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Country Economic Report 2006:5

Migration and Pro-Poor Growth in Albania

– An Integrated Economic Analysis

Foreword

This country economic report explores the main challenges, constraints and opportunities for sustainable pro-poor economic development in Albania against the backdrop of the dramatic transformation of the Albanian economy and society since 1990 and in the context of EU integration. Starting from the assumption that improved employment and income opportunities for the poor provide the main avenue for reducing material poverty, the study applies an integrated approach to economic analysis by linking employment analysis with analyses of the business environment and of the macroeconomic situation. Albania stands out as one of the countries with the highest rates of overseas labour migration in the world. To capture this aspect, which has profound implications for livelihoods as well as for the country's development overall, overseas labour migration is integrated into the methodological framework and given prominence in the analysis. The study is a product of an on-going methodological work within Sida's cooperation between the Department for Infrastructure and Economic Cooperation and the Department for Policy and Methodology aimed at achieving a sharper poverty focus in economic analysis.

The study is part of a series of country studies, undertaken by Sida itself and by various Swedish universities and research institutes in collaboration with Sida. The main purpose of these studies is to enhance our knowledge and understanding of current economic development and challenges in Sweden's main partner countries for development cooperation. It is also hoped that they will have a broader academic interest and that the collaboration will serve to strengthen the Swedish academic resource base in the field of development economics.

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Executive Summary

The present study identifies and analyses the main challenges, constraints and opportunities for sustainable pro-poor economic development in Albania, against the backdrop of the specific characteristics and contemporary development of the country. The study is based on a methodology for analysing economic development from a poverty perspective developed within Sida, which focuses on the role of the economic actors, in particular the poor, as creators of economic development.[1] While the process of gradual integration in European structures provides a main context for the analysis, the study stops short of an in-depth analysis of the specificities of EU integration and their implications for economic development in Albania. However, it is hoped that this study can serve as a basis against which the developmental consequences, at least in an economic sense, of the EU integration agenda can be judged.

Few countries have undergone such fundamental transformation in such a short period of time as Albania. Over a period of little more than fifteen years it has been transformed from a totalitarian state to a fledging democracy and from an autarkic economy based on the principles of central planning to an open market-based economy.

Following the collapse of the socialist regime and system, Albania has attained a number of characteristics of underdevelopment.

– The collapse of the socialist system resulted in a virtual collapse of the non-agricultural sectors and a regression of agriculture into subsistence farming. The industrial base created over forty years of socialism was virtually wiped out over in the course of a few years. As a consequence, and despite impressive economic development in the past years, the level and structure of the economy resembles that of many underdeveloped countries rather than that of most other European countries.
– There is a huge mismatch between the human resource base and the capacity of the economy to use these resources efficiently and productively. In 1989 the Albanian economy employed some 1.4 million people, by 2001 this figure had fallen to 1.0 million, while an estimated 660,000 to 800,000 Albanians had migrated and were working abroad. Still, large-scale open unemployment and under-employment continue to plague the domestic economy and labour market.

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[1] See Sida (2006).

- The large emigration of particularly young people in search of work abroad has resulted in a loss of a large part of the country's human resources and in 'brain drain'.
- The past fifteen years have seen very rapid urbanisation and migration from the mountainous interior toward the coastal areas and the major cities. This migration has to a large extent been driven by push factors rather than by attractive employment opportunities in the areas of destination.
- The economic development has been highly concentrated to the Tirana – Durrës metropolitan area, resulting in large regional economic imbalances.
- The institutional framework is very weak. The abrupt collapse of the socialist regime left Albania in an institutional vacuum. This situation was prolonged and exacerbated by the financial crisis and civil unrest in 1997. As a result, formal institutions are still very weak in Albania and the roles, authority and responsibilities of different actors in the Albanian society have yet to be firmly established.
- The educational and health systems have deteriorated, both in terms of quantity, quality and access. The gap in this respect between Albania on the one hand and the countries of the European Union on the other has widened.

The Faces of Poverty

During the socialist period lack of resources was greatly reduced as a cause of poverty. Instead, specific aspects of lack of opportunities and vulnerability emerged as key causes of and expressions of poverty. Government control over all production factors and a lack of freedom to move severely curtailed the opportunities for individuals to enhance their well-being by their own accord. A fairly well-developed social security system reduced some aspects of vulnerability at the same time as the totalitarian political system created new forms of vulnerability. The subordination of the judiciary to the whims and will of the political leadership and a denial of basic human rights, such as the freedom of speech or the right to a fair trial, resulted in very specific, yet profound, forms of insecurity and vulnerability.

The collapse of the socialist system and the rather tumultuous transformation of the society to one based on the principles of a market economy and political pluralism has changed the face of poverty as well as made it much more visible. The economic crises in the 1990s resulted in sharp increases in material poverty, but the past seven years has seen a steady decline in material poverty. By 2005 some 19 per cent of the population lived below the poverty line and 4 per cent lived in extreme poverty. There are large rural – urban as well as regional variations in poverty. Lack of access to adequate employment opportunities is a principle cause of poverty and unemployment and under-employment, not least in agriculture, is strongly associated with poverty. Migration for work abroad has provided a principle avenue for escaping poverty not only for the migrants themselves, but, through remittances, also for families and relatives left behind at home.

However, poverty has more dimensions than the strictly material ones. It is also a question of empowerment; of having a combination of resources and opportunities that make it possible to assume control over and shape ones own life. This aspect attains a particular importance in Albania, where transfers and remittances play such a crucial role for the material standard of living at all levels; at the individual and household level and not least at the regional and national level.

At the individual level the sharp decline in the labour force participation of women implies that the empowerment which normally follows from having a place of work and an income of ones own has been lost for many, particularly women. At the household level, the large dependency on remittances and, to a lesser degree, public transfers has arguably a similar effect. At the regional level, there is an increasing divide between regions that produce more than they consume and regions that mainly consume, as economic activities become concentrated to a few urban areas. At the national level, too, a large gap has emerged between production and consumption as a result of the dependency of the Albanian economy on remittances. Increases in material welfare have only partly been due to an ability of Albania as a country and economy to reduce poverty and increase living standards through its own efforts. Thus, an inability to be master of one's own development can be found at all levels in Albania today and that it constitute an important aspect of poverty.

Challenges, Opportunities and Main Constraints

During the 1990s growth was entirely driven by productivity gains, i.e. more efficient use of production factors such as capital and labour. An important implication of this development pattern was that growth was not translated into increased employment. The driving forces of economic growth are now changing. In the years to come growth will have to be driven both by increased use of production factors, such as capital and labour, and increased factor productivity through technological development and a more enabling business environment. This in its turn will require high levels of investment in both physical and social capital. Physical infrastructure and physical productive capital need to be rapidly developed, as does the qualifications and skill levels of the human resources.

The geographic location combined with a highly mobile labour force implies that Albania has limited possibility to specialise in low-wage activities as the option of migration exerts an upward pressure on the domestic cost of labour. Hence, there will be a continued need to focus on increasing the efficiency and productivity of the economy. This underscores the need for an enabling economic environment, well-functioning institutions and not least a high level of qualification of the labour force.

Albania's economic integration into European economic structures has so far been very lop-sided. While there has been far-reaching integration in terms of the labour force, economic integration through trade and foreign direct investments remains undeveloped. Labour migration, trade and FDI can be seen as communicating vessels that exercise a high influence on each other. For Albania to achieve both sustainable economic development and EU integration, the economic integration needs to become more balanced and trade relations and FDI must be forcefully developed.

The large scale migration for work abroad has, at least during the 1990s, been both inevitable and overall beneficial. At the national level, it cushioned the impact of the virtual collapse of the domestic economy in the early 1990s and has been instrumental to maintaining macroeconomic stability, not least on the external front. The inflow of capital has created conditions for demand-led growth, which the domestic economy has yet to respond to and exploit. At the individual and household levels the option to migrate abroad for work has for hundreds of thousands of families been crucial for escaping severe poverty.

However, migration abroad has had downsides as well. The social costs of migration have been very high. While migration for work has served as a salvation from poverty for many, it is a second-best solution. At the national level, too, migration is a mixed blessing. Through migration the country has lost much of its human resources, at least for the time being. This loss is magnified as migration is selective, in terms of age, levels of education etc. Migration has resulted in a detachment of consumption from production at all levels – national, regional as well as household – that arguably is both unsound and unsustainable.

It has been estimated that during the 1990s half of the young people moving out of their parental home ended up abroad. This is an enormous loss for a country that is trying to build a new future on the ruins of a failed economic and political system. If these migrants become lost to the country in the sense that they do not return, the demographic, economic and social consequences will inevitably be very severe and Albania will risk becoming a chronically aid and remittance dependent economy. On the other hand, it can be argued that Albania today has an enormous asset abroad. Some 800,000 Albanian's, most of them young and in their most formative and productive age, are living and working in other European countries in the European Union, which Albania aspires to become an integrated part of. They possess not only language skills, but more importantly they have been exposed to and have gained profound knowledge of societies and economies that in many respects serve as role models for Albania. If a major share of the migrants can be induced to return to Albania, they will bring with them not only human resources (skills, knowledge etc.) and large amounts of financial capital, but also social capital in the form of contacts abroad and knowledge about neighbouring countries in the EU function and, not least, a vision of what Albania could be like and of the changes required to put Albania on a sound path of economic, political and social development.

Governance issues, the lack of a formal and informal institutional framework conducive to a sound market-based economic development and an unsound relationship between politics and business stand out as the most fundamental constraint to pro-poor growth in Albania. Close and unsound links between politics and business and a high level of corruption prevent the development of a 'level playing field' for all economic actors. At the heart of the matter is a need to clearly define and confine the realm of politics and to clearly demarcate the boundaries between politics and business. Closely linked to this is also the issue of developing and of both defining and enforcing the role of other institutions in society, such as the judiciary. A 'social contract' between the state and the citizens, based on trust and on an understanding of the role of the state in a market economy, needs to be developed in order for the state to effectively provide public goods, such as physical infrastructure, the rule of law etc.

The educational system stands out as another major Achilles' heel and constraint on sustainable economic development and poverty reduction in Albania. A good educational system is also fundamental for a deepening of the democracy and the development of a civil society. The level, quality and relevance of education among the young who graduate from the educational system deteriorated sharply during the 1990s and while some improvements may have been registered in the past few years, it is still arguably below the level of that attained during the socialist period while the gap when compared to other countries in Europe has widened. At the same time, the human resource base of in particular young people has been depleted through migration. Strong efforts to improve both the delivery and the coverage of the educational system are needed in order not to compromise the prospects for sustainable economic, and societal, development in coming years. Vocational training needs to be re-developed and secondary education in general needs to be made in tune with the demands of the economy and the labour market. The coverage of education has declined, with high dropout rates and low rates of continuation into secondary and tertiary education among children from poor and from rural households emerging as a particularly disturbing phenomenon. This trend needs to be broken in order to prevent poverty in Albania from becoming chronic and intergenerational.

