

Albania: Economy

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BACKGROUND

A peripheral and relatively less developed province of the Ottoman Empire, Albania became an independent country in 1912. Historically, the western and southern lowlands had a semi-feudal economy characterized by large landed estates. In the tribal uplands of the north, smallholdings and peasant farms were the main source of livelihood. Modern manufacturing was limited to a few foreign-owned (mostly Italian-owned) concerns, such as the Korça beer factory. Before long, the Government of Ahmet Zogu, who proclaimed himself King Zog I in 1928, became heavily indebted to fascist Italy, which was awarded an oil concession, public works contracts and the right to establish a bank of issue.

With the establishment of a communist Government led by Enver Hoxha in 1944, all arable land was expropriated and transferred to either state farms or peasant co-operatives. By 1959 (1967 in the north), collectivization was complete, with the sole exception of tiny family plots. With financial and technical support from the Union of Soviet Socialist Republics and, later, the People’s Republic of China under Mao Zedong, Albania embarked on a vigorous path of industrial modernization, investing heavily in mining, metal processing and defence. Notable projects included the ‘Stalin’ textile combine in the capital city of Tirana, inaugurated in 1951, and the ‘Steel of the Party’ metallurgical complex in Elbasan, which began operations in the 1970s. The share of industry in net material product (the communist-era equivalent to gross domestic product, or GDP) increased from some 7% in 1950 to 44.6% in 1989. In addition, the communist regime built Albania’s first railway network, reclaimed malaria-infested coastal swamplands, and erected several hydroelectric dams on the Drin river basin, completing the electrification of the country. The growth in real GDP per head averaged 3.6% per year during 1950–73. Health and education improved significantly, with the literacy rate increasing from around 16% of the population in 1928 to 92.1% in 1989. Cultural modernization brought women into the labour force for the first time in Albania’s history.

High fertility rates and the regime’s pro-natalist policy fuelled rapid population growth (of 2.4% per year during 1950–90). Yet, exceptionally strict controls on internal migration kept urban expansion to a minimum, leading to overcrowding, underemployment, and declining living standards in rural areas. By 1978 the ever-mounting repression of private economic activity and the termination of Chinese food aid had led to deteriorating economic conditions. Capital depreciation and the continuing expansion of the labour force caused the growth rate of GDP per head to level off at 0.6% per year during 1974–90. By 1985, acute food shortages forced Hoxha’s successor, Ramiz Alia, to give more scope to private initiative in agriculture. The popular protests that erupted in 1990, however, precipitated the collapse of the communist regime, ushering in a period of unprecedented economic reforms.

THE TRANSITION TO A MARKET ECONOMY

Beginning in mid-1990, the communist leadership lifted price, wage and trade controls, allowed free markets for agricultural products, and legalized independent labour unions. The right to private property and free enterprise was reintroduced. State-owned enterprises (SOEs) became progressively corporatized, with more decentralized decision-making, greater profit retention and worker-elected managers. The reform agenda

gathered pace as a democratically elected executive came to power in April 1991 and, again, in March 1992. In contrast to other post-communist countries, Albania quickly privatized agricultural land based on the principle of redistribution to former co-operative workers, rather than restitution to historical owners. This policy contributed to the emergence of small and fragmented land holdings. Overlapping claims and rampant informality led to property disputes and uncertainty about land title—a problem that continues to the present day. In the early 1990s factories and state farms were spontaneously abandoned, and often vandalized, fuelling a wave of mass migration from rural areas. In peri-urban localities, informal settlements appeared almost overnight.

The privatization of housing units provided aspiring entrepreneurs with collateral and start-up capital, promoting a rapid expansion of the private service sector, which accounted for more than 50% of GDP by the early 2000s (compared with only 20% in the 1980s). In contrast, the share of industry's value added in GDP collapsed from around 45% in the 1980s to less than 20% in the 2000s. In mid-1995 the Government launched a voucher scheme for the privatization of large SOEs. Owing to outdated technology and product designs, however, many former SOEs did not survive the new competitive market environment. By the late 1990s, the market value of privatization vouchers had dropped to a fraction of their face value. Nevertheless, several strategic companies were subsequently (and successfully) privatized by auction—for instance, Albtelecom in 2007 and the electricity distribution operator in 2009.

In 1990 the country's borders reopened for the first time since 1945. Decades of exceptionally brutal state repression (even by the standards of other communist countries) had fuelled a desire to emigrate. By 2010, nearly 1.5m. Albanians (more than one-half of the country's resident population) were estimated to be living abroad. In the wake of a rapid inflow of migrant remittances, private savings grew from close to zero in 1990 to some 14% of GDP in 1995. Owing to an undeveloped private banking system and a lack of investment opportunities, much of this new-found wealth found its way into various locally owned pyramid investment schemes. A series of illegal economic activities—drug, fuel and arms smuggling, human trafficking—flourished. The inevitable collapse of the pyramid schemes in January 1997 inflicted heavy financial losses among the general population. The ensuing civil unrest, which was quelled with the assistance of an Italian-led peacekeeping force, caused an 11% drop in GDP, in addition to over 2,000 casualties.

