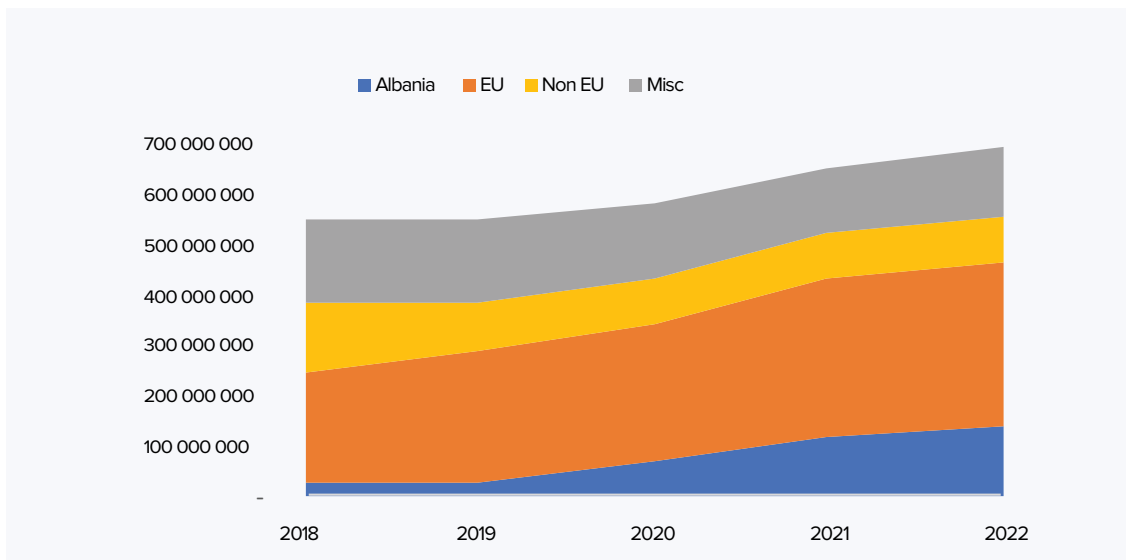
126. Law no. 7559, dated 22.04.1992 "on the Bank of Albania" and of Law no. 7560, dated 28.04.1992 "on the Banking System in Albania"



**Figure 25. The value of DEPOSITS in the banking system, according to the origin of the owner (value in 000 ALL) 2018-2022**



**Figure 26. The value of LOANS in the banking system, according to the origin of the owner, (value in 000 ALL) 2018-2022**



Source: BoA (2023)

foreign ownership. The banking sector has generally preserved an upward growth trend during the period 2005-2021. The total assets have constantly increased both in nominal terms and as a percentage of GDP (from 62% to 94% in 2021). In 2022, the banking sector continued to expand its activity and its assets reached 1,880 billion ALL, especially from the increase in treasury operations and investments in securities.

However, because the annual growth rate of the nominal GDP was higher compared to that of the growth of the balance of the banking system, the share of the assets of the banking sector decreased by almost 8 p.p., (in 88%) despite its expansion in absolute value. (Figure 24)

There is an increasing trend in the nominal value of deposits across almost all banks, except for



those with mixed ownership,<sup>127</sup> which marked a decrease during 2020-2021. Although the deposits portfolio in the banking sector is dominated by banks with EU ownership, the share of deposits held by domestically owned banks has increased since 2019. Consequently, in 2022, the total deposits in domestic banks and other banks of non-EU origin managed to exceed the amount of deposits in banks of EU origin. The loans portfolio is also mainly dominated by banks of EU origin. Most banks with EU ownership are branches of large international banks, which play a very important role in the financial market due to their advanced financial and human resource practices in the sector.

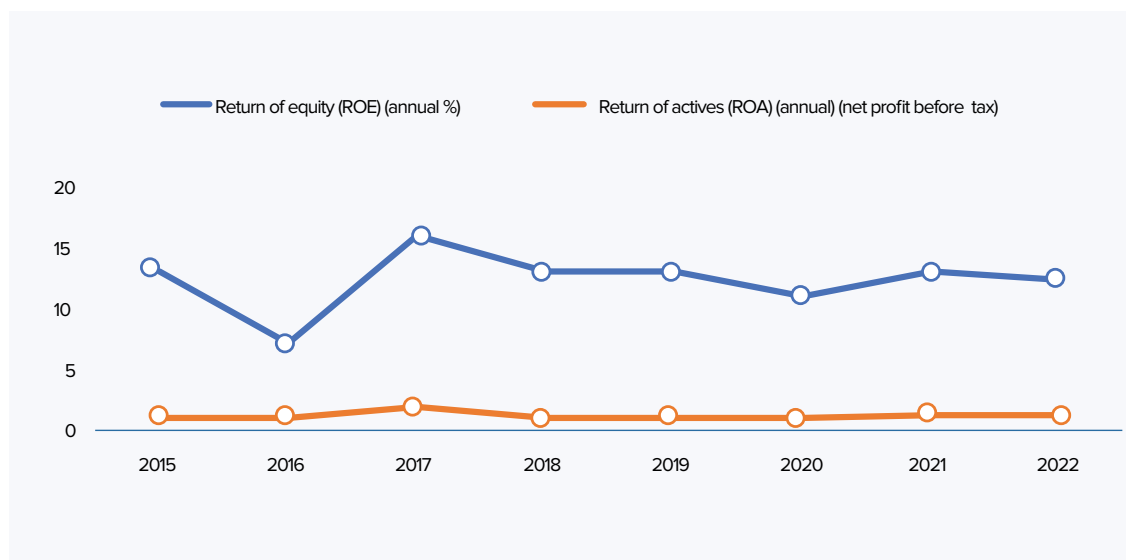
An estimated 75% of the country's banking financial market is owned by five banks National Commercial Bank namely BKT, Raiffeisen, Credins, Intesa SanPaolo and OTP. BKT has the highest share of total banks sector's assets, ranging in the interval of 26-29% over the period 2014 -2022, followed by Raiffeisen Bank, with 15% of assets (in 2022) with a declining trend since 2014 (22%). Credins Bank is the third biggest bank with 16% of assets in 2022, compared to 11% in 2014. In terms of Loans, the highest share of loan portfolio was held by BKT until 2018 (24%), but it has decreased to 13%

in 2022, while 17% of the loan portfolio in the banking system in 2022 is held by Raiffeisen Bank. Investing in T-bills and T-bonds is widespread in the Albanian banking system. Almost one third (30% in 2022) of the total bank investments in T-bills and T-bonds are held by BKT, which disposes 26% of the total value of deposits in the sector, with Raiffeisen Bank ranking second (11-20% of the total). The share of the value of deposits have increased by 6% for Credins Bank and have decreased by 6% in the Raiffeisen Bank over the period 2014-2020.<sup>128</sup>

### Profitability position of the Banking Sector

The profitability of the Albanian banking sector has been positive with fluctuations in certain years not affecting the sector's soundness and stability. During 2004-2007 the Return on Equity (RoE) was around 20%, but it decreased to 0.76% in 2011 (the lowest historic level of the last two decades due to the global financial crisis). After recovering for 4 consecutive years, reaching 13% in 2015, the RoE fell back to 7% in 2016 (due to slower bank lending activities<sup>129</sup>) and recovered again in the following years. The stability in the financial result of the banking sector is reflected in the stability of the profitability indicators of the banking sector, as result of an increased level of lending in the econo-

Figure 27. ROE and ROA for Bank sector in Albania 2015-2022



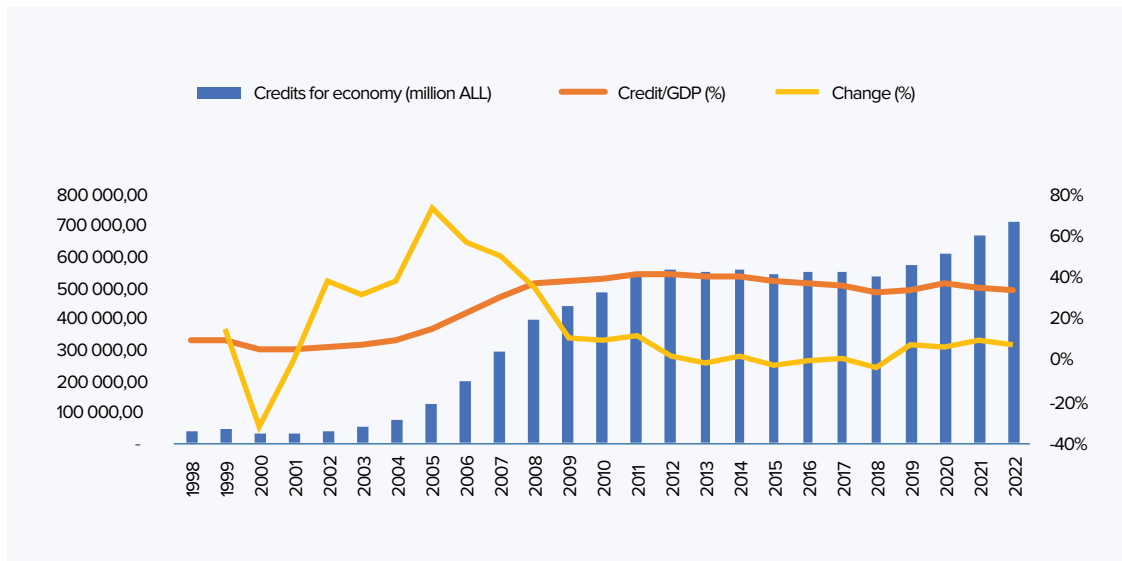
Source: MFE (2022)

127. Owners in different countries

128. Albanian Association of Banks and Bank of Albania (2022)

129. Albanian Association of Banks, contribution of the Banking Sector to the Albanian Economy and Society, 2018.

Figure 28. Credit for the economy (million ALL, % of GDP and change ratio over years), 1998-2022



Source: BoA (2023)

my, respectively RoA and RoE, which marked 1.2% and 12.3% respectively in 2022, from 1.3% and 12.9% that were in 2021. No major impact has been noticed in the RoE rate due to the Covid-19 pandemic. Annual Return on Assets (ROA), net profit before taxes, have remained positive and at stable values at 1% since 2017.

### Credit for the economy

Credit to economy includes claims of depositor corporations (second tier banks, savings and loans associations [SLA-s] and central bank) on other financial corporations, claims on local government and public administration, claims on public nonfinancial corporations, claims on other nonfinancial corporations and other resident sectors. Lending in nominal value and as a percentage of GDP has increased significantly over years. In 1998, lending to the economy stood at ALL 37 billion (10% of GDP), while in December 2022 it was around ALL 714 billion (EUR 6 billion), equivalent to 33.4% of GDP. The stock of bank loans in 2022 has expanded by 6.6% compared to a year ago. Growth has been supported by new loans, where the largest increase was registered in loans to individuals. Since the 2000s, the lowest annual lending growth rate in the economy was recorded as -3.2% in 2018, while the highest growth rate of more than 50% was recorded during the 2005-

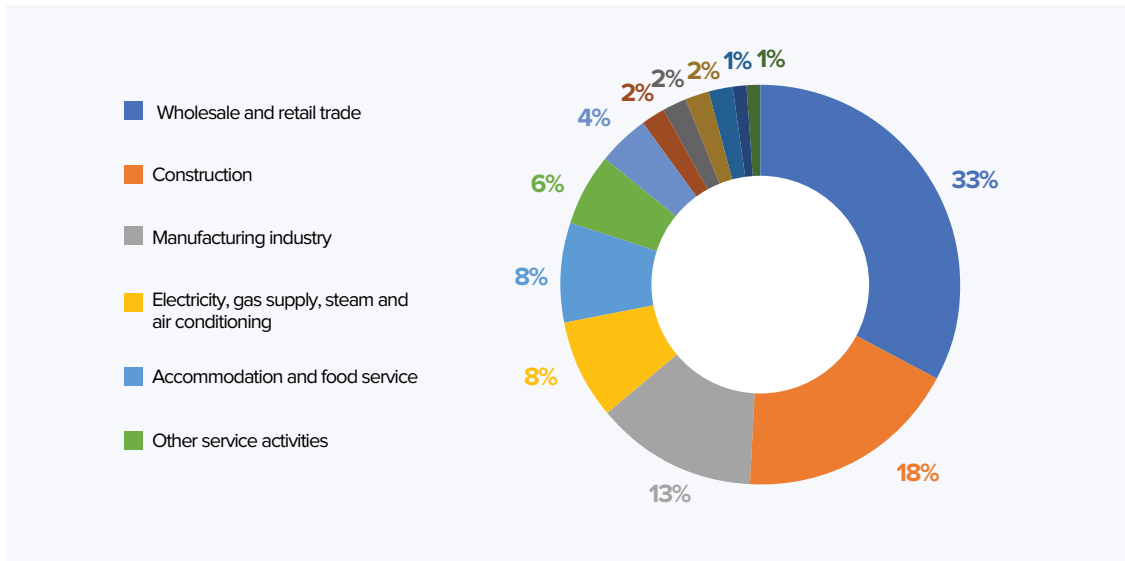
2007 period. The banking sector is the primary lending source for the economy (more than 90% of lending). Since 2012, investment funds have also been introduced as alternative sources of financing.

Businesses are the economic agents which hold the higher share of loans in the economy (63%), followed by individuals (33%), with the remaining 4% held by the public sector.<sup>130</sup> The largest weight of lending is to private non-financial corporations, accounting for ALL 412 billion or 58% of total lending in the economy in 2022 (while in 2021 marked ALL 395 billion or 59 percent). From this category, the highest share is comprised of the “Wholesale and retail trade” sector, which takes about 33% of the total lending (over ALL 132 billion). Other credited sectors are: “Construction” (about 18%), “Manufacturing industry” (13%), “Electricity, gas supply, steam” (8%), “Accommodation and food service” (8%), and “Other service activities” (6%).

The Albanian banks started to invest in Government bonds after 2010 and they continue to be the main long-term sovereign debt holders in the economy with more than 80% of bonds issued. While volume of T-bills held by banks has mainly declined since 2005, in 2022 it still counts for 42.7% of the total issued T-Bills. In ad-

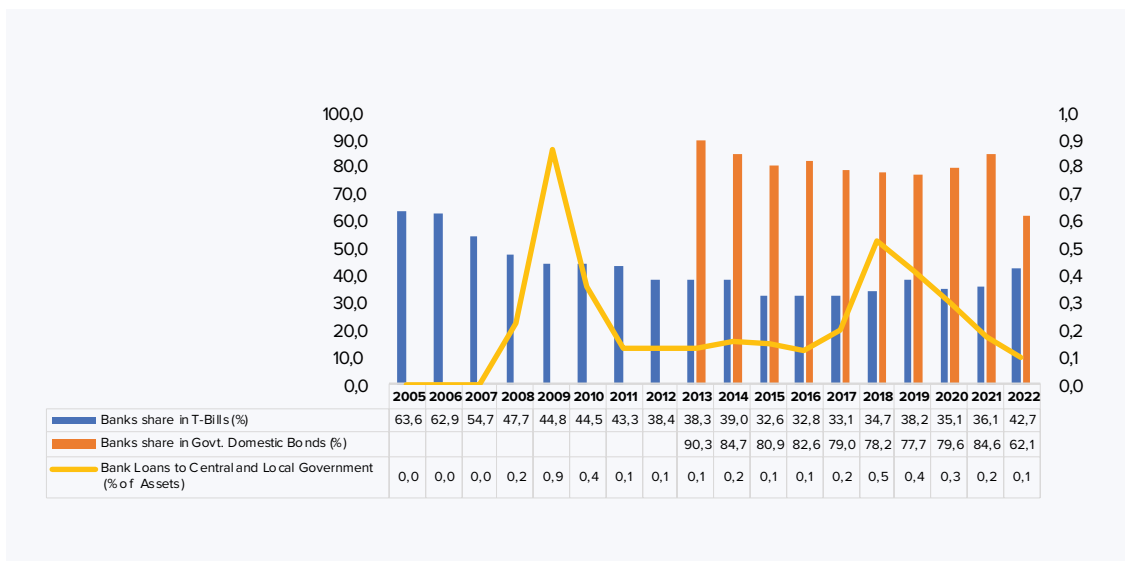
130. Values for 2022 can be found at: [https://www.bankofalbania.org/rc/doc/RSF\\_6M2\\_2022\\_shqip\\_web\\_23933.pdf](https://www.bankofalbania.org/rc/doc/RSF_6M2_2022_shqip_web_23933.pdf)

Figure 29. Lending by sectors, December 2022 (million ALL)



Source: BoA (2023)

Figure 30. Banks share in Government Securities & lending to Central and Local Government



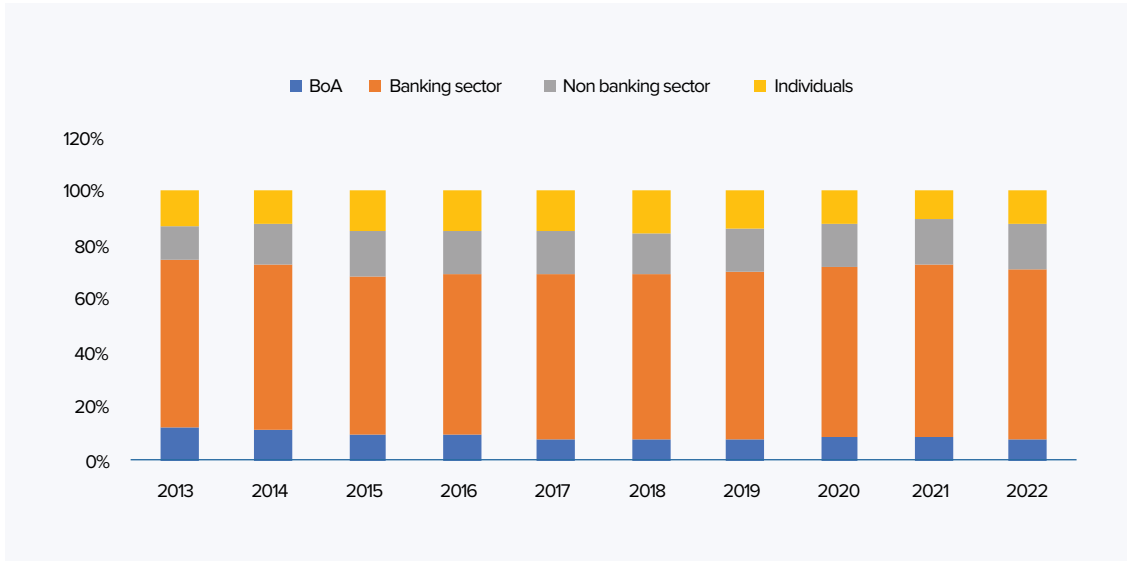
Source: BoA and MoFE (2023), authors' visualizations

dition to holding a part of the public debt, banks have played a role also in supporting the central and local governments with financing, but at lower levels.

Banks remain the main debtholder in the country: more than 60% of the total burden of the sovereign debt is held by them (63% in 2022). Banks play an instrumental role also in facilitat-

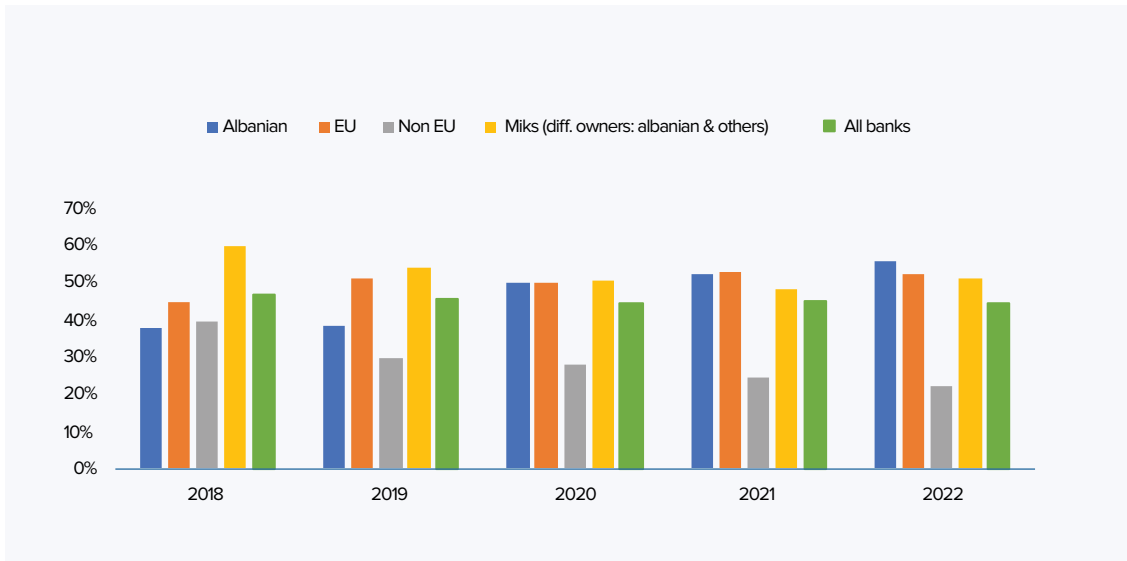
ing citizens' purchase of the public debt. Banks' lending to the central and local government reached its highest level (64%) in 2021 showing the important role of the banking sector in Albania in supporting financing for public investments and government interventions during crises, such as that of the Covid-19 pandemic. An important indicator to illustrate the banking sector performance and its activity is Cred-

Figure 31. Banks share in Government bonds lending to central and local Government



Source: MoFE (2023)

Figure 32. Credit to Deposit ratio, according to banks owner and for total banking sector, 2018-2022



Source: AAB (2022)

it-to-Deposit (CTD) or Loan-to-Deposit (LTD) ratios. In recent years the LTD ratio for the whole banking sector<sup>131</sup> has been relatively stable, between 44-46%, showing that the banking sector is liquid and there is no pressure on potential financing resources. It is observed that banks with capital from EU countries and domestic capital show a relatively higher CTD ratio after

2021, while banks with owners from non-EU countries have a lower (and a decreasing over years) CTD ratio, highlighting the latter's more conservative lending approach. In terms of Financial Soundness Indicators (FSI), the banking sector is well capitalized. Capital Adequacy Ratio (CAR), which is also known as Capital to Risk (Weighted) Assets Ratio (CRAR), is the ratio of

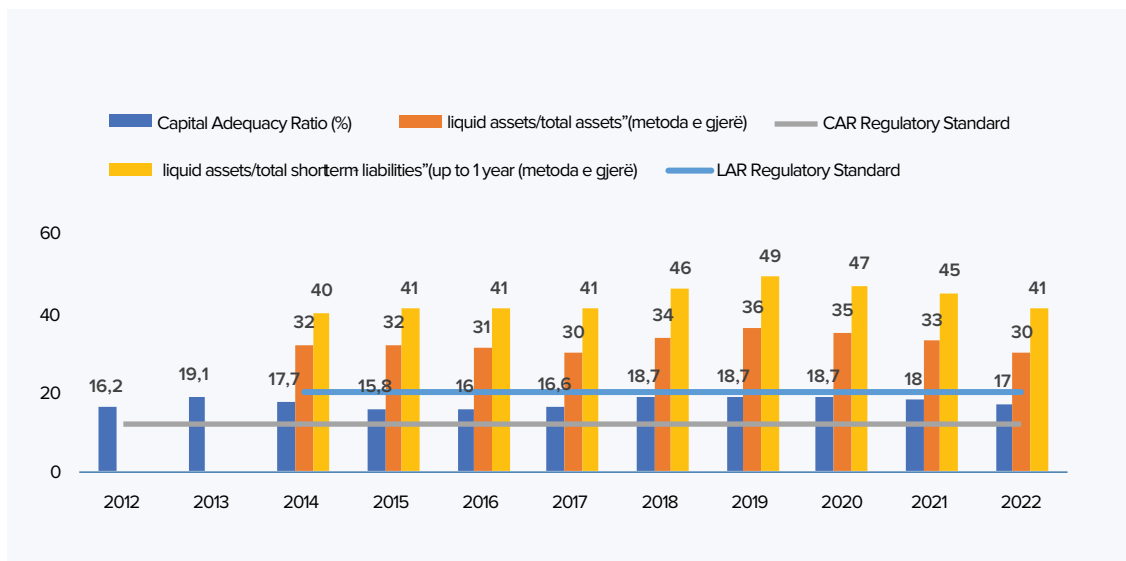
131. Denoted as 'all banks' in the graph

**Figure 33. Capital Adequacy Ratio (CAR): Capital to Risk Weighted Assets Ratio (CRAR %) and Regulatory capital in million ALL**



Source: BoA (2022)

**Figure 34. Capital Adequacy Ratio and Standard CAR**



Source: BoA (2022)

a bank’s capital to its risk, hovers at between 16-19% during 2014-2022. All banks meet the minimum required CAR of 12%. Last four years, 2018-2021 the capital adequacy ratio remained stable at 18% and 17% in 2022. The regulatory capital level of the banking sector (level required by BoA<sup>132</sup>) has increased over the years,

reaching ALL 173 billion at the end of 2022, up from ALL 128 billion in 2014.

At the end of 2021, the CAR stood at the 18% level, remaining unchanged during the period, but falling by 0.7 percentage points compared to the level of the previous year. The ratio of

132. Regulatory capital is the bank’s capital, calculated according to the requirements of the BoA regulation, for covering credit risk, market risks and operational risk (according to

liquid assets to total assets in banks' balance sheets continues to remain high, especially after 2017, despite the fact that during the last years, owing to the impact of the Covid-19 pandemic, it showed a declining trend. At the end of 2022, its value was 30% compared to 33% in the previous year. The performance after 2017 reflects the growth with higher rates of liquid assets compared to the growth of general assets. Similarly, due to the faster growth of liquid assets compared to short-term liabilities, the ratio of liquid assets increased from 41% in 2017 to 49% in 2019, followed by a decline to 41% in 2022, respectively, due to the pandemic effect.