Poor physical infrastructure is another fundamental constraint on economic development in general, and on pro-poor and a regionally more balanced growth in particular. The poor state of roads and other means of communication, the availability and predictability of access to electricity and lack of environmental infrastructure, in particular regarding waste disposal, sewage systems and access to clean water are clear examples on constraints on sustainable economic development as well as on a more balanced regional development.

Bringing all regions of the country into the mainstream of economic development is another major development challenge. The very rapid urbanisation and growth of the Tirana – Durrës urban area carries high costs in terms of strains on urban planning and development and provision of social services at the same time as other parts of the country risk becoming permanently dependent on public financial transfers. Agriculture alone cannot shoulder the role of bringing the economically peripheral regions into the mainstream of the economic development, but this will require a geographically more dispersed development of the non-farm sectors as well. The present pattern where many if not most of the farm households live on subsistence farming supplemented by remittances, and where remittances arguably often reinforce the subsistence orientation of agriculture, needs to be broken. Improved physical infrastructure and a focus on linking the present policy of decentralisation of many state functions and responsibilities to the local level with forceful efforts to foster good governance at the regional and local level are perhaps the two most fundamental instruments for reducing the large regional imbalances in economic and social development and in economic opportunities for poor people.

Development and EU Integration: Two Sides of the Same Coin?

It is generally agreed that Albania has no future outside of European structures and that EU integration, aimed at a future EU membership, is a central and indispensable aspect of Albania's overall development. EU integration is a prerequisite for sustainable development in Albania, just as development is a prerequisite for genuine EU integration. However, these two processes are not the same and should not be regarded as such. Thus, several questions arise.

- In what fields and to what extent is the EU integration agenda genuinely in tune with Albania's development requirements?
- To what extent does a focus on the EU integration agenda detract attention and resources from crucial development aspects that fall outside this focus?
- Are there areas where there is genuine discord between the EU integration agenda and the needs and requirements from a development perspective?

The EU integration agenda addresses some of Albania's key development challenges; primarily the establishment of the rule of law based on the respect for human rights and the creation of an institutional framework in line with the needs of a modern democracy and market economy. Shortcomings in these fields impose a major constraint on Albania's development and the EU provides both a role model in this regard and a roadmap. However, for this to happen there must be a focus on the content rather than the formality of institution building.

While adequate and well-functioning institutions are a necessary condition for sustainable development, they are not a sufficient one. Other fundamental constraints on development, such as shortcomings in the educational system in particular and the provision of public services more generally and inadequacies in the physical infrastructure, must also be addressed. None of these constraints on development in Albania are at the fore of the EU integration agenda, and in a situation where both the human and the financial resources for development in Albania are scarce, there is a risk that a lopsided focus on the institutional aspects of development by necessity takes place at the expense of sufficient focus on other aspects.

There are indications that the focus on the EU integration agenda is diverting resources from other core development areas. At 3.1 and 2.5 per cent of GDP, respectively, expenditures on education and health care are very low compared to those of other European countries. Another cause of concern is the declining share of capital expenditures in total government expenditures. Both the downward trend and the low level of public investments are worrying in view of the very large needs for public investments in physical infrastructure, such as roads, electricity and sewage systems. It is hard to escape an impression that austere fiscal policy in combination with a need for large public expenditures on areas directly connected to the EU integration agenda is exerting a squeeze on other areas that are vital from a development perspective, but not necessarily in the focus of the EU integration agenda, such as education, health care and physical infrastructure.

There is also a question of the level of sophistication with regard to institutions, standards etc. required by the EU integration agenda as part of the Acquits Communautaire are appropriate, affordable or, indeed, even feasible for Albania at its present level of development. By being required to aim very high in these regards, and to shoulder the accompanying costs in terms of money and human resource capacity, other more vital and fundamental development needs are neglected.

In the field of trade there is a disharmony between development interests of Albania and the regulatory framework laid down by the EU. The countries of the European Union are by far Albania's most important trading partners. However, while imports have developed rapidly and account for the equivalent of 30 per cent of Albania's GDP, Albania exports no more than 8 per cent of its GDP. This is even less than during the period of extreme autarky under socialism.

An important reason behind Albania's extremely poor export performance is to be found in weaknesses in the domestic economy. The Albanian manufacturing sector, in particular, still remains very small. This is something of a chicken and egg situation, as possibilities of export-led growth would speed up re-industrialisation and economic growth. However, the poor export performance is also due to formal and informal trade barriers. Although Albania has a free trade agreement with EU as well as with the neighbouring Balkan counties, significant non-tariff barriers remain. Poor productions standards, lack of standard-related legislation, inadequate standard-related certification and control capacity, and not least the non-extension of the pan-European agreement on rules of origin to Albania and the other countries in the Western Balkans, are main constraints on the development of exports to EU. Furthermore, many of the main Albanian export products are exempted from free trade agreement with EU and subject to 'managed' trade in order to protect 'vital' EU economic interests. In 2003 no less than 62 percent of the Albanian exports to EU fell under the concept of 'managed' trade and, thus, subject to restrictions incompatible with the principles of free trade.

The study stops short of analysing the specificities of EU integration and its possible implications for economic development in Albania. However, there is clearly a need to dig deeper into these issues. In particular, there is a need to:

- Estimate the costs, in terms of money and human resource capacity, of the implementation of various aspects of the EU integration agenda, and set these against the available domestic resources for development in Albania and the prospects for external support to help cover these costs.
- Estimate the implications for Albania's trade relations with EU of all the trade-related requirements laid down by EU, the informal as well as formal trade barriers, and the tariff and non-tariff barriers for accessing the EU markets.

1 Introduction

Few countries have undergone such fundamental transformation in such a short period of time as Albania. Over a period of little more than fifteen years Albania has been transformed from a totalitarian state to a fledging democracy and from an autarkic economy based on the principles of central planning to an open market-based economy. Yet, a long road remains ahead before Albania attains the levels of development found in much of the rest of Europe. It takes time and much effort to escape yoke of poverty and absence of rule of law. This development takes place in the context of gradual integration in the economic, social and political structure of the EU and alignment of the institutional and regulatory framework with that of the EU countries. There is a consensus that Albania has no future outside of these structures and that EU integration, aimed at a future EU membership, is a central and indispensable aspect of Albania's overall development. However, while EU integration is a prerequisite for sustainable development in Albania, just as development is a prerequisite for genuine EU integration, these two processes are not the same and should not be mixed up.

The objective of the present study is to identify and analyse the main challenges, constraints and opportunities for sustainable pro-poor economic development in Albania, against the backdrop of the specific characteristics and contemporary development of the country. While the process of gradual integration in European structures provides a main context for the analysis, the study stops short of analysing the specificities of EU integration and its possible implications for economic development in Albania. However, it is hoped that this study can serve as a basis against which the developmental consequences, at least in an economic sense, of the EU integration agenda can be judged.

The study is based on a methodology for analysing economic development from a poverty perspective developed within Sida, which focuses on the role of the economic actors, in particular the poor, as creators of economic development.[2] A focus on the poor as creators of growth calls for a focus on employment and labour productivity in economic analysis. The methodological approach in this study takes the human resources and the need to create conditions conducive to unleashing the creative and productive forces inherent in this resource base, with particular

[2] For a further methodological discussion see Sida (2006).

emphasis on the poor, as the starting point of the analysis. Hence, in countries such as Albania with a significant share of its human resources working abroad, the integration of migration and resulting remittances in the analysis becomes essential. The coverage of the analysis is defined by the economic actors rather than where they perform their activities. Enhancing employment and the returns to labour by (i) strengthening the productive *resources and capacity* of the individual people, in particular the poor, and by (ii) opening up *opportunities* for all to make full use of the productive resources at hand, is seen as the main avenue for reducing income poverty and achieving pro-poor growth. Thus, it is crucial to consider the poor not only as consumers who should receive a share of the country's growth, but more importantly as active participants in the economy, which makes an employment analysis necessary, and as independent economic agents, which points to the importance of a business climate analysis. This approach has implication on the definition of the poor in Albania where a large proportion of the population have an income that might be above the poverty line, but when most of this income is derived from remittances or social transfers and not employment, these people may still be poor in the sense of lack of resources and capacity or opportunities to use their resources and capacities. Employment and the remuneration derived from employment are determined by the supply and demand for labour. An employment analysis casts light on the supply side of labour and the functioning of the labour market, while a business environment analysis gives insights on the level of, potentials for and constraints to economic activities and the resulting demand for and, through productivity, returns to labour.

The study consists of two main parts, divided into seven chapters. Chapter Two – *Development Dynamics* – analyses in some depth the dynamics and characteristics of the dramatic economic development and transformation in the past few decades, exploring not least its implications on employment and incomes. Chapter Three – *Major Challenges and Opportunities* – brings out key challenges and issues for sustainable future pro-poor growth, resulting from the preceding chapter. Chapter Four through Six – *Employment Analysis, Macroeconomic Analysis and Business Environment Analysis* – provides analyses of the characteristics of the labour force and the labour market, of the macroeconomic situation and of the business environment against the backdrop of the challenges and issues highlighted in Chapter Three. Chapter Seven – *Binding Constraints for Pro-Poor Growth* – concludes the study with an identification and discussion of the binding constraints for pro-poor growth in Albania, based on the preceding analysis.

2 Development Dynamics: A Background

2.1 The Legacy of the Past

Albania's legacy from the socialist period has much in common with that of the other socialist countries in Eastern Europe, but also contained some highly specific features.

Social and economic backwardness. Albania was the most poorly developed country in Europe until WW-II, socially and economically. It had low scores on social indicators (infant mortality, illiteracy etc) and a very low level of economic development. During the socialist period sustained gains were made in the fields of education and, to a lesser extent in health. However, the gains in economic field were for most part less impressive and not lasting.

Extensive and unsustainable economic development during the socialist period. Following the introduction of the socialist regime, the economy became based on the principles of central planning which were gradually enforced throughout the entire economy leaving no scope at all for private initiatives or private production. In contrast to the other socialist countries there was no room at all for private production and there were no steps towards decentralisation or towards allowing the market to play a role, even at the margins of the economy, prior to the collapse of the economic system in 1990. The focus of the efforts to develop the economy was exclusively on increasing physical production, with no regard to costs, productivity or comparative advantages. The economic development was extensive in nature. Increased output was achieved by increases in the mobilisation and use of resources (labour, land and capital) rather than through more efficient use of the resources. While the system was good at mobilising resources, it was using them poorly.

High rates of growth in 1960s and 1970s were fuelled by aid from Soviet and later China and largely due to large-scale investment in industry and should be seen against very low starting point. Growth rates petered out in 1980s and became slightly negative in second half of this decade (Table 2.1). The decline was a result of the cessation of aid from first the Soviet Union and later China, and in particular to a gradual exhaustion of the ability to mobilise additional resources (in particular capital) combined with an inability to increase factor productivity and to foreign exchange constraints to the import of technology and machinery.

Table 2.1: Development of the population, gross national income and labour productivity during the socialist period. Average annual growth rates. Percentages.