Starting in 1998, Albania embarked on a process of social and economic stabilization. The security situation has greatly improved. With the support of the aid community (and, later, the European Union, or EU), many critical market-supporting institutions (for example, the judiciary) have been reformed and strengthened, and the business environment has improved considerably. Between 1998 and 2010 real GDP growth averaged 6.5% per year, but was already on a declining trend as the immediate benefits of marketization were offset by a low pace of technical change and continuing specialization in low-value added economic activities.

ECONOMIC GROWTH

Barely affected by the global financial and economic crisis of 2007–08, the Albanian economy experienced a more visible slowdown in the aftermath of the 2010–11 eurozone debt crisis. It never went into recession, however, recording a growth rate of 3.3% during 2015–18. In 2019 real GDP growth slowed to 2.1% following a devastating earthquake that struck central Albania in November, leaving 51 people dead, around 750 injured, and some 14,000 homeless or displaced. Real GDP dropped by 3.3% in 2020, but rebounded strongly in 2021 and 2022. By 2022, aggregate output had reached US \$18,916m. at current prices. In 2015 the size of the informal economy was estimated at 26% of official GDP, suggesting that national accounts figures may underestimate the real level of economic activity by as much as one-quarter.

Since the early 1990s Albania's resident population has decreased steadily as a result of mass emigration and declining fertility. During 2011–20 the total population fell at an estimated annual rate of 0.3%. In the post-pandemic period, migration flows have experienced a dramatic acceleration, both from rural areas and amongst middle-income (especially, young) urban residents. Informed observers suggest that the resident

population might now have dropped below 2 mln, down from 2.8 mln according to the 2011 census. The findings of the 2023 census, the first one since 2011, are expected to be published in mid-2024. Fertility rates are also low, at 1.39 births per woman in 2021, down from 3.3 in the 1980s. In the context of a strong cultural preference for sons, the legalization of abortion in 1995 resulted in a sharp rise in male births as Albanians increasingly resorted to (illegal) pre-natal sex selection, especially in the aftermath of the 1997 unrest. The sex ratio at birth has since stabilized at around 109 male births per 100 female births.

In per-head terms, the average annual rate of GDP growth was 3.5% during 2016-19, the second lowest in the Western Balkan region, and well below the corresponding figures for Bulgaria (3.9%) and Romania (5.8%). In spite of being the second-poorest economy in the region, Albania's income per head is actually diverging from, rather than converging to, that of its richer Balkan neighbours. By 2022, GDP per head had reached US \$6,810 at current prices, or \$19,496 on an international purchasing-power parity (PPP) basis. At market exchange rates, Albania's income level corresponds to 18% of the EU average (34% on a PPP basis), or 49% of that of Bulgaria, the poorest EU economy (55% on a PPP basis).

During 2014–17, capital and labour additions contributed over three-quarters of total GDP growth, confirming the extensive character of Albania's pre-pandemic growth model. Total factor productivity growth, which had been zero or negative in previous years, has also experienced a rebound, however. On the expenditure side, consumption has been the main component of GDP growth in recent years. The rate of gross capital formation, which averaged 24% of GDP during 2016–19, has been on a steady decline since 2005, partly explaining the progressive slowdown of output growth observed over the same period. Investment in fixed assets relies extensively on foreign savings—that is, foreign direct investment (FDI) and, increasingly, foreign loans. Gross domestic savings, which amounted to 8.7% of GDP over this period, contributed 36% of gross capital formation. Encouragingly, however, their contribution to aggregate investment displays an upward trend, indicating Albania's emerging ability to mobilize domestic resources for development.

THE BALANCE OF PAYMENTS

Albania is a small open economy with a fairly high dependence on international trade and capital flows. The external sector is characterized by large and persistent imbalances. The policy of economic self-reliance pursued by the Hoxha regime tended to produce a positive current account balance. Since the transition to a market economy, the current account balance has turned negative, reaching its lowest value (a deficit equivalent to 15.6% of GDP) in 2008. For the past 20 years, Albania has run a current account deficit well in excess of 6% of GDP. Putting downward pressure on the current account is a large trade deficit, which averaged US \$2,024m. in 2015–19. Migrant remittances and foreign aid (averaging \$977m. over that period) finance less than one-half of this deficit. The remainder is covered by surpluses on the financial account (\$869m.) and, to a lesser extent, on the capital account (\$112m.) of the balance of payments. These figures indicate that external loans and, to a lesser extent, FDI are key determinants of Albania's macroeconomic stability. The trade deficit (in goods and services) increased substantially in 2020-21, but by 2022 it was already back to pre-pandemic levels.