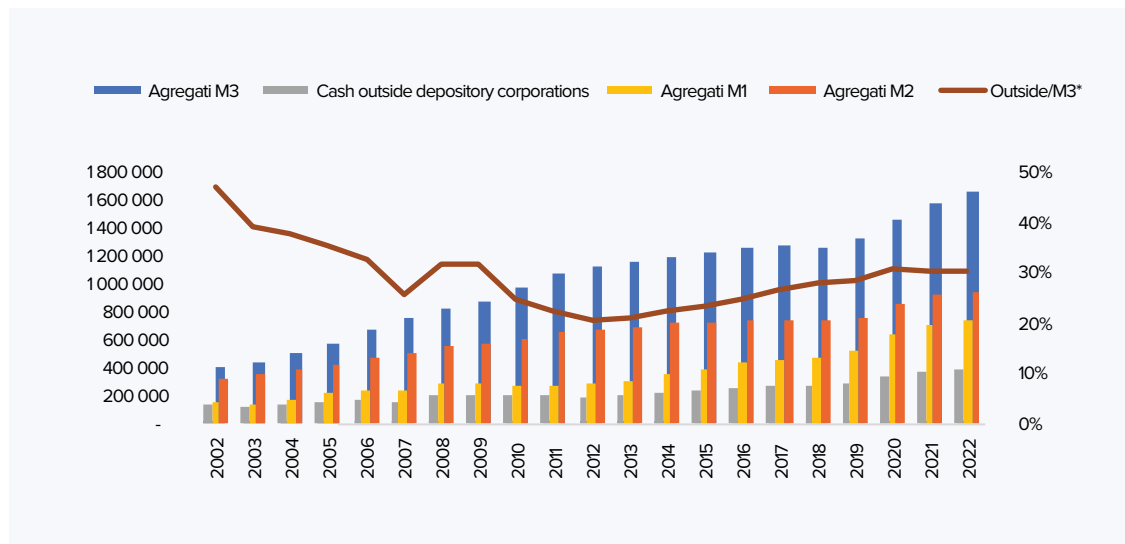
Non-Performing Loans (NPL), as one of the main FSI of banking sectors, shows that there is a major improvement in managing loans, with NPL declining from 25% in 2014 to 5% in September 2023. Over the last few years, a restructuring of deposits with agreed maturity has been observed, noting an increasing trend for deposits with longer maturity periods. Specifically, deposit holders of over two years have increased their portfolio, from 15% in 2016 to 43% in October 2023.<sup>133</sup>

### Monetary aggregates

To analyse the financial capacity of an economy, the analysis of money outside depository corporations is also important as a potential source of investment and finance in the economy. The money outside depository corporations has almost tripled in 2 decades, from ALL 130 billion (around EUR 985.5 million) in 2002 to about ALL 388 billion (around EUR 3 billion) in 2022. Also, the M3 aggregate of broad money has experienced significant growth. If we look at the ratio of money outside depository corporations with general money (excluding that outside depository corporations) it is observed that over 30% of the money in Albania is outside the banking system. This demonstrates the presence of potentially large volumes of financial resources for investment in, and support of economic development. Over the 2002-2013 period, this ratio has decreased from 47% to 21% of M3, while there has been an upward trend after 2013. Money kept outside depository systems may be used to invest in bonds, real estate, luxury assets, precious metals, or crypto currency.

Another important indicator for the financial sources' capacities in the economy is also the

Figure 35. Monetary aggregates and ratio of money outside versus M3<sup>134</sup>



Source: BoA (2023)

133. 40% in December 2022

134. M1 (money outside of depository corporations plus current accounts and demand deposits in lek of non-bank residents, excluding the central government), M2 (M1 plus time deposits in lek of non-bank residents, excluding the central government) and M3 broad money (M2 plus deposits in the currency of non-bank residents, excluding the central government). M3\* is M3 minus cash outside of depository corp.

level of commercial investment, which defines investments occurring when an investor commits money or capital to purchase a for-profit property or business. Private investment levels have increased over the years, standing at an estimated ALL 323 billion (EUR 2.6 billion) in 2021, which is 23% higher than its previous year.

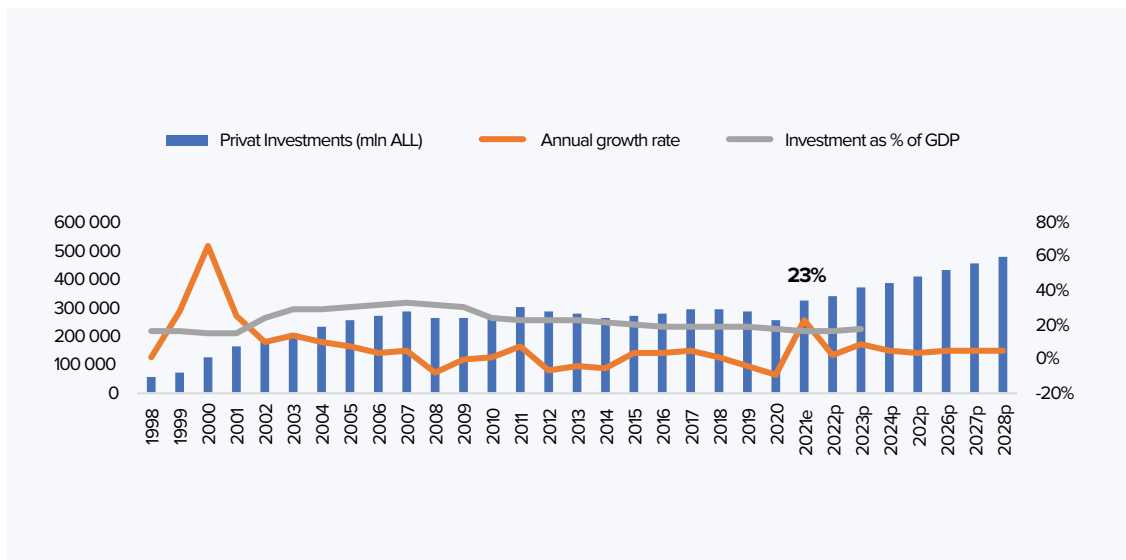
**Banking digitalization**

Electronic banking, and especially online and digital banking, has been one of the main priorities for banks in recent years, but the Covid-19 pandemic accelerated the move towards digitization at an unprecedented pace. In the coming years, banks in Albania will have to visualize and create a revolutionary customer experience, offering integrated and seamless services through digital channels in order to retain existing customers and attract new ones. Banks have embarked on the shift from “banking as usual” to “banking as digital”, aiming to adopt the main drivers for transitioning to digital bank as in other countries, including for e.g., developing simple, convenient mobile apps and website experience, clear and simple bank communications, and competitive pricing. Among the strategies that the banking system is using to promote the spread of digitization is the use of price incentives to increase the use of electronic payments, whereby fully electronic payments and transactions will be less costly compared to cash-based transactions. The full digitization of banks implies the performance of all the following procedures:

from opening of an account without going to the bank; to making national or international bank transfers, as well as various payments, of any type of service and/or goods, without going to the bank; to signing bank documents, contracts, for loans or deposits, without physically going to the bank; to paying obligations to the state, taxes, VAT, health and social insurance without going to the bank; to paying for utility services: energy, water, telephone, fines without going to the bank; to exchanging currencies without having physical money in your hands and without going to the bank; to checking the balance of your accounts at any time without going to the bank; to paying for public services without going to the bank. At the time of writing, the following are still not carried out “without going to the bank”: remote account opening; making international transfers for businesses and partially for individuals; electronic signature; payment for public services.

Digitalization can be translated into opportunities created by the bank: such as using the e-banking application on your mobile phone, connecting to the Internet from a computer, using a debit or credit card where there is a physical or virtual POS, using ATMs. The banking industry in Albania is well-oriented towards digital banking and 2022 data shows an optimistic trajectory: 10 out of 11 banks operating in the country offer internet (e-banking) and mobile banking services. Also, six banks offer

**Figure 36. Private Investment levels (as part of GDP components) and annual growth rate**



Source: BoA

e-commerce services, four of which are the banks with the largest portfolios in the country (Raiffeisen, BKT, Credins and Intesa SanPaolo). Eight out of 11 banks have POS in the country. About half of bank users (50%) use digital banking products: 39% only use mobile banking, 4% only online banking, and 7% use both. Almost all digital banking users use the mobile/online banking app to check their account balance/debit or credit card (98%). Half of the digital product users (51%), use the mobile/online banking application for bank transfers. About 42% of users of digital banking

bank accounts are connected to the Internet, 24% more than in 2021. In 2022, 5.6 million transactions (for a total of ALL 1,372 billion) were performed via home banking (mobile banking). According to CEE Fintech Atlas,<sup>136</sup> Albania lags behind other countries in the region on several digitalization indicators. For instance, during 2019, around 13% of people over age 15 in Albania accessed a bank account online, a ratio that varies at around 12-15% of population in recent years, while in other countries such Kosovo, Serbia and Bosnia and Herzegovina, it is more than 15%. Mobile is used less in Albania than other coun-

**Table 5. Cards & Home Banking 2022**

No	Indicator	2022
1	Card with a cash function	1,369,838
2	Card with payment function	1,296,788
	- Debit	1,184,622
	- Credit	112,166
3	No. of Transactions with Cards	20,149,816
4	Volume of Transactions with cards (mil ALL)	175,334
5	No. of Online Transactions	6,279,470
6	Volume of Online Transactions (mil ALL)	1,564,907
7	No. of outlets	396
8	No. of ATMs	855
9	No. of POS	16,227

Source: Bank of Albania (2023)

products use them for utility payments and/or fine payments.<sup>135</sup> Approximately, 12.5 payments/person are conducted electronically (or about 28,572,582 non-cash payments) compared to the target of 10 payments/person as defined in the National Strategy of Small Value Payments (2018-2023). At the end of 2022, 28.2% of active bank accounts are accessible from the Internet, signifying that 878 thousand

tries as a means of paying utility bills; similarly, the share of population that make or receive digital payments is lower in Albania compared to other countries in the region. Much more needs to be done to increase the awareness of the population regarding new banking services and products in order to reduce consumers' scepticism towards digital banks.

**Table 6. Transactions via home banking**

	2015	2016	2017	2018	2019	2020	2021	2022
<b>No. transactions</b>	1,404,052	1,791,989	2,263,607	2,911,837	3,623,642	4,119,802	5,129,064	5,654,782
<b>Value in mln ALL</b>	282,756	343,583	550,096	885,777	960,060	1,044,936	1,206,352	1,372,059

135. Albanian Association of Banks (2022). Confidence and perception of customers in banks

136. <https://www.cee-fintechatlas.com/country/albania/>



## 5.2.2. Capital Markets

### Background of capital market developments in Albania

The first attempt at developing the Albanian capital market dates back to May 1996 when the Tirana Stock Exchange (TSE) was established, initially as a department of the Bank of Albania with the core activity being the primary and secondary market for short-term government debt securities (treasury bills) and with the aim to spin-off after a certain period of time. The establishment of TSE was also related to the start of mass privatization in Albania, an ownership transformation process that triggered growth of capital markets in the Central European Countries in 1996-1997. For almost two decades since its inception, TSE failed to exercise its core duties, namely, the listing and trading of corporate securities and market of financial instruments. As such, in 2014 the MoF as TSE's sole owner decided to close down this entity, while in April 2022 its license was suspended by the Financial Supervisory Authority (FSA) and TSE was removed from the public register of licensed entities operating in the Albanian capital market.

Several factors hindered the development of TSE, including: the interruption of mass privatization process after the 1997 pyramid crisis; investors' lack of trust in investment professionals and financial institutions after the financial crisis that followed the collapse of the pyramid schemes; lack of adequate and efficient market infrastructure for issuing, trading, clearing and settlement; and lack of crucial institutions for effective functioning of a capital market.

The first licensed private institution for securities exchange is the Albanian Securities Exchange (ALSE), which started as an ambitious project in 2014 by Credins Bank, with the intention to establish a regulated capital market institution in Albania as an investment platform. In 2016, two other institutions, ABI Bank and AK Invest (non-banking financial institution), joined this initiative. In 2017, ALSE was licensed and in 2018 it became opera-

tional supported by the establishment of two other institutions: (i) the Albanian Financial Instrument Settlement and Registration (AFISaR),<sup>137</sup> mandated to deal in securities, to distribute securities on the account of the Albanian Government and issue securities for its own account (investment firms can become direct or indirect participants of AFISaR), and (ii) the Albanian Interbank Payment System (AIPS), which is the Real Time Gross Settlement (RTGS) system of the BoA. Banks can be direct participants in AIPS, while investment firms can be indirect participants accessing the system through a bank, known as a settlement bank.

For one year, ALSE traded only government securities, because the depository institution for non-governmental securities was lacking. The Central Securities Depository (CSD) for non-governmental securities, named the Albanian Securities Register (ALREG), was created by Credins Bank and ABI Bank at the end of 2019. ALREG was licensed by the BoA to act as a settlement system operator. ALREG has the technical capabilities to connect with ALSE's trading system and to act as registrar and perform the clearing and settlement for the corporate bonds which would be traded at ALSE and Over-the-Counter (OTC).<sup>138</sup> The approval on 1<sup>st</sup> March 2021 of ALREG membership as indirect participant in the AIPS System of BoA has made the post-trade infrastructure<sup>139</sup> fully available. The compliance of ALREG with the requirements of the law on capital markets was approved in 2022<sup>140</sup>, legitimating ALREG to act as Securities Registrar and a CSD.

Apart from ALREG, the Share Registration Centre (QRA), majority-owned (85%) by the Ministry of Finance, acts as the registrar for the shares resulting from Albania's mass privatization process as well as the shares of several registered joint stock companies. For the companies that registered their shares with QRA, the transfer of ownership takes place after QRA checks the notarized trading contracts concluded by the buyer and the seller.

137. Law No. 8269 dated 23.12.1997 "On the Bank of Albania", article 1.4.d.

138. OTC is the process of trading securities via a broker dealer network. OTC is the case when the companies do not meet the requirements to list on a standard market exchange such as the stock exchange and their securities (stocks, bonds and derivatives) can be traded OTC.

139. Post-trading refers to the activities that take place after an exchange of securities has been agreed upon. This includes clearing and settlement. Clearing and settlement is the term used to describe the processes and the infrastructures required to finalize a transaction.

140. Board decision of ASFA no. 91 date 28.04.2022.

Three out of 9 investment services envisaged in the law are currently performed in Albanian financial market, namely: 1. The reception and transmission of orders in relation to one or more financial instruments; 2. The execution of orders in relation to one or more financial instruments; 3. Dealing on own account.

Other services such as Portfolio management; Investment advice; Underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis; Placing of financial instruments without a firm commitment basis; Operation of a Multilateral Trading Facility (MTF) and Operation of an Organized Trading Facility (OTF) are not yet active.

Last year, banks as capital market entities, in addition to the fulfilment of their obligation to comply with the requirements of the law “On Capital Market”, have requested the expansion of the license with other financial instruments beyond Government securities and with additional new investment and ancillary services, as predicted by the law and regulations in force, indicating that banks are making efforts to advance regarding the capital market.

**Such developments are:**

- In July 2021 there is one bank was licensed to provide investment services as well as the ancillary service of safe-keeping and administration of financial instruments on behalf of clients.
- In October 2021 was given to another bank the right to perform online investment services, through a trading platform created by a European Investment Bank, which enables the Albanian investor to invest in new instruments that are listed and traded in international markets, for purpose of their portfolio diversification.
- In the first half of 2022, two banks were authorized for providing the service of Underwriting, which is a necessary step in support of the issuance of securities with public offering to the benefit of further capital market development.

The Register of Security Charges (RSC) is another instrument which serves as a CSD. RSC was created in 2001 in order to: (i) register the security charges on account of chargers (creditors) on charges’ (debtors’), and the movable tangible and intangible property; (ii) make available to vendors and buyers an information database with tangible and intangible assets that may be used as collateral. Since April 2009, the operation and management of the registry functions were awarded on a 20-year concession agreement to a private company (although it remains the property of the MoF). The Register of Security Charges is comprised of two parts: the client database (with information on their financial standing) and the database of credit insurance transactions which is an electronic registry wherein the clients enter their security charges, extend the deadline of such securities, and record the changes and expiration of existing security charges. The main customers of the register are the commercial banks and branches of foreign banks, lending organizations and institutions, leasing companies, legal and notary studios, local and central tax authorities, as well as the individuals with a stake in security charges.

The post-trade market in Albania is, therefore, fragmented, with one fully operational securities settlement system and registrar for Government T-bonds and T-bills (AFISaR) under the supervision of the BoA; one registrar for equities of joint stock companies with state ownership (QRA); the private licensed CSD ALREG under the supervision of ASFA; and RSC, which also serves as a CSD. Further clarification of the future of CSD’s institutional activity is important to increase the efficacy and make the existing institutions fully operational.

Since its licensing in 2019, the ALREG Company, has registered 19 bonds issues via private placement, with a value of about ALL 10.3 billion. During 2022, ALREG registered 9 issues, amounting to approx. ALL 4.69 billion, approx. 75% of which is denominated in EUR, 1.14% in USD and 23.81% in ALL. Currently, ALSE comprises three members (ABI Bank, Credins Bank and Intesa SanPaolo Bank). It has limited trade volumes and does not yet fulfil its mission to mobilize financing for the Albanian companies which fully rely on bank credits. Furthermore, these initiatives have not yet been supported by other banks as shareholders or brokers in a regulated market.

The adoption of the 2020 Law on Capital Markets<sup>141</sup> has been a crucially important development in terms of increasing investors' trust in financial markets and offering better protection of their interests by setting stricter licensing requirements for entities operating in the capital and investment fund markets, setting transparency requirements for issuers and listed companies, setting higher requirement for the market operators, increasing competition between the market operators and other market participants through clearer operation rules, and increase supervisory power. As of 2020, several new regulations as required by the Law have been approved<sup>142</sup> with 13 others are in the drafting process.

### Primary market

Government securities' market. Currently the Albanian Government remains the sole issuer of government securities. Government securities are issued in national and foreign currency in the form of T-bills (3-, 6- and 12-month maturity periods) and T-bonds (2-, 3-, 5-, 7- and 10-year maturity periods). In November 2021, the Albanian Government issued for the first time a 15-year maturity bond.

The decision for issuing T-bills and T-bonds sits with the MoFE based on the Public Debt Management Mid-term Strategy 2022-2026. The banks and institutional investors are the largest buyers of government bonds and bills in the primary market on their account and on behalf of their clients, while households still own only a small percentage of government securities as they traditionally orient their investments towards bank deposits. The secondary trading of government T-bonds and T-bills takes place across the following three separate markets: (i) Inter-Bank Market (over the counter trades, bank to bank, on Reuters and Bloomberg platforms); (ii) Government Retail Market (over the counter, bank to clients); (iii) ALSE (stock exchange trades). The primary market for government T-bonds and T-bills, as well as the Inter-Bank Market are supervised by BoA, while the Government Retail Market and ALSE are supervised by AFSA. The trades ex-

ecuted on the Government Retail Market are settled by the bank, which trades with their clients and are reported monthly to AFSA and are recorded in the Securities Government Retail Market system operated by AFSA. The primary market of the government T-bills and T-bonds T is fully operational, while the secondary market is mostly on OTC basis. ALSE trading volume since the beginning of the Exchange operations in February 2018 until December 2022 reached about EUR 29.965 million.<sup>143</sup> In ALSE, even during the year 2022, were carried out only transactions in bonds of the Albanian Government (in ALL).

The latest statistical data on the retail government securities market for the period January-December 2022 show that the purchase in the primary market dominates reaching 67.77% of total volume of transactions, while the activity in the secondary retail market still remains low constituting about 11.98% of the transactions (lower than figure in 2021 of 14%). The volume of outstanding government securities' secondary markets for 2022 was dominated by short-term instruments (T-bills) at 50.52%, while long-term instruments (bonds) stood at 49.48%, marking a light increase in long term securities compared to 2021.

With the intention of developing the government securities market and encouraging the secondary market and liquidity increase, the MoFE supported by the World Bank has established the Primary Dealer System, implemented in Albania since 2018 with participation of five banks participating as Market Makers (Tirana Bank, FIB, ABI, Union Bank, Credins Bank). In addition to the right to participate in the auction on behalf of themselves or their clients, these banks have the exclusivity to participate in the primary market and to trade Bonds with maturity of 3 and 5 years through the Primary Dealer system platform upon meeting certain criteria. Seven reference bonds (3 with 3-year maturity and 4 with 5-year maturity) have been issued in the primary market and traded through the Primary Dealer system since the second half of 2018 up to July 2022. However, no evidence

141. Law No. 62/2020 "on Capital Markets" dated 01.09.2020 fully compatible with European directives and regulations.

142. Regulation no. 195, dated 29/12/2020 "on Licensing of Investment Firms, Branch Registration and Recognition of Foreign Investment Firms"; Regulation no. 196, dated 29/12/2020 "on Certification and Qualifications of Investment Firm Key Function Holders"; Regulation no. 197, dated 29/12/2020 "on Clients Suitability Assessment"; Regulation no. 187, dated 16/12/2020 "on the Form and Registering Procedure of Bond Issuance Offering Memorandum"; Regulation no. 188, dated 16/12/2020 "on the Registration and Activity of Investment Firms' Tied Agent".

143. ALL 3.6 billion (AFSA), converted in Euro with average exchange ratio for period 2018-2022.

exists on the impact of Primary Dealer System on the development of secondary market.

**Corporate bonds market**

An increasing trend is recently noted in corporate bonds market issued through private placement. Although the market has been active since 2011, it has remained very illiquid due to the lack of secondary market for such securities. The total outstanding volume of bonds with private placements, issued in three currencies (ALL, EUR, and USD), has increased, reaching about EUR 82 million at the end of 2021, 25% higher than in 2020. This figure reached EUR 121 million by 2022, about 47% higher compared to the end of 2021.<sup>144</sup> There are eight issuers of corporate bonds with private placement (both subordinated debt and private corporation bonds): five banks (Credins Bank, Tirana Bank, ABI, Union Bank, FIB), one microcredit institution (NOA micro-credit institution), and two commercial companies. During 2022, AFSA registered two 11 offering memorandums of six issuers (5 banks and 1 trade company). Banks are very active players in vitalizing the capital market using the issuance of bonds mainly for the purpose of meeting their regulatory requirements (subordinated bonds). One of the banks in particular has a long history of issuing bonds through private placement and as of June 2022 has successfully concluded 21 issues. The increase in the number of issues of

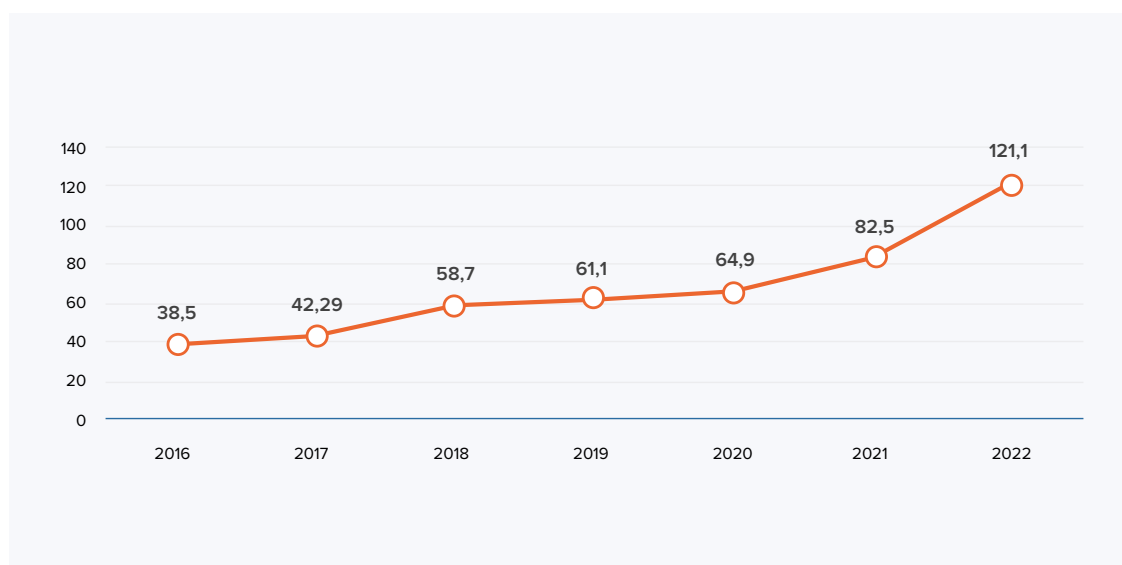
corporate bonds has remained very limited given the number of participating investors. This is because the Albanian capital market lacks brokers, investment companies and intermediate institutions, which normally should be the banks themselves. The investors up to date are mainly individuals and a limited number are legal entities.

Nevertheless, the upward trend of this market shows that there is potential on the supply side with respect to the issuance of bonds through public offering. As previously mentioned, the government securities market and the private placement bond market together constitute the most active segments of the Albanian securities market, while equities, corporate bonds with public offering and derivatives market are still absent. Although the main preconditions with respect to macroeconomic stability, legal framework as well as trade and post-trade infrastructure are in place, this market is still facing challenges, which needs to be addressed in collaboration with all the key institutions and participants of the capital markets.

**Secondary market**

In ALSE, all securities issued by private entities (Sh.P.K and Sh.A) are traded in the form of short-term debt (3-, 6- and 9-month commercial notes) and long-term debt (corporate bonds, municipal bonds, mortgage bonds, convertible

**Figure 37. Outstanding Bonds Issued through Private Placement (In Million EUR)**



Source: AFSA (2023)

144. The outstanding amount of this of financial instrument reached from approx. ALL 10 billion at the end of 2021 to approx. ALL 14 billion at the end of 2022, marking an increase of approx. 40%

into shares, etc.). In 2022, 50.52% by transactions in short-term instruments (T-bills) and, at 49.48% by transactions in long-term instruments (T-bonds). Initially, they are issued in the primary market organized by a bank designated by the issuer. In case of private offering, based on the Law on Capital Markets, mandatory listing on a regulated market (including ALSE) is not required, but in order to allow investors liquidity at any time (return to cash of their position), issuers can apply for admission to listing at ALSE, only after fulfilling the legal requirements related to the publication of the prospectus, or any other document as defined in the Law. Then the owners (investors) can resell them before maturity to liquidate their position on the ALSE Stock Exchange.

In 2021, the ALSE Stock Exchange continued the efforts with potential businesses to attract them towards listing by examining in more detail the use of listing as an alternative for raising capital and financing for their activity. The businesses continue to be sceptical and hesitant. The improvement of the legal framework and bylaws for the requirements that must be met by businesses to issue securities in public offering is expected to attract the first businesses to be listed on the ALSE Stock Exchange. In 2022 a new service to the general domestic financial market was reached in relation to investment services digitalization. AFSA granted the right to a banking entity to provide the online sale service of treasury bills through a digital platform, which is expected to have a positive impact on the secondary market of government securities, and on increasing the client financial literacy.

### 5.2.3. Other financial institutions

#### I. Microfinance & SME Financing

Micro-Finance Institutions (MFIs) started their activity in Albania in 1992 mainly due to the World Bank involvement as a key promoter of the financial inclusion of the poor by means of micro-loans. At the time, Albania's economy hardly had any private entrepreneurs, farmers, and businesses, as all economic activity was state-owned. In the context of state-owned enterprises and state ownership of all agricultural land, microfinance was seen as the most effective way to support a successful transition towards self-employment and private ownership. Throughout the years, through institutional

#### Main challenges of the stock exchange

- Low membership and interest by the local banks to invest in ALSE and to act as brokers. ALSE has 3 members, while Macedonian stock exchange has 10 members, Croatian Stock Exchange has 13 members and the same is true for other countries in the region.
- Low awareness level of the companies, low level of trust in the capital market and low level of readiness to be involved. This was confirmed by a study of Deloitte in 2020 with 40 companies of different industries.
- Low financial education level of the population.
- Low investor basis with different investment horizons and risk tolerances (individuals, institutional investors and foreign investors).
- Lack in infrastructure to issue security titles in EUR. This requires the cooperation of the BoA to connect AIPS EUR with ALREG.