	1950–60	1960–70	1970–80	1980–85	1985–90
Population	2.8	2.9	2.3	3.1	2.0
Gross national income	9.1	7.4	4.6	1.5	-1.1
Labour productivity	7.4	1.4	2.7	-0.6	-2.6

Source: Pashko 1994: 65. See also Sjöberg (1991: 120).

Remark: Labour productivity presumably refers to wage workers only, i.e. excludes most of the farm population.

A policy of extreme autarky. Following the rupture of relations with the other socialist countries, economic self-sufficiency in all areas was made an overriding political and economic goal. This had a number of implications. Maximising food production, particularly of cereals, became a strategic objective in order to ensure self-sufficiency in the context of a rapidly growing population and rather limited availability of land suitable for agriculture. The industrial development was severely hampered by the policy of autarky. The policy of extreme import substitution made the production inherently inefficient, which was further underscored by the inability to import technology, machinery and other inputs. In the 1980s exports amounted to a mere 10 percent of the gross social product, leaving precious little scope for imports.[3]

A continued rapid population increase. Falling death rates combined with sustained high fertility and birth rates resulted in a rapid population increase and rapidly growing labour force. The population increased from 1.2 million in 1950 to 3.2 million in 1989, i.e. at a rate of 2.5 percent per year.[4] In sharp contrast to the other socialist countries in Europe, the growth rate remained high throughout the socialist period.

Table 2.2: Population dynamics and rural – urban distribution.

Year	Total pop. (1000)	% urban	% rural	Index: 1950=100		
				Total	*Rural*	*Urban*
1950	1,218.9	20.5	79.5	100	100	100
1960	1,626.3	30.9	69.1	133	116	202
1970	2,135.6	31.8	68.2	175	150	272
1980	2,671.3	33.6	66.4	219	183	360
1985	2,962.2	34.2	65.8	243	201	406
1990	3,196.8	36.1	63.9	262	211	462
1995	3,025.1	38.6	61.4	249	192	470
2000	3,058.5	41.1	58.9	251	186	505
2005	3,135.0	44.5	55.5	257	180	559
April 2001	3,069.3	42.2	57.8	252	183	518

Sources: Misja, Vejsiu & Bërxholi (1987: 142); INSTAT (2006).

A slow pace of urbanisation and very tight controls on population movements. The absence of small enterprises meant that a small number of large enterprises had to assume task of generating industrial employment. Furthermore, the

3 Pashko (1991: 137–138).

4 Pashko (1994: 65).

focus on heavy capital intensive industry reduced the employment creating impact of the industrialisation, at the same time as the services sectors, which typically are much more labour intensive, remained very underdeveloped.[5] The result was a very slow pace of urbanisation and a slow transition of the population from agriculture to the non-farm sectors of the economy. The rate of urbanisation increased by a mere 5 percentage units between 1960 and 1990 – from 30.9 percent in 1960 to 36.1 percent in 1990 (Table 2.2) – and the share of the labour force working in agriculture declined at a similarly leisurely pace; from 55.6 percent in 1960 to 51.3 percent in 1985 (Table 2.3). Combined with the rapid growth of the population and of the labour force this implied that the rural, agricultural population almost doubled between 1960 and 1990 (Table 2.2). As a consequence, the average size of holding per agricultural household (in the cooperative sector) fell from 4.6 hectare in 1950 to 2.1 hectare in 1983.[6]

Draconic controls on population movements effectively hindered rural – urban migration, as well as migration between different parts of the country.[7] These controls go a long way towards explaining the very slow pace of urbanisation. While a rapidly increasing population pressure on the land and a deteriorating land/labour ratio in agriculture created a strong and increasing pressure for exit from agriculture a migration from rural areas, this option was effectively denied the rural population. As a result considerable rural – urban differences in living standards developed and a migration pressure, which was to explode after 1990, pent up. The migration controls also had regional dimensions. Regional differences in birth rates implied that population growth was particularly high in the mountainous and least developed northeastern parts of the country.[8]

Table 2.3: Distribution of labour force by main economic sectors.

	1960	1970	1985	2001
Primary	55.6	52.2	51.3	50.6
Secondary	26.5	29.2	30.0	13.7
Tertiary	17.9	18.6	81.3	35.7
All industries	100.0	100.0	100.0	100.0

Sources: Misja, Vejsiu & Berxholi 1987: 244, Census (2001c: 34).

Full employment was maintained at the cost of falling labour productivity. During the last decade of the socialist period falling rates of economic growth, which in the latter half of the 1980s became negative, combined with continued high rates of growth of the labour force resulted in falling labour productivity in agriculture as well as in the non-farm sectors, which translated into falling incomes.[9] Productivity among the wage labour force, i.e. excluding workers on collective farms, fell by over 15 percent in the 1980s. In agriculture, the decline took the form of a deteriorating land/labour ratio that could not be compensated for by increases in land productivity.

5 Pashko (1991: 136–138).

6 Misja, Vejsiu & Bërxholi (1984: 235). Authors' calculation.

7 For a detailed discussion see Sjöberg (1991b) and (1992).

8 Birth rates in the northeastern parts of the country were considerably higher than in the southern and western parts of the country (Misja, Vejsiu & Bërxholi [1987: 96]).

9 A fall which probably took the form of falling purchasing ability – resulting from shortages of consumer goods – as much as falling purchasing power.

2.2 Employment Dynamics: An Explosion in Mobility

Three independent but parallel developments, discussed in greater detail below, have conditioned the dynamics on the employment scene since the regime change in 1990.

1. The emergence of severe and persistent imbalances between the supply and demand for labour in the domestic economy, resulting on the one hand from a rapid increase in the working age population and from a dramatic contraction of demand for labour on the other hand.
2. The establishment of the freedom of movement and to migrate, both within the country and abroad, which resulted in a sudden and dramatic increase in mobility, although the latter freedom has not been entirely embraced by the neighbouring countries at the receiving end of the migration.
3. A re-emergence of traditional, patriarchal values and norms, which at least in the field of work had been suppressed during the socialist period and which has made it not only acceptable, but for many apparently the preferred option, for women to confine themselves to the realm of the home.

The dramatic development on the employment scene in the wake of the socialist economic and political system should also be seen against the fact that during the socialist period work was not only a right, but also an obligation. As discussed above, full employment was a political priority pursued even at the expense of obvious over-staffing of firms, under-employment in agriculture and falling levels of productivity. Yet, even so, the dismal performance of the economy in the 1980s combined with rapid increases in the labour force made it increasingly impossible for the regime to uphold the goal of full employment. By 1989 some 7.3 percent of the labour force – 9 percent of the female and 5.7 percent of the male labour force – was openly unemployed (Table 2.6).

2.2.1 Imbalances in the supply and demand for labour on the domestic front

By 1990 Albania had one of the most youthful and rapidly growing populations in Europe. Large numbers of young people entered the labour market each year at the same time as the small size of the age groups reaching retirement age implied that natural attrition from the labour market was limited. As few vacancies were created as a result of retirements, a rapid expansion of employment opportunities would have been required to absorb the young entrants into the labour force. In 1989 there were four persons aged 15 – 19, i.e. who were about to enter the labour market, for every person aged 60 – 64, i.e. who was about to retire from the labour market, implying that for every four young persons entering the labour market three new jobs would have had to be created, while only one job would appear as a result of vacancies created by retirement (Table 2.4). At a ratio of 4.8 entrants for every person leaving working age, the demographic pressure on the labour market was far higher in the rural areas, where the scope for new productive employment often was poorest, than in Tirana.

By 2001 the demographic pressure on the labour market had lessened somewhat, as the ratio for the country as a whole had fallen from 4.0 to 2.6 (Table 2.4). Falling fertility, registered already in the 1980s, and migration, resulting in an overall ageing of the population, were behind this change. The disparity between rural and urban areas had also been considerably reduced, largely as a result of rural-urban migration. Yet, by 2001 there were still 2.6 entrants into the labour market for every person leaving, suggesting a continued high pressure on the labour market.

This very strong demographic pressure on the labour market was accentuated by a relaxation of the retirement age and a dwindling of the real value of pensions. During the socialist period the official retirement age was 59 for men and 54 for women. Since then, the retirement age has been increased to 65. This postponement of retirements has obviously implied that voluntary labour market attrition due to age has been considerably less than it would otherwise have been.[10]

Table 2.4: Ratio of entrants into working age over those leaving working age.

	Ratio of 15–19 year old over 60–64 year old	
	1989	*2001*
Tirana urban	2.0	1.9
Other urban	3.2	2.3
Rural areas	4.8	3.0
Whole country	4.0	2.6

Source: Census (2001c: 27).

The collapse of the socialist planned economy was followed by a dramatic contraction of the demand for labour. Non-farm employment went into a free fall and urban unemployment, ostensibly unknown in the past, became endemic. Within the space of less than two years state sector employment declined by almost half as state institutions disintegrated and firms closed down (Table 2.5). As might be expected, the nascent private sector was only able to absorb a small fraction of the redundant labour. The result was open unemployment, which by 1993 had grown to about 400,000, i.e. approximately 40 percent of the non-farm labour force. The employment situation in agriculture was hardly better. Plagued by underemployment, excessively low land/labour ratios and falling productivity to start with, the collapse of the collective farm system and all the backward and forward linkages associated with the old agricultural system, agricultural production fell as the sector retreated into subsistence farming. Hence, Albania found itself with a young and rapidly growing, reasonably well-educated and, not least, restive labour force, but with no economy to match it.

Following the virtual collapses of non-farm employment in the early 90s the employment generating capacity of the domestic economy stagnated at a very low level. Despite generally impressive rates of economic growth the increase in domestic employment has at best been sluggish.[11] For reasons discussed in greater detail in section 2.3 below, the economic growth has been driven by increased productivity rather than by increased use of labour. In other words, economic growth has resulted in little increase in employment.

[10] The retirement age in agriculture is much more fluid than for non-farm wage employment and retirement is more gradual. Still, it is reasonable to assume that the actual age of retirement has increased also in agriculture.

[11] GDP doubled between 1992, the year when the economy bottomed out, and 2004. See Table 2.11.

Table 2.5: Employment dynamics in the early years of transition, excl. collective farm employment.

	December 1991	December 1992	October 1993
State sector	850,000	610,000	454,000
Private sector	40,000	62,000	101,000
Unemployed	74,000	394,000	(243,000)

Source: Sjöberg (1994: 93).

Remark: Other sources put unemployment in mid 1993 at 437,000, i.e. 44 percent. Over the period another 450,000 – 500,000 were working in agriculture outside the state sector, while some 200,000 – 300,000 are estimated to have left the country for work abroad (Sjöberg [1994: 103]).