TRADE

As the productive economy recovered from the transition shock, exports of goods and services have experienced a slow but steady increase. They now represent the largest source of foreign exchange. Following a slowdown in the aftermath of the eurozone debt crisis, export growth rebounded to an average annual rate of 7.1% during 2015–19. In 2021 export earnings amounted to 30.6% of GDP, having recovered quickly from a one-time blip in 2020; they also covered as much as 70% of the cost of imports, compared with 46% in 2000.

Services, including travel and tourism and ICT, account for around one-half of Albania's total exports. The Government and donor agencies have placed a particular emphasis on developing a tourism industry, with tourist inflows from Poland, Czechia and, increasingly, Western Europe. In November 2022 parliament approved the US \$2,500m. 'Durrës Yachts & Marina' project for the coastal city of Durrës. As part of the project, which is being funded by an Abu Dhabi-based property developer, the city's container port is to be converted into a yacht marina and luxury estate, and the commercial and passenger terminals relocated to the nearby town of Porto Romano. A similar project is under development in the southern city of Vlorë by Balfin Group, a conglomerate owned by Albania's wealthiest individual, Samir Mane.

In 2019, exports of merchandise goods (as opposed to services) represented around 17% of GDP. Exports are dominated by low-value added manufactures and natural resources, including apparel and footwear, oil and minerals, and base metals. In 2009 Albania signed a Stabilization and Association Agreement (SAA) with the EU. The treaty provided for the near-complete liberalization of bilateral trade with the bloc. Apart from Kosovo, Albania's largest export markets—Italy, Spain and Greece—are all EU member states. Italy alone bought over 42% of Albania's total exports in 2021. Since January 2007 Albania has also been a member of the Central European Free Trade Agreement (CEFTA), which mandates the full elimination of tariff and non-tariff barriers to trade among the six Western Balkan countries and Moldova. The available evidence indicates that CEFTA membership has had a stimulating effect on trade flows, promoting Albania's integration with regional partners, notably Serbia and Kosovo.

The Albanian economy remains highly import-dependent, with imports of goods and services averaging 45% of GDP in recent years. Imports are quite diversified, including both consumer products and intermediate goods. The share of industrial machinery and equipment in total imports has been stable, at just over 5%. The main import partners in the EU are Italy (accounting for around 26% of Albania's total import expenditure in 2021), Greece and Germany. Imports from other Western Balkan countries contribute negligible shares, whereas Türkiye (formerly known as Turkey) and (more recently) China have become important import markets.

AID, REMITTANCES AND FOREIGN SAVINGS

In recent years the Albanian economy has become progressively less dependent on migrant remittances. This trend was both the result of economic stagnation and crisis in Italy and Greece, which together host almost 1m. Albanian workers, and the natural weakening of social ties between permanent migrants in host countries and source communities. In 2015–19 personal remittance inflows accounted for around 10% of GDP on average, compared with 17% in the early 2000s. The share of remittances in GDP has remained stable through the pandemic and post-pandemic years. Owing to the use of informal cash transfers, rather than digital payment services, however, the true volume of remittances may be systematically underestimated.

Similarly, the share of overseas development assistance in total GDP declined from an average of 9.6% in 1996–2000 to 1.6% in 2015–19. Aid disbursements peaked in 2021 (3.5% of GDP) but returned to pre-pandemic levels in 2022. During 2015–19 the three largest aid donors were the EU (averaging US \$112m. per year), Germany (\$40m.) and Switzerland (\$22m.). In comparison with the early 2000s, the contributions of the USA, the World Bank and Italy have declined substantially in both absolute and relative terms. In February 2020 an international donor conference convened by the EU resulted in pledges by donors of €1,150m. in aid towards post-earthquake reconstruction.

During 2015–20, FDI inflows amounted on average to 8.2% of GDP. Sectorally, around 70% of investment flows were in electricity generation, oil and gas, banking and insurance, with less than 4% of FDI flows going into manufacturing. As of 2023, the main countries contributing to Albania's FDI stock were the Netherlands (16.5%), Switzerland (16%) and Italy (11%). Dutch capital is entirely related to the Devolli hydropower project in south-eastern Albania, constructed by a Norwegian state-owned hydropower

company, Statkraft. The project began commercial operations in 2020. Similarly, Swiss investment is almost entirely attributable to the Trans-Adriatic Pipeline (TAP) project, a multi-country joint-venture to construct and operate a gas pipeline linking Italy to Türkiye and Azerbaijan. In November 2020 TAP began commercial operations. In contrast, the stock of Italian FDI is widely dispersed over various sectors, including logistics (Petroliera Italo-Albanese), banking (Intesa Sanpaolo Bank), retail (the Conad supermarket chain) and light manufacturing.