#### Potential actions of the stock exchange

- Listing of state-owned companies
- Provision of fiscal incentives to companies (including SMEs) and investors listed in the stock exchange
- Obligatory listing of companies with more than 50 shareholders that fulfil legal requirements
- Clarifying the activity of the RBS and its future perspective in the framework of financial market
- Integrating AFISaR and ALREG would increase the synergy and trust in the stock exchange
- Incentivizing banks to become members or shareholders of ALSE;
- Ensuring support of foreign financial institutions

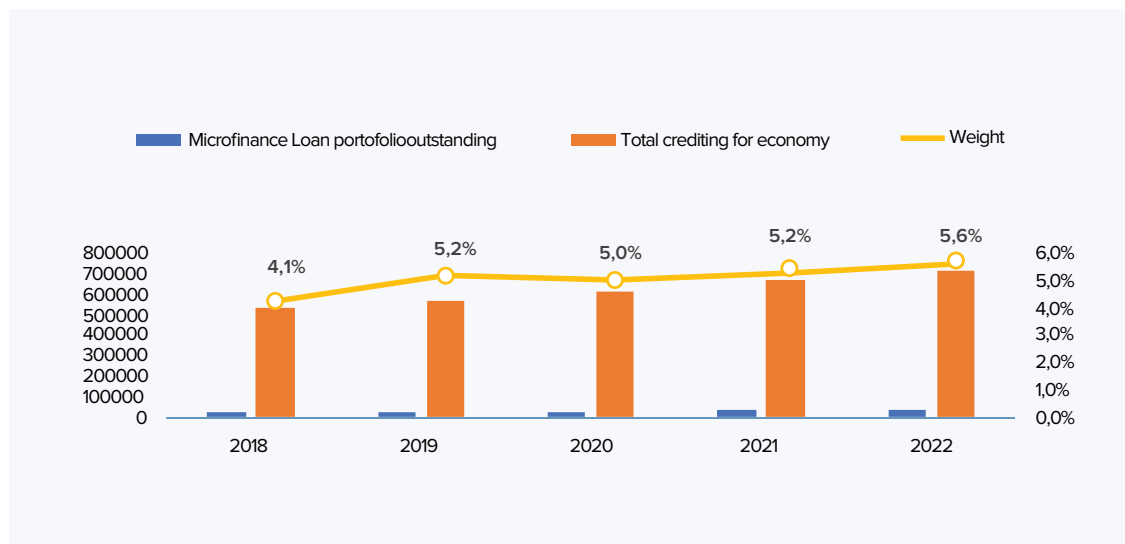
evolutions MFIs have undergone upgrades and strategic repositioning, and currently represent a diversified set of actors, shareholders and clients, national and international, with a full coverage of the Albanian territory and financial market. The microfinance sector has entered a new phase of its development in line with the socio-economic developments of the country, as well as the growing market demands not only for products and services that serve to raise living standards for individuals and enable free enterprise for micro-businesses, but also to ensure sustainability in quality of life and consolidation of local business activity, especially family businesses.

Most of Albania’s MFIs follow a socially responsible policy targeting financially excluded individuals and disadvantaged areas. The microfinance has, therefore, been accompanied by its social mission of “supporting the weakest without access to finance and without opportunities for financial development” (Albanian Microfinance Association, 2022).<sup>145</sup> In this context, all MFIs have continued to work with customer awareness and increased level of financial education, continuously increasing the transparency with which financial services and products are provided. In Albania, micro-finance supports a large number of individuals, micro and small businesses, and other market segments, with

a strong focus on creating jobs, narrowing the gender gap in entrepreneurship, and offering financial solutions in a sustainable manner. The country is expected to continue to demonstrate a strong demand for micro-finance products.

The Albanian microfinance sector currently consists of two institutional categories: (i) the Non-Bank Financial Institutions (NBFIs), involved in microfinance activities providing microcredit and other types of lending such as financial leasing or factoring, and (ii) financial cooperatives called Savings Loans Associations (SLA), a special form of organization where registered members — who are also co-owners — can deposit their savings and are eligible to receive loans. Although the microfinance sector (NBFIs and SLAs) represents a very small share in financial intermediation (4.4% of the financial segment in 2022<sup>146</sup>), it plays a crucial role in serving individuals, farmers and small businesses who do not have access to the banking system. The main activity of NBFIs is lending (43% in 2022), followed by payments and transfers (21%). Loans for individuals account for 54% of total loans, while 46% belongs to businesses. The weight of the financial segment covered by NBFIs has increased over the years, reaching 3.7% of GDP in 2022. The SLAs’ share of GDP has remained almost constant over the years, standing at 0.7% of GDP in 2022. In 2022, non-banking financial

Figure 38. Microfinance sector’ loan portfolio and weight of total crediting in economy



Source: Authors’ calculation with data from BoA and AMA, 2023

145. Can be accessed at: <http://ama.com.al/wp-content/uploads/2023/09/AMA-Annual-Report-2022-web.pdf>

146. 3.7% NBFIs and 0.7% SLAs and Union



institutions dominated the non-bank sector’s activities, contributing significantly to its dynamics. Microfinance accounted for 50% of the non-bank sector’s overall activity, underscoring its pivotal role within this segment.<sup>147</sup> In the same year, the non-banking and microfinance sector faced multiple challenges. The spike in energy and oil prices not only increased operational expenses but also complicated the core lending process by driving up interest rates amidst high inflation.

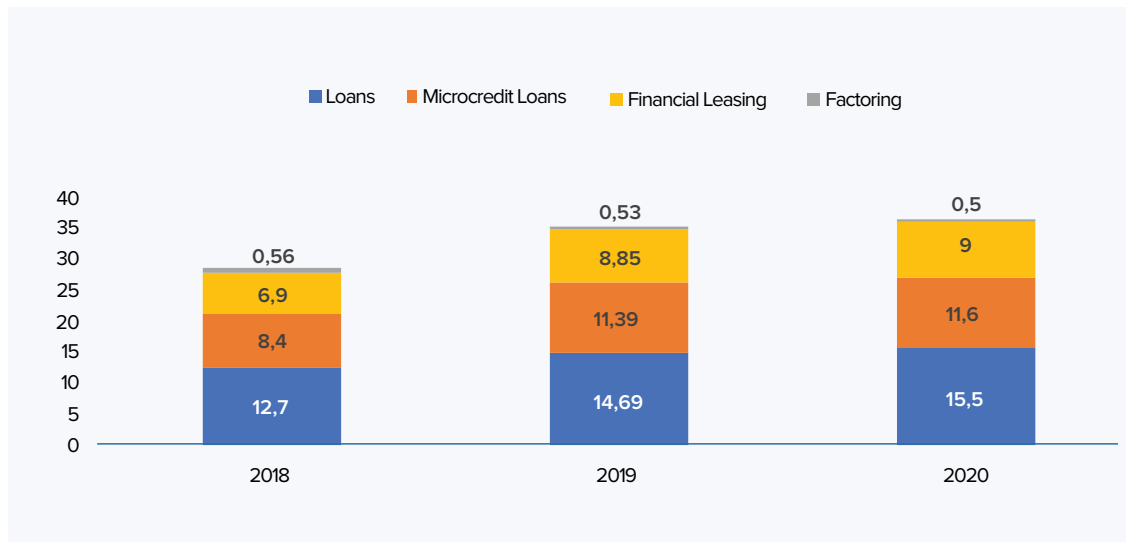
Concurrently, the sector faced uncertainty regarding financing sources, both domestic and international, affecting both capitalization and the rising cost of funds. Although demand from businesses remained relatively stable, individual loan requests temporarily declined. This was due to concerns about future prospects and a marked increase in the cost of living, making consumers more cautious. The portfolio of NBFIs and SLAs represents 5.6% of the total lending portfolios to the economy (including the banking system). Compared to 2018, the microfinance portfolio has increased from 4.1% to 5.6% in 2022.

In 2022, Albanian Microfinance Association (AMA) Members<sup>148</sup> possessed a total gross loan portfolio of ALL 39.6 billion (more than 270,000 active clients).<sup>149</sup> The largest share is business loans with ALL 20.2 billion or 53%, followed by loans for individuals with 11.3 billion or 30%, and the rest corresponding to other loans.

Most of the NBFIs loan portfolio is held by lending and microcredit entities (74%), followed by financial leasing entities (25%) and the portfolio of factoring entities (1%). The loan portfolio of NBFIs reached 6% of the total credit of the banking system in 2021, with an increase of 0.3 percentage points compared to the previous year. The non-bank financial system counted a total of 38 non-bank financial entities (NBFIs) at the end of 2022 with an addition of 3 entities in relation to 2021. NBFIs’ assets account for 4.14% of the total assets of the banking system.

In 2022 micro-finance loan portfolio outstanding amounted to ALL 39.6 billion, or 13.1% higher than in 2021. Even though the number of loans disbursed increased by 14.6%. Portfolio at risk

Figure 39. Financial Activity in Microfinance Sector



Source: AMA (2022)

147. 42% NBFIs and 8% SLAs

148. The BoA is the supervisor of the NBFIs and SLAs, but its Report on Financial stability does not provide data on micro-finance sector. As such, the data and information presented from this point refer to AMA monitoring reports that cover only the AMA members, which are the largest MFIs.

149. During 2020, AMA consisted of 9 members, including 6 NBFIs (Agrokredit, Agro & Social Fund, Crimson Finance Fund Albania, BESA Fund, luteCredit Albania, Kredo Finance and NOA), as well as two SLAs (Fed Invest SCA LLC and UniFin SCA), expanding by 2 members compared to the previous year. In 2021 there were 36 NBFIs and 12 SLAs operating in the market. During 2022, there were 38 NBFIs, 16 SLAs and 1 union.

(PAR) showed improvements in 2021 compared to 2020 (reduced from 13% to 6%). SLAs have experienced an increase in the number of members with saving in credit, which demonstrates a higher impact of microfinance on economic activity.

The non-banking part of the financial system continues to remain well-capitalized and with a good quality of the loan portfolio for credit institutions, which have reported a decrease in the ratio of non-performing loans compared to the end of the previous year. The reports of the Bank of Albania also cite that the exposure of the banking sector to the non-banking sector (NBFIs) remains low and stable, while the sensitivity of the non-banking sector to the activity of the banking sector remains high and results in an increase compared to December 2021. Over 80% of the financing granted for agriculture in 2022 originated from microfinancing.

### SME financing

SMEs (1-249 employees) represent 99.8% of all enterprises in Albania, while large enterprises (250+ employees) account for only 0.2%.<sup>150</sup> The SME dominance is comparable to the EU average, though the share of micro enterprises is slightly higher in Albania than in the EU

(37% vs. 29.9%), as is the share of medium-sized enterprises (50-249 employees). However, in contrast to the EU, Albanian SMEs account for a much larger share of employment (81.6% vs. 66.7%) and value added (72.4% vs. 56.5%). Microenterprises are the largest employment contributors, accounting for the largest share of employees, in particular in the accommodation, food, and trade sectors. However, the significant employment generation role of microenterprises does not match their contribution to investments, which is the lowest among the four groups of enterprises, indicating their low productivity and growth potential.

This sector is generally characterized by high informality (especially in agriculture), limited availability of collateral and low levels of financial capacity. Limited access to financing, especially bank loans, is a challenge for Albanian SMEs. Improving access to finance is considered critical to strengthening the competitiveness of SMEs and supporting recovery, and hence is included as one of the main objectives of the 2021-2027 Business and Development Strategy (BIDS). As part of this strategy, it is considered necessary to increase the effectiveness of existing grant schemes for SMEs and to introduce and promote new financial tools

Table 7. Trend of indicators over years

Indicators over years	2018	2019	2020	2021	2022	Change '22 vs. '21
Loan portfolio outstanding, billion ALL	21.7	29.7	30.4	34.77	39.6	13.1%
No. of active loans	81,301	180,083	162,672	156,992		
Disbursed volume, billion ALL	18	27	15	29	34.2	18%
Number of loans disbursed	88,619	286,853	176,930	260,979	297,813	14.6%
Portfolio at Risk (PAR in %)	6%	12%	13%	6%		

Table 8. Numbers of members over the years

	2018	2019	2020	2021	Change '21 vs. '20
No. of members of credit and savings associations	77,739	87,216	112,690	100,769	-11%
No. of members active with savings in the credit	12,431	9,665	8,853	16,664	88%

<sup>150</sup>. INSTAT, Business Register 2021.



and instruments. This priority action is based on and complements existing initiatives supported by donors, such as the EBRD Program for the Support of Albanian Agribusiness, the European Fund for South-Eastern Europe and the Italo-Albanian Program for the Development of SMEs in Albania. The EBRD is also supporting the carrying out of a comprehensive analysis of all existing SME support schemes and the development of an information platform detailing the available funding opportunities, which are part of the ERP 2020–2022.

The Law on SMEs provides the legal framework for various forms of financial support to SMEs, including loan guarantees. But apart from classic grants, no other financial scheme is offered to SMEs in Albania. AIDA is the central public institution providing business support services and financial support to SMEs with public grants from the government to support the innovative and technological ability and capability of SMEs to enhance product and service improvements, creation of a favourable environment for innovation, as well as designated assistance to new businesses. However, the demand has been rather low with only 373 SMEs having received grants from AIDA funds during 2014–2019, amounting to ALL 264 million. There are different factors that make SMEs reluctant to apply for AIDA's financial services, including SMEs perception that the application procedures for AIDA's funds to be inhibiting<sup>151</sup>; the small grant sizes that demotivate the potential applicants to go through the lengthy application process; and, the requirement to meet, as part of the application, in person with the grant staff at the AIDA offices in Tirana which is an obstacle for SMEs located in other regions.

Additional donor-financed SME financing schemes complement the financial landscape, including the EU for Innovation programme, which has supported 23 companies with grants. The program's strict admission criteria contribute to its relatively modest participation rate. Furthermore, the GIZ ProSEED programme contributed to the IDEA scheme from 2018 to mid-2021, dispensing EUR 750,000 in grants to support newly established businesses (operating for no more than two years). Individual entrepreneurs could receive grants up to EUR 4,000, while groups could be awarded up to

EUR 7,000. Other significant projects aimed at enhancing access to finance for SMEs include the EBRD's Albanian Agribusiness Support Facility (AASF) and the Italian-Albanian SME Development Program in Albania. The latter has implemented a cost-sharing grant scheme that assists SMEs in credit access by covering 50% of the costs associated with preparing a business plan, benefiting approximately 12 SMEs.

As part of the EBRD ERP 2020–2022, the Access to Finance Platform (managed by AIDA) was created to serve Albanian SMEs that aim to expand and invest in their activity by taking advantage of the financial opportunities that the market offers, with grants, loans or other financing initiatives. This online platform is intended to offer a “one-stop-shop” service that offers consolidated information on access to SME financing from various private and public, national and international institutions, organizations and companies.

BIDS 2021–2027 outlines key strategic goals aimed at enhancing support for SMEs. These include revamping the current grant scheme by increasing the maximum grant amount per project to bolster the fund's attractiveness and impact. Moreover, it plans to streamline the process with an online grant application and management system, coupled with the introduction of new financial mechanisms. Notably, a state guarantee scheme will be established, along with additional support measures such as loan guarantees. A notable innovation is the creation of a EUR 50 million guarantee instrument for manufacturers to mitigate the costs associated with transitioning to new production lines in response to order changes. In collaboration with the “EU for Innovation” project, a pilot program will be launched to establish a network of business angels. This strategic focus on improving access to finance is expected to spur investment growth, facilitating capacity expansion, technological upgrades, productivity enhancements, and the launch of innovative products and services by SMEs.

## II. Investment Funds

The first investment fund in Albania (Raiffeisen Prestigj) was established in 2011, soon followed by the establishment of a second one in 2012 (Raiffeisen Invest Euro). In 2016 and in 2018,

151. SME Policy Index. OECD/ETF/EU/EBRD (2019), SME Policy Index: Western Balkans and Turkey 2019 Small Business Law Enforcement Assessment for Europe.

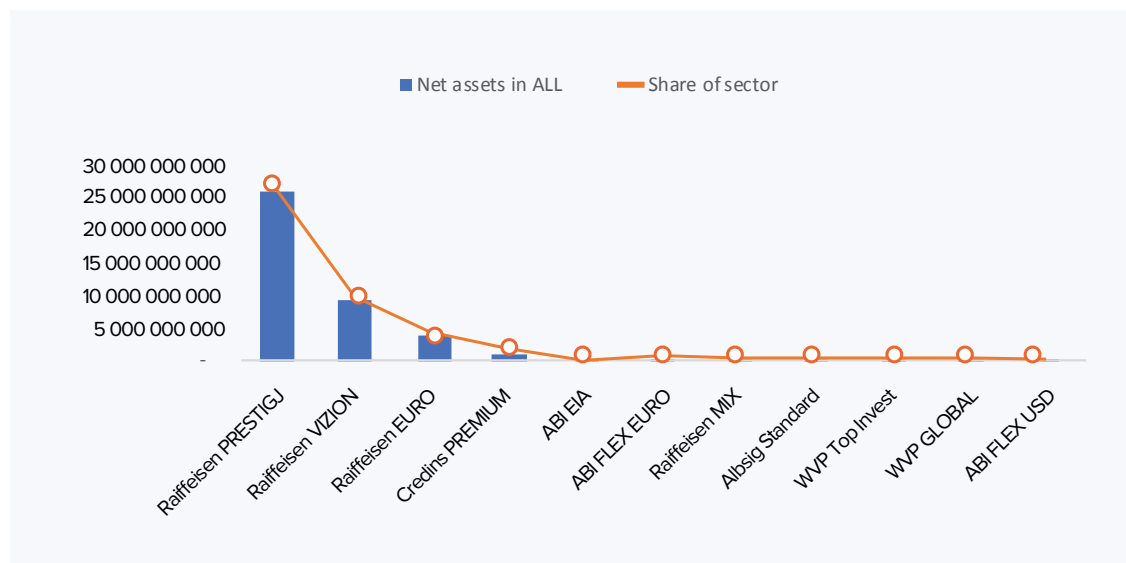
three other investment funds were established (namely “Credins Invest” Sh.a., “WVP Top Invest”, and “Raiffeisen Vision”). As of 2022, there are thirteen investment funds operating in Albania,<sup>152</sup> eleven non-UCITS<sup>153</sup> funds and two Alternative Investment Fund (AIF).<sup>154</sup> The net assets of investment funds experienced significant growth, expanding from ALL 16 billion in 2012 to ALL 77.71 billion in 2021, which represented roughly 4% of the GDP and 4% of the total assets within the financial sector. However, in 2022, they experienced a downturn, declining to ALL 41.47 billion. This marked a decrease of ALL 36 billion, or 43.7%, with specific asset classes seeing notable declines: government bonds were 44% lower, treasury bills dropped by 71%, and corporate bonds fell by 76%.

Market investments saw an increase from ALL 59,656 million to ALL 68,863 million in 2021, only to be significantly reduced by half to ALL 34,085 million in 2022. The sector’s initial growth was propelled by inflows from investors, predominantly retail, along with favourable re-

turns on assets, particularly domestic sovereign bonds, up until 2021. However, 2022 witnessed a sharp 27.7% reduction in the number of financial institutions’ (FIs) members, indicating that the investment funds were then held by approximately 29,000 investors, down from 41,000 the previous year. These investors were almost entirely retail clients, with institutional investors making up less than 0.1% of the total. The central bank’s swift hike in interest rates in 2022 adversely impacted the net asset value by diminishing returns and lowering share prices. This led some investors to sell off their shares and exit the investment funds, contributing to the overall decrease in market investments detailed above.

The sector is highly concentrated. The largest fund accounts for 62.7% of total Investment Funds’ assets; while the three largest investment funds account for 94% of the sector’s assets. The funds are related to five asset management companies, including one<sup>155</sup> which accounts for 76% of the fund’s net assets (in 2022).

Figure 40. Total Net Assets by Fund, end of 2022



152. The regulatory framework for open-ended funds in Albania distinguishes between (i) Undertakings for Collective Investment in Transferable Securities (UCITS), (ii) non-UCITS and (iii) Alternative Investment Funds (see Law No.56/2020 on Collective Investment Undertakings).

153. UCITS are subject to a specific European Union (EU) regulatory framework. For the purposes of this report, UCITS should be understood as investment fund structures that are subject to requirements broadly equivalent to those of the EU framework.

154. In the EU, AIFs are all investment funds that are not UCITS, while in Albania AIFs are funds which are neither UCITS nor non-UCITS as defined in the Albanian legislation. AIFs are typically marketed to professional investors, unlike other types of funds which can be sold to retail investors.

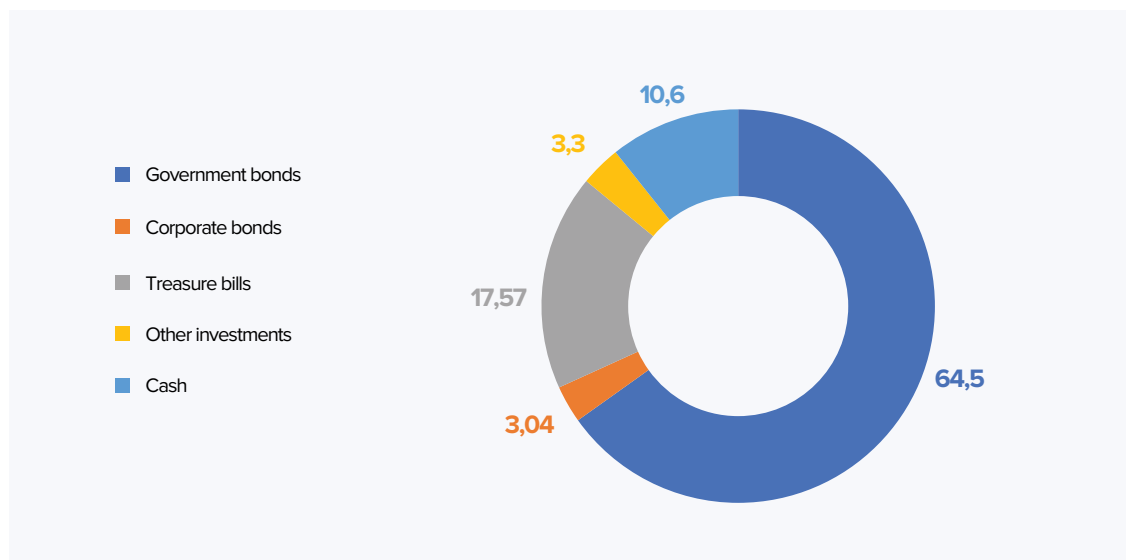
155. Raiffeisen Invest company

Investment Funds are primarily exposed to the domestic sovereign bond market. Some funds have recently launched investments in foreign sovereign bonds and corporate bonds, as well as in foreign equities, albeit in small amounts. Overall, around 65% of funds' assets are composed of domestic sovereign bonds. Most funds also have significant exposures to cash (such as Flex EUR and Flex USD).

The total net assets of the Collective Investment Undertakings (CIU) market by end 2022 reached about ALL 46.1 billion, with a decrease of 43.7% compared to 2021. The total net assets of open-ended investment funds with public offer at the end of 2022 was about ALL 41.4 billion, with a decrease of about 47%, while the net assets of alternative investment funds amounted to ALL 4.7 billion. The number of members in the open-ended investment funds with public offer market reached 28,929 at the end of 2022, marking a decrease of about 27%. During 2022 CIU's assets operating in the market were managed by five management companies, three of which perform the management activity for both investment funds and voluntary pension funds.

The market for open-ended investment funds with public offer is mainly dominated by investments in Albanian government bonds and treasury bonds, which constitute about 76% of the assets of this market, marking a light decrease from 2021 (81.5%). In accordance with the requirements of the legal and regulatory framework, the Management Companies have kept the necessary liquidity for the investment funds investing in non-active markets (liquidity indicators in accordance with legal requirements). During 2022, another investment fund was licensed. AFSA has received a licensing request of a fund with a master feeder structure, where the master would be a CIU operating in a foreign country and the feeder an entity that will be licensed in Albania. During 2022, an increased interest in cross border marketing and selling of units of CIU operating in other countries was presented to AFSA.<sup>156</sup> In September 2023, "Eurizon Capital", an investment fund under the Intesa SanPaolo Group was authorized by AFSA to operate in Albania. This creates a new opportunity for Albanian investors to have a direct access to European market for investments in collective mutual funds within the EU. This is an important step towards the integration of Albanian financial market to EU market.

Figure 41. Portfolio Composition



Source: AFSA (2023)

156. Two regulations are drafted in order to make the recognition of funds licensed in EU member states. AFSA, through Decision no. 186, dated 29.09.2022, which adopted an amendment to Regulation no. 106, dated 30.06.2021, enabled the investment funds market to invest with higher rates of return, un-invested liquid assets and, as a result, paved the way to a positive impact of these new investments on the performance of investment funds.

### III. Private Insurance Market

The insurance industry in Albania is relatively new. Prior to 1991, there were no insurance companies operating in the country. As of 2022, there are 12 insurance companies in the Albanian insurance market, 8 non-life insurers and 4 life insurers. Insurance law requires the separation of life from non-life insurance and does not allow for composite undertakings to operate. All insurance products should be offered by locally registered insurers.

In 2022, the gross written insurance premiums (GWP) amounted to ALL 21 billion (around 1% of GDP) with an insurance density of around EUR 62. In the last 10 years there has not been any insurer failure in the Albanian insurance market.

The insurance market has a total of 48.51% (2022) of GWP owned by foreign capital insurance companies (Austrian insurance groups) and 51.49% of GWP owned by domestic capital insurance companies. In terms of assets, foreign capital insurance companies own a total of 45.89% of the market assets compared with 54.11% owned by domestic capital insurance companies.

Between 2017 and 2022, the Albanian insurance market grew in all segments in terms of GWPs. All insurance segments recorded a positive trend throughout the period. Non-life insurance maintained its share of approximately 91.75% of all written premiums. Although life insurance GWP grew even with double digits over this period, remains an underdeveloped segment.

Life insurance premiums increased by approximately 40% between 2017 and 2022. The life insurance market in Albania is dominated by credit life insurance, and demand for it is mainly bank-driven. Credit to households in Albania generates not only life insurance, but also usually property insurance for assets financed through lending. The life market players have also built a network of medical facilities in Albania, supporting the health insurance too.

The non-life insurance sector remains dominated by Motor Third Party Liability Insurance (MTPL), accounting for 67% of total non-life premiums in 2022. Similar to other emerging economies, the motor insurance in Albania developed early due to compulsory third-party liability insurance.