By 2001 total domestic employment stood at 1,042,000, as against 1,443,000 in 1989 (Table 2.6). Hence, domestic employment declined by some 400,000 or 28 percent over the period. This decline should be seen in light of the fact that over the same period the population in the economically active age groups increased by at least half a million.[12]

The combination of a rapidly increasing population in the economically active age groups and a contracting labour market left only three options open: migration abroad for work, increased open unemployment or withdrawal altogether from the labour force. For many, migration abroad for work, despite the uncertainties, risks and costs that this involved, became the preferred option. By 2001 it can be estimated that some 663,000 Albanians were working abroad. In other words, four out of ten Albanians at work were working abroad.[13] Some 150,000 had joined the ranks of the openly unemployed and an additional 300,000 had opted out of the labour force. Thus, of those aged 15 or more and still residing in Albania less than half were employed by 2001, as against about two thirds in 1989. Some 14 percent were openly unemployed, i.e. twice as many as in 1989. In addition, 38 percent were economically inactive, as against 25 percent in 1989.

This overall picture hides large gender differences. Generally speaking, the brunt of the burden of the contraction of the labour force has fallen on the women. Overseas migration was at least during the early years an option primarily for the men. However, over the years women, too, have begun to join the ranks of overseas migrants in substantial numbers, often to join spouses already working abroad. By 2001 the census results suggested that a third of the males and a fourth of the females aged 25–29 had left the country.[14] Men have also fared much better than women on the domestic employment scene. The share of women in the total domestic employment has fallen from 46 percent in 1989 to 38 percent by 2001. In 1989 the rate of employment was universally high for both women and men, at 64 and 68 percent, respectively, of those aged 15 or above. By 2001 this rate had fallen dramatically to a mere 36 percent for women, while the decline for men had been much more modest (Table 2.6). Put differently, by 2001 half of the women aged 15 or more were economically inactive and an additional 14 percent were unemployed.

These labour market dynamics also display large rural – urban differences, particularly for the female labour force. In rural areas, women have by and large responded to the poor labour market prospects by withdrawing from the labour force altogether, while in urban areas

[12] Census (2001c: 35). See also Table 2.11.

[13] In reality the importance of overseas employment was even higher, as the figures do not include those working abroad on a seasonal basis or for less than one year.

[14] Census (2001e: 8).

Table 2.6: Domestic labour force participation in 1989 and 2001 by sex.

	1989			2001		
	Total	Females	Males	Total	Females	Males
			Number (1,000)			
Employed	1,443	664	779	1,042	392	650
Unemployed	157	94	62	306	155	162
Domestic labour force	1,600	758	842	1,347	548	800
Inactive	532	283	249	823	554	269
Total aged 15 +	2,132	1,041	1,090	2,170	1,101	1,069
Memorandum item:						
Employed abroad				*663*		
Total labour force				*2,010*		
			% of total population aged 15 +			
Employed	67.7	63.8	71.5	48.0	35.6	60.8
Unemployed	7.3	9.0	5.7	14.1	14.1	14.0
Domestic labour force	75.0	72.8	77.2	62.1	49.7	74.8
Inactive	25.0	27.2	22.8	37.9	50.3	25.2
Total aged 15 +	100.0	100.0	100.0	100.0	100.0	100.0

Source: Census (2001c: 28).

Remark: All figures refer to the population aged 15+.

Table 2.7: Labour force participation rate and employment rate by area and sex. Percentages.

	LFP rate		Employment rate		Discrepancy	
	1989	2001	1989	2001	1989	2001
Men						
Tirana urban	76.6	71.1	68.7	57.0	7.9	14.1
Other urban	78.9	73.3	70.5	56.6	8.4	16.7
Rural	76.5	76.4	72.3	63.9	4.2	12.5
Whole country	77.2	74.8	71.2	60.8	6.0	14.0
Women						
Tirana urban	72.1	52.8	61.7	34.7	10.4	18.1
Other urban	74.7	56.6	62.5	30.9	12.2	25.7
Rural	72.0	45.1	64.7	38.5	7.3	6.6
Whole country	72.8	49.7	64.9	35.6	7.9	14.1
Both sexes						
Tirana urban	74.4	61.7	65.2	45.6	9.2	16.1
Other urban	76.8	64.7	66.5	43.4	10.3	21.3
Rural	74.3	60.7	68.6	51.1	5.7	9.6
Whole country	75.0	62.1	68.2	48.0	6.8	14.1

Source: Census (2001c: 29).

Remarks: LFP rate: employed + unemployed/total population aged 15+.

Employment rate: employed/total population aged 15+.

Discrepancy: LFP rate minus employment rate, i.e. unemployed as percent of population aged 15+.

women have tended to remain in the labour force, but have often been forced into open unemployment. According to the 2001 census some 34 percent of the female labour force in Tirana was unemployed. In other urban areas, the percentage reached over 45 percent (Table 2.7). The corresponding unemployment rates for men, though still high, were considerably lower; 20 percent in Tirana and 23 percent in other urban areas. By contrast, open unemployment was somewhat higher for men than for women in rural areas. These figures should be interpreted in the light of the domestic migratory movements in the 1990s and the revival of patriarchal values, particularly in rural areas. Much of the large-scale withdrawal of women from the labour force in rural areas can probably be ascribed to the combined effect of a lack of employment opportunities and the reappearance of housekeeper as role model for women.[15] Much the same factors have probably prompted the massive migration of, predominantly young, women from rural to urban areas in the 1990s.[16] Fleeing the prospects of a life confined to the home in a village, many women have ended up unemployed in urban areas.

Agriculture still accounted for half of the total domestic employment in 2001 (Table 2.8). The de-industrialisation of the economy in the 1990s is amply reflected in the employment data. The industrial sector, broadly defined to include mining, construction and utilities, accounted for a mere 14 percent of the domestic employment, down from 30 percent in 1985 (Table 2.8 and 2.3). However, the largest 'sector' by far was work abroad, which outstripped even agriculture in terms of the numbers employed. The structure of the economy followed rural-urban lines distinctly. Agriculture accounted for over 83 percent of all employment in rural areas, but only about two percent of the employment in urban areas.[17]

Table 2.8: Employment by economic sector and sex in 2001. 1,000.

	Agriculture	Industry	Services	Total domestic	Abroad
Females	212	42	138	392	
Males	315	101	234	650	
Total	527	142	373	1,042	*663,000*

Source: Census (2001c: 34).

2.2.2 Overseas migration for work

Overseas migration became an obvious and arguably inevitable solution to the extreme lack of employment and income opportunities at home. Little more than a decade later, by 2004, an estimated one million Albanians in all – out of a population of 3.2 million in 1989 – had left the country on a temporary or permanent basis. A comparison between the actual demographic development and a simulated development assuming no migration at all, based on the censuses of 1989 and 2001, bring out a clear and compelling picture (Table 2.9). Albania has had a high rate of natural increase due a large population in the fertile age groups and high, but falling, rates of fertility. Over the inter-censal period of twelve years, the population would have increased by almost 600,000 people, or 19 percent. In reality the population fell by some

15 In rural areas the distinction between inactive and active is somewhat blurred as many female housekeepers also work in agriculture.

16 In contrast to overseas migration, domestic migration has involved slightly more women than men (Census 2001b: 21).

17 Census (2001c: 34).

112,000 people over the period, implying a loss of 711,000 people. Most of this loss was directly due to migration, but migration has also had an indirect impact on population growth through reduced birth rates. Fewer children are conceived when spouses are separated by large distances and female migrants will for obvious reasons not bear children in Albania. Migration also absorbed a large part of the labour force, in particular among the younger age groups. In the absence of migration, the population in the active age groups[18] living in Albania would have increased from 1.641,800 in 1989 to 2,143,600 in 2001. In reality it fell marginally to 1,632,900.

Table 2.9: Impact of overseas migration on Albania's demographic development 1989–2001.

	1989	2001 Observed	2001 Simulation	Difference simulation over observed
Population in 1989	3,181,693	3,069,275	3,780,654	711,379
Growth 2001–1989		-112,418	598,961	
Aged 0–19	1,371,310	1,193,948	1,398,842	204,894
Aged 20–39	1,043,595	880,882	1,243,835	362,953
Aged 40–64	598,158	751,972	899,796	147,824

Source: Census (2001b: 35). Authors' recalculation.

Remark: Simulation depicts expected development assuming no migration abroad.

Although dramatic as it stands, this picture underestimates the migration of labour abroad, as it only refers to migrants residing abroad for more than a year. Much of the migration, not least to Greece, is of a temporary or even seasonal nature.

Migration has taken place in waves. Some 300,000 people are estimated to have left during the first turbulent years, between 1989 and 1992, and by the mid-90s the figure had risen to 400,000.[19] The collapse of the pyramid 'savings' schemes in late 1996 triggered another wave of migration. By 2000 official estimates concluded that some 800,000 Albanians were living abroad. In subsequent years the pace of net migration abroad seems to have fallen, in part probably due to increased rates of return migration. Since 2000 it is estimated that gross out-migration has fallen to about 30,000 per year, while return migration has risen to about 11,000 per year.[20]

Greece has throughout this period been the prime country of destination, followed by Italy. However, the pattern and characteristics of migration has changed over time. In the early years Greece was the destination for well over 80 percent of the migrants, but in later years Italy has become an increasingly important destination.[21] By 2004 it is estimated that some 600,000 Albanians were living in Greece and about 250,000 in Italy, out of a total of about a million Albanians living

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[18] Here defined as those aged 20–64.

[19] Census (2001b: 34); Carletto *et.al.* (2004).

[20] Census (2001b: 8).

[21] Carletto *et.al.* (2004). See also King (2004).

abroad.[22] Most of the migration is intended to be temporary and considered as illegal. Overall, since 1990 only a third of the migrants have been in possession of the necessary legal documents (visa, residence permits, work permits), although this share has increased steadily from 10 percent in 1990 to 47 percent in 2002.[23] Irregular migration has been much more frequent to Greece than to Italy. In particular in Italy, and to a lesser extent in Greece, many migrants have benefited from a post facto regularisation of their migration and work status. The benefits of such regularisation and increased opportunities for legal migration are obvious. However, in the case of Italy this would also seem to be associated with a tendency for temporary migration to translate into permanent. By contrast, no such trend seems is observed in Greece.[24]

Most migrants lacking the necessary permanent residence and work permits, seemingly irrespective of educational level and skills, are confined to the lower end of the labour market abroad and to performing physical labour requiring little or no skills. A survey found that some 39 percent worked in agriculture, 30 percent as construction workers and 13 percent as unskilled labourers in the transport sector. This is a pattern that would seem to have remained constant since the early 1990s, suggesting that their status as temporary migrant workers for most put a lid on their chances of occupational advancement while abroad.[25]

Most of the migrants to Greece have originated from the southern parts of the country, no doubt due to the geographic proximity as well as historic ties. A substantial Greek minority has since long lived in southern Albania. Migrants to Italy more commonly originate from Tirana and other major urban centres. The population in the north and northeast of the country have displayed the lowest propensity to migrate abroad. The very large exodus from these parts of the country has primarily been to Tirana and other main cities within the country. Young males predominate among the migrants, although the share of female migrants has increased. Typically, men pioneer as migrants and once a migration channel has been well-established women follow suit for work, to joint their spouses or both. However, there have also been other considerations behind female migration. A peak in female migration between 1997 and 1999 can probably largely be attributed to the break down of law and order following the collapse of the pyramid schemes, which led many families to decide to send ostensibly more vulnerable female members of the household abroad.[26] Migration is selective also in other respects. Migrants tend to be better educated than non-migrants, although this difference is considerably less pronounced for migrants to Greece than for migrants to Italy.[27] Evidence on the economic status of the migrants is mixed. There is some evidence that migrants to Italy come from relatively better off economic circumstances, while for migrants to Greece no such pattern can be discerned. Indeed, one study suggests that migrants to Greece tend to come from poorer circumstances than the population at large. [28]

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22 King (2005).