Since the mid-2000s Albania has also become increasingly reliant on foreign loans to finance its consumption and investment needs. The stock of external debt (the total of private and public debt owed by Albanian entities to non-residents) grew dramatically from 31% of gross national income in 2000 to 75% in 2017, resulting in a large and growing surplus on the financial account of the balance of payments. Since 2017, however, the stock of external debt has stabilized.

SECTORAL COMPOSITION OF THE ECONOMY

By 1989, 45 years of state-led industrialization under communism had made industry the leading sector of the economy, accounting for 51% of net material product. Agriculture and services produced 32.7% and 16.3% of total output, respectively. The early transition years precipitated a reallocation of labour and capital from industry and agriculture to the urban service economy. During the 1990s, however, agriculture continued to account for the largest share of output, as land privatization and rural-to-urban migration had a stimulating effect on farm productivity. Since then, the contribution of agriculture has steadily declined, stabilizing at around 19 % of GDP in 2010. The services sector expanded rapidly in the early transition years. Its contribution to GDP (at some 47% in 2022) has also been stable in recent years. The fastest-growing sector of the early 2000s, construction, accounted for almost 20% of GDP by 2005. Its share has since contracted to around 12% in 2022. Yet, the contribution of construction to total output remains around twice as high as in other Western Balkan countries. Since 2010 industry (mining, utilities and manufacturing) has experienced a recovery, rising from 10% of GDP to 14.1% in 2021. Although over 90% of registered entities are small enterprises (with up to 50 employees), around 50% of total employment and value added are attributable to large enterprises (with a minimum of 250 employees).

As the result of land fragmentation, uncertainty over land title, and imperfect credit and insurance markets, agriculture is still plagued by severe inefficiencies. The sector consists of 350,000 small family farms using low levels of purchased inputs and technology. Only a minority of farming households hire non-family labour. Few employ mechanized tools and chemical fertilisers. Cultivation is focused on non-industrial food crops and is heavily orientated towards auto-consumption, with excess production sold on the local market (often informally), and low volumes sold for export.

Averaging 3.4% annually during 2015–19, the growth rate of industrial output was slower than in previous years. In 2013 oil and mining generated close to one-half of industry's total value added. Since then, the extractive sector has experienced a slowdown. Manufacturing, in contrast, continued to grow faster than the overall economy (6.7% a year during 2015–19), with total manufacturing value added reaching 6.5% of GDP in 2022.

Kurum International, owned by Türkiye's Kürüm Holding, is the only steel producer in Albania, and the largest manufacturing firm by exports and turnover. Having privatized parts of the Elbasan metallurgical complex in 1998, the company produces steel ingots, iron bars and, since 2019, galvanized wire for sale in Albania, Kosovo and North Macedonia. Following financial problems in 2015–16, the company was placed into administration and successfully restructured. A notable recent development is the emergence of an automotive supply cluster. Since 2015 several foreign-owned companies have started to produce simple car parts (cables and rubber seals) for export. These include France's Delmon Group in Elbasan, and Yura of the Republic of Korea (South Korea) in Fier.

During 2015–19 the service sector grew at a similar rate as the economy as a whole. The call centre industry is the second most important service sector after tourism and hospitality. In 2015 there were 848 companies offering telemarketing and data-entry services for the foreign (mostly Italian) market, at that time employing over 25,000 (typically young) workers. Albanian-owned Intercom Data Services (IDS), the most important enterprise in the sector until its restructuring in 2018, was for many years one of Albania’s largest private employers, with over 3,600 workers in 2014. A dwindling number of proficient Italian speakers, tighter regulations in the main export market (Italy), and a global shift to digital marketing have adversely affected this sector, however. By 2021, the number of active firms had fallen to just over 100, and the payroll stood at less than 13,000 formally registered workers. Of these, around 3,700 were employed by French-owned Teleperformance, now the largest concern in this industry.

Other recent developments in the services sector include the establishment, through a public-private partnership with Turkish Airlines, of flag carrier Air Albania in 2018. Air Albania has quickly gained market share in spite of strong competition from low-cost European carriers, which are now connecting Albania to a number of European destinations. In 2021 Albania's second airport was inaugurated in the northern city of Kukës.

SECTOR CASE STUDY: APPAREL AND FOOTWEAR

An apparel and footwear cluster emerged in Albania in the early 1990s, with little connection to the state-owned textiles industry that had existed under communism. As early as 1997 garments accounted for over one-half of total goods exports. Although Albania’s export mix has become somewhat more diversified in the past two decades, apparel and footwear together remain the largest export category, generating around one-third of export revenues. These two sectors also employ the largest share of workers in industry, with up to 70,000 employees in 2023.