**Table 9. Insurance penetration and the insurance density, calculated separately for life, non-life insurance**

Insurance penetration		2017	2018	2019	2020	2021	2022
GWP to GDP (in %)	Life	0.08	0.07	0.07	0.07	0.08	0.08
	Non-Life	0.97	0.96	0.97	0.94	0.94	0.90
	<b>Total</b>	<b>1.04</b>	<b>1.03</b>	<b>1.04</b>	<b>1.01</b>	<b>1.02</b>	<b>0.99</b>
Population		2,870,324	2,862,427	2,845,955	2,829,741	2,793,592	2,761,785
Insurance density (ALL)	Life	420	400	427	412	512	610
	Non-Life	5,223	5,515	5,763	5,457	6,385	7,008
	<b>Total</b>	<b>5,643</b>	<b>5,914</b>	<b>6,191</b>	<b>5,869</b>	<b>6,897</b>	<b>7,619</b>
Insurance density (EUR)	Life	3	3	3	3	4	5
	Non-Life	39	43	47	44	52	57
	<b>Total</b>	<b>42</b>	<b>47</b>	<b>50</b>	<b>47</b>	<b>56</b>	<b>62</b>

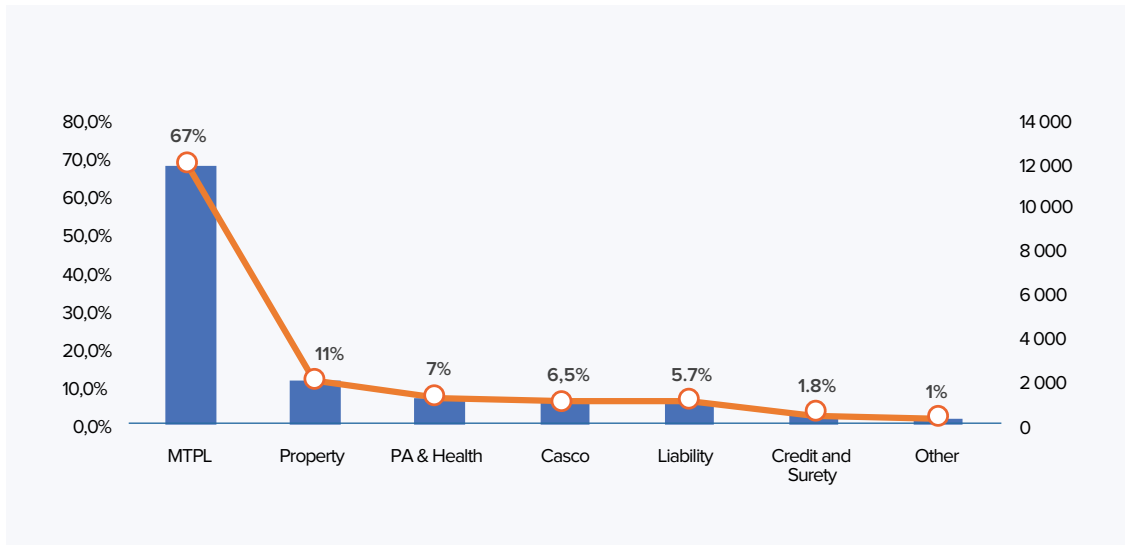
Source: AFSA (2023)

**Table 10. Insurance Market 2017- 2021**

Change in % (year on year)		2018/2017	2019/2018	2020/2019	2021/2020	2022/2021
GWP growth	<b>Total</b>	4.5%	4.1%	-5.7%	16.0%	-3.6%
	<b>Non-life</b>	5.5%	3.9%	-5.5%	15.4%	-4.2%
	<b>Life</b>	-5.2%	6.5%	-4.2%	22.7%	4.1%

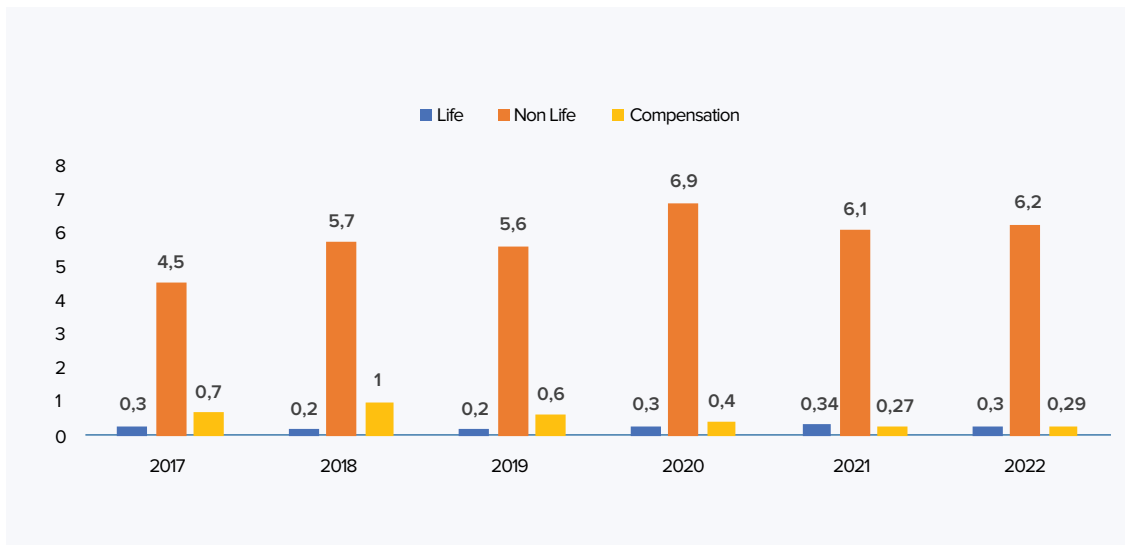
Source: AFSA (2023)

Figure 42. Non-life insurance premium breakdown (in ALL million, by 2022)



Source: AFSA (2023)

Figure 43. Gross Paid Insurance Claims (ALL Billion)

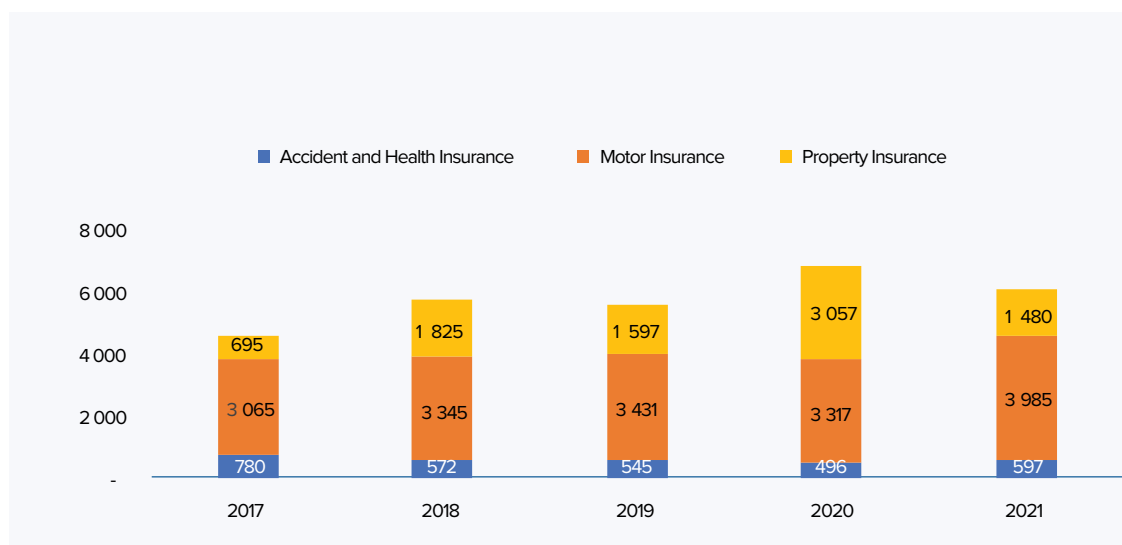


Source: AFSA (2023)

As shown in figure 42, 11% of non-life premiums came from property insurance, 7% from personal accident and health, 6% from general liability, 6% from CASCO (voluntary motor insurance), and the rest from other insurance business lines. MTPL lines of business (domestic MTPL, motor green card and border policies) are mandatory by law. Market shares of voluntary and compulsory insurance in 2022 were, respectively, 37.84% and 62.16% of total GWPs,

with similar shares over the previous five-year period. In 2022, gross paid claims amounted to ALL 6.830 billion, marking a 2.39% increase compared to 2021.

Gross paid claims per type of Non-Life and Life insurance amounted to ALL 6.3 billion and ALL 0.293 billion, respectively. Compensation Fund Paid Claims amounted ALL 0.2 billion.

**Figure 44. Gross Paid Non-life Insurance Claims (ALL Billion)**

Source: AFSA (2023)

In recent years, the non-life insurance sector has seen notable improvements in its underwriting performance, as evidenced by combined ratios consistently below 100%. The net retention ratio of non-life insurance, which compares net written premiums to gross written premiums, consistently hovers around 85%. This improvement is partly due to the implementation of stringent reinsurance regulations within the legal and

regulatory framework. These regulations include setting maximum limits for 'per risk' net retention and establishing criteria for reinsurers that align with the EU's Solvency II directive. Additionally, with the World Bank's technical assistance, the AFSA implemented a risk-based regulatory approach to oversee earthquake risk coverage by insurance companies. This regulation mandates that non-life insurers minimize

**Table 11. Performance indicators of non-life insurance market**

Indicator (non-life)	2017	2018	2019	2020	2021	2022
Solvency Ratio (SR)	28%	34%	106%	170%	184%	
TP coverage with admissible assets	103%	93%	121%	132%	130%	
Liquid Assets-to-Total Liabilities	59%	61%	48%	56%	58%	
Real Estate to Total Assets	11%	12%	10%	13%	15%	
Subsidiaries to Total Assets	9%	10%	10%	10%	10%	
Insurance Receivables to GWP	9%	9%	9%	10%	10%	
Insurance receivables to total assets	5%	5%	4%	6%	5%	
Claims Ratio	31%	34%	38%	32%	35%	36.3%
Expense Ratio	64%	63%	60%	61%	61%	55.2%
Combined Ratio	95%	97%	98%	93%	96%	91.4%
Net Retention	79%	82%	82%	83%	85%	

Source: AFSA (2023)

\*Empty cells represent missing data.

their retention levels and delegate a significant portion of earthquake risk to highly-rated reinsurers. Consequently, this approach helped mitigate the financial impact of claims following the 6.4 magnitude Richter earthquake on 26 November 2019, enabling a smoother absorption of these shocks in the insurers' balance sheets.

Concerning investments held by life and non-life insurers, they mainly consist of government securities as indicated in the table below. (Table 10) In addressing the primary risks to the insurance sector's stability and insurers' vulnerability to

insurance market to absorb damages up to approximately EUR 170 million without adversely impacting key financial indicators, such as the Required Solvency Margin and the Minimum Solvency Margin. This demonstrates the sector's preparedness to manage significant risks without compromising its financial health.

As shown in Figure 45, during 2021, for contracts active at the time of the event, the potential loss was estimated to fall between EUR 170 million and EUR 480 million, with a probability ranging from 98.3% to 99.5%.

**Table 12. Securities/total Investments (in ALL thousands)**

Year		2017	2018	2019	2020	2021
Government securities	Life	1,520,380	1,174,819	1,248,678	898,647	1,240,534
<b>TOTAL INVESTMENTS</b>	<b>Life</b>	<b>2,851,233</b>	<b>2,821,768</b>	<b>3,577,821</b>	<b>4,258,444</b>	<b>4,400,739</b>
<i>Government securities / total investments</i>	<i>Life</i>	<i>53%</i>	<i>42%</i>	<i>35%</i>	<i>21%</i>	<i>28%</i>
Government securities	Non-life	2,066,219	2,249,878	2,534,631	3,154,888	3,797,405
<b>TOTAL INVESTMENTS</b>	<b>Non-life</b>	<b>16,573,473</b>	<b>17,825,514</b>	<b>18,573,518</b>	<b>20,770,317</b>	<b>23,061,550</b>
<i>Government securities / total investments</i>	<i>Non-life</i>	<i>12%</i>	<i>13%</i>	<i>14%</i>	<i>15%</i>	<i>16%</i>

Source: AFSA (2023)

adverse events like pandemics, catastrophic weather conditions, and severe economic downturns, Albanian insurers utilize AIR Worldwide's stochastic risk models to evaluate the impact of such incidents or natural disasters. These event-based models are instrumental in estimating the comprehensive distribution of annual damages.

Bylaw no. 57, dated 26 May 2017, "on the calculation of Net Retention of aggregate maximum coverage of risks deriving from insurance contracts," is aligned with the AIR Worldwide stochastic model. This bylaw specifies that the recurrence interval for earthquakes is 60 years. The insurance coverage limit for earthquake risk varies between EUR 4.5 million and EUR 900 million, while insurance companies' retention ranges from EUR 100,000 to EUR 500,000. Should an earthquake occur in 2022, the existing reinsurance agreements would enable the

#### IV. Private Pension Funds

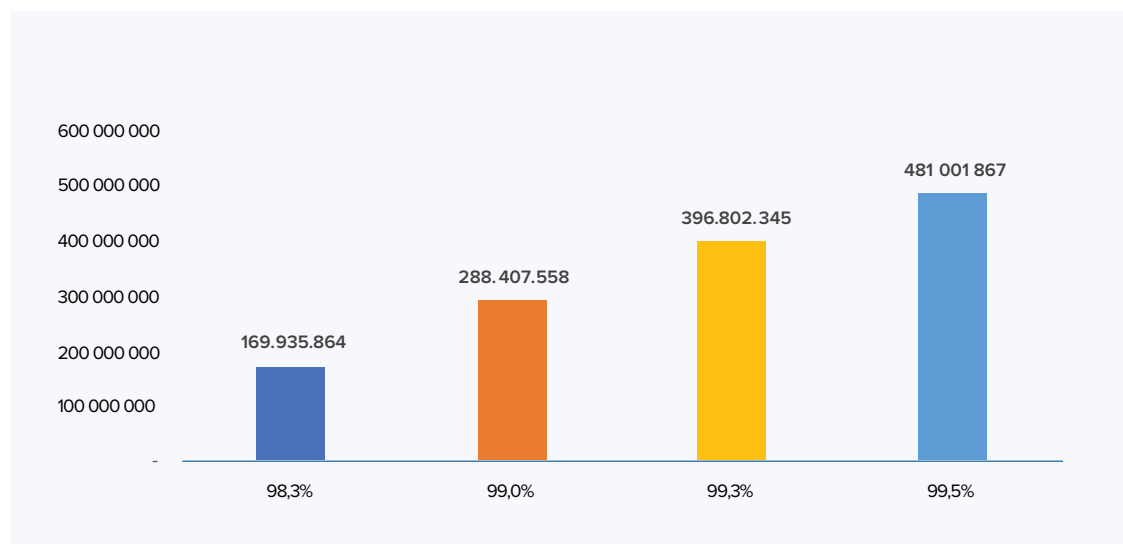
The first private pension fund was approved in 2010 following the licensing of the management company of voluntary pension funds, the approval of its prospectus, and contract of the voluntary pension fund. Currently, there are 4 management companies, 4 pension funds and 6 depositories operating in the Albanian voluntary pension funds market. In 2015, the implementation of the tax benefits began for voluntary pension funds for the: (i) contributions made by each member of a voluntary pension fund up to the extent defined in the law on voluntary pension funds, as well as contributions made by the employer or any other contributor, in the name and on behalf of members of the voluntary pension fund; (2) return on investment, including capital gains from investments made with pension fund assets. In addition, the voluntary pension fund is considered exempt from income tax. AFSA has worked on improving the legislation regarding

Table 13. Exposure to earthquake risk at 31.12.2021 (in EUR)

Insurance Companies	Maximum Coverage	Company Retention	Exposure (SI)	Standard Claim (PML)	Reinsurer (Leader)
<b>Albsig sh.a.</b>	40,000,000	400,000	2,349,137,805	40,874,998	Hannover Re
<b>Ansig sh.a.</b>	4,500,000	250,000	171,515,042	2,984,362	Score Re
<b>Atlantik sh.a.</b>	7,000,000	250,000	372,442,823	6,480,505	Polish Re
<b>Eurosig sh.a.</b>	10,000,000	150,000	368,278,539	6,408,047	Hannover Re
<b>INSIG sh.a. (non-life)</b>	10,000,000	200,000	324,894,017	5,653,156	Hannover Re
<b>Intersig sh.a.</b>	900,000,000	100,000	1,136,462,653	19,744,089	VIG Re
<b>Sigal sh.a.</b>	55,000,000	500,000	3,922,433,774	69,817,529	UNIQA Re
<b>SIVIG sh.a.</b>	900,000,000	250,000	1,032,941,313	17,973,179	VIG Re
<b>TOTAL</b>	1,926,500,000	2,100,000	9,678,105,967	169,935,864	

Source: AFSA

Figure 45. Standard claim with a return period from 60 years up to 200 years (in EUR)



Source: AFSA (2023)

the private pension funds and aligning it with Directive 2016/2341/EC “On the activity and supervision of Occupational Pension Institutions”. The growth of the net assets of the voluntary pension funds market has been in double digits, with total net assets of ALL 5.69 billion

in December 2022, marking an increase of 24% compared to the end of 2021.

The investment value of the voluntary pension funds market grew over the period 2012-2022, standing at ALL 5.49 billion in December 2022,



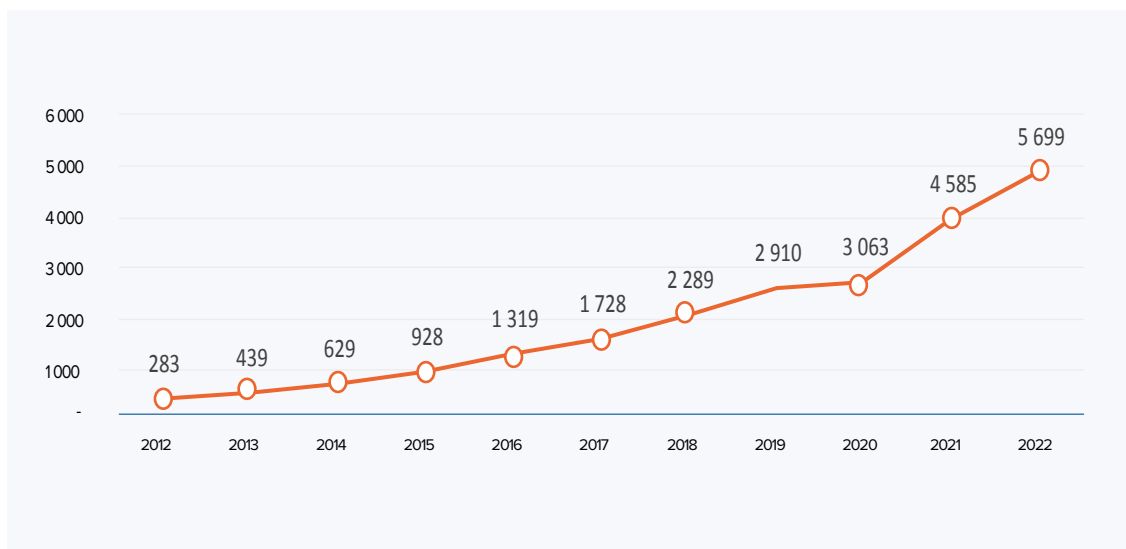
demonstrating an increase of 30.57% compared to the end of 2021. Member numbers in the voluntary pension funds has increased, too. At the end of 2022, the market had 36,518 members, representing a fivefold increase compared to 2012.

**V. Crypto Assets**

The main piece of regulation on crypto assets is Law No. 66/2020 “On Financial Markets based on distributed ledger technology”, which regulates the issuance of Digital To-

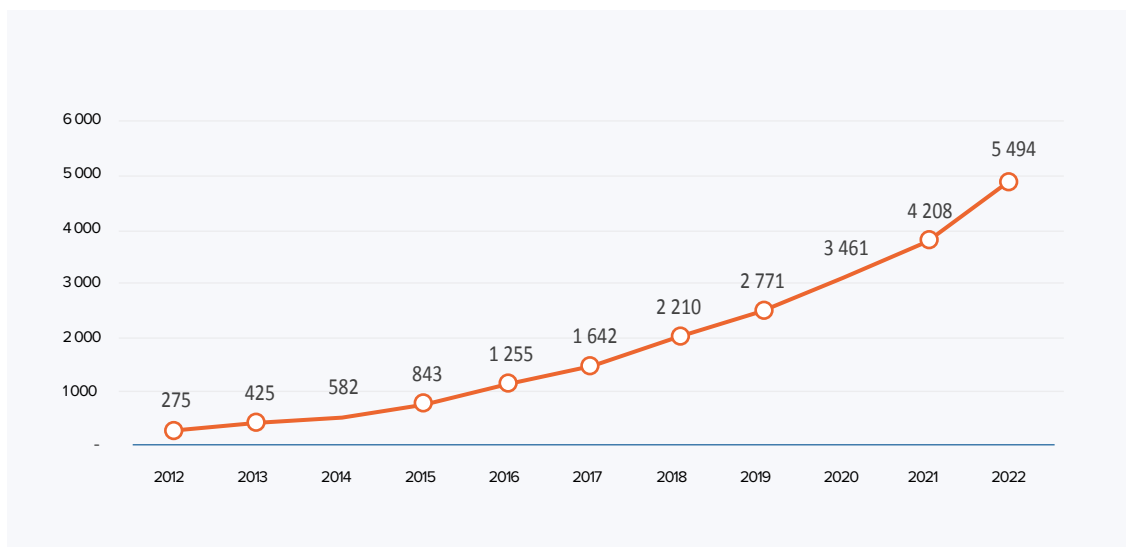
kens/Virtual Currencies and the licensing, monitoring and supervision of entities that are engaged in the distribution, trading, and custody of Digital Tokens/Virtual Currencies. The law stipulates that the Albanian Financial Supervisory Authority (AFSA) and the National Agency for Information Society (NAIS) are the responsible authorities, whereby AFSA reviews and supervises regulatory and financial compliance with the provisions of the law, and NAIS reviews and supervises the technological compliance thereof.

**Figure 46. The net Asset value of voluntary pension funds (in ALL million)**

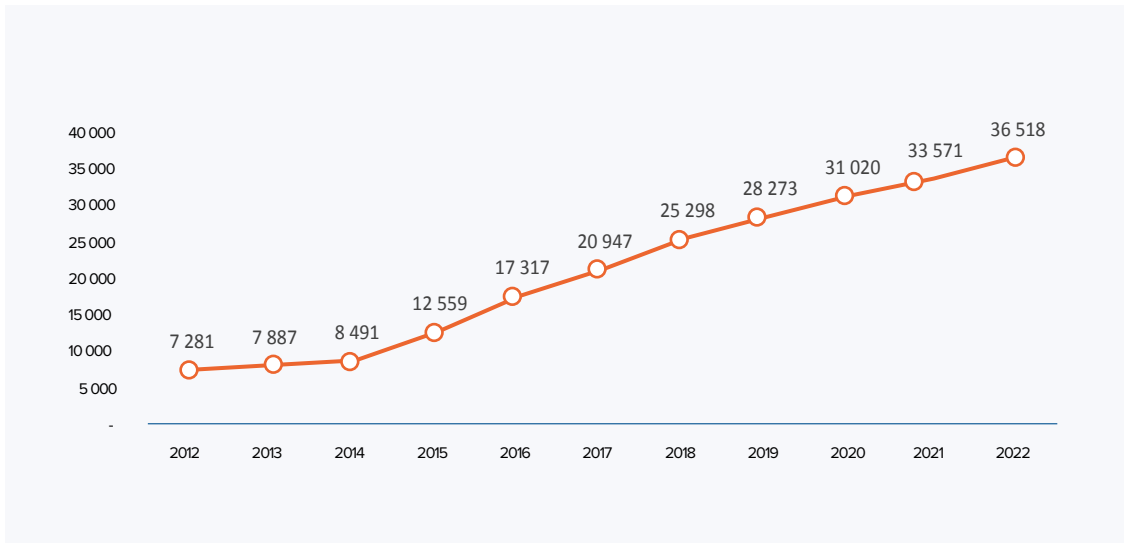


Source: AFSA (2023)

**Figure 47. Total investment portfolio in voluntary pension funds (in ALL million)**



Source: AFSA (2023)

**Figure 48. The number of members in the voluntary pension funds market**

Source: AFSA (2023)

**Law No. 66/2020 foresees 5 types of licenses, namely:**

- DLT Exchange license, for platforms facilitating the exchange of digital tokens, virtual currencies, and FIAT money. These are separated into three categories, depending on the type of tokens that are listed for trade (for example, Utility Tokens, Asset Tokens, Payment Tokens, Security Tokens, Virtual Currencies).
- Third Party Custodian Wallet Provider license, for entities carrying out custody services for holders of digital tokens/virtual currencies.
- Innovative Service Provider license, for entities that act as system auditors and carry out all technological assessments and reviews in the name and on behalf of the license holder.
- Digital Token Agent license, for legal persons that act as legal representatives of the license holders while also carrying out and monitoring all the regulatory obligations thereof.
- Automated Collective Investment Undertaking license, for collective investment undertakings which are already licensed, which also engage with digital tokens via the usage of systems carrying out robot-advisory and algorithmic trading functions.

In addition, the law also provides for the authorization procedures for the issuance of Initial Coin Offerings and Security Token Offerings, requesting the publication of a white paper or prospectus subject to the form of offering. Operationalization of Law No. 66/2020 was a key focus area in 2021. To that end, AFSA has approved 4 regulations, with 2 other regulations are under public consultation, while NAIS has approved 5 further bylaws.

In addition, international cooperation has also been at the forefront of AFSA's agenda. It has hosted 2 IMF missions whose scope was to strengthen capacities and legal frameworks regarding money laundering-related activities of Virtual Assets Service Providers (VASPs), as well as those in licensing and supervision of crypto-asset service providers. Furthermore, AFSA has joined the IOSCO Fintech Network, a forum for regulators to share experiences and exchange information on emerging fintech regulatory issues, trends, and risks. In addition, AFSA has set up contact with the Financial Supervision Authority of Malta, which has a similar crypto regulation as Albania, in order to draft a bilateral MoU with strong emphasis on service providers of crypto-assets. This will be followed up with more bilateral MoUs with other counterparts in this domain.

## 5.3. International Public Finance

### Section summary

International public finance has lent crucial support to Albania's development needs since 1991, prepared the country for EU membership, and provided crisis response over the last three decades. Although the volume of international public finance has grown substantially over this period, its proportion as a percentage of GDP has remained at a rather steady rate of around 5% given the country's GDP growth over the last three decades. Foreign assistance has evolved in terms of financial modality, source of funds, and the supported sectors and activities. Whereas the 1990s was dominated by Official Development Assistance (ODA) (grants and soft loans) allocated towards humanitarian and balance of payment support, the 2000s witnessed a growing use of Other Official Flows (OOF) as the main modality for international public finance. Priority sector for international financial assistance have also evolved over time: whereas in the 1990s foreign aid focused on sectors such as transport and communication, agriculture, and private enterprise development, the 2000s instead prioritized energy, water, social development, and the rule of law, and the 2010s allocated more aid towards governance reforms, energy and financial services.