23 Carletto, Davis & Stampini (2005).

24 Carletto *et.al.* (2004).

25 Carletto, Davis & Stampini (2005).

26 Arrehag, Sjöberg & Sjöblom (2006).

27 Carletto *et.al.* (2004); Carletto, Davis & Stampini (2005).

28 Carletto *et.al.* (2004); Arrehag, Sjöberg & Sjöblom (2006).

International migration has indeed become a key feature in the Albanian society. About half of all Albanian households have experiences of international migration, either through current household members or through off-springs living abroad.[29] Some 28 percent of all households receive remittances and remittances make up 13 percent of the total income of all households.[30] For the recipients these remittances make a major difference to the household economy. According to the 2002 Living Standard Measurement Survey the average amount received was 88,600 Leke, with rural households receiving more (104,400 Leke) than those in urban areas (68,900 Leke).

2.2.3 Internal migration

Parallel to the exodus abroad, there has been large scale domestic migration. During the period between the 1989 and 2001 censuses some 252,700 people migrated from one prefecture to another.[31] Poverty and lack of employment and income opportunities has been a main driving force behind the domestic, as well as the overseas, migration. The prefectures suffering the highest rates of out migration have on the whole coincided with those with the bleakest economic performance. They fall into two categories: (i) the historically backward mountainous regions in the northeast (Kukës, Dibër) and (ii) regions dominated by heavy industry developed during the socialist period (Elbasan in particular, but also Shkodër, Berat). The greater Tirana – Durrës region served as the main magnet for the migrants, almost half ended up in Tirana alone. Although the migration has been associated with an unprecedented rate of urbanisation, it has by no means been an exclusively rural – urban phenomenon. Rural – rural migration, from the highlands to the lowlands, as well as urban – urban, from derelict mono-industrial towns to cities and towns with a more diversified economy, have also been important features in the overall migration picture.

While high rates of internal migration in the wake of the collapse of the socialist system may have been inevitable. The continued exodus of primarily young people from in particular the north-eastern parts of the country should be a serious cause for concern. It reflects an increased polarisation of the country where the demographically and economically buoyant Tirana – Durrës area stands in sharp contrast to continued stagnation and decline in other parts of the country, particularly in the northeast. Half of the movements between 1989 and 2001 have been in the direction of Tirana – Durrës, and half of these have originated from the Dibër and Kukës prefectures in the northeast.[32]

The prefectures of Kukës and Dibër in the northeast lost 29 and 21 percent, respectively, of their population between 1989 and 2002 due to migration. At the district level migratory losses were even more dramatic. Net out migration over the 12 year period amounted to over 30 percent in the northeastern districts of Kukës, Tropojë and Dibër.[33] This region also consistently ranks the worst on economic and poverty related indicators. It

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[29] Carletto *et.al.* (2004).

[30] The figures derive from the 2002 Living Standard Measurement Survey and refer to a 12 month period prior to the survey. The source does not distinguish between overseas and domestic remittances, but the former are estimate to make up 80 per cent of the total. The figures are likely to underestimate actual flows. Balance of payment data suggest much higher flows.

[31] Census (2001b). Albania is divided into 12 prefectures and 36 districts.

[32] Census (2001e: 9).

[33] Census (2001b: 19).

still has the lowest rates of employment and the highest rates of unemployment in country and work, where it exists, is seldom permanent or full-time. It also has the highest headcount poverty rates in the country, reaching over 40 percent in districts such as Bulcuizë, Has and Kukës. As the migration has been highly selective, the impact has been considerably more severe than the numeric figures alone would indicate. The young and the better educated migrate, while the less educated tend to stay behind. Thus, migration is undermining the scope for future economic development and prefectures such as Kukës, where presently remittances, social welfare and subsistence agriculture provide the main sources of livelihood, are being caught in a poverty and external dependency trap. [34]

At the other end, the rapid inflow of migrants has created havoc to urban planning and strained provision of communal services to the limit it cities such as Tirana. It also fuels urban unemployment and is a main factor behind the continued high rate of unemployment in Tirana. Indeed, the high rates of unemployment in the main urban centres can only be successfully tackled if the plight of the poorest parts of the country is addressed.

2.2.4 Loosing the young generation?

The employment drama appears in an even starker light when an age perspective is introduced into the picture. It would appear that they young graduates of the educational system that have endeavoured to enter the domestic labour market have essentially been confronted with a closed door. This has in particular been the case for women. The 2001 census showed that age specific employment rates for women remain well below 45 percent until the age of 45, where after it suddenly increased to 60–70 percent for the 45 – 55 age group. By contrast, the employment rate for men increased gradually between the age of 20 and 35, where after it remained at slightly over 90 percent until the age of 55. This suggests that women entering working age already since the early 1980s have found it very difficult to obtain and maintain employment. In 1989 around 90 percent of the women aged 25 to 49 were employed, by 2001 this share had fallen to below 40 percent in both rural and urban areas. Among men, too, the rate of employment has gone down, in particular in the 25–29 age group, although not by as much. Unemployment for men aged 20–24 reached well over 70 percent in the urban areas and 50 percent in the rural areas, but was considerably lower for the older age groups, to 10–20 percent for the 20–39 age group. By contrast, it remained high for women across the age groups up to the age 40–49.[35] For women, in particular, a university degree provided the only near-certain entry ticket to the domestic labour market. This applied to a much lesser extent to men, for whom the level of education would seem to have been a much less important determinant of the chances of finding employment.

The extremely poor domestic employment prospects for the young entrants into the labour market in the 1990s are also reflected in the distribution of employment by economic sectors for different age groups (Table 2.10). In 2001 the share of non-farm employment among the employed was highest among those aged 35–49, i.e. among those who had entered the labour market in the 1970s and 1980s. Some 62 percent of

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[34] See Mecaj and Sjöberg (2003). Some 57 per cent of the population in the Kukës prefecture and 45 per cent of those in the Dibër prefecture received public economic aid in 2001, as against 22 per cent of the population of Albania as a whole. In the same year, the regional GDP for Kukës was ostensibly less than half of that for the country as a whole. (Kukes MDG [2004: 7]).

[35] Census (2001c: 58–59).

those aged 20–24 and employed worked in agriculture, as against only 41 percent of those aged 41–44. Hence, agriculture has become an employment repository not only for the old, but also for the young, while those in-between have preserved non-farm jobs obtained in the 1970s and 1980s.

Against this backdrop it should come as no surprise that young people have left the country in droves. Indeed, an analysis of household history data, based on the 2004 Living Standard Measurement Survey, presents a dramatic picture in this regard. Among all offspring still alive but not living in the household some 35 percent were stated to live abroad. It was found that among those who left the parental household after 1990 some 48 percent lived abroad. In other words, almost half of those who have moved out of their parent's household since 1990 have moved abroad.[36] Such a development is clearly not sustainable, for demographic reasons if nothing else. Breaking this trend by offering the young entrants into the labour market attractive and adequate employment opportunities at home is arguably one of the greatest challenges facing Albania at the present.

Table 2.10: Employed population by sex, age group and economic sector. 2001. Percentages.

Age group	Men			Women			Both sexes		
	I	*II*	*III*	*I*	*II*	*III*	*I*	*II*	*III*
15–19	65.4	10.0	24.6	65.3	11.4	23.3	65.4	10.6	24.0
20–24	66.3	10.9	22.8	58.8	12.2	29.0	62.2	11.6	26.2
25–29	55.5	13.0	31.5	48.8	11.3	39.9	52.7	12.3	34.9
30–34	48.2	14.9	37.0	46.0	12.2	41.7	47.4	14.0	38.6
35–39	44.7	16.7	38.6	45.2	13.0	41.8	44.9	15.5	39.6
40–44	41.3	18.2	40.6	41.5	12.6	45.9	41.4	16.4	44.2
45–49	38.9	19.0	42.1	52.2	8.2	39.7	44.1	14.8	41.1
50–54	41.1	17.3	41.7	60.9	7.9	31.2	49.4	13.3	37.3
55–59	49.3	15.4	35.4	87.5	2.1	10.4	56.0	13.0	30.9
60–64	63.3	10.4	26.2	92.1	1.6	6.3	72.7	7.6	19.7
15 +	48.5	15.5	36.0	54.0	10.7	35.3	50.6	13.7	35.7

I: Agriculture, II: Industry, III: Services

Source: Census (2001c: 90).

2.3 Collapse and New Economic Forces

The collapse of the socialists system resulted in a virtual collapse of the non-agricultural sectors and a regression of agriculture into subsistence farming. GDP fell by an estimated 44 percent between 1989 and 1992, while gross industrial output fell by close to 80 percent in the period. Thus the industrial base constructed in the course of over 40 years of socialism was virtually wiped out in three years. The fall in agricultural production was less drastic (about 25 percent between 1989 and 1991) and the recovery quicker. By 1994 agricultural production would seem to have been back at the 1989 level. However, as the system of collectivised farming and compulsory delivery to the state collapsed, agriculture reverted into subsistence farming. The resulting acute food shortages in the urban areas had to be relieved by food aid from abroad in the early 1990s.

Efforts to re-establish macroeconomic stability and, often spontaneous, structural reforms followed in the wake of the economic and institu-

[36] Carletto *et.al.* (2004); Carletti, Davis & Stampini (2005).

tional collapse. These included price and trade liberalization, privatization and reconstruction of state enterprises, fiscal discipline, reduction of the inflation rate, reduction of the foreign debt, introduction of a floating exchange rate, reformation of the banking sector, land reform, steps to develop a legal framework for a market economy etc.[37] As shown in Table 2.11, the reforms yielded results and economic growth, based on market allocation mechanisms, recovered already in the mid-90s from a rock-bottom level. However, the 1997 crises of pyramid schemes and the 1999 Kosovo war brought both the economic and institutional progresses to a temporary halt. Fortunately, political stabilisation and renewed reform efforts put the economy back on a path of growth already by 1998. Since then growth has been sustained at a fairly high level (Table 2.11). FDI began to increase from a very low level and an already high inflow of remittances increased further.[38]

Table 2.11: Development of GDP. Annual growth rate and Index: 1989=100.

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
%	-13.1	-28	-10	9.6	9.4	8.9	9.1	-10.9	8.6	13.2	6.5	7.1	4.3	5.7	6.7
Index	86.9	62.6	56.3	61.7	67.5	73.5	80.2	71.5	77.6	87.8	93.5	100.2	104.5	110.5	117.9

Sources: Pashko (1994: 67–71) for the years 1989–1993; World Bank (2006:6) for years 1994 and 1995; INSTAT for 1996–2004.