As of 2021, there are approximately 400 active garment manufacturers, many of which are labour-intensive, *maquila*-style (assembly processing) workshops employing an almost exclusively female workforce. The majority are domestically owned, some by female entrepreneurs. Most companies operate an own-equipment, ‘Cut, Make & Trim’ (CMT) business model oriented towards the Italian market. Typically, a foreign contractor supplies the inputs (such as pre-cut fabrics, buttons, threads) and receives a semi-finished or finished product (men’s suits, shirts, T-shirts). The operations performed by Albanian firms are limited to cutting, sewing, ironing and packaging. Working conditions are sometimes quite poor. A minority of firms source their inputs independently, and only a few companies (Krienko and Donianna being the most prominent) operate an ‘own design, own brand’ business model. In the footwear segment, Italian-owned Albaco Shoes, which specialises in the production of safety workwear, is the most important concern and the second-largest employer in Albania’s private sector (after Teleperformance), with around 2,000 employees.

Since at least 2013 the sector has benefited from a preferential customs regime, grants from the state and the donor community, and a government-run wage subsidy scheme. Workers are typically trained in-house, and business managers complain of skills shortages, which are aggravated by the poor quality of Albania’s vocational schools. Due to sluggish labour-productivity growth, increasing competition, and the recent appreciation of the local currency (the lek), profitability has fallen substantially, even as export volumes have increased. The sector was severely hit by the COVID-19 pandemic, although some apparel manufacturers responded to the crisis by diverting production to face masks and other protective equipment.

SECTOR CASE STUDY: PETROLEUM AND MINING

Albania holds the largest onshore oil reserves in continental Europe, as well as substantial reserves of chromium, copper and nickel ore. Until the China-driven commodities boom of the early 2000s, low commodity prices could not justify the high costs of revitalizing an industry ravaged by over a decade of

abandonment and mismanagement. During 2005–15, however, natural-resource extraction was Albania's most dynamic industrial sector. In 2013 oil and mining generated, respectively, 40.4% and 8.8% of total industrial gross value added, and 31.0% and 9.3% of total goods exports.

In 2018 there were six oil and gas companies, almost all foreign-owned, active in the southern Fier-Ballsh-Kuçovë triangle. By far the most important is Bankers Petroleum, which signed a production-sharing agreement with state-owned oil company AlbPetrol in 2004. Previously Canadian-owned, Bankers was acquired by a Chinese firm in 2016. Albania's oil is considered 'heavy', and requires additional processing costs.

Privatized in 2008 to a then little-known Albanian businessman, ARMO was the only petroleum refiner in Albania, with operations in Fier and Ballsh. Following years of mismanagement, the company was taken over by its creditors—first, an Azerbaijani firm (in 2013) and, later, Albania's Banka Credins (in 2016). In 2018 the assets of the Fier and Ballsh plants were split up and sold to two domestic investors, one of which ceased operations in October 2019. The owners of the former ARMO assets have left behind hundreds of millions of euros in tax arrears, unpaid salaries and outstanding debts to banks and suppliers, making the 'ARMO affair' one of the least successful privatizations in Albania's post-communist history.

Around 100 chromium miners, many of which domestically owned, are active in the eastern region of Bulqizë. The largest concern is AlbChrome, a former SOE acquired in 2001 by an Italian mining company under a 30-year concession agreement. In 2013, after six years under Austrian ownership, AlbChrome was bought by Samir Mane's Balfin Group. Currently, it operates several mines and ore processing facilities, as well as two ferrochrome smelters in Elbasan and Burrel. It is also one of Albania's largest private companies by exports and number of employees. Over the past 10 years Albania has ranked as one of the world's 10 largest producers of chromium ore and concentrates, with most of the output exported to China. There is much potential to industrialize this mineral further and to scale up production of refined ferrochrome, a higher value-added product used in stainless steel applications.

THE LABOUR MARKET

Owing to outward migration, corporate restructuring, and public sector cuts, economic growth was accompanied until recently by declining rates of labour-force participation. Since 2013, however, the supply of labour has started to grow again. In 2023, 60.2% of working-age individuals participated in the labour market. The share of economically active women (52.8% in that year) was lower, but was still the highest in the Western Balkan region. The number of individuals in employment has followed a similar trend, with growth in employment creation (4.3% per year) exceeding GDP growth during 2015–19. Owing to its specialization in labour-intensive activities, for the last 15 years the Albanian economy has consistently reported one of the lowest rates of unemployment (at 11.1% in 2023) in the region.