Aid allocation towards critical economic sectors such as water, agriculture, and social sectors (such as health and education) has declined significantly over time. The EU has been Albania's largest donor, providing 100% grant assistance within the framework of the EU financing Instrument for Pre-Accession (IPA). IPA II that covered the period 2013-2020 was disbursed through various instruments such as conditional budget support focusing on policy areas such as Democracy and Governance, Rule of Law, Economic Governance, Competi-

tiveness, and Growth, and IPA III 2021-2027 is under implementation.

The growing use of OOF, most of which accompanies non-concessional interest rates, over ODA as the dominant aid modality over the last decade has increased Albania's debt levels and pressured the domestic budget. Given the pressure to reduce the debt to GDP ratio, capital investments (which are typically covered by OOF) could be subject to suspension, further impacting the budgeting process, the realization of investment projects, and potentially disrupting the implementation of government policies.

Therefore, orientating aid flows towards ODA remains very important for the years to come. Greater alignment between aid allocation and strategic NSDI pillars is also vital for maximizing aid efficiency and effectiveness.

### 5.3.1. Official Development Assistance & Other Official Flows

Foreign aid has been crucially important for Albania over the last three decades to quickly respond to the emergency and crisis situations throughout its transition path, to support the country's development and community needs, and to support the country's preparation for the EU membership. External assistance was mobilized soon after the major political changes that took place in Albania in 1991. Development aid has evolved over the years in terms of financial modality, source of funds, and the supported sectors and activities.

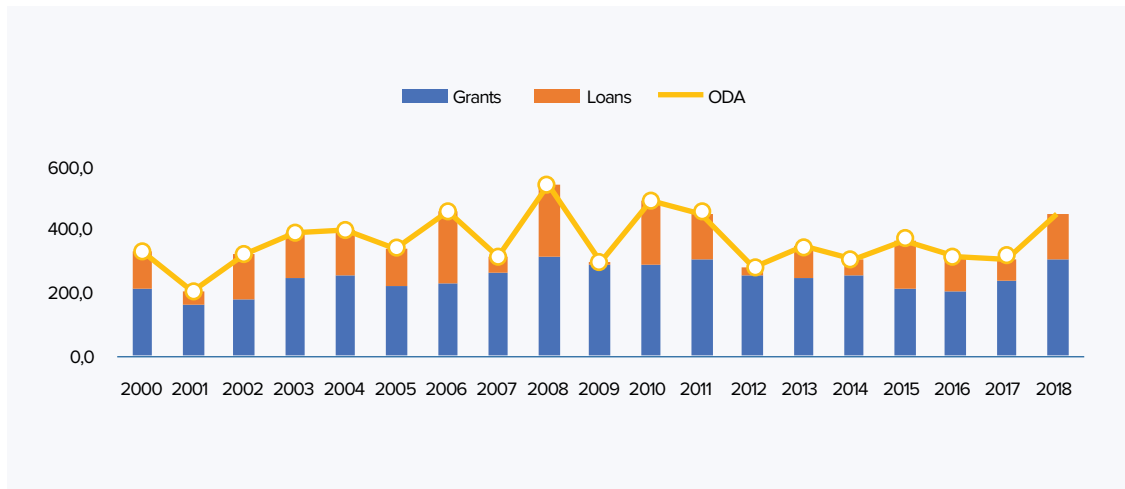
Official Development Assistance (ODA) flows, comprising grants and soft loans, were the only form of foreign aid until 2006. Although the ODA flows have not significantly varied since 2000, their share as a percentage of GDP has decreased (due to GDP growth). This period has also seen the growing use of Other Official Flows (OOF) as a foreign aid modality in Albania. In 2013, 2014 and 2018, OOF commitments

marginally exceeded ODA flows to the country. The non-interest concessional rates associated with OOF have an impact on Albania’s domestic budget through their effect on the country’s debt levels. Given the pressure to reduce the debt-to-GDP ratio, capital investments (which are typically covered by OOF) could be subject of suspension, further impacting the budgeting process, the realization of investment projects, and potentially disrupting the implementation of government policies.

**Sectorial Aid Allocation**

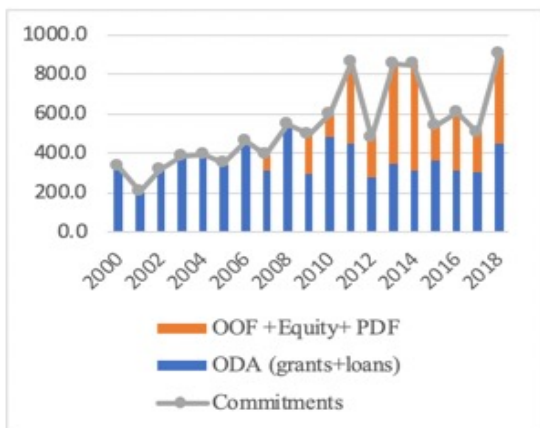
The sectorial distribution of ODA over years has changed. During 2001-2010, the most dominant sectors supported by foreign aid were Energy (23%), Democratization and Rule of Law (18%), Social Development (15%) and Water (14%); while during 2013-2018, aid flow disbursements indicate that key recipient sectors included Governance and Other Social Services (28.2%), Energy (14%), Financial Services and Business (9.7%), and Transport & Communication (9.0%). It

**Figure 49. ODA composition trend (Grants + Loans, in USD million)**



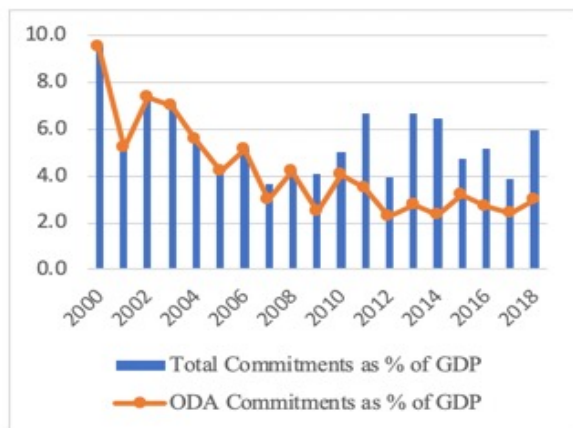
Source: Authors’ calculations based on data from OECD and MFE (2023)

**Figure 50. ODA versus OOF, 2000-2018**



Source: Authors’ calculations based on data from OECD and MFE (2023)

**Figure 51. Commitments as % of GDP**



Source: Authors’ calculations based on data from OECD and MFE (2023)

is noted that critical economic sectors such as the Water Sector have not received foreign assistance and the support to the agriculture sector has declined over time, too. In 2021-2022, top ODA donors for Albania are EU institutions (45.8% of total average of the two years); Germany (28.4%); Switzerland (5.6%); Turkey (5.6%) and the remaining 14.6% from USA, Sweden, Austria, Italy, and United Arab Emirates.<sup>157</sup>

The decision on which aid flows to choose, rather than which sector priorities to support, will be based on: (i) the type of financing (soft vs. commercial loans) and the potential subsequent impact on debt sustainability; (ii) modalities of aid (projects vs. program-based approaches, such as budget support and trust funds).

Given that budget support funds go to the Treasury and are assessed based on results rather than specific activities, the government has more flexibility and thus a preference for such funds; (iii) alignment of aid flows to the government's domestic, EU, and international policy priorities; (iv) synergies between traditional international public flows, international private flows, and innovative financing instruments.

#### EU, the largest multilateral donor to Albania

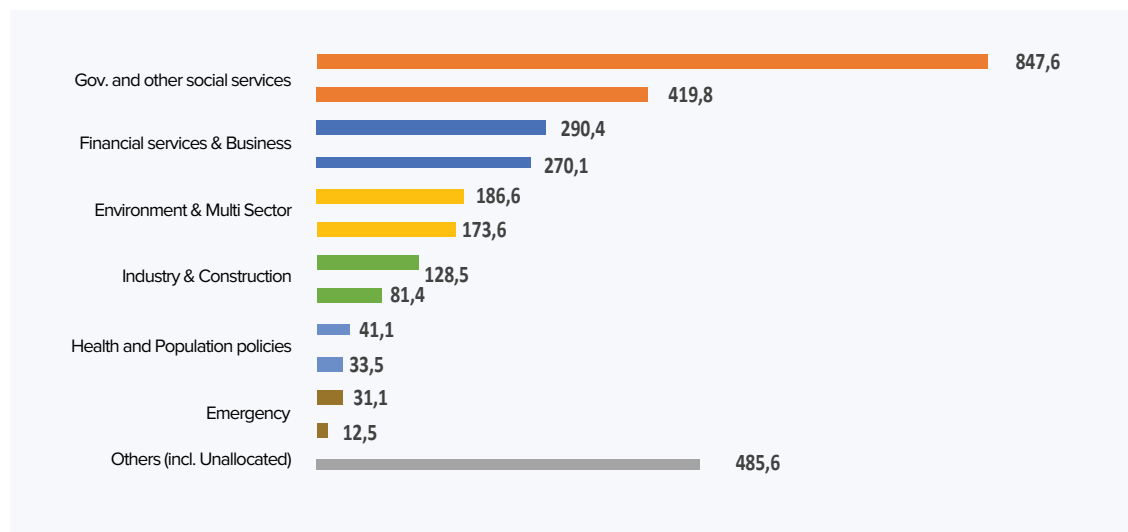
The EU offers 100% grant assistance within the

framework of the Instrument for Pre-Accession (IPA). The disbursement levels under IPA have been very high, indicating a healthy absorptive capacity. IPA grants have been important for supporting the judicial reform efforts, socio-economic reforms particularly related to skills and labour market, infrastructure improvements in transport and environment, and support to the work for the approximation of the legislation at sector level.

Albania has benefited from the IPA 2007-2013 component I—Technical Assistance and Institutional Building, and IPA Component II—Cross Border Cooperation (CBC). Subsequently, under IPA II 2013-2020, the supporting philosophy shifted from components to policy areas, with approx. EUR 650 million used across five policy areas, namely: Democracy and Governance, Rule of Law (which received the majority of IPA financing), Economic Governance, Competitiveness, and Growth.

IPA III 2021-2027 envisages a support of EUR 551.25 million.<sup>158</sup> Different management modes are used to disburse IPA funds, one of which has been the Sector Budget Support, conditioning the allocations to the sector performance indicators. Connecting IPA funds with the strategic NSDI pillars is crucially important for maximizing the funds' efficiency and effectiveness.

Figure 52. Sectorial Distribution of Aid Disbursements, 2013 - 2018 (USD million)



Source: MFE, 2023

157. Dashboard information, filtering required for recipient country: [https://public.tableau.com/views/OECDACAiddata-glancebyrecipient\\_new/Recipients?:embed=y&:display\\_count=yes&:showTabs=y&:toolbar=no?&:showVizHome=no](https://public.tableau.com/views/OECDACAiddata-glancebyrecipient_new/Recipients?:embed=y&:display_count=yes&:showTabs=y&:toolbar=no?&:showVizHome=no)

158. CoM Decree, no. 447, July 2023 on National Single Project Pipeline

In order to modernize and increase the efficiency of the decision-making, since 2000 Albania has established the Integrated Planning System (IPS) which is a framework of principles and operating structures that aim to ensure that government policies and financial planning are coherent, efficient and integrated. IPS encompasses 3 management information systems: EAMIS – External Assistance Management Information System; AFMIS – Albanian Financial Management Information System; AGFIS – Albanian Government Financial Information System. EAMIS is created to record and retain information regarding the projects financed by the foreign aid, foreign direct investments, and concessions/PPPs. The General Directory of Procurement and Contracting of EU funds and the Directory for the Implementation of the WB projects and those of other donors oversee foreign aid, while a special unit under the MFE oversees the EAMIS projects. However, over the years, it has been noted that MFE has concentrated more on registering and processing loans data. On the other hand, donors responsible for populating grants data have not been sufficiently active in providing information to ensure the alignment of grants with the budget.

## 5.4. International Private Finance

### Section summary

Remittances from emigrants have been the largest and most consistent source of international private financing resource in Albania, contributing to financing the trade deficit and poverty reduction in the country. Currently, there are 1.4 million Albanian emigrants living mostly in countries such as Greece, Italy, United States and Germany. Remittance inflows constituted 15-20% of GDP during 1996-2006, dropping to around 10% in the period 2007-2020, mainly due to increased GDP size. The remittances inflow per capita in 2022 stood at around USD 626. Given their resilience to internal shocks and their quick recovery in the face of crisis, remittance inflows have been not only a stable source of revenue for the economy but also a crucial financial resource for crisis response. As a major source of for-

ign exchange inflows, they also play a crucial role in financing the country's trade deficit, covering about 38.8% of it in 2022 and, therefore, of great importance to macroeconomic stability of the country. In the context of the country's weak social protection schemes, remittances continue to be an important form of social protection and poverty alleviation. Around 23-26% of households receive remittances, and the latter constitute the only source of household income for 24.4% of remittance-receiving households, and for the rest they account for 14-23% of their income.

Despite the introduction of relevant Foreign Direct Investment (FDI) and privatization laws in the 1990s, high risks associated with political and social instability, low levels of economic diversification and a weak financial system have hampered FDI flows to Albania. The pyramid crisis of 1997 was a blow to the country's efforts at creating a conducive foreign investment environment. FDI net inflows reached a low of around 1% of GDP by 1999 before starting a steady recovery, reaching over 11% of GDP by 2009 just before the onset of the Global Financial Crisis. Since then, FDI net inflows and the overall FDI stock have followed a declining trend as a percentage of GDP. Albania's vulnerability to external shocks, regional and global volatilities, ranging from the Eurozone crisis to the Covid-19 pandemic, have further undermined FDI flows to the country. Most FDIs since 2000 have been brownfield investments stemming from the privatization of strategic State-Owned Enterprises (SoEs), such as banks, tele-communications, and energy companies, with only a minor share of greenfield investments. Institutional and regulatory reforms, capacity improvements and economic developments since the early 2000s have aimed at enhancing the country's greenfield investment climate. By 2010, SoE privatization was no longer a source of FDI, and foreign investments began to fall into the greenfield investment category – although

they have not managed to surpass the total brownfield investment levels. During the first 25 years of transition, energy, mining, infrastructure, manufacturing, agriculture, and food processing were the priority FDI sectors in Albania. Energy and power generation sectors have continued to attract the majority of greenfield investments to date. After reaching a peak in 2009, net FDI inflows have been volatile, with various shocks, such as the Eurozone crisis and the Covid-19 pandemic having a major impact on the inflows. By the end of 2022, FDI stand at a level of 6.7% of GDP with net inflows at 5.4%. International commercial borrowing from the private sector has also followed a volatile pattern since 2008, in some years surpassing the levels of FDI. Net Foreign Portfolio Investment inflows have also fluctuated widely since 2010, with their overall levels far below net FDI inflows since the early 2000s. Over the medium term, as the large energy-related FDI projects are completed, Albania's ability to attract new FDI flows to a variety of sectors will be increasingly important for sustainability and growth.

Illicit Financial Flows (IFFs) constitute a significant challenge to Albania, particularly in terms of their drain on potential private financial resources, their integration into official financial system, their large associated informal economies and associated cash flows, and their undermining of the state institutions. Around 22% of Albania's economy is considered to fall into the illicit economy category. One of the key reasons for the prevalence of illicit financial activity is the inability of the state's institutional capacity, integrity and development to keep pace with the scale of trade. Progress has been made in establishing appropriate legal, regulatory and enforcement mechanisms to counter IFFs in Albania, although the country still lacks formal methods and procedures to measure and assess the extent and activities of the illegal economy and the criminal activities and products in circulation.

### 5.4.1. Foreign Direct Investments & Foreign Portfolio Investments

The first Law on Foreign Direct Investment (FDI) was introduced in 1993, along with serious efforts to implement an ambitious reform agenda regarding ownership transformation, establishing a free-market economy and opening up Albania to the regional and global economies. During the first years of transition, FDIs were primarily concentrated in small, light, and less capital-intensive industries. The privatization strategy approved in 1995 called for an increased participation of foreign investors in strategic sectors. Meanwhile, improvements in the infrastructure and communication sectors began to facilitate this process. In 1993, the Petroleum Law was adopted, paving the way for the signing of several production-sharing agreements with foreign companies, initially for offshore sites, and starting from 1996, for on-shore sites as well. As a result, oil exploration, minerals (such as chromium), and gas production became the sectors attracting most of the FDI flows. Additionally, the booming activity of the Pyramid Schemes is believed to have contributed to the increase in FDI during the period (from USD 65 million in 1994 to USD 97 million in 1996).<sup>159</sup> The Pyramid Scheme crisis of 1997 destroyed the country's efforts at creating a conducive investment ecosystem. The high risks associated with political instability, a weak financial system, and social unrest halved FDI levels, leaving the country unable to recover until 2000, when the FDI stock and net FDI per capita began to rise significantly.

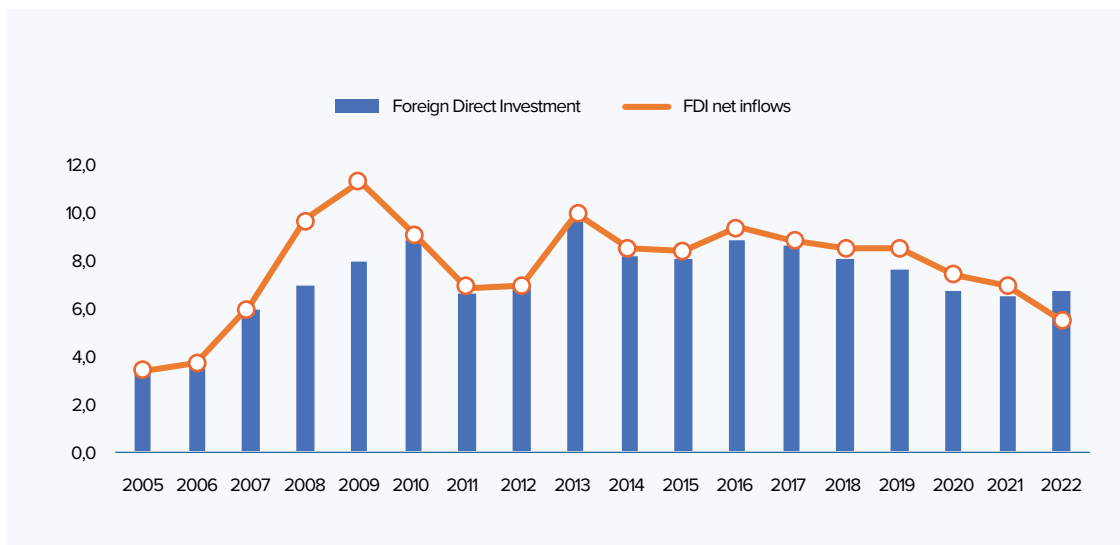
FDI stock and net FDI inflows as a ratio to GDP experienced an increasing trend until 2009, equalling 7.9% and 11.2% of GDP respectively. The Great Recession of 2008 caused both FDI stock and net FDI inflows to decrease, recovering only after 2012. Since 2013, FDI have shown on average a decreasing trend and never reached their peak level of 2009. At the end of 2022, FDI stood at 6.7% of GDP, with net inflows at 5.4%.

Since 2000, most FDI has come from brownfield investments resulting from the privatization of key strategic state-owned companies. These include two major state-owned banks (second-level banks, specifically the National Savings Bank and the National Commer-

159. IMF. (1997, Apr). Staff Country Report No. 97/21, Albania—Recent Economic Developments.



Figure 53. FDI stock and net FDI flows in Albania (as % of GDP)



Source: Reporting from BoA to EC, 2023

cial Bank), the state communication company ALBTELEKOM, the state-owned mobile company AMC, Albania Refining and Marketing of Oil (ARMO, 86% state-owned), and the power distribution company OSSH (76% state-owned). By 2008 and 2009, FDI inflows had significantly increased, reaching USD 1.2 billion and USD 1.3 billion, respectively, accounting for 9.7% and 11.2% of GDP – the highest in the region after Serbia.

Starting from 2002, efforts were made to improve the country’s legal and institutional frameworks and to enhance the administrative capacities in place for attracting fresh flows of foreign investment. Examples of such reforms include: a new Investment Promotion Agency established in 2002; a new bankruptcy law adopted in 2003; a new law on concessions and another one on public procurement adopted in 2006 (increasing the length of PPPs/concessionary contracts from 20 to 35 years); the Albania One Euro initiative, which was launched in 2006 to attract FDI through the construction of several industrial zones and the sale of land and other state property at symbolic – very low prices<sup>160</sup>; reforms of business registration and licensing procedures;

introduction in 2010 of special protection provisions for foreign investors; establishment of a one-stop shop for mining activities; and the introduction of a flat rate tax system. After 2008, concessional contracts were given in the industrial and energy sectors, expanding the scope of foreign investments. By 2010, SoE privatization was no longer a source of FDI, and foreign investments began to fall into the green-field investment category. Energy power generation became the focus of FDI, initially through the construction of small hydropower plants. However, FDI in this sector did not reach the higher levels associated with the privatization of SoEs, indicating weak institutional and structural factors, such as a lack of economic diversification. FDI inflows declined in 2011 and 2012 but began to recover after 2013, though they never returned to the levels seen in 2009.

After 2013, the government introduced other measures to support and promote FDIs, for example, through territorial reforms, improved sector-based legislation, a new legal package on foreign investments, tourism, renewable energy, fason<sup>161</sup>-clothing activities, Technological-Economic Development Areas (TEDA), special protection status for foreign and strategic

160. EBRD. (2010). Transition Report Recovery and Reform

161. A business model prevalent in the textile and garment sector of Albania, which involves the production of clothing and footwear for foreign companies, typically under contract manufacturing arrangements and based on specifications provided by them. Once produced, the products are sold under the label of the foreign clients.



investors, economic diplomacy program,<sup>162</sup> liberalization of labour market for foreigners, introduction of one-stop shops for various investor services, and introduction of electronic investment applications. The annual FDI inflows increased in subsequent years (2013, 2017 and 2018), largely reflecting two major foreign investments in the country – the Devoll hydro-power plant (The Netherlands), and the TAP gas pipeline (Switzerland), both of which brought about an increase in direct and indirect employment, an increase in GDP, improvements in infrastructure, as well as other indirect benefits. The Covid-19 pandemic caused a significant decline in FDIs, with a recovery observed since 2021.

At the end of 2020, the annual growth rate of FDI stood at 22.7%.<sup>163</sup> The principal driving sector has been real estate development, as residential purchases from non-residents have increased fast. Additional positive contributions have come from FDIs in electricity, mining, and manufacturing. A large chunk of foreign investment relates to re-invested earnings, reflecting the good economic performance during the year. Portfolio investments have generally reflected falling liabilities to non-residents. This is associated with local commercial banks active in purchasing stakes in the Albanian Eurobond issued recently. As a result, although the overall General Government liability remains the same, it has shifted from non-residents to residents.

Albania ranks as the second largest attractor of FDI as a percentage of GDP, with an average annual inward FDI-as-share of GDP averaging 8.1% between 2011 to 2021. The peak value was 9.9% in 2013 and the lowest was 6.8% in 2011.<sup>164</sup>

**Sectorial distribution of FDIs.** The FDI priority sectors for Albania during the first 25 years of transition were energy, mining, infrastructure (PPP), manufacturing, agriculture and food processing. In 2008 and 2010, the FDI stock was dominated by the services sector covering respectively 66% and 65% of the overall FDI stock; by 2012 this had declined to 46%. During 2010-2013 there was an expansion of FDI in the extractive industry, as well as oil and mineral sector, from 2% of the FDI stock in 2008

### Priority development areas

The legal framework in place stipulates that the status of a development priority area can be selected by the relevant line ministry, the Albanian Development Investment Agency (AIDA), or the Committee of Strategic Investment, and must be approved by the Council of Ministers. The priority development areas (state-owned) will be utilized to (i) orient investments in a manner that benefits from existing infrastructure, leverages a specialized labor market, and protects the environment from industrial impacts and (ii) address high unemployment rates by making investments aimed at enhancing the skills and employability of the population. AIDA has identified different potential development areas, which are deteriorated assets of enterprises from the communist regime, including the former Metalurgical Combine in Elbasan, the chemical factory in Fier, the tobacco factory in Shkodra, the cable factory in Shkodra, the fish deposit in Korca, as well as the Kamza industrial park.

up to 23% of the stock in 2012. A large part of the FDI stock in the manufacturing industry relates to the petroleum refining and construction material industries.<sup>165</sup> Since 2014, out of the five sectors with significant FDI stock presence, “Infrastructure” and “Manufacturing” have dominated. The high level of FDI in “Infrastructure” in 2016 was largely due to investments in the TAP gas pipeline, which accounted for about 40% of the total. In recent years, FDI priorities have shifted towards tourism, energy (including the Skavica Hydropower Plant), and renewable energy. Other key sectors include port transport and infrastructure (such as Vlora Airport, Durres Port, and other small ports), agriculture and fishing, the automotive industry, ICT & BPO, and economic zones.

162. <https://punetejashtme.gov.al/diplomacia-ekonomike/>

163. MFE, 2022, Economic Reform Program 2023-2025

164. [https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Enlargement\\_countries\\_-\\_finance\\_statistics&ol-did=607024#Foreign\\_direct\\_investment](https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Enlargement_countries_-_finance_statistics&ol-did=607024#Foreign_direct_investment)

165. Demeti A., & Rebi, E. (2014). Foreign direct investments (FDI) and Productivity in Albania. *Inter disciplinary Journal of Research and Development*, Vol (I), No.1

### AIDA (Lead, Aftercare and Investment potential areas)

The Albanian Development Investment Agency (AIDA) offers Lead and Aftercare services for investors. AIDA acts as a “one-stop shop” for investors by addressing all initial needs and serves as a “deal closer” by guiding investors through the entire facilitation process, particularly for high-profile projects. An essential component of the Leads services is linked to the economic diplomacy initiative, which mobilizes Albanian embassies abroad to identify, inform, and promote potential investors to invest in Albania.

AIDA staff are specialized around economic clusters, ensuring that the assistance provided to investors is professional and tailored. In 2021, there were 19 lead projects with a total investment of EUR 132 million, attracting interest from investors in Italy, Germany, China, the Netherlands, and Austria. The sectors with the most interest include automotive manufacturing, processing industries, renewable energy, agriculture, construction in Technological-Economic Development Areas (TEDA), and BPO. Of the 19 lead projects, 15 continue to be active leads, and AIDA is working to convert them into realized investments or “deals.” AIDA’s Aftercare services provide daily assistance to investors to facilitate their business plan development and communication with central and local institutions, aiming to support further expansion and reinvestment in Albania. With assistance from the IFC, AIDA has established a communication network with 10 municipalities and other investment-related institutions and has developed an institutional mechanism for resolving investment issues. Lead and Aftercare activities have been crucial in identifying investment barriers, which are reported to MFE as critical to address to improve the business climate in Albania.