The economic recovery has been accompanied by a remarkable structural change. This magnitude of this structural change is clear from figures on the growth rates of different sectors between 1990 and 2004 (Table 2.12) and on the development of the various sectors contribution to GDP (Table 2.13). In contrast to other East European countries where industrial decline was more gradual and where much of the industrial capital stock could be saved and reconstructed, the industrial sector in Albania has had to start from scratch since the collapse of the socialist system wiped out the capital stock almost entirely.

The agricultural sector has registered continued, though moderate, growth since 1998. There has been a pronounced shift in the structure of agricultural production away from crops associated with mechanised farming to more labour intensive crops that do not require much processing or mechanised farming and to crops yielding a higher value per hectare. Thus, cereal production has gone down, while production of vegetables and fruits, which yield a high value per hectare, but also subsistence crops such as potatoes and forages, have gone up. Livestock production has increased as a whole and now account for half of all agricultural production. However, agriculture is still plagued by severe structural problems. The average farm household hold little more than one hectare of agricultural land and holdings are further fragmented into a number of plots. The land labour ratio remains very high with underemployment and low labour productivity as a result. Poorly developed channels to markets make it difficult and risky to produce for the market, a situation that is aggravated by fierce import competition. Thus, most of the production is for own consumption and market-oriented agriculture has yet to get a firm foothold in the country. For many, overseas migration for work by one or several of the household members seems to offer a more promising and rewarding means of obtaining cash

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[37] For more details see for example World Bank (2004: 7–17).

[38] World Bank (2004: Table 2).

Table 2.12: GDP growth by main sectors of the economy.

	Total	Agriculture	Industry	Construction	Trade	Transport
1990	-10.0	-4.3	-0.1	-14.3	-9.1	-15.9
1991	-28.0	-24	-37.9	-28.1	-11.7	-28.0
1992	-7.2	18.5	-51.2	7.0	9.0	-14.9
1993	9.6	10.4	-10.0	30.1	16.0	13.0
1994	8.3	8.3	-2.0	15.0	11.0	18.0
1995	13.3	13.2	6.0	21.2	13.5	18.8
1996	9.1	3.0	13.6	18.5	20.1?	-1.0
1997	-10.9	-17.1	-25.2	-16.9	-0.4	12.2
1998	8.6	6.2	27.5	-13.3	2.2	20.3
1999	13.2	5.3	23.3	19.4	7.3	55.4
2000	6.5	6.6	1.3	46.5	-9.8	15.8
2001	7.1	2.7	6.1	32.7	3.2	9.4
2002	4.3	2.1	-5.1	21.5	1.6	12.6
2003	5.8	3.2	29.0	23.6	-5.2	6.5
2004	6.2	6.2	14.1	7.7	2.6	7.6
89–92	-39.1	-13.8	-69.7	-34.1	-12.5	-42.3
93–96	*46.7*	*-16.8*	*25.7*	*-16.4*	*80.0*	*95.2*
98–04	64.3	37.0	136.0	225.5	0.9	205.6
89–04	29.0	-18.5	54.7	48.7	58.3	286.2

Sources: INSTAT 2006 (revised numbers from 1997).

Remark: Industry includes manufacturing mining and utilities.

Trade includes trade, hotels and restaurants and 1990–95 also 'other activities'.

income than producing agricultural products for the market. Thus, while the role of agriculture as a source of income and livelihood remain vital for a large part of the population, it has as yet not been able to serve as a source of enrichment.

Table 2.13: Sectoral Distribution of GDP. Percentages.

Year	Agriculture	Industry	Construction	Services	-of which trade	All sectors in domestic economy	Remittances
1989	36	40	7	17	..	100	0
1993	55	14	9	22	..	100	15.6
1996	36.1	8.6	5.0	49.2	26.9	100	16.6
1998	28.9	7.2	4.9	58.9	26.4	100	16.5
2004	22.6	10.0	13.8	53.7	21.6	100	12.9

Sources: UNSTAT (http://unstats.un.org) for 1989 and 1993.
INSTAT (http://www.instat.gov.al) for 1996–2004.

Remark: Figures for 1989 in particular should be seen as approximate.

The industrial sector has yet to recover from the virtual collapse in the early 1990s. In particular the reconstruction of the manufacturing sector is still at a very early stage.[39] The impressive growth rate of the industrial sector since 1998 should be seen against its very low level at the starting point. By 2004 it

[39] It should be noted that the industrial sector includes not only manufacturing, but also mining and utilities, such as gas and electricity.

share of GDP was still only 10 percent, the contribution of manufacturing was even lower. The reindustrialisation of Albania has only just begun.

The services sectors have been the main driver of growth. The services sectors presently account for well over half of GDP, as against a mere 17 percent in 1989. In recent years growth has been particularly impressive in transport and communication in, while the growth in trade would seem to have slowed down. The second most important driver of growth in recent years has arguably been the construction sector (Table 2.12). A long-standing neglect of construction, in particular residential construction, during the socialist period, together with investment of remittances in housing and a construction need resulting from the rapid urbanisation explain the phenomenal growth of this sector. While its importance as an engine of growth during the past years, and probably also in coming years should not be under-estimated, it is doubtful if it can maintain this role in the long term. The contribution of remittances to the national income is estimated to be about 13 percent. This it's contribution is considerably higher than that of the industrial sector, but if falls behind that of services and agriculture (Table 2.13).

Economic growth since the collapse has mainly been driven by more efficient allocation of resources rather than more production factors or technological development. The World Bank growth accounting exercise, presented in Table 2.14, shows that both the contraction of the economy during the collapse and the recovery the following years were driven by increased total factor productivity (TFP).[40] The decrease in TFP was mainly due to the chaos when moving from a centrally planned allocation mechanism to a free market and the redundant capital stock. The increase in TFP was the effect of the stabilisation and reform programs that increased productivity in the Albanian economy by allocating and using its production factors more efficiently. Hence, the internal migration is one of the most important explanations for this increase in TFP. The contribution of TFP growth has declined significantly as the benefits from the reforms and resulting internal migration fade out, and is only modestly compensated by total factor growth. Capital growth has started to increase but need to increase further in order to sustain current growth levels.

Table 2.14: Growth by components. Percentages.

	Annual GDP growth%	Contribution from			
		Capital growth	Labour force growth	Total factor growth	TFP growth
1990–92	-15.26	0.47	0.78	1.24	-16.50
1993–96	9.25	-0.54	-0.51	-1.05	10.30
1998–01	7.35	0.05	0.56	0.60	6.75
2002–03	5.35	0.78	1.07	1.85	3.50
1993–03	6.27	-0.05	0.18	0.13	6.14

Source: World Bank (2004: 22).

Remark: TFP = Total factor productivity growth.

[40] World Bank (2004).

2.4 Winners and Losers: Dynamics of Poverty and Inequality

Poverty is not new to Albania. Albania remained one of the poorest and least developed countries in Europe until the middle of the 20th century, with economic and social indicators reminiscent of those of the poorest countries in Africa at the present. The socialist period brought relief from poverty in several, but not all respects. Health and educational standards increased vastly from very low levels and arguably remain the greatest achievement of human development of this period. Material poverty, too, was substantially reduced during the socialist period, although the achievements in this field were more uneven. Universal freedom from hunger was achieved, but less extreme material want remained widespread as a result of frequent and prolonged shortages of basic goods and foodstuffs and poor housing conditions.

Inequality was severely curtailed during the socialist period. An official maximum wage difference of only 1:2 was introduced in 1976.[41] Actual inequality was considerably larger. Most of the rural population worked in agriculture as members of collective farms. Their income was determined by the production results of each particular farm rather than by any official wage policy and with increasing over-population in agriculture was want to suffer. The severe restrictions on mobility implied together with the ban on private ownership of production factors such as land and the near-impossibility of accumulating personal wealth meant that life prospects and opportunities were determined by where you were born rather than by whom. Opportunities for economic and social advancement were incomparably more curtailed in rural areas, not least in the mountainous interior, than in Tirana.

During the socialist period lack of resources was greatly reduced as a cause of poverty. Instead, specific aspects of lack of opportunities and vulnerability emerged as key causes of and expressions of poverty. Government control over all production factors and a lack of freedom to move and, indeed, more often than not to choose occupation and a ban on the pursuit of private economic activities severely curtailed the opportunities for individuals to enhance their well-being by their own accord. A fairly well-developed social security system removed an otherwise important form of vulnerability. On the other hand, the repressive totalitarian political system created new forms of vulnerability. The subordination of the judiciary to the whims and will of the political leadership and a denial of basic human rights, such as the freedom of speech or the right to a fair trial, resulted in very specific, yet profound, forms of insecurity and vulnerability.

The collapse of the socialist system and the rather tumultuous transformation of the society to one based the principles of a market economy and political pluralism has changed the face of poverty considerably as well as made it much more visible. Still, for many years poverty analyses in Albania were hampered by lack of data. A qualitative poverty study, based on field studies in ten areas in 2000, provided a first broad picture of the poverty situation.[42] The study found that lack of access to adequate employment opportunities was a principle cause of poverty. The role of migration as an escape from poverty was also clearly brought out. As one of the interviewed put it: 'A poor family is considered to be one that does

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41 Census (2001d: 9). Actual wage differences are believed to have been higher as the 1:2 ratio referred to different categories of labour.

42 De Soto *et.al.* (2002).

not have a member who can emigrate abroad…'.[43] The findings of this study are by and large confirmed in a subsequent quantitative study based on the results of the 2002 living standard measurement survey.[44]

Table 2.15: Poverty rates by region, 2002. Headcount rates. Percentages.

	Poor	Extremely poor
Tirana	17.8	2.3
Other urban	20.1	4.8
Rural	29.6	5.2
Total	25.4	4.7
Coastal region	20.6	3.6
Central region	25.6	4.6
Mountain region	44.5	10.8

Source: World Bank (2003: 11, 41).

By 2002 a quarter of the Albanian lived below the poverty line and five percent lived in extreme poverty (Table 2.15). Preliminary data from the 2005 LSMS suggests that material poverty has fallen considerably in recent year. The share of the population living below the poverty line is estimated to have fallen from 25.4 percent in 2002 to 18.5 percent in 2005, while the shares living in extreme poverty are estimated to have fallen from 4.7 to 3.5 percent.[45] According to the LSMS from 2002, remittances have played a major role in reducing income poverty. It has been estimated that in 2002, the head count poverty rate would have been 32 percent instead of 22 in the absence of remittances.[46] The incidence of poverty was considerably higher in rural areas than in the towns and cities, but the analysis also revealed large regional differences. Poverty was by far most widespread in the mountain areas, where close to half of the population was classified as poor and over ten percent as extremely poor (Table 2.15). Apart from demographic characteristics – the higher the dependency ratio within the household, the higher the risk of poverty – access (or the lack thereof) to employment opportunities, at home or abroad, and levels of education stood out as main determinants and causes of poverty. Poverty was strongly associated with unemployment and with underemployment in terms of hours of work, the latter particularly in agriculture. The poverty incidence among households with children living abroad was, at 12–18 percent, considerably lower than among households with no family members abroad (31 percent).[47] It is clear that work abroad provided escape not only for the migrants themselves, but also for families and relatives left behind at home. According to the 2002 survey some 22 percent of the households received remittances from abroad.