However, there is a severe shortage of quality jobs for the highly skilled, who often seek employment abroad. The rate of self-employment (at 34.2% of total employment in 2018) is the highest in the Western Balkans, own-account work being most prevalent amongst the poorly educated. Furthermore, estimates indicate that informal employment relations (unregistered sole proprietorships, wage employment without a contract, etc.) affect around one-third of all employed adults. Since 2017 agriculture is no longer the largest sector of employment. Nevertheless, in 2021 it continued to account for 33.8% of total employment, while services and industry accounted for 44.3% and 21.9%, respectively.

Wage levels have grown steadily in recent years, partly as a result of growing labour scarcity caused by out-migration. Labour productivity, by contrast, has probably remained flat since 2015. Since 2021, the wage-price spiral induced by the post-pandemic inflation has led to a rapid acceleration of wage growth, with the gross average monthly salary reaching €695 in mid-2023, a 30% increase compared to early 2021 (or a 60%

increase compared to 2019). Wage levels, however, remain the lowest of all the Western Balkan-6 economies. The gender pay gap is estimated to be around 10%.

With the exception of the mining industry, unionization rates are low. In the last few years, however, a number of independent (and more militant) workers' organizations have become active in the oil and call centre industries, provoking occasional episodes of labour unrest.

SOCIAL INDICATORS AND MIGRATION

With a sharp rise in the supply of and demand for education, the proportion of school-age individuals enrolled in secondary and, especially, tertiary education increased significantly between 2003 and 2014. In 2021 total enrolment in secondary and tertiary education reached 96% and 57%, respectively. Both figures are well above the corresponding averages for middle-income economies, indicating Albania's achievement in human capital accumulation and potential for catch-up growth. Yet, concerns remain about the quality of education, despite tighter regulations for private providers being in force since 2014. In general, Albanian women tend to be better educated than their male peers. The public healthcare system is generally perceived to be poor and rife with corruption. For this reason, many Albanians resort to private healthcare providers.

Partly as a result of insufficient investment in public goods such as healthcare, the transition from communism has brought about a slow but steady rise in income inequality. The ongoing wave of migration is further depleting the urban middle-classes, further aggravating the polarization of incomes. Yet, absolute poverty has declined. By 2012 the share of households with indoor access to running water (78%), sanitation (94%), and 24-hour electricity (68%) had grown substantially compared with 2002, when the corresponding figures were as low as 50%, 61% and 14%. In 2019 only about 21.8% of Albanians lived below the national poverty line. Geographically, the incidence of poverty is lowest in the southern prefectures of Gjirokastër and Korçë, and highest in the northern regions of Kukës and Lezhë. Social policies have played a limited role. Ndihma Ekonomike, an unconditional cash-transfer programme aimed at poverty reduction, has been shown to be poorly targeted, and to have had little effect on household consumption or children's school attendance.

By contrast, outward migration has been one of the most consequential drivers of poverty reduction. At the household level, remittance inflows from family members abroad are known to increase food consumption, the range of affordable consumer goods, and self-reported life satisfaction. Rural households generally prefer using remittances to move out of crop production and establish non-farm businesses, rather than investing in farm development. On the negative side, it has been shown that migrants' transfers have no positive impact on the recipient households' investment in education. Furthermore, Albanian migrants were (until recently) predominantly male. Thus, female household members have often had to increase the number of hours of unpaid work carried out on the family farm to compensate for the loss of male family labour, with negative effects on female labour supply. Out-migration has also led to a scarcity of men in the marriage market, reducing women's bargaining power and biasing the intra-household distribution of consumption in favour of men. On the positive side, the skills and savings brought back by returning migrants have been shown to promote business ownership and upward occupational mobility, including for women.

MONEY, CREDIT AND BANKING

In 1990 Albania had three large state banks. A number of foreign-owned private lenders commenced operations in the aftermath of the 1997 unrest. In 2018, the four largest banks by total revenues were Banka Kombëtare Tregtare (which emerged from the privatization process in 2000), Banka Credins (Albania's first private financial institution with 100% domestic capital), Austria's Raiffeisen Bank (which privatized a state-owned bank in 2004), and Italy's Intesa Sanpaolo (created from the merger of Banca Italo-Albanese, a savings bank that had entered the Albanian market in 1993, and the American Bank of Albania).

The 2000s were characterised by a dramatic expansion of bank lending, with the private credit-to-GDP ratio growing from under 5% in 2000 to over 39% in 2011. The number of commercial bank branches also increased from less than 10 per 100,000 adults in 2004 to over 24 in 2011. Capital markets remain poorly developed, however. Non-bank financial institutions are limited to a few micro-credit organizations. On the Albanian Securities Exchange (ALSE), licensed in 2017 with capital from three domestic banks, the only traded securities are treasury bills. Venture capital is all but non-existent. Financial development is also hampered by a low level of financial literacy among the general population. The payment system is poorly digitalized, with mobile payment services widely used by citizens without bank accounts. In 2021, only 44.2% of individuals aged 15 or over had a deposit account with a bank or a mobile-money provider. Less than 10% of the adult population owned a credit card.