**FDI by country of origin.** During 2007-2013, 31% of the total FDI in Albania originated from Greece. Canada was also an important investor during this period, contributing 20% of total FDI stock in 2012 and concentrating on the extractive industries. Other important investing countries during the period included Austria, the Netherlands, and Turkey.<sup>166</sup> This has changed over the period 2014-2021, with most FDIs now coming from Switzerland, Netherlands, Italy, and Turkey. (Figure 54)

FDIs are crucial for economic development of Albania. Empirical analysis<sup>167</sup> has demonstrated that FDI has had a positive effect on GDP growth, has improved the functioning of the market economy and increased competitiveness, opened the country to regional and international trade, and increased collective knowledge including technological advancement and productivity. Over the medium term, as the large energy-related FDI projects head towards completion, Albania’s ability to attract new FDI flows will be increasingly important for sustainability and growth.

#### 5.4.2. Remittances

Emigration is a widespread phenomenon in Albania. The highest level of outward migration was noted in 1991-1992 (first flow), reaching a peak in 1997-1998 (second flow) after the collapse of the pyramid schemes.<sup>168</sup> In the last two decades, around 25% of the country’s total population emigrated, equivalent to about 35% of the active population. According to approximate data, around 1.4 million Albanian citizens currently live and work abroad. The majority (around 70-75%) lives in Greece and Italy.<sup>169</sup>

Remittance inflows to Albania started soon after the first wave of outward migration in 1990-1991 (in the early ‘90s, remittances were monetary and in-kind) and constituted one of the largest sources of foreign exchange inflows. Ever since, remittances have had a very positive effect in supporting the economic growth of the country, constituting a larger share of GDP than FDIs and export revenues. Most importantly, the remittance inflows have not only been a stable source of revenues for the economy but have also been a crucial resource in times of economic crisis. Remittance inflows have

166. Merollari, K., and Koti, S. (2015). Foreign Direct Investments in Albania, Structure and Dynamics. *European Journal of Economics and Business Studies*, Volume 1, Issue 2.

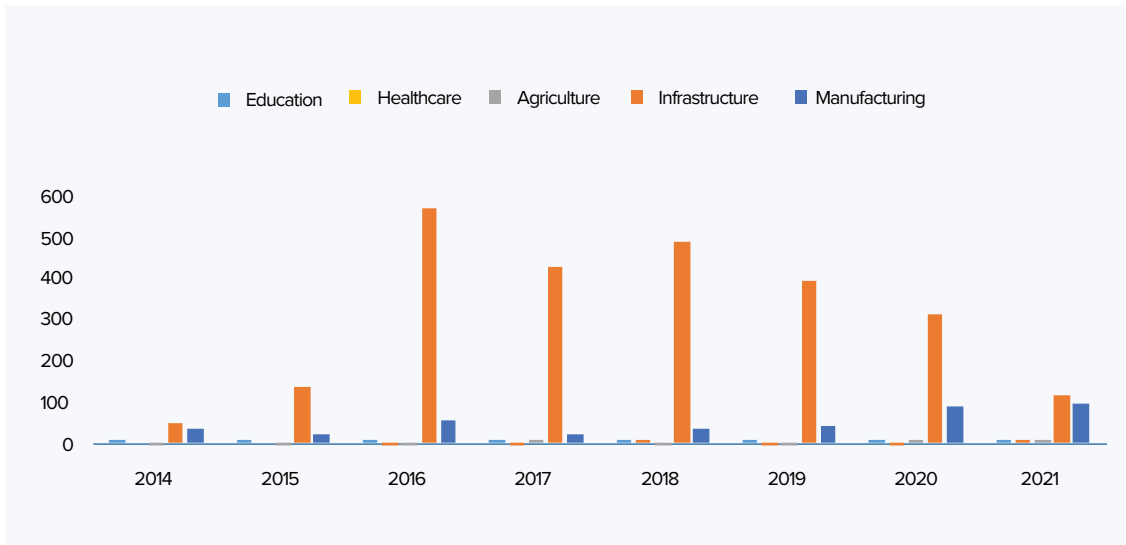
167. Hoxhaj, M., & Pulaj, I. (2022). An Overview of Foreign Direct Investment in Albania. *European Journal of Business and Management Research*

168. According to UNFPA (1997: 3), between 1990 and 1995, the number of emigrants represented 9-11% of the total population in 1995.

169. Greece hosts the highest number of Albanian immigrants in the world; around 500 thousand Albanians live in Italy.

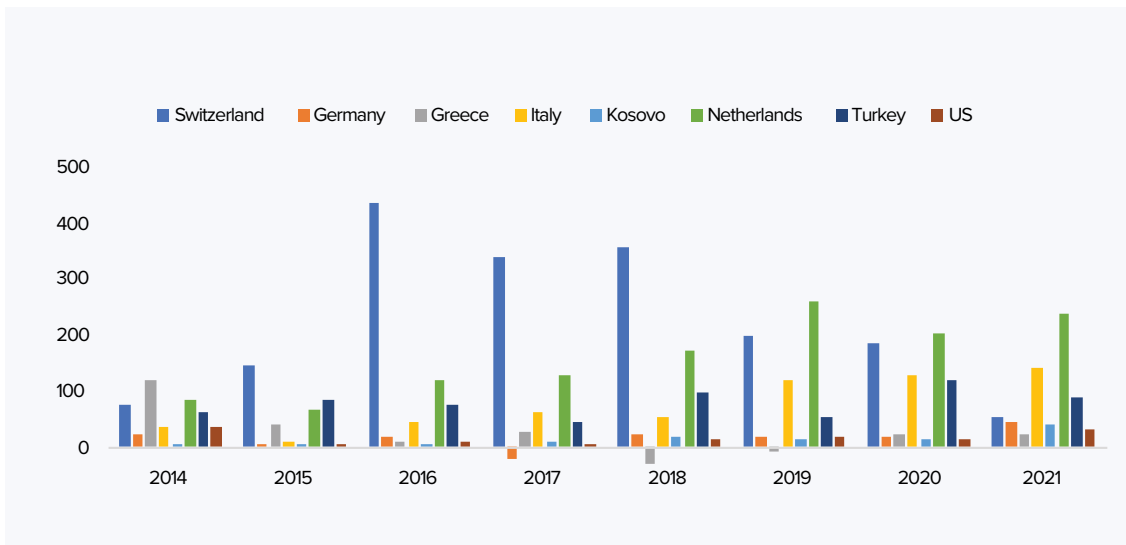
<https://punetejashtme.gov.al/en/shqiptaret-ne-bote/>

Figure 54. FDI by sector (million EUR)



Source: BoA, 2022

Figure 55. FDI by country of origin (EUR million)



shown a very quick recovery in the aftermath of shocks such as the 1997 economic crisis, the 2019-earthquake, and the Covid-19 pandemic.

Until 2007, remittances showed an increasing trend, representing 10% to 20% of the country's overall GDP. With the 2008 financial crisis and Global Recession, remittances sharply decreased from 2009 onwards, especially from Albanian emigrants living in Italy and Greece. Over the period 2007-2020, the average remittances inflow as percentage of GDP decreased, dropping to less

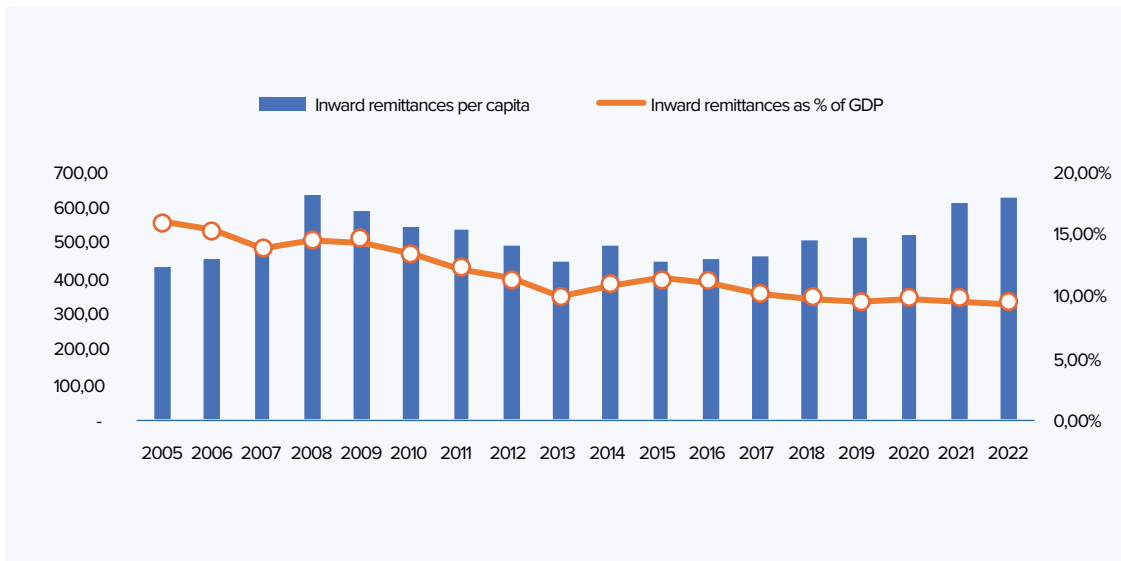
than 10% in 2020. The remittances inflow per capita in 2022 stood at around USD 626.

Remittance inflows as a percentage of GDP have been consistently higher than the share of FDI and ODA inflows. This has been particularly the case until 2007 when FDI and ODA inflows were minimal. After 2007, the FDI inflows as a percentage of GDP have increased coming closer to the remittances level. Remittances remain crucially important to cover the trade deficit. In 2022 remittances constituted 38.82%

of the trade deficit of goods. The ratio of remittances to the export of goods in 2022 was 116.96% and to the imports of goods 29.15%. This indicates that the remittances are very important for the macro stability of the country. They remain an important source of revenue when the earnings from exports and FDIs decrease, contributing to the overall level of income, consumption, and economic growth. Remittances have also been crucial for poverty

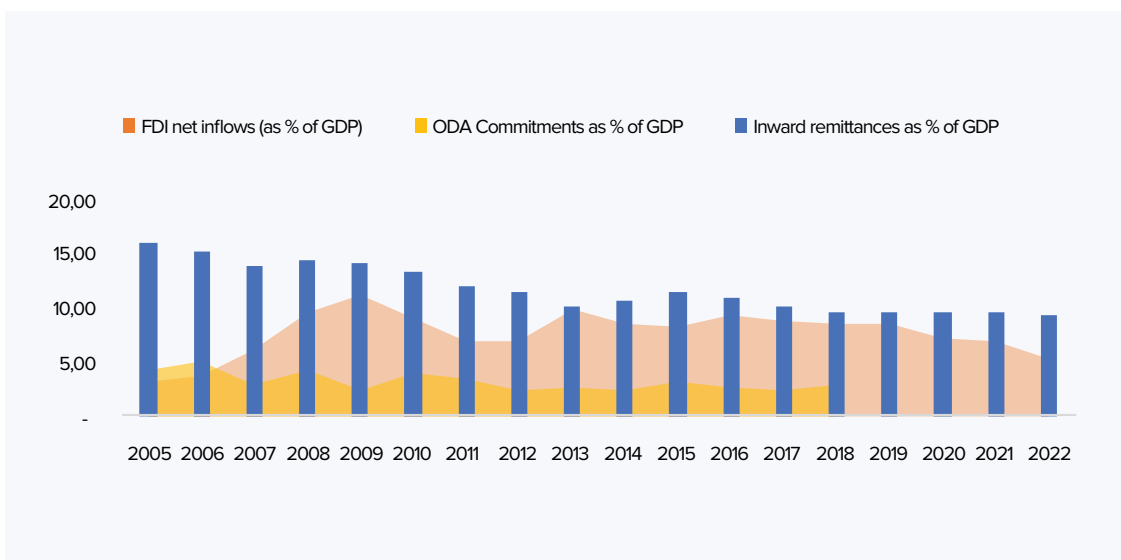
alleviation in Albania, particularly in the context of weak social protection schemes. The Albanian Household Wealth Survey data indicates that 23-26% of households receive remittances. For 24.4% of remittance-receiving households, this is the only source of household income; for the rest of remittance-receiving households, remittances are the second most important source of household income, accounting for 14-23% of their income.<sup>170</sup>

Figure 56. Inward Remittances per capita (in USD) and as % of GDP (secondary axis)



Source: BoA and WB (2023)

Figure 57. Inward remittances, FDI net flows and ODA commitments (as % to GDP)



Source: Authors' calculations based on data from BoA and OECD (2023)

170. Frasher, A., & Dushku, E. (2021). Remittances and their impact of poverty: the case of Albania 2021

An analysis of the Bank of Albania<sup>171</sup> predicts that remittance inflows will remain stable (stationary) in the long run. The analysis of other characteristics shows that remittance performance in the short run is influenced by autoregressive behaviour, thus confirming their stable performance.

Although remittance flows have shown strong resistance to shocks, the speed of their return to equilibrium is estimated to be relatively slow. The analysis concludes that in the long run the flows are positively affected by output performance in the sending and receiving countries, and negatively impacted by elements related to primary sovereign risk and faster price increases.

## 5.5. Other financing sources

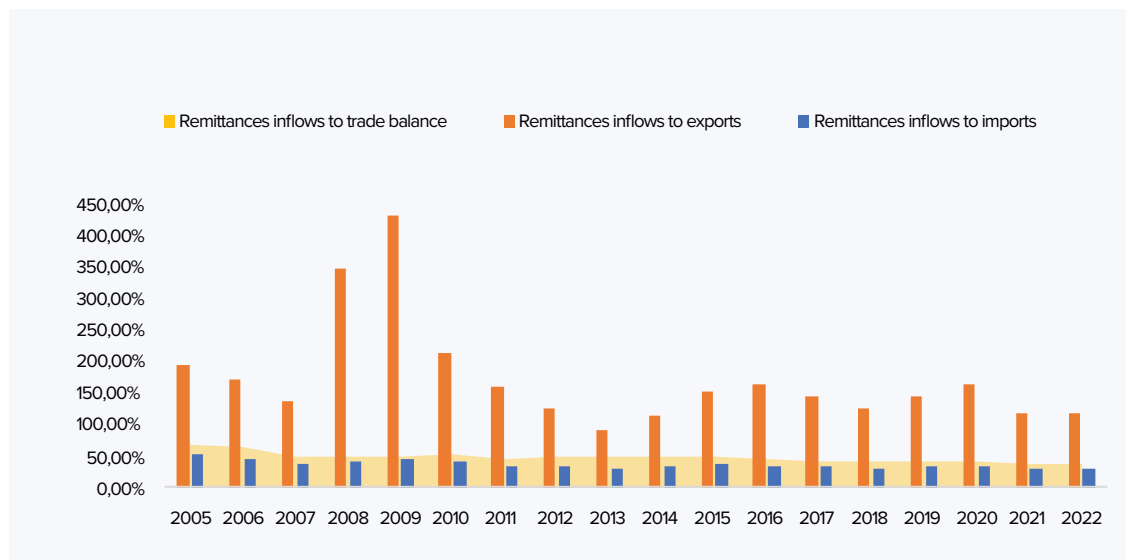
### 5.5.1. NGOs

NGO sector mobilizes a modest amount of financing, but they have been crucial for the advocating and promoting democracy and good governance, as well as for educating and supporting people's rights along with the provision of services for different categories in need. They have offered a vast experience in public sector reforms and an-

ti-corruption strategies by supporting a transparent, effective, and accountable public administration and promoting the rule of law.

There is a considerable variation in between the number of registered NGOs (according to the database of AMSHC and the Commercial Register) and those that are active (according to the General Directorate of Taxation [GDT]). 2022 GDT data reports 219 registered and active NGOs in Albania in 2021 (out of a total of 247 registered ones). This number has increased significantly since 2003, with almost all of them concentrated in the service sector. Despite efforts to obtain a complete picture of the funds mobilized by NGOs and their main activities, comprehensive information remains unavailable. The tax directory is the only source of information, but it was found that financial data submitted by international NGOs was not processed. Therefore, the report focuses on the largest 50 International NGOs in terms of the number of employees and the value of transactions they perform. Based on this data, the liquid assets of these NGOs amounted to EUR 44 million at the end of 2021, equivalent to 0.3% of GDP. Their total assets reached EUR 176 million, or 1.2% of GDP. Key activities and the related asset allocations include: (a) EUR 8 million allocated to activities of

**Figure 58. Remittances inflows to trade balance, exports and imports**



Source: Authors' calculations based on data from BoA and INSTAT (2023)

171. Shijaku, G. (2020). A statistical and empirical view of remittances flow. *Bank of Albania*

other NGOs, mainly in education, local governance, and decentralization; (b) EUR 0.7 million for social care services and humanitarian services, particularly for marginalized groups; (c) EUR 12 million for activities of religious organizations; (d) EUR 155 million for activities of economic organizations and employers.

An important donor for CSOs is the State Agency for the Support of Civil Society (AMSHC), whose mission is providing financial assistance to promote the sustainable development of civil society and creation of favourable conditions for citizens' initiatives around issues of public interest.

During 2021-2022, AMSHC allocated EUR 18 million to 134 projects on the following priority fields: social support (30%); European integration (22%); fight against corruption and public legal education (11%); environment and sustainable development (16%); tourism and culture (15%) and more than one priority field (6%)<sup>172</sup>.

By 2020, the top ten development partners supporting civil society in Albania were (in descending order) (1) European Union; (2) Germany; (3) Switzerland; (4) United States; (5) Sweden; (6) Austria; (7) Italy; (8) France; (9) Poland; (10) Netherlands.

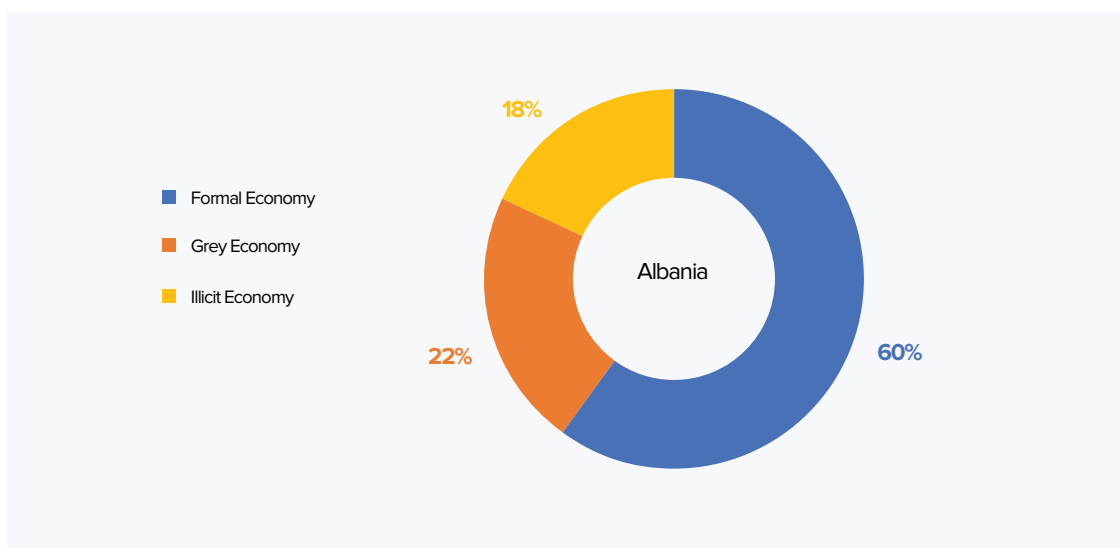
### 5.5.2. Illicit Financing

#### Illicit Financial Flows and recent estimates (approximates)

Similar to other Western Balkan countries, Illicit Financial Flows (IFFs)<sup>173</sup> constitute a significant challenge for Albania, particularly in terms of their integration into official financial system; their association with informal economies; the widespread use of cash; and the overall weakness of the state, state institutions and democratic culture.<sup>174</sup>

One of the primary reasons for the prevalence of illicit financial activity in the Western Balkans region in general is that the development of capacity and integrity of state institutions has not kept pace with the scale of trade. The prominence of cash economy also facilitates IFFs in various ways across different formal sectors and industries. The three most significant generators of IFFs<sup>175</sup> are deemed to be drug trafficking, illicit trade in counterfeit and substandard goods, and smuggling of migrants. A large amount of imbalance between trade revenues and foreign exchange reserves can be attributed to over-invoicing relative to the actual value of goods and services entering the country. The cumulative estimate of trade mis-invoicing in Albania amounted to EUR 4.9 billion between 2008 and 2017.

Figure 59. Estimates of formal versus informal economic activities (as % of GDP)



Source: Global Initiative (2020)

172. State Agency for the Support of Civil Society (AMSHC), Annual Report 2022

173. UN definition: 'money that is illegally earned, transferred or used and that crosses borders' and that is generated from three sources: criminal activity, corruption and tax fraud

174. Reitano, T. & Amerhauser, K. (2020), Illicit financial flows in Albania, Kosovo and North Macedonia, Key drivers and current trends. Global Initiative against transnational organized crime, Political economy report. Can be retrieved at: <https://globalinitiative.net/analysis/iffs-western-balkans/>

175. IFFs components are classified as follows: (a) corruption related; (b) crime (drugs trafficking, illicit trade and smuggling of migrants); and (c) tax evasion.

From 2013 to 2017, import under-invoicing and export over-invoicing represented some 21.8% of the country's total trade volume – a very high figure even when compared to other developing countries. No recent data are provided in this respect.

The tax to GDP ratio is 18.3% in Albania, 20.1% in Bosnia and Herzegovina, 17.2% in North Macedonia and 24.1% in Serbia (figure for Montenegro not available). These levels are similar to (and in some cases above) what is seen elsewhere in Europe (average of 19.9%).<sup>176</sup> The fight against organized crime and corruption is one of the key requirements for EU accession, especially related to Chapters 23 and 24 of the EU acquis. Combatting organized crime and corruption is one of GoA's top priorities and significant progress has already been made with regards to the specialized prosecution office focusing on organized crime and corruption, organized crime risk assessments, and anti-organized crime strategies.<sup>177</sup> Similarly, being aware of the country's vulnerabilities with regard to money laundering, Albania has made some progress with establishing specialized anti-money laundering departments, conducting money laundering risk assessments, and introducing anti-money laundering strategies.<sup>178</sup>

Albania does not apply any formal methods or procedures to measure and assess the extent of activities of the informal economy or the criminal activity/products in circulation.<sup>179</sup> Currently, the Albanian Financial Intelligence Unit (AFIU) collects information on reported suspicious cases from various institutions (mainly banks and notaries), follows up those cases and address them to the Prosecutors and Policies. In recent years, there has been a focus to address some cases to the GDT in order to further assess, from a fiscal point of view, those cases that are suspicions of fiscal evasion/concealment of revenues. Based on data provided by the Agency of the Administration of Seized and Confiscated Assets (established in 2004<sup>180</sup>) for the period 2011-2020, the cumulative value of seized assets reached EUR 54.25 million by the end of 2020 (for a total of 840 assets, 25% of which were seized in 2020). In line with the EU directive 2014/42/EU on the use of confiscated assets for public interests or social purposes, Albania has adopted Law No.10192, dated

3/12/2009 “on the Prevention and Combatting of Organized Crime and Trafficking Through Preventive Measures Against Assets”, and DoCM no.632, dated 2010, aimed at establishing an enabling environment to support this approach. Pioneering work in the social reuse of assets confiscated from organized crime groups has been carried out by an initiative called Confiscated Assets Used for Social Experimentation (CAUSE). This EU initiative linked the local civil society organization Partners Albania with the Italian experience. Since 2016, the Partners Albania for Change and Development initiative (USAID) aims to establish social enterprises with the confiscated assets belonging to organized crime.

The 2022 EU progress report for Albania, which assesses the country's performance with regards to EU integration, notes that Albania is moderately prepared on Chapter 24 – Justice, Freedom and Security, despite some progress made. The EU recommendation on this chapter is to “(1) continue developing the systematic use of parallel financial investigations when dealing with organized crime, illicit trafficking, terrorism, and money laundering; (2) swiftly achieve the overdue completion of the action plan agreed with the Financial Action Task Force (FATF) on preventing money laundering and countering terrorism financing with a view to delist Albania from the FATF list of jurisdictions under increased monitoring for strategic deficiencies; (3) implement the asylum law and resume referrals to the asylum procedure; align return procedures with the existing legal framework; continue to address the issue of unfounded asylum applications and fully align national legislation with the EU list of visa-required third countries; (4) keep strengthening the fight against organized crime, including through cooperation with EU Member States, as well as EU agencies, including Europol and Eurojust and increase the proactive use of Europol's Secure Information Exchange Network Application (SIENA) for the exchange of information and its practical extension to additional law enforcement agencies; (5) establish without delay an asset recovery office in line with the EU Acquis that is in charge of the identification and tracking of criminal assets, as foreseen by national legislation; and (6) ensure that the Special Prosecution Office and Na-

176. OSCE. (2021). Illicit Financial Flows - The lifeblood of crime and corruption for the South-Eastern Europe. Can be retrieved at: <https://www.osce.org/secretariat/505096>

177. Ibid

178. Ibid

179. <https://fiu.gov.al/albanian-financial-intelligence-unit/>

180. Under the Ministry of Finance, AASCA is responsible for the administration or use of seized and confiscated assets from organized crime: anything from bank accounts to cars and real estate for sale, rent or social reuse of these assets. A special fund has been created by the agency to use money earned from renting out confiscated properties to support civil society organizations, anti-trafficking activities and victims of organized crime.



tional Bureau of Investigation continue to increased operational access to all relevant databases.”

On Chapter 29 – Customs Union, the reports that Albania is moderately prepared, with limited progress made. The EU recommends to “(1) approve legal provisions and develop the New Computerized Transit System; (2) continue efforts in pursuing the fight against smuggling, corruption and imports of counterfeit products, including through strengthening administrative capacities and improving cooperation among the bodies involved; and (3) accede to the FCTC Protocol to Eliminate Illicit Trade in Tobacco Products.”

### 5.5.3. Informal economy

There is a large shadow economy<sup>181</sup> in Albania; informal economic activity (including unregistered businesses, workers without contracts, and businesses underreporting sales, wages, and so on) accounts for about 27% of GDP. This is comparable to other Western Balkan countries, but higher than the STEE7 countries or EU’s new member countries.<sup>182</sup> The informal economy remains large: IMF estimated that it accounted for about one third of GDP in 2019<sup>183</sup>, and that it is most widespread in trade, tourism, manufacturing and construction. About one-third of the country’s workers are employed in the informal sector, a figure that exceeds half when the agriculture sector is included. The agriculture, construction, and services sectors (which include trade, transport, and accommodation) tend to have a higher incidence of informal activity (11).<sup>184</sup> The sectors most exposed to informal employment are trade and tourism, accounting for almost 50% of total identified cases, followed by manufacturing at 20% and construction at 18%.<sup>185</sup> According to the Southeast Europe Leadership for Development and Integrity (SELDI)<sup>186</sup> survey, hidden employment in

Albania increased in 2019 compared to 2016, as it did in four of the other WB countries.<sup>187</sup> The Hidden Employment Index indicates that 47% of Albania’s employment has some level of informality.