43 De Soto *et.al.* (2002: xvii, 39).

44 World Bank (2003).

45 IMF (2006a: 11).

46 IMF (2006b: 50).

47 World Bank (2003: xii).

Table 2.16: Poverty incidence by educational attainment for people aged 21 or more. Percentages.

	Tirana	Other urban	Rural	All areas
No schooling	19.0	20.5	30.7	26.6
Primary	26.7	26.1	30.8	29.3
Secondary	10.5	14.3	19.5	15.6
Vocational 2 yrs	14.2	14.4	17.1	15.0
Vocational 4 yrs	10.9	8.2	16.5	12.0
Higher education	2.9	2.6	3.8	2.9
Total	15.9	18.8	28.1	23.7

Source: World Bank (2003: 29).

Remark: Those with no schooling were no doubt primarily elderly, who in most instances would be drawing pensions.

The causality between education and poverty would seem to go both ways. Poverty is strongly and significantly negatively correlated with education. The higher the level of education, the lower the incidence of poverty (Table 2.16). Completing secondary or vocational education reduces the risk of poverty by half compared to only having achieved primary education, while obtaining a university degree provides a virtual guarantee against poverty. However, poverty is also found to be a cause of poor education. Less than 20 percent of the children from poor households enrol in secondary education, as against 47 percent of the children from non-poor households (Table 2.17). Hence, the mutual causality between low education and poverty risk perpetuating poverty from one generation to another.

Table 2.17: Net enrolment rates by income levels, 2002. Percentages of relevant age groups.

Level of education	Not poor	Poor	Extremely poor	All groups
Primary	94.1	91.6	88.6	93.3
Secondary	46.7	19.4	19.8	38.7
Tertiary	11.2	0.4	0.0	8.7

Source: Census (2001e: 29).

However, poverty has more dimensions than the strictly material ones. It is also a question of empowerment and the ability to assume control over ones own life, of having a combination of resources and opportunities that make it possible to create a better life. This aspect arguably attains a particular importance in Albania, where transfers play such a crucial role for the material standard of living at all levels; at the individual and household level as well at the regional and national level.

At the individual level the sharp decline in the labour force participation of women implies that the empowerment which normally follow from having a place of work and an income of ones own has been lost for many, particularly women. At the household level, the high dependency on remittances and, to a lesser degree, public transfers has a similar effect. Although, it can be argued that the decision for one or several household members to migrate abroad for work often may be a joint household decision and part of a unified household economic strategy, rather than independent decisions by the individuals concerned. At the regional level, it is clear that there is an increasing divide between regions that produce more than they consume and regions that mainly consumes, as economic activities are increasingly concentrated to a few central urban areas. As noted earlier, there are extremely large variations in the regional GDPs, which can be used as an indicator of regional economic production. This implies that in large parts of Albania poverty in terms of not having the resources and opportunities needed for economic and social development is much more severe than the indicators of consumption and headcount poverty levels would suggest. At the national level, too, there is an increasing gap between production and consumption as a result of the dependency of the Albanian economy on remittances. Increases in material welfare have only partly been due to an ability of Albania as a country and economy to reduce poverty and increase living standards through its own efforts. These imbalances at the regional and national level also affect non-material aspects of poverty at the individual and household levels. While, as discussed above, during the socialist period opportunities to improve your conditions of living largely depended on where you were born, as geographic mobility was strictly controlled, at present such opportunities largely depend on ability to be geographically mobile. For those for whom migration is not an option – for personal, family or economic reasons – the opportunities to make the most of ones resources to improve the conditions of living are very limited, particularly in the rural areas and in the economically more backward regions. To conclude, it can be argued that a lack power to be masters of owns own development can be found at all levels in Albania today and that it constitute an important aspect of poverty.

Yet, poverty in Albania is still largely a transient rather than chronic phenomenon. It is primarily due to lack of opportunities, rather than lack of resources. The severe lack of employment opportunities due to the virtual collapse of the economy in the early 1990s and the subsequent prolonged period of jobless domestic growth, coupled with unequal and still difficult access to employment abroad, is the single most important cause of poverty. However, there is one important caveat to this conclusion. While illiteracy has been successfully eradicated, a large part of the population has no more than primary education. As discussed above, the incidence of poverty among those with only primary education is twice as high as among those who have completed at least secondary education. As the Albanian economy becomes increasingly sophisticated and integrated in the European economic structures the need for good levels of education and vocational and professional qualifications in order to enter and succeed on the labour market is likely to increase. Against this backdrop, the fact that enrolment rates to secondary education are low and that they would appear to have fallen to about half of the 1990 levels give cause for serious concern. Public spending on education had by 2003 fallen to almost half of what it was in 1990.[48] Addressing this negative trend of investment in human resources stands out as an imperative challenge.

[48] World Bank (2003).

3 Major Challenges and Opportunities

Albania has by now reaped the growth dividends that were a result of the efficiency gains obtained through improved resource allocation and utilisation following the transition to a market economy. During the 1990s growth was entirely driven by more efficient use of production factors such as capital and labour, not least by the massive reallocation of labour. An important implication of this development was that growth was not translated into increased employment. The driving forces of economic growth are now changing. In the years to come growth will have to be driven both by increased use of production factors, such as capital and labour, and increased factor productivity through technological development and a more enabling business environment. This in its turn will require high levels of investment in both physical and social capital. Physical infrastructure and physical productive capital need to be rapidly developed, as does the qualifications and skill levels of the human resources.

The geographic location combined with a highly mobile labour force implies that Albania, in contrast to other developing countries, has limited possibility to specialise in low-wage activities. The option of international migration puts pressure on the domestic market to increase productivity and hence the potential returns to employment. In order to reduce the large scale migration for work abroad and to entice Albanians already abroad to return home, it must be made attractive to work as well as to run a business in Albania.

The large scale migration for work abroad has, at least during the 1990s, been both inevitable and overall beneficial. At the national level, it has cushioned the impact of the virtual collapse of the domestic economy in the early 1990s and been instrumental to maintaining macroeconomic stability, not least on the external front. The inflow of capital has created conditions for demand-led growth, which the domestic economy has yet to respond to and exploit. At the individual and household levels the option to migrate abroad for work has for hundreds of thousands of families been crucial for escaping severe poverty. It can be argued that no other factor has been as important for reducing poverty in Albania during the past fifteen years. The large numbers of Albanians working abroad constitute an enormous potential for the development of Albania. If a large part of them decides to return home, they will bring with them not only their own human capital, but also financial capital and not least social capital. They will bring with them a profound knowledge of the societies in neighbouring countries that are also Albanian's main trade partners as well as networks of contacts.

However, migration abroad has had downsides as well and the development towards a dualistic society with a large share of the population being dependent on transfers from the productive part of the population needs to be reversed. The present concentration of economic development is incompatible with a strategy aimed at creating enabling conditions for all to use their resources to improve their standard of living and escape from poverty. Moreover, the social costs of migration have been very high, as families are divided, children do not benefit from the presence of both parents as they grow up etc. While migration for work has served as a salvation from poverty for many, it is a second-best solution. The preferred solution is almost always to have the opportunities at home to improve ones life. At the national level, too, migration is a mixed blessing. Through migration the country has lost much of its human resources, at least for the time being. This loss is magnified as migration is selective, in terms of age, levels of education etc.

The massive exodus of young people poses a severe challenge for the future of the country. If most of them can be enticed to come back to Albania after some years of work abroad, the potential gains to the country are enormous. Such a return migration would imply an injection of human resources and capital as well as knowledge and social capital gained in other EU countries, which if put to good use could be instrumental for Albanian's social and economic development and integration into EU structures. On the other hand, if these migrants become lost to the country in the sense that they do not return, the demographic, economic and social consequences will inevitably be very severe and Albania will risk becoming a chronically aid and remittance dependent economy. The migration of a large number of young people makes the investment in human resources a particularly important strategic issue.

Albania's economic integration into European economic structures has so far been very lop-sided; while there has been far-reaching integration in terms of the labour force, economic integration through trade and foreign direct investments remains undeveloped. For Albania to achieve both sustainable economic development and EU integration, the economic integration needs to become more balanced. In other words, it is essential that trade relations and FDI are forcefully developed. Labour migration, trade and FDI can be seen like communicating vessels that exercise a high influence on each other. For instance, increased exports and FDIs will result in more and better jobs at home, which in its turn will lower the incentives to migrate. An interesting question that deserves to be explored is if the large Albanian Diaspora resulting from labour migration can in anyway be used to promote FDI into Albania and stronger trade relations?

Another major development challenge must be to bring all regions of the country into the mainstream of economic development. It very rapid urbanisation and movement of the population to a few urban areas where growth is taking place carries high costs in terms of strains on urban planning and development and provision of social services at the same time as other parts of the country risk becoming permanently dependent on public financial transfers. While urbanisation is an inevitable consequence of a reindustrialisation and development of the Albanian economy, its present pace and pattern risks undermining the sustainability of more long term economic and social development. Given the circumstances, agriculture has registered impressive development over the past years. However, it faces formidable challenges to develop into an efficient and market-oriented sector of the Albanian economy, not least in the context of fierce import-competition. Agriculture alone cannot shoulder the role of bringing the economically peripheral regions into the mainstream of the economic development, but this will require a geographically more dispersed development of the non-farm sectors as well. Firstly, for agriculture to prosper, it needs to be better integrated with the other sectors of the economy and the upstream and downstream linkages of agriculture need to considerably strengthened. This requires a more diversified economic structure within regions. Second, local non-farm employment and income opportunities need to be created to provide exit possibilities for the, still, large surplus labour force in agriculture. At present migration provides the virtually only such exit opportunity. The present pattern where many if not most of the farm households live on subsistence farming supplemented by remittances, and where remittances arguably often reinforce the subsistence orientation of agriculture, needs to be broken.

4 Employment Analysis

4.1 Characteristics of the Labour Force

Out of a total labour force of approximately two million at the time of the 2001 census, some 663,000 or 33 percent were working abroad, slightly over half were employed in the domestic economy, while some 300,000 belonged to the domestic labour force but were unemployed.[49] If those working on a short term or seasonal basis abroad are included, the number of Albanian's working abroad can be estimated to be about 800,000. It is important to keep this fact in mind in the subsequent analysis, which is largely confined to the characteristics of the domestic labour force.

Table 4.1: Labour market characteristics of Albanian population aged 15–64 in 2001.