Following a tightening of risk criteria in 2010–11, several banks became much less proactive in their lending operations. By 2019, total credit to the private sector had declined to 31.6% of GDP. In 2016 the loan-to-deposit ratio (at just over 50%) was the lowest in the Western Balkan region. Credit demand is also relatively low, with a lack of bankable projects and a relatively high share of firms (63%) reporting no willingness to take out a loan. Following the eurozone debt crisis, the share of non-performing loans (NPLs) had increased significantly, to 23.5% of total bank loans by 2013—the highest in the region. Since then, however, a national NPL resolution strategy co-ordinated by the central bank, the Bank of Albania, has successfully reduced the share of NPLs to around 8%.

Until very recently the (government-independent) Bank of Albania adopted a highly accommodative monetary policy stance. The policy rate was progressively reduced from 6.25% in 2008 to a record low of 1.0% in 2018. Over the same period the monetary base was increased at a rate of 4.9% per year. As a result, interest rates on lek-denominated loans declined considerably, stimulating a relative expansion of lek-denominated lending. Until 2022, however, the rate of inflation (averaging 1.7% during 2015–19) remained well below the central bank's target of 3%.

Albania maintains a fully flexible exchange rate regime. The domestic economy is highly euroized, with around one-half of loans and many market transactions (real estate, luxury goods) denominated in euros. Euroization weakens the transmission of monetary policy and increases the risk of bankruptcies and instability in case of systemic shocks. In 2017 the Ministry of Finance and the Bank of Albania announced a series of de-euroization measures, including higher liquidity ratios for banks' euro operations. This policy accelerated the appreciation of the lek, reinforcing a trend that had already begun in late 2015 following strong export growth and a surge in FDI. An increase in profit inflows from illicit activities (for example, drug trafficking) reportedly also contributed to currency appreciation. In mid-2019, however, the exchange rate stabilized, following the central bank's decision to intervene by purchasing foreign currency.

FISCAL POLICY

Until the COVID-19 pandemic, the central bank's accommodative stance was counter-balanced by the Government's fiscal discipline, mirroring the policy approach pursued by eurozone economies. While this policy mix was beneficial for macroeconomic and financial stability, it has limited the policy space available to the Government to stimulate economic growth and development.

As in many emerging economies, the tax system relies heavily on indirect taxation. While personal income tax is progressive, corporate tax is levied at a flat rate of 15%. Recent administrations have also taken steps to combat informality and tax evasion, which is known to be particularly high prior to elections. With total government spending averaging 13% of GDP (until the pandemic), Albania has a small state compared with a typical advanced economy. Social security payments absorb around 33% of government spending, followed by general public services (18%), education (11%) and health (10%). Since the early 2000s capital spending has been stable at around 14% of the government budget. An exceptional rise in public investment

was recorded during the 2007–10 period, when the single largest public infrastructure project of the post-communist period—a motorway to the Kosovo border—was implemented.

During 2014–17 the Albanian Government launched a stabilization programme supported by an International Monetary Fund credit arrangement. The aim of the programme was to reduce the overall budget deficit (which had increased to over 5% of GDP in 2013) and control the rise of public debt (which had reached a peak of 74% of GDP in the aftermath of the eurozone debt crisis). By 2019 the stock of public debt, owed to domestic and foreign lenders in almost equal measure, had been reduced to less than 68% of GDP, while the overall budget deficit had dropped to 2% of GDP. Between 2002 and 2019 yields on long-term government bonds declined from 14% to 5.7%, demonstrating Albania’s stable sovereign credit rating. In contrast, the Government’s extensive reliance on public-private partnerships, which had a total investment value equivalent to 35% of GDP in 2020, has been cause for alarm.

THE COVID-19 PANDEMIC AND ITS AFTERMATH

In 2020, the COVID-19 pandemic plunged Albania into its first recession since 1997. Real GDP contracted by 3.3%, as the Government imposed one of the most stringent lockdowns in Europe, with trade and remittances falling by 17% and 20%, respectively. The main sector through which the pandemic affected the Albanian economy was travel and tourism, which in 2019 accounted for around one-fifth of GDP and two-fifths of total exports of goods and services. To contain the economic impact of the health crisis, the central bank cut the policy rate to a record low of 0.5%. For its part, the Government launched a fiscal stimulus package worth 2.8% of GDP, consisting of tax deferrals, loan guarantees and social transfers. As a result, public debt soared to around 84% of GDP in 2020, the highest level ever reached in the post-transition period. As a large part of the banking system is foreign-owned, Albania also indirectly benefited from the European Central Bank’s emergency asset-purchase programme.