Widespread informality undermines competition, hinders the efficient allocation of state and private resources, and reduces tax revenues and funding of social security systems. For most regional economies informality is driven by: (a) weak overall institutional and regulatory environment; (b) insufficient enforcement capacity of public authorities; (c) corruption; and (d) low awareness of the negative social implications.<sup>188</sup> Since 2015, the government has implemented ‘anti-informality’ campaigns, which have become more sophisticated over time and have targeted several high-risk sectors. These campaigns have yielded positive but insignificant and unsustainable results, hindered by a lack of reliable data.

The fiscalization<sup>189</sup> efforts, which started in 2021 aimed at improving the availability of real-time information about economic activity. However, fiscalization is not part of a wider, comprehensive strategy for tackling all aspects of informal economic activity and informal employment. To tackle informality more broadly, it would also be necessary to ensure progress on property tax reforms and initiatives to decrease tax loopholes.<sup>190</sup> At the time of writing, no cross-cutting strategy to tackle informality has been drafted or adopted. Reducing informal employment and redesigning relevant tax policies, as part of the Medium-Term Revenue Strategy (MTRS), should help increase social contributions and income tax revenues, in addition to raising employment and minimum wages. Since January 2022, a special Anti-Informality Unit has been established in the Ministry of Finance and Economy.

181. The shadow economy is known by different names, such as the hidden economy, gray economy, black economy or lack economy, cash economy or informal economy. All these synonyms refer to some type of shadow economy activities and have been used frequently, and quite inconsistently.

182. Medina, L. & Schneider, F. (2019). Shedding Light on the Shadow Economy: A Global Database and the Interaction with the Official One. *CESifo Working Paper No. 7981*. Can be retrieved from: [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3502028](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3502028)

183. IMF. (2019). WP 19/278, “Explaining the Shadow Economy in Europe: Size, Causes and Policy Options”

184. World Bank. (2021). Country Economic Memorandum 2021 for Albania - Strengthening the Sustainability of Albania’s Growth Model

185. EC, 2022 Country Progress Report for Albania

186. SELDI. (2020, Nov). Hidden economy in the Western Balkans 2020: Trends and Policy Options. *Policy Brief No. 11*

187. The Hidden Employment Index reflects the existence of any of five practices common in the hidden economy: (a) Working without a written contract with the employer; (b) The “official” remuneration written in the contract is lower than the wage actually paid to the employee, as agreed upon verbally between the two parties; (c) The employee has no social security coverage; (d) The base for the social security contributions paid is the amount written in the contract, and not the higher amount actually received; (e) There is no health insurance on the main job.

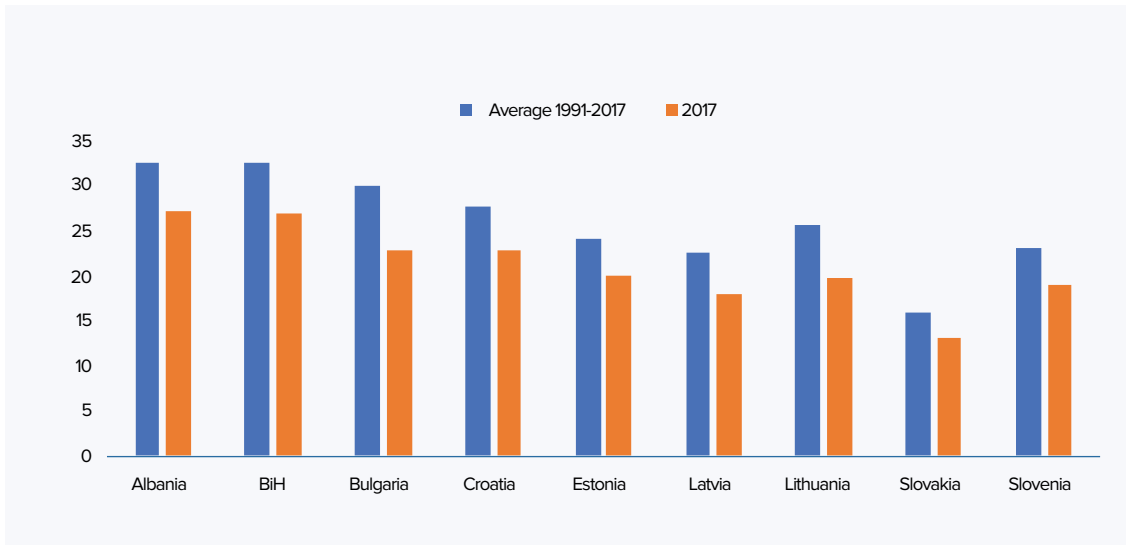
188. EC Overview and Country Assessment on the Economic Reform Programs of Albania, Montenegro, North Macedonia, Serbia, Turkey, Bosnia and Herzegovina and Kosovo\*, Institutional Paper 180, June 2022.

189. The adoption of fiscal laws to combat informality in the retail sector.

190. Ibid

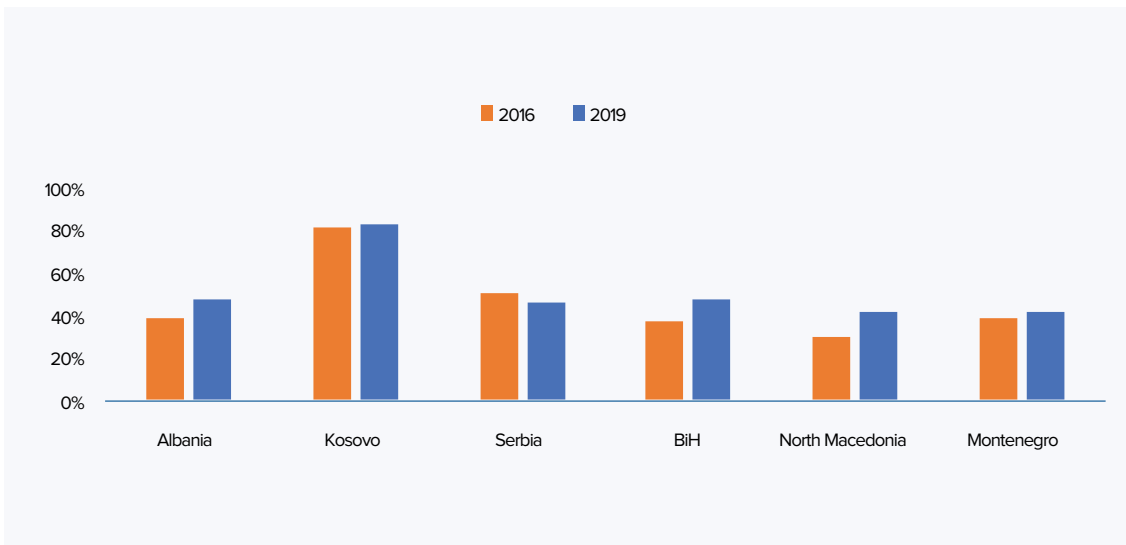


Figure 60. Informal economy in 2017 (in % of GDP)



Source: Medina & Schneider, CESifo (2019)

Figure 61. Hidden Employment Index



Source: SELDI, 2020

Increased public service digitalization, financial inclusion, and labour inspections have benefited the business environment and the formalization of the economy, but the informal economy remains significant. Albania has a large informal sector, and its economy is primarily cash-based. In 2021, a leak of salary data for about 630,000 citizens enabled the recently established special Anti-Informality Unit to target the

widespread practice of underreporting salaries at the individual business level. Consequently, the tax authorities reiterated their call for businesses and self-employed individuals to correct their revenue declarations. These measures significantly reduced the number of employees receiving the minimum wage (about EUR 243) and contributed to a statistical wage increase.<sup>191</sup>

191. EC, 2022 Country Progress Report for Albania

# Chapter VI.

## ALBANIA IN THE WESTERN BALKANS REGIONAL CONTEXT

The Western Balkan countries have increased their cooperation particularly after 2014 with the start of the so-called Berlin Process, an initiative intended to accelerate the region's EU accession by promoting stronger connectivity and regional market.<sup>192</sup> Currently, the WB region continues to face significant challenges in establishing functional democracies, resolving outstanding bilateral issues among specific countries, strengthening governance, combating corruption, and fostering economic development. It is believed that regional integration can positively promote faster economic development and greater political stability. Initiatives such as those focusing on connectivity, aiming to integrate the Western Balkans into European transport and energy corridors, are under implementation. However, significant obstacles make this process slow and time-consuming.<sup>193</sup> After the recovery efforts from the Covid-19 shock, the six WB economies, are facing new challenges as result of the war in Ukraine, which has prompted a sharp increase in energy and food prices, slowdown of growth in other European countries, and a decline in purchasing power and business confidence. The businesses in the region declare labour shortages as their key concern.<sup>194</sup> The countries are trying to keep fiscal deficit under reasonable levels, while financial support has been allocated to most vulnerable groups as a compensation for increased food prices. The budget allocations to subsidize the energy price hike has increased fiscal risks, although the non-per-

forming loans have remained low with a strong loan growth, while the region's financial sector is expected to be impacted by the weakening business and consumer confidence. The region's economic growth will be insufficient to overcome the financial pressures due to ongoing risks and uncertainties. To tighten the fiscal space, the World Bank has recommended increasing the level of market competition, remove entry barriers to business, increase retention and reinvestment among foreign investors, reduce barriers to female labour force participation, improve the quality of education, and raise standards of governance, including digitalization. The ongoing crisis also underpins the importance of accelerating the green transition in the region away from volatile hydrocarbons toward cleaner electricity generation, as well as greener production, finance, and consumption patterns<sup>195</sup>.

**Economic performance.** According to the Bertelsmann Transformation Index,<sup>196</sup> in 2022, Albania ranked high compared to other countries on Governance/Management and Political Transformation (rule of law being the weakest aspect); while in Economic Transformation Albania equals B&H, followed by Kosovo, with all three assessed lower than Serbia, Montenegro, and North Macedonia. The weak aspects with low scores under the Economic Transformation Index are “level of socioeconomic development”, “monetary and fiscal stability” and “private property”.

192. With two dedicated plans: the Multi-annual Action Plan for the Regional Economic Area: <https://www.rcc.int/docs/383/consolidated-multi-annual-action-plan-for-a-regional-economic-area-in-the-western-balkans-six>, followed by the Common Regional Market Action Plan: <https://www.rcc.int/docs/543/common-regional-market-action-plan>

193. <https://www.wbif.eu/sectors/energy>

194. Regional Cooperation Council, 2021, Labor Markets in the Western Balkans, 2019&2020

195. World Bank. (2022). Western Balkans Beyond the Crises. Regular Economic Report No. 22

196. Can be accessed at: <https://bti-project.org/en/?&cb=00000>

Albania was one of the Western Balkan countries that recorded a more moderate contraction in economic growth in 2020, ranking second after Serbia. In 2021, it was among the countries with higher economic growth rates, ranking third after Montenegro and Kosovo. In 2022, Albania again ranked second, this time after Montenegro, with the highest growth rate. Currently, Albania's GDP per capita is lower than the WB6 regional average.<sup>197</sup> Albania is one of the two countries with the lowest level of unemployment rate compared to the other countries in the region (second only to Serbia). Similarly, while the youth unemployment rate is problematic in all WB countries, Albania and Serbia have the lowest rate in the region. Generally, inflation has been low in all WB countries over the last years, except 2022-2023 when the inflation rate increased due to the hike in global energy and commodity prices. Albania managed to contain inflation (which remained lower than in other WB countries) partly due to unchanged energy prices.

**Public tax revenues** as a percentage of GDP in Albania – standing at 29.1% - are the second lowest among the WB6<sup>198</sup> and are low compared to the EU average level of around 42% and WB average level of 35%. Despite having similar or higher tax rates compared to peer countries, Albania has shown low revenue generation over the years due to a narrow tax base and inefficient administration and collection. Unlike other countries, Albania projects future gradual increases in the revenue-to-GDP ratio in its ERP report. Although VAT in Albania is relatively high at a standard rate of 20%, its implementation efficiency is not as high compared to the region. The VAT threshold is quite low, and due to informality and a narrow tax base given tax exemptions, VAT productivity is low, with a 54% collection rate compared to the EU average of 61%.<sup>199</sup> In terms of public expenditure, Albania needs to increase both the level and efficiency of expenditures on education, health, and social protection to match the levels of investment

in human capital seen in peer countries,<sup>200</sup> including the WB6 and STEE7 countries.<sup>201</sup>

Similar to other WB peer countries, Albania achieved a substantial decrease in **fiscal deficit** in 2021, due to a combination of strong revenue performance and under-execution of capital expenditures.<sup>202</sup> The country projects a return to the fiscal consolidation path in the upcoming medium-term period, during which a lower fiscal stimulus compared to the recent three years will be required by fiscal policy. Albania's **debt level** is the second highest among the WB6 countries (after Montenegro), although it is currently considered to be under control. Unlike most regional peer countries, according to projections and assuming compliance with fiscal rules in line with ERP guidelines, public debt is expected to gradually decline in the upcoming medium-term period.

All WB6 have institutionalized aspirations for attracting more **FDIs** by creating agencies for fostering foreign investment. Countries are making regional investment agreements. Many of the improvements made to the investment environment in the WB are the result of necessary reforms for EU membership. In terms of FDIs as a percentage of GDP in 2022, Albania (6.7% of GDP) ranks third after Montenegro (13.5% of GDP) followed by Serbia as second (7.1% of GDP).<sup>203</sup>

Total FDI net inflows in Albania are at a comparatively high level relative to other countries in the region and neighbouring countries. However, Albania is limited in terms of the diversity of FDI source countries and companies. Another concern is the sectoral distribution of FDI, as the manufacturing and tourism sectors, which are priority areas for the economy, have not attracted significant investment. Recently, the WB region has become a more attractive investment destination due to the provision of tax breaks and other subsidies to foreign investors, as well as the establishment of special eco-

197. [https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Enlargement\\_countries\\_-\\_recent\\_economic\\_developments#Gross\\_domestic\\_product\\_per\\_capita\\_2C\\_in\\_purchasing\\_power\\_standards](https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Enlargement_countries_-_recent_economic_developments#Gross_domestic_product_per_capita_2C_in_purchasing_power_standards)

198. European Commission, 2022, Economic Reform Programs for the WB and Turkey, Institutional Paper

199. IMF Technical Assistance, 2020, Tax Policy Reform Options for the MTRS

200. STEE7: Seven small transition economies of Europe: Bulgaria, Croatia, Estonia, Latvia, Lithuania, the Slovak Republic, and Slovenia. Data are missing for all the WB6 economies in the IMF GFS database in recent years.

201. World Bank. (2021). Country Economic Memorandum 2021 for Albania - Strengthening the Sustainability of Albania's Growth Model

202. European Commission, 2022, Economic Reform Programs for the WB and Turkey, Institutional Paper

203. European Commission. (2023). EU Candidate Countries' & Potential Candidates' Economic Quarterly (CCEQ), Technical Paper 064

conomic zones in Bosnia and Herzegovina, North Macedonia, and Serbia. These economies have attracted substantial foreign investment inflows into their manufacturing sectors, especially in car components industries, integrating their economies into global supply chains. Despite numerous initiatives to promote regional cooperation over the past two decades, connectivity remains poor, particularly in terms of transport infrastructure.

According to the **Doing Business** Databases,<sup>204</sup> in 2020 Albania ranked as the second lowest rated country after Bosnia and Herzegovina, while North Macedonia ranked highest. Albania ranks low in the region for almost any assessed area of doing business, particularly in “dealing with construction permits,” “registering property,” “paying taxes,” “enforcing contracts,” and “resolving insolvency.” Corruption is perceived as more problematic for Albania and Bosnia and Herzegovina compared to other countries in the region. However, the Competitiveness Index ranks Albania third in the region, after Serbia and North Macedonia.

The objective of spurring long-term economic growth in the WB is based on the European Union’s Economic and Investment Plan (EIP) proposed in October 2020. The 10 flagship projects, organized into six thematic areas, have identified priority projects to be financed during the forthcoming period. Poor transport and energy infrastructure, inefficient energy systems, the twin green and digital transition, private sector development, and youth unemployment have all been selected as key policy priorities. These six areas of priority action have been chosen jointly by the European Union and Western Balkan governments.

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204. Not subject of update after 2020

# Chapter VII.

## MACROECONOMIC ISSUES AND FISCAL SPACE CHALLENGES FOR INFF

### 7.1. Macroeconomic Challenges to INFF

Albania is experiencing a rapidly shrinking population due to emigration and decline in birth rates. This is causing pressures both on the pension system and the labour market. The share of pensioners to the total population (60+ years old) has increased from 19% in 2010 to 22.6% in 2022. Long-term forecasts indicate that the share of population in pension (60+ years old) will reach 28.3% by 2031.<sup>205</sup> Although contributions have increased over the last decade, the 2022 level of deficit in the pension system is twice the deficit level in 2010. It is believed that the underreporting of wages in the private sector impacts the contribution levels in the pension system. The aging population has created important gaps in the labour market, which might influence the remittances, emigration patterns, as well as the comparative advantages for investments.

Labour participation of the 15–29-year-old age group has decreased by 30% over the period 1989-2020.<sup>206</sup> Although the number of migrants from other countries to Albania and returning emigrants has increased, this is insufficient to offset the emigration numbers. Brain drain continues to be a highly costly phenomenon, particularly for occupations that are difficult to fill in the labour market. While the unemployment rate has declined, it still remains in double digits. Youth unemployment at the end of 2022

was 21.5%, nearly twice the EU27 level of 13.8%. The largest employers are the services and agriculture sectors, representing 44.2% and 33.9% of total employment, respectively. This is also reflected in the average wage, which is almost twice the minimum wage at the time of writing. Conversely, the public average wage is 20% higher than the average wage in the private sector by the end of 2022. The underreporting of wages in the private sector is impacting the national average wage level.

Some 9% of the Albanian population are beneficiaries of the Ndihma Ekonomike scheme, with 22% of the population at risk-of-poverty (INSTAT/SILC, 2021). About 95% of the **overall social protection** budget is in the form of cash transfers (only 5% dedicated to social services at national and local level), while the total budget for social assistance (Ndihma Ekonomike) benefits remains at 0.3% of GDP. The Ndihma Ekonomike program has had a limited impact on reducing poverty risk. Local governments are responsible for social care provision; however, their fiscal space is insufficient to significantly increase social protection funding at the local level.

The shadow economy accounts for around 25-35% of GDP, undermining competition, reducing tax revenues, and affecting the funding of social security system. It also hinders the efficient allo-

205. <https://www.instat.gov.al/>

206. Hoxhaj, M., et al. (2022). Analysis of demographic changes, labour market trends and challenges in Albania: Social economic challenges

cation of state and private resources. Informality in employment continues to be problematic, particularly in the agriculture sector.

**Significant financial resources are required to address the national and sectorial strategic priorities** envisaged in more than 40 sectorial and cross-sectorial strategy documents, each highlighting the indicative cost for achieving the objectives, the related financial sources, and the existing financial gaps. Despite the work to apply the costing template for each strategic document, no complete financial scenario is provided to cover the needs, no funds mobilization strategy to fill up the financial gaps, and no analysis of the financial aspects of strategy implementation including the impact of financial gaps in the implementation progress of the strategy. The same can also be noted in the NSDEI, which does not provide an exhaustive chapter on financial considerations and risks scenarios. A crucially important instrument to operationalize the NSDEI, sectorial strategies and government priorities in concrete national and regional megaprojects/projects is the National Single Project Pipeline (NSPP) as part of the Integrated Planning System (IPS). It includes 145 projects, totalling EUR 16.1 billion, classified as either premature, partially matured, or matured for financing.<sup>207</sup> The intention is to ensure an efficient combination of all sources of funding (internal, foreign sources, credits, grants, PPPs, private) for their financing. According to EIP for the WB financial indicators, the financing needs are 89%. The EU accession process will be accompanied with increased financial needs to support the reforms, however, no clear financing scenario is available in this direction.

A narrow focus on GDP will not be sufficient for Albania to achieve its development goals. According to the World Bank (2021), four reform priorities are essential for a stronger Albanian growth model: (1) investing in people, (2) increasing firm productivity, (3) building a more sustainable growth model, and (4) strengthening public finances. Under the third priority, growth needs to become greener, more resilient, and more protective of vulnerable groups, making financing more challenging but ultimately more sustainable. Additional funding sources are needed to **upgrade the growth model**, which can

be achieved by effectively deploying expenditure needs and implementing the approved Medium-Term Revenue Strategy (WB, 2021).<sup>208</sup> Strengthening rule-based governance, which directly affects increased revenue collection, and addressing forgone public revenue (tax expenditures) through higher compliance and improved tax administration, are also crucial. Since the ERP 2022-2024, GoA has projected steady economic growth and gradual fiscal consolidation starting from 2023, as fiscal stimulus used in recent years is expected to be less necessary for economic recovery in the medium term. Additionally, the fiscal space should be increased through revenue mobilization by deploying extra fiscal resources, including foreign capital flows and mobilizing domestic private capital both inside and outside financial institutions.

**Inflation** has remained stable after 2011, staying below 2% and aligned with target inflation levels. However, since the end of 2021, inflationary pressure has increased, reaching 6.7% during 2022 and 7.4% by the end of the year, with significant rises in food (14.2%) and transportation (6%) costs. The Bank of Albania confirms that rising prices are spreading across a wider range of goods and services. In response to rising inflation, BoA raised interest rates from 0.25% to 2.25% in October 2022 (following a similar approach in 2023) and announced that, according to its forecasts, the inflation rate had not yet peaked. This increase in interest rates may influence credit levels in the economy, increase non-performing loans (NPLs), and slow economic recovery and growth following recent shocks.

In Albania, the central government bears the majority of post-disaster recovery costs, relying primarily on the Reserve from the Council of Ministers as the main *ex-ante* resource available for contingencies. GoA faces vulnerability due to a large insurance protection gap for both public and private assets and lacks sovereign insurance to provide budget support during emergencies (WB, 2021). Over the past three years, this has led to a substantial funding gap in responding to the 2019 earthquake, the Covid-19 pandemic, and energy and commodity price shocks, which have been financed

207. Please, see more details in Section 4.4 of this report.

208. World Bank. (2021). Country Economic Memorandum 2021 for Albania - Strengthening the Sustainability of Albania's Growth Model

with *ex-post* sources of funding such as budget cuts, reallocations, borrowing, or donor aid. These methods, while rapid, are costly and disruptive. Under the limited *ex-ante* sources of funding, public expenditures were reallocated through Normative Acts, crowding out important planned expenditures and presenting an opportunity cost in terms of forgone or delayed returns. Furthermore, ODA, as a potential funding source, has been provided as loans.

The banking sector dominates Albania's financial services, representing 90% of financial sector assets and covering more than 60% of the total sovereign debt stock (63% in 2022). It is also the primary lending source for the economy (35% of GDP, equivalent to more than 90% of lending). However, it is estimated that 30% of the country's money is outside the banking system, and the secondary market remains underdeveloped. Although banks are highly liquid and the NPL rate is very low, lending is not aligned with development priorities. Financial education is low, and while efforts are being made to digitalize banking operations, there is uncertainty about how quickly banks can modernize their operations. Green financing is in its initial stages, primarily focused on renewable energy.

## 7.2. Fiscal space challenges for INFF

Almost one-third of public expenditures is allocated to social protection, but this still falls short of the EU27 average. Issues persist in targeting and adequacy, with an increased deficit in the public social insurance system and a growing number of beneficiaries compared to contributors due to the aging population.

Public debt remains high and vulnerable to re-financing risks. The widening fiscal deficit, driven by supportive fiscal policies and the sharp economic slowdown, has exacerbated the overall public debt. Subsidies to counter the increase in imported energy prices have also negatively impacted the debt stock. However, this trend reversed in 2022-2023 due to economic growth and exchange rate dynamics. A rise in debt interest payments is anticipated in the medium term.

Despite a decrease in stock arrears in 2016 due to the implementation of the Strategy for the Prevention and Repayment of Arrears, the total stock of arrears for both central and local governments has increased since 2017. Currently, considerable stock arrears exist in the tax system, with almost 70% deemed uncollectable. There is also a high accumulated stock of arrears in the energy sector (more than EUR 1 billion) and unpaid bills to special categories such as ex-owners and ex-prosecuted individuals. Contingent liabilities continue to be a fiscal burden.

ODA flows have declined as a percentage of total official flows as Albania has gradually moved towards a higher income ranking. Increased OOF, most of which carry non-concessional interest rates, have pushed up debt levels. The EU accession process will put additional stress on aid flows and concessional loans.

### Risks and their financial impact

Albania identifies a broad set of risks within three categories: (a) risks not linked to government activities, (b) risks linked with government activities, and (c) risks linked to public sector entities' (SoE) activities. Albania is considered one of the most risk-exposed countries in the region,<sup>209</sup> with 10 out of 11 identified risks. Only four of these risks are measured (financial sector crises, changes in debt interest rates, government guarantees, and government litigation lawsuits), but none are disclosed. No measurements exist for environmental degradation, PPPs, and SoEs. Over the last decades, the country has faced several risks, including macroeconomic shocks (1991), a financial sector crisis (1997), natural disasters such as floods, fires, and earthquakes (most notably the 2019 earthquake), and the Covid-19 pandemic, which have created significant fiscal challenges. GoA lags in monitoring, reporting, and managing such fiscal risks and adopts only an *ex-post* policy approach.

**The 2019 Earthquake.** Albania was severely affected by the November 2019 earthquake. A Post-Disaster Needs Assessment (PDNA) was completed on January 30, 2020, with financial support from the EU, UN, and WB. It assessed the damage at EUR 985 million, primarily driven by housing damage. The government initially used the Public Reserve Fund, which had a total allocation of around EUR 4 million, for the

209. OECD, Government at a Glance Western Balkans 2020 – Albania factsheet

emergency response. The 2020-2022 budget sanctioned the Reconstruction Fund with an approved amount of EUR 975 million, of which EUR 370 million was disbursed over 2020-2021, and EUR 167 million during 2022. According to the Macro-Fiscal Framework 2024-2026, the levels of the Reconstruction Fund for 2020, 2021, 2022, and 2023 are 1%, 1.6%, 1.5%, and 0.2% of GDP, respectively.

**The Covid-19 Pandemic.** Two instruments were used to respond to the effects of the Covid-19 pandemic: allocations from the Reserve Fund of the public budget and the sovereign guarantee fund, allocating EUR 112.5 million for the Anti-Covid-19 Social Package, EUR 5.2 million for other emergencies, and EUR 20.8 million to the Ministry of Health and Social Protection in 2020. Two Sovereign Guarantees were mobilized for a total of EUR 355 million: Sovereign Guarantee I (EUR 92 million) and Sovereign Guarantee II (EUR 125 million). Additional funds were used in 2021 to double social assistance (EUR 46.4 million) and for the Reserve Fund (EUR 28.9 million). Loans from the IMF, CEB, and World Bank were used to finance the pandemic response. The expansive fiscal policies used during this period impacted the budget deficit, which reached 6.7% of GDP in 2020 and 4.6% of GDP in 2021, up from around 2% in the previous four years. Consequently, public debt increased by 10 percentage points, reaching 74.3% of GDP in 2020 from 65.8% in 2019. In 2022, public debt decreased to 64.6% of GDP.

**Energy and commodity price hikes.** The war in Ukraine began affecting global food and energy prices, with ripple effects felt in Albania as well. The government subsidized the energy sector through a sovereign guarantee in 2021 and allocated funds in 2022 to subsidize the energy sector and support the most vulnerable people against price increases.



# Chapter VIII.

## CONCLUSION AND RECOMMENDATIONS

This report has assessed the status of the current financial inflows and their past trends in Albania (both domestic and foreign, public and private, non-concessional and concessional), to identify challenges to, and opportunities for increasing levels of finance for development and to enhance the latter's alignment with the country's developmental priorities and vision. The report also assessed various aspects of the public sector management system, and identified certain institutional factors that constrain planning, budgeting and implementation of public investments and service delivery, hence affecting the efficiency and capacity of public sector to utilize existing finance as well as the capacity to leverage domestic and international private finance. It offers recommendations to improve efficiency in the use of available finance and identify opportunities to mobilize additional finance. The report's analysis of Albania's financing landscape forms the foundation for dialogue about the roles that different types of financing can play in achieving the sustainable development challenges.

### Overall financing strategy recommendations

#### Domestic public finance

In Albania, tax revenues are the main contributor to public revenues, accounting for around 25-27% of GDP, with grants and non-tax revenues (including ODA and budget support) representing an insignificant share of total public revenues by comparison. However, several significant challenges undermine the government's ability to maximize its tax revenues and the latter's redistributive potential. The government has introduced several policies aimed at tackling the obstacles to a more efficient and productive tax system, yet this has been hindered by the under-declaration and under-re-

porting of taxable incomes. Recent tax policy reforms have allowed for more exemptions and hence a narrowing of the tax base, further complicating tax administration and revenue collection. To fight informality, the VAT threshold in Albania has been kept low compared to the regional economies, yet this has not been able to produce the expected results. Informality combined with the narrow tax base resulting from exemptions, together with insufficient capacity of the tax administration, have caused an under collection of VAT. Given that VAT is the main revenue contributor, maintaining a robust and stable VAT is of considerable importance. While enhancing the alignment of public spending with SDG-aligned investment requires further attention, the first step is to improve public revenue collection. Given the significance of tax revenues in public revenues, further advancement of tax policy reforms remains crucial in enhancing public revenue collection. With the aim of mobilizing public revenues, it is important for GoA to reduce inefficiencies both in the tax policy formulation (increasing tax compliance and/or addressing tax loopholes) and in the tax administration (strengthening control and reducing arrears) through the implementation of the fiscal reforms that started in 2021.

#### Eliminate or streamline inefficient tax incentives.

According to the World Bank, reducing tax exemptions, including VAT, could result in an additional 0.2% of GDP in annual tax revenues for the country. In addition, better targeting of tax exemptions could be combined with sustainability and developmental objectives to maximize both the fiscal and social benefits of the tax policy, for example through policies such as addressing environment and health issues through targeted tax and incentive instruments

or optimizing targeted tax incentives (concessions and exemptions) to individuals and corporates to align with SDGs. Furthermore, public revenues can be further increased by strengthening the alignment of the tax policies and instruments with the achievement of SDGs, including addressing socio-economic inequalities through tax options to enhance the progressivity in current taxes on income and VAT, introduce new forms of taxation, and improve distributional impact of tax policies.

Tax expenditure reporting and regular cost-benefit analyses can be used to show the value for money and effectiveness of existing tax incentives in mobilizing fiscal revenues as well as investments that contribute toward national SDGs. This would ease the elimination of ineffective tax incentives and pave the way for introduction of effective, impactful incentives.

**Improve tax administration (strengthening control and reducing arrears).**

Addressing inefficiencies within the tax administration necessitates to continue the modernization efforts of the tax administration system to enhance the efficiency and effectiveness of tax collection while mitigating tax evasion and fraud. In this context, other reforming steps should be accelerated such as capacity building in tax data management, promoting the utilization of digital payments and financial transactions, along with enhancing digital literacy to bolster the tracking capabilities for tax-related purposes. Increasing access to reliable data will improve the quality of public revenue and expenditure projections and planning in Albania. Realistic forecasting is expected to improve the budget planning and budget execution in the future. Also, on the public expenditure side, the discrepancies between projected and actual public expenditure values should be under control and budget should be resilient to shocks and crises.

**Enhancing public resource mobilization.**

To better align the generation and collection of taxes with SDGs, Albania could consider implementing new tax strategies. For instance, implementing a carbon tax could serve as a suitable policy approach that not only generates revenue but also aids in achieving the country's emissions reduction objectives. Any initiative like that should be preceded by a more in-depth analysis to inform a multi-stakeholder dialogue process to address critical policy

trade-offs related to the introduction of a carbon tax. If successful, such new taxes could result in immediate revenue gains and expansion of fiscal space for the government, enabling higher spending on services and investments in key areas of sustainable development. Resource mobilization policies need to be complemented with a reduction in inefficiencies in government expenditure. Spending on social protection constitutes one of the main public spending items in Albania, with contributory revenues only covering 60% of the total social protection expenditures, indicating a significant gap in the system's ability to provide adequate social protection for citizens. Hence, the social insurance scheme remains largely subsidized by the government, contributing to large fiscal deficit. Enhancing social protection expenditure does not imply reducing its coverage. Rather, it entails more precise targeting, enabling the expansion of the current social protection framework. This involves reinforcing the institutional alignment between social assistance and the labour market, re-evaluating eligibility criteria and distribution methods, and building the capacity of the system at both national and local levels to effectively address the immediate and evolving needs of the population in the medium and long run. Enhancing the sustainability of the public administration and pensions systems and better targeting of social transfers are crucial in reducing the government's public expenditure burden.

The government's revenue mobilization could also be enhanced through increasing the engagement of non-state actors in public service delivery and infrastructure investments. A wider use of PPPs could strengthen private sector engagement, for example through service delivery or management contracts in which the GoA takes a regulatory role and/or uses the budget as a financial incentive to leverage NGO and private sector participation. For larger investments in utilities and infrastructure, investments in PPPs can potentially attract additional external finance through FDI, while social sector service delivery (e.g., secondary, and tertiary education) could bring in added concessional finance accessible by INGOs, who in turn cooperate with domestic NGOs and private sector actors. SDGs could also be mainstreamed across all phases of PPP development, from identification to preparation, transaction, and management. This can be done through the explicit inclusion of SDGs in PPP capacity building

programs, project eligibility/selection/prioritization criteria; considering important issues such as gender and inclusiveness in the composition of PPP agreements; and, using specifications to incorporate sustainability into procurement processes. In addition, strengthening the role played by the civil society and NGOs in monitoring large scale PPP projects and the transparent execution of their public procurement processes can help strengthen public scrutiny to ensure PPPs' value for money and contribution to welfare benefits and sustainable development.

### International public finance

#### Reorient towards ODA and priority sectors.

Although the volume of international public finance has grown substantially over the period under analysis, its proportion as a percentage of GDP has remained at a rather steady rate of around 5% given the country's GDP growth over the last three decades. The 2000s witnessed a growing use of Other Official Flows (OOF) as the main modality for international public finance in Albania. The growing use of OOF, most of which accompanies non-concessional interest rates, has increased Albania's debt levels, and pressured the domestic budget. While OOF are a form of international public finance they are more commercial in nature than ODA so mobilizing OOF can in fact fall into a wider private investment strategy. Reorienting aid flows towards ODA remains very important for sustainability of international public finance flows to Albania. Greater alignment between aid allocation and strategic NSDI pillars is also vital for maximizing aid efficiency and effectiveness. The 2010s witnessed more ODA being allocated to governance reforms, energy, and financial services, with much less allocated towards critical economic sectors such as water, agriculture, and social sectors (such as health and education).

#### Consider alternative sources of public finance.

Albania has opportunities to raise larger volumes of ODA concessional finance, particularly from global funds targeting SMEs, renewable energy, and climate change. Mobilization of additional finance would require more conducive national policies and regulations and a strong government capacity for policy planning, budgeting, project implementation and monitoring. Attracting higher levels of ODA can also help crowd in other sources of financing in support

of non-traditional and more innovative projects such as low carbon technologies and decarbonization of the industry and transportation sector. Greater access to ODA financing also enables Albania to raise additional concessional finance from the growing number of global funds and DFIs. International philanthropic organizations represent an underutilized potential funding source, particularly in critical social sectors like healthcare and education. Facilitating the broader engagement of such organizations and foundations in Albania would necessitate the resolution of regulatory and legal constraints.

### Domestic private finance

Total private investment to GDP ratio presents a small and volatile trend in Albania. Although private investment levels have grown substantially since the late 1990s, they play a much smaller role in financing economic development in the country compared to public finance. When it comes to mobilizing domestic private finance, Albania's financial system suffers from low levels of development and is dominated by banks, holding 90% of the financial sector's assets. The Tirana Stock Exchange (TSE) was suspended in 2022. Even though the Albanian Securities Exchange (ALSE) and the Albanian Securities Register (ALREG) provide the complete technical infrastructure for listing and trading the corporate securities in LEK, no Albanian companies are yet listed, and as such, they do not yet fulfill the mission to mobilize financing for the Albanian companies which continue to fully rely on bank credits.

#### Increase access to finance for SMEs.

The Albanian economy is characterized by the dominance of Micro, Small and Medium-sized Enterprises (MSMEs). Given their significance in terms of job creation, their relative resistance to external shocks and their potential to contribute to inclusive growth and innovation, SMEs are important potential strategic partners for government in achieving the ambitious development goals set out in both the NSDI and the SDGs. To boost the development of SMEs and improve their access to financial resources, several policy measures can be pursued, drawing inspiration from successful implementations in similar economies. These measures include creating a supportive ecosystem for SME financing, which encompasses the establishment of venture capital companies, encouraging investments from business angels, facilitating platforms for

start-ups to emerge and communicate, and providing programs for incubation and acceleration. Additionally, regulatory reforms are crucial, with a focus on addressing issues like cash-flow-based lending, exploring alternatives to traditional collateral, enabling lending in cash, and enhancing the utilization of credit history through methods such as credit scoring systems. It is also important to diversify loan security options, allowing providers to use various forms of collateral, including goods for sale and future harvests. Strengthening the legal and institutional frameworks to support more effective partial credit guarantee funds is another essential step. Furthermore, implementing SME financial literacy and mentoring programs can enhance SMEs' ability to secure and manage financing. Collaboration with international financial institutions for capacity-building programs can help commercial banks and MFIs serve the SME market more efficiently. Lastly, optimizing regulations to develop digital financial services for SMEs, reducing transaction costs, and providing clarity on tax implications and incentives for digital finance transactions are essential. Exploring alternative financing platforms, such as capital markets, crowd-funding, and Peer-to-Peer digital lending, along with investments in technologies to reduce funding costs for MSMEs, can further enhance their access to finance.

#### **Enhance the business climate for private investments.**

Enhancing the business environment continue to be essential to attract both domestic and international private investments. To achieve this, proactive policies aimed at improving the business climate can be implemented including establishing investment and guarantee facilities to attract private sector funding for green-field projects and start-ups, as well as for the development of sustainable SMEs. While ensuring access to finance is crucial, it is equally important to provide concessional terms for business development services and research to support the growth of SMEs and the creation of new production lines within existing industries. Many countries with similar income levels have already initiated venture capital programs and challenge funds, often with donor support, to promote SMEs in key sectors like agriculture and renewable energy. In addition to creating a more favourable regulatory environment, GoA could also consider promoting venture capital funds or programs that include comprehensive

business development services. These reforms have the potential to mobilize funds from various private sources and increase investor confidence and interest in projects aligned with the country's development priorities and needs.

#### **International private finance**

##### **Develop financial intermediaries to channel remittances towards development.**

Remittances from emigrants have been the largest and most consistent source of international private finance in Albania, contributing to financing the trade deficit and poverty reduction in the country. Given their resilience to internal shocks and their quick recovery in the face of crisis, remittance inflows have been not only a stable source of revenue for the economy but also a crucial financial resource for crisis response. With a more diversified range of financial intermediaries, remittances can become an additional source of finance for investment in private sector development.

Enhancing the overall business environment in the country and facilitating the entry of new financial intermediaries and instruments into the financial sector can transform remittances into more than just a significant source of funding for household consumption. They can also become an additional means of financing investments in SMEs. While remittances typically contribute to progress on people-oriented SDGs (1-6) by supporting household expenditures, directing remittances towards local development projects can bolster prosperity-related SDGs. To formulate effective remittance policies, it is essential to conduct thorough analysis to gain a deeper understanding of how remittances currently impact household spending and how they can be strategically channelled into local development initiatives.

##### **Reduce the cost of receiving remittances.**

Reducing the cost of receiving remittances can play a significant role in channelling remittances into the country's formal financial systems and utilizing them for development-related expenditures. Reducing remittance costs to 3% by 2030 is a global target under SDG 10.7. Drawing insights from the experiences of other nations, there exist diverse and innovative financing approaches to consider. These approaches include encouraging diaspora involvement in both economic and cultural initiatives, such as participation in tourism projects. Additionally, remittances can be directed towards microfi-

nance or local development efforts, which might entail the establishment of diaspora micro-loans for rural areas or support for diaspora-owned businesses. Furthermore, blending remittances with ODA or public budget funds presents an opportunity for co-financing development projects. This co-financing model, exemplified by IFAD's Financing Facility for Remittances (FFR), can amplify the available resources for developmental purposes. Lastly, there is the important task of promoting financial inclusion by expanding the range of banking and non-banking products accessible to migrants. This effort can facilitate migrants' access to banking services and help them achieve financial inclusion in their countries of origin. By exploring these innovative financing strategies, the potential of remittances and diaspora engagement to drive economic development can be unlocked.

#### **Increasing and diversifying green-field FDIs.**

Despite the introduction of relevant Foreign Direct Investment (FDI) and privatization laws in the 1990s, high risks associated with political and social instability, low levels of economic diversification and a weak financial system have hampered FDI flows to Albania. Albania's vulnerability to external shocks, regional and global volatilities, ranging from the Eurozone crisis to the Covid-19 pandemic, have further undermined FDI flows to the country. Most FDIs since 2000 have been brownfield investments stemming from the privatization of strategic State-Owned Enterprises (SoEs), Energy and power generation sectors have continued to attract most green-field investments to date. Over the medium term, as the large energy-related FDI projects are completed, Albania's ability to attract new FDI flows to a variety of sectors will be increasingly important for sustainability and growth.

#### **Align private investments more closely with SDGs.**

To align the private sector's interests more closely with the advancement of SDGs, various approaches can be explored such as encouraging companies to report on their sustainability practices, increasing the use of mechanisms like PPPs and blended finance to match public and private funding, integrating SDGs and sustainability principles into strategies for promoting FDI, and utilizing frameworks like UNCTAD's 'Investment Policy Framework for Sustainable Development' (IPFSD) to identify sustainable investment opportunities through the use of an

agreed set of sustainability criteria, to allow for targeted investment promotion activities. In this respect, Albania can draw inspiration from successful practices in other nations such as the issuance of green, social, and sustainability (GSS) bonds, resilience bonds for funding projects related to adaptation and resilience, in conjunction with other financial sources like ODA and risk finance. Another international established market-intelligent tool that can be explored is the SDG Investor Platform which helps the private sector identify investment opportunities with significant potential to advance the SDGs in alignment with government policies and sustainable national development trends. The platform is active for around 40 countries. By implementing the above, Albania can encourage the private sector to actively engage in projects and investments that contribute to the country's sustainable development goals.

#### **Better assessment of the extent and nature of IFFs.**

Illicit Financial Flows (IFFs) constitute a significant challenge to Albania, particularly in terms of their drain on potential private financial resources, their integration into official financial system, their large associated informal economies and associated cash flows, and their undermining of the state institutions.

One of the key reasons for the prevalence of illicit financial activity is the inability of the state's institutional capacity, integrity, and development to keep pace with the scale of trade. Progress has been made in establishing appropriate legal, regulatory and enforcement mechanisms to counter IFFs in Albania, although the country still lacks formal methods and procedures to measure and assess the extent and activities of the illegal economy and the criminal activities and products in circulation. It is important for Albania to begin with assessing the current situation and capacity to better tackle illicit financial flows.

Having more extensive and detailed data on the volume and characteristics of these financial flows would facilitate the development of a more comprehensive strategy for addressing them. Such an approach could be a crucial element of the government's overarching fiscal agenda, as effectively managing illicit financial flows can enhance citizens' confidence in the government and their willingness to comply with tax regulations.

**Develop a long-term holistic financing strategy.**

Albania stands to gain from formulating a comprehensive, long-term financing strategy that outlines the necessary investments to advance both its priority sectors and a sustainable development agenda. Such a strategy can serve as the groundwork for implementing policies aimed at mobilizing essential public and private funding. This becomes particularly crucial for countries grappling with limited fiscal capacity and sluggish private sector investment. It can enhance the efficiency of public expenditure by aiding the prioritization of government spending in areas that may not be attractive for financing from other sources. By identifying financing gaps in specific sectors and regions and highlighting their contributions to sustainable development outcomes, this strategy can also boost the government's ability to attract additional resources from non-state entities. Such a strategy can be integrated into existing development plans through cost estimates and analyses of funding gaps for the implementation of identified priority interventions or developed as a complementary document to NSDEI. However, it is essential to pair the identification of financing gaps and targets with the coordination of institutional responsibilities to oversee resource mobilization planning comprehensively and holistically. Establishing such a long-term, all-encompassing resource mobilization strategy will not only advance sectorial priorities but also drive progress toward achieving sustainable development objectives.

**Develop an SDG-focused financing strategy. Establish cost estimates of sectorial and SDG interventions.**

The alignment, harmonization and mainstreaming of the SDG targets across NSDI and national sectorial and cross-cutting strategies, policy documents and national plans is done from the SDG perspective. This alignment is an incorporate part of NSDI 2023-2030, while costing refers only to strategic objectives of each national policy documents and related measures to be implemented for their achievement. Budget analysis focusing on public spending towards achievements of SDGs are carried out providing a snapshot of spendings vis-a-vis the SDGs and NSDI sectors. However, there is a need for a costing assessment of the national development strategy and priority SDG targets to estimate the total financing requirements of achieving Albania's development vision, which would entail a detailed costing, allowing a con-

trasting of the available identified financing with the magnitude and scope of required financing, as well as informing financing policies to incentivize certain financing flows and instruments towards specific financing needs. Enhancing the precision and comprehensiveness of costing exercises, especially at the level of priority SDG targets, can render these estimates more practically useful for policymaking. Achieving this may entail initially conducting mid-to-long-term costing exercises to inform the proposed process or developing cost estimates for specific sectorial and SDG priority initiatives.

Furthermore, it would be relevant to discuss and contemplate the advantages of including the costing of long-term development priorities as a standardized component of the policy development process, as currently happens in many countries. Peer learning and the sharing of best practices with them can aid in capacity building and facilitate the seamless integration of systematic costing of financing needs into county's planning processes. Additionally, conducting a more systematic and detailed analysis of how public spending contributes to the SDGs at the level of individual targets can help uncover financing gaps specific to the SDGs and formulation of more precisely targeted financing policies.

**Coordinate SDG prioritization and funding at national and sub-national levels.**

It is crucial to ensure that prioritization of budget allocation for SDGs is not solely determined at the central level but is also strengthened at subnational levels through various measures such as improving the fiscal framework to enable transfers from the central government to subnational authorities, building the capacity of subnational authorities in areas like data collection, revenue generation, and diversification and exploring innovative financing mechanisms, such as municipal bonds, to fund projects and infrastructure with a focus on sustainability, including green and social bonds for SDG-related initiatives. Providing capacity-building support at the local level is essential to facilitate SDG-related investments, leveraging local ideas and consultations to consider unique local contexts in the allocation of public resources. Local governments face challenges related to limited administrative capacity and financial autonomy, hindering their ability to develop context-specific strategies for efficient resource allocation. Moreover, many sectorial policies are highly



centralized, offering limited flexibility for local authorities and stakeholders to adapt measures in response to evolving needs.

Given Albania's ongoing fiscal consolidation efforts, it is important to assess how they may impact SDG financing. Such an assessment can provide valuable insights into the role of local budgets in contributing to SDG progress, enhancing our understanding of the financing landscape at the subnational level.

**Establish a comprehensive, results-oriented monitoring and review framework.**

Albania has an active SDG dashboard established and managed by INSTAT, which shows data with information on respective 17 SDGs as well as the reference to the respective targets and global indicators. This serves as a monitoring tool to evidence the progress for each monitored indicator. Also, Albanian Government has established the Integrated Planning System (IPS) which consists in 3 management information systems related to government and external financing. As a complementary tool, Albania could consider the establishment of a DFA dashboard to help systematize the government's holistic approach to financing the Sustainable Development Goals (SDGs) beyond public funds and establish a continuous connection between public policies for private finance and national sustainable development objectives. A DFA dashboard would offer a practical bridge between the long-term resource requirements of the country's development strategy and the medium-term financing trends and approaches. Furthermore, adopting a DFA dashboard would serve the dual purpose of enhancing the data ecosystem. It remains important that DFA dashboard be harmonized with INSTAT SDG dashboard and IPS under the MFE.

**Develop diversified, sector-based and thematic financing strategy.**

Since DFA has clearly concluded that public financing is insufficient to cover development priorities the goal of the financing strategy would be to mobilize private capital through blended finance mechanisms for crucial investments by mitigating risks and reducing the perception of risk. Industries with substantial potential, such as renewable energy, present opportunities for leveraging blended finance. The financing strategy would create a clearer path for a strengthened collaboration with multilateral development banks and other international devel-

opment partners who frequently employ such mechanisms globally. For an effective execution of the financing strategy, the enhancement of government capacities and the improvement of the regulatory framework to support the private sector's involvement and contribution to public investments remains crucially important. As an integral part of financing strategy other instruments can be envisaged such as establishing investment facilities, developing the domestic capital market, enhancing the business environment for new start-ups and better access to finance SMEs.

It is also of vital importance for the country's public and private financing strategies to be closely aligned with Albania's development, sectorial and socio-economic priorities. As discussed in this report, NSDEI focuses attention on three pillars of democracy and strengthening of institutions and good governance; sustainable economic development, connectivity, and green growth; and social cohesion. NSDEI dedicates a special chapter to the Agenda on Sustainable Economic Development, Connectivity and Green Growth, highlighting four specific sectorial priorities including agriculture and rural development; tourism; energy and natural resources; and digitalization, which should be reflected in the financing strategy.

The potential to mobilize additional finance varies between sectors. It is recommended that relevant line ministries based on their experience regarding financing mechanisms and on newly explored financing opportunities develop sector-specific financing strategies that are aligned with the country's broader development and SDG financing strategy. As a basis for developing financing strategies in specific priority sectors, it is recommended that sector-specific studies be undertaken in priority sectors as a follow up to the DFA. These would assess the sector-specific barriers to mobilizing finance, the associated risk factors, and the landscape of international financing in that sector in order to identify successful strategies and actors used for mobilizing finance in other countries. To illustrate, this may include identifying policy areas where PPP arrangements can be used, where national private actors can mobilize finance for projects that directly or indirectly support SDG targets, where international funding mechanisms such as challenge funds can be utilized, or where existing ODA or OOF funding can be further increased. It may also

include identifying areas where non-state partners may contribute to increasing government's absorptive capacity, for example, by delivering services that traditionally have been delivered by the public sector but where private sector actors may be able to deliver more effectively. The sectoral financing strategies can cover priority development sectors such as agriculture, energy, tourism, etc., as well as social sectors such as healthcare, social protection, etc.

### **Strengthen the SDG governance**

#### **Establish governance through an INFF committee.**

There are a number of existing bodies which could form an INFF governance system, without necessitating the creation of additional institutional structures. These include the ad-hoc Parliamentary Subcommittee on Sustainable Development within the Parliamentary Commission on Economy and Finance, as well as the Inter-Ministerial Committee for Sustainable Development comprising key government institutions, business communities' representatives, civil society, academia and international organizations. Another crucially important body is the Strategic Planning Committee (SPC) chaired by the Prime Minister, which approves the priority strategic projects. SASPAC serves as the technical secretariat for both Committees.

Under such governance system, it should be decided under which mandate the INFF should be placed, and which other bodies can contribute to the finalization of the INFF Financing Strategy and its implementation.

The Inter-Ministerial Committee on Sustainable Development, with its multi-actor composition, provides an adequate forum for discussing INFF and the related strategy. At the same time, SPC could assume additional critical functions in this respect such as the review and monitoring of how public and private finances align with Albania's sustainable development objectives, promoting coordination efforts to advance key initiatives that align these financial resources with the country's sustainable development goals, orienting focus around SDGs that are lagging in terms of progress, incorporating them into policy and financial deliberations. The committee could also lend support to the incorporation of more comprehensive SDG monitoring and evaluation tools into various government processes, such as planning and budgeting, which could then be monitored through the Parliamentary Subcommittee on Sustainable Development.

### **Develop a robust monitoring, evaluation and learning system.**

#### **Enhance statistical capacity to facilitate policy and monitoring.**

It is important to integrate a framework for monitoring the SDGs into existing monitoring systems to facilitate not only the measurement of SDG progress but, more importantly, to form the foundation for evidence-based and performance-oriented policymaking and budgeting. Addressing the data deficiencies necessitates improvements in both administrative and statistical data. Establishment of a comprehensive and reliable statistical system is indispensable to evidence-based policymaking, enhancement of resource allocation efficiency, establishment of baseline measurements, and monitoring progress toward SDG achievement.

Establishing a coherent system of generating the necessary data to analyse the SDG alignment with strategic documents and with national budget is important. This will help not only monitoring efforts, but it will enhance the credibility and confidence in the management of public funds and enhance transparency, accountability, and public engagement – something that in turn will catalyse the mobilization of diverse stakeholders, including the private sector and civil society, for financing the SDGs. Statistical data and capacities to monitor the SDG achievement must be extended also to the line ministries for the single SDGs as well as for the cross-cutting ones.

### **Create an enabling environment for accountability and dialogue.**

Creating an enabling environment for accountability and dialogue is crucial to garner support from non-governmental stakeholders for the SDGs. The private sector and NGOs can play pivotal roles by becoming valuable partners for the government by offering technical expertise, innovative ideas, additional financial resources, and improved efficiency in the delivery of government investments and services. The cooperation with private sector can be achieved through a systematic dialogue, concrete results in improving business environment and regulative processes. Providing trust-worthy information to private businesses and civil society is crucial for having their participation, contribution and commitment.