Due to policy stimulus, a revival of travel, construction and extractive activities, and weak implementation of COVID-19 containment measures, the Albanian economy experienced a robust recovery in 2021. Real GDP grew at an estimated rate of 8.9%, far exceeding earlier forecasts. Credit to the private sector grew strongly in a low-interest rate environment. Yet, bank deposits continued to expand as consumption expenditure by households remained below potential. In early 2021 the Government launched a mass immunization programme, with vaccine doses provided by the European Union and COVID-19 Vaccines Global Access (COVAX, a programme administered by the World Health Organization to supply low- and middle-income countries). Albanian state bodies have also approved, purchased and administered Chinese- and Russian-manufactured vaccines. By mid-2022, however, uptake had been low, and only around 43% of the population had completed the vaccination cycle.

The global economic shock resulting from the Russian Federation’s full-scale invasion of Ukraine in February 2022 has presented Albania with new challenges. Inflation began to rise dramatically in the last quarter of 2021, exceeding the central bank’s 3% target rate in early 2022. The central bank responded promptly by raising its core policy rate to 1% in March—its first interest rate hike in 11 years. As a result of the global energy and food crisis, consumer prices increased dramatically in the second half of 2022, with the monthly inflation rate accelerating to 8% year-on-year in October–November. Between July 2022 and March 2023 the central bank increased interest rates further, from 1% to 3%. By February 2024, inflation had fallen below the central bank’s 3% target.

Far surpassing expectations, the Albanian economy expanded by 4.8% in 2022 and 3.5% in 2023, on the back of robust activity in tourism and, especially, real estate. The recent construction boom in Tirana continued unabated, with more glass-and-steel towers and public infrastructure projects being built in the city centre. In 2023 property prices in the capital and coastal resorts were estimated to have more than doubled relative to 2017 (and more than trebled relative to 2013), with a large segment of the salaried population now unable to enter the real estate market. Money laundering from criminal activities allegedly

contributed significantly to the recent house price bubble, together with soaring construction costs and a general increase in demand from rising household incomes.

In the long-run, however, property prices might be negatively affected by population decline. The new wave of migration induced by the COVID-19 pandemic is bringing young Albanians to new destinations such as Germany and the United Kingdom, and away from traditional migration destinations such as Italy and Greece. In the UK, 140,000 Albanian nationals are now estimated to reside, compared with only 13,000 in 2011. Many new arrivals are asylum seekers; some are known to be involved in lucrative criminal activities such as cannabis cultivation and trade. Due to emigration, some sectors of the Albanian economy are beginning to experience labour shortages, with a minority of firms in agriculture, hospitality and apparel now hiring foreign workers from Bangladesh, India and the Philippines.

The illicit financial flows stemming from criminal activities abroad partly explain the recent upward trend in the value of the lek, which rose by 13% against the euro between June 2022 and June 2023. The local currency has since stabilized at a rate of around 105 lek per euro, having gained a substantial 25% in value compared to the 2011-2015 period. In May 2024, however, the lek traded at almost 100 against the euro. .

CONCLUSION

No other middle-income economy has experienced such dramatic socioeconomic transformations as Albania has since 1990. Over the last 20 years remarkable progress has been achieved in several areas—poverty reduction, access to basic services, and international economic integration, among others. The capital city of Tirana has undergone dramatic changes, with new public amenities (a modern stadium, a pedestrianized main square, a new mosque) and vastly improved waste collection services.

While hundreds of thousands of Albanians have shared in the benefits of post-communist economic growth, Albania will not be able to sustain, let alone accelerate, its economic dynamism unless it makes serious efforts to upgrade its productive capabilities. The export mix has diversified at a slow rate and remains dominated overwhelmingly by labour-intensive goods (apparel), low-value added services (IT and tourism), and primary commodities (chrome and oil). To avert the middle-income trap and move towards EU accession, the Government will have to improve dramatically the skills and human capital of the country's labour force, direct savings and investments towards higher-return activities, and facilitate the discovery and development of new comparative advantages. Realizing these goals will help improve the sophistication of the productive economy, and increase the returns from (especially, export-oriented) economic activities. More efforts are also needed to slow down the rapid demographic decline that Albania is currently experiencing (also partly by welcoming and integrating workers from lower-income economies), and sever the links between politics and organized crime.

The post-pandemic environment and the US–China rivalry in global trade are presenting Albania with new challenges—but also opportunities. In particular, the ongoing shift towards near-shoring and ‘friend-shoring’ (the relocation of supply chains to countries perceived as low-risk and geopolitically close) by Western multinationals will make it possible for the Albanian economy to attract new foreign investments, especially in automotive, and thereby insert itself into higher-value segments of global production chains.

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