	Men	Women	Tirana	Other urban	Rural	Total
LF participation rate	82.9	55.9	69.8	72.3	67.4	69.3
Employment rate	67.3	40.0	51.6	48.4	56.8	53.5
Unemployment rate	18.8	28.5	26.1	33.0	15.7	22.7
Wage employment (a)	30.7	32.7	68.3	61.0	10.2	31.5
Part time (b)	47.1	49.4	32.3	43.5	52.6	47.6

(a) As percent of total employment.

(b) Less than 35 hours/week. As percent of total employment.

Source: World Bank (2004: 71).

Remark: Employment rate calculated as percent of those aged 15–64.

Unemployment rate calculated as percent of labour force.

As discussed earlier, the productive deployment of labour in the Albanian economy has gone done sharply from an, admittedly very high, level until 1990. The much reduced ability of the economy to generate adequate employment and income opportunities has been a main factor behind the large scale migration abroad for work. Even so, the labour force remaining in Albania remains poorly utilised (Table 4.1). By 2001 only slightly more than half of those aged 15–64 were gainfully employed. This share was substantially lower among women – 40 percent –

[49] There is no information on unemployment among those working abroad. However, it is reasonable to assume that it is limited in scale and of short duration.

than among men, 67 percent. An additional 16 percent of this age group, or 23 percent of the labour force, were openly unemployed. Unemployment was much higher among women than among men (Table 4.1). The highest rates of unemployment (33 percent of the labour force) were registered in urban areas outside Tirana. The comparatively low rates of open unemployment in rural areas were due to the predominance of agriculture in the rural economy. The low utilisation of the labour force in the domestic economy is further underscored by the high share of part-time employment in total employment. Almost half of those employed worked less than 35 hours per week.

After almost half a century of intensive socialist industrialisation, followed by a decade of painful transition to a market economy, Albania is today an almost completely de-industrialised country. By 2001 manufacturing employment accounted for less than 5 percent of total domestic employment. The virtual collapse of the manufacturing sector is the single most important factor behind the low level of economic activity and utilisation of the domestic labour force. More or less by default and for lack of other options agriculture has re-emerged as the main source of employment and incomes. Agriculture accounts for more than half of the total domestic employment (Table 4.2). The rural economy is entirely dominated by agriculture. Less than 17 percent of the rural employment is non-farm. The urban employment scene is dominated by services. Trade accounts for about a quarter of the urban employment. Together with hotel and restaurants this figure increases to a third. There are clear gender-based differences in the pattern of employment by economic sectors. Construction is a realm of the men, while women dominate in the education and health sectors. While the collapse of manufacturing is likely to have affected men and women more or less equally, the construction boom is benefiting men while public sector cut-backs have affected women negatively.

Table 4.2: Employment by main branch of economic activity, area and sex, 2001. Percentages.

	Men	Women	Total	Tirana	Other urban	Rural
Agriculture	48.5	54.0	50.6	0.2	2.5	83.4
Mining	1.1	0.3	0.8	0.2	1.8	0.5
Manufacturing	4.5	5.5	4.9	12.2	8.8	1.5
Utilities	1.8	0.6	1.4	1.6	2.5	0.8
Construction	8.0	4.2	6.6	7.4	15.1	2.4
Trade	12.8	9.7	11.6	26.7	24.0	2.8
Hotel & restaurants	4.0	3.5	3.8	9.2	7.8	0.9
Transport & commun.	7.4	4.1	6.1	10.6	12.6	2.2
Education	3.1	7.8	4.9	6.7	9.2	2.5
Health & social work	1.2	4.9	2.6	4.9	5.1	0.9
Other	7.6	5.3	6.7	20.6	10.5	2.3
All branches	100.0	100.0	100.0	100.0	100.0	100.0

Source: Census (2001c: 36).

Wage employment accounts for a mere third of the total employment. In other words, more than half of those employed are self-employed (Table 4.3). The high share of self-employment is primarily due to the dominant role of agriculture, where the vast majority are self-employed working on their own farm. However, in urban areas, too, self-employment accounts for well over a third of total employment. Wage employment is considerably more common among women than men, particularly in urban areas. It accounts for three quarters of the female employment in Tirana as against 64 percent of the male employment. The high share of women in public sector employment is probably the main factor behind this difference.

Most of the urban employment (73 percent) is permanent (Table 4.4). In rural areas this figure is lower due to the seasonal nature of agriculture.[50] Still, it should be noted that about a fifth of the urban employment is considered to be temporary or occasional. It is also noteworthy that women enjoy permanent employment to a higher degree than men, probably due to their predominance in the public sector.

Table 4.3: Employment by employment status, 2001. Percentages.

	Employees	Self-employed	– unpaid family members	Total
Men				
Tirana urban	63.6	36.4	8.5	100.0
Other urban	57.1	42.9	11.0	100.0
Rural	11.6	88.4	16.0	100.0
Whole country	30.7	69.3	13.7	100.0
Women				
Tirana urban	75.6	24.4	7.5	100.0
Other urban	67.8	32.2	9.8	100.0
Rural	8.0	92.0	12.9	100.0
Whole country	32.8	67.2	18.0	100.0
Both sexes				
Tirana urban	68.3	31.7	8.1	100.0
Other urban	61.0	39.0	10.5	100.0
Rural	10.2	89.8	19.0	100.0
Whole country	31.5	68.5	15.3	100.0

Source: Census (2001c: 37).

Remark: Self-employed includes employers and unpaid family members.

The role of agriculture as an employment buffer is reflected in the fact that full-time employment, here liberally defined as those working at least 35 hours per week accounts for less than half of the employment (Table 4.5). However, in urban areas, too, full-time employment is far from being a pervasive norm. Some 32 percent of those employed in Tirana and 43 percent of those employed in other towns work less than full time. In urban areas women work more frequently full-time than men, suggesting that part time employment is a characteristic of private sector self-employment rather than public sector wage employment.

[50] The distinction between permanent versus seasonal employment in agriculture would seem to have left ample scope for subjective interpretation in the census.

Table 4.4: Employment by duration of contract, area and sex. Percentages

	Permanent	Temporary	Seasonal	Occasional	Total
Men					
Tirana urban	70.8	18.1	6.1	5.0	100.0
Other urban	70.6	15.5	8.5	5.3	100.0
Rural	61.1	8.8	25.8	4.2	100.0
Whole country	65.0	11.8	18.6	4.6	100.0
Women					
Tirana urban	78.1	14.3	4.9	2.7	100.0
Other urban	76.8	13.1	6.9	3.2	100.0
Rural	61.6	7.5	26.9	4.0	100.0
Whole country	67.8	9.9	18.7	3.6	100.0
Both sexes					
Tirana urban	73.7	16.6	5.6	4.1	100.0
Other urban	72.9	14.6	7.9	4.6	100.0
Rural	61.3	8.3	26.2	4.2	100.0
Whole country	66.0	11.1	18.6	4.3	100.0

Source: Census (2001c: 39).

Table 4.5: Employment by working hours. Hours per week. Percentages.

	Over 34	15–34	Under 15	Total
Men				
Tirana urban	66.6	32.7	0.7	100.0
Other urban	55.8	43.4	0.8	100.0
Rural	50.6	41.6	7.9	100.0
Whole country	53.9	41.1	5.0	100.0
Women				
Tirana total	69.5	29.8	0.7	100.0
Other urban	57.8	41.4	0.8	100.0
Rural	42.2	48.0	9.8	100.0
Whole country	49.8	44.0	6.2	100.0
Both sexes				
Tirana urban	67.7	31.6	0.7	100.0
Other urban	56.5	42.7	0.8	100.0
Rural	47.4	44.0	8.6	100.0
Whole country	52.4	42.2	5.5	100.0

Source: Census (2001c: 40).

Table 4.6: Distribution of employment by status of formality, 2004. Percentages.

	Agriculture	Non-agriculture	All sectors
Formal wage employment	0.9	42.3	22.1
Informal wage employment	5.4	27.1	16.5
Self-employed/unpaid	93.7	29.2	61.4
Employer	0.0	1.4	0.0
All forms	100.0	100.0	100.0

Source: World Bank (2006: 63).

Table 4.7: Incidence of informal employment in selected sectors, 2004. Percentages.

Sector	Informal as % of total employment in sector	% distribution of informal employment	
		Wage employment	Self-employed
Manufacturing	48.1	62	38
Construction	83.2	70	30
Services	72.0	33	67
Public administration	3.0	78	22

Source: World Bank (2006: 65).

Remark.: Self-employed includes employers and unpaid family workers.

Over 40 percent of the non-farm wage employment is informal in the sense that it is with an informal enterprise or not based on any regular written contract. Altogether, some 56 percent of the non-farm employment can be characterised as informal (Table 4.7).[51] Informal employment is most common in the construction sector (83 percent) and in services (72 percent), but is also high in manufacturing (48 percent) (Table 4.8). This suggests that informal employment may be more common among men than women. According to a recent LSMS, working hours are considerably longer in the informal than in formal sector; 48 as against 40 hours per week. There would not seem to be much difference in the average monthly wage between formal and informal employment. However, as working hours tend to be longer in informal employment the hourly wage would seem to be on average 10 to 20 percent lower for those informally employed.[52]

Remittances are, and will be in the near future, a driving force for the Albanian economy. An important question is therefore the effect of migration on the labour supply of those who do not migrate. On the one hand, remittances make it possible for a household to achieve a certain income level with less labour input. On the other hand, remittances may make it possible for the household to maintain the same levels of production and income at home if the remittances are used for productive investments or if there was excess labour before a person in the household migrated. It is difficult to draw any firm conclusion in the case of Albania due to lack of empirical evidence. However, one study shows that emigration had a significantly negative effect on labour efforts in farming households in Albania.[53]

A survey from 2005 on Albanian migrants reports that as many as 76 percent of the migrants were employed prior to their departure. A

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[51] Here taken to include informal wage employment, self-employment and those working as unpaid family members.

[52] World Bank (2006: 66).

[53] Germenji and Swinnen (2004).

majority were employed in agricultural and extraction industries, or manufacturing and construction sectors.[54] Another survey from 2004 concludes that 55 percent were employed full time, 26 percent seasonally employed, 14 percent unemployed and 5 percent were employed part time. About 25 percent were employers, 3 percent farmers and 41 percent employees. This points to low productivity and returns to labour as the main determinants for migration, rather than lack of employment opportunities. Employment in the host country varies by destination. In Greece the majority of men work in construction and agriculture, while they in Italy work in construction, manufacturing and services. Women in both Greece and Italy mainly work with housekeeping. It is interesting to note that the jobs in Italy are at a "higher level in the hierarchy of professions" [than in Greece] and that some Albanians in Italy have moved to self-employment and invested in their own business. Some 80 percent of all the respondents held a full time employment.[55]

Real wages increased rapidly until 1996 from a rock-bottom level in 1992. This trend was broken in 1997, when the financial and economic crisis reduced real wages by almost 30 percent in the course of one year.[56] Since 1999, with the resumption of economic growth, real average real wages have increased at a high and steady pace of about ten percent per year.[57] The highly positive development of real wages reflects to some extent the substantial increases in labour productivity. As noted earlier (Section 2.3) growth has largely been driven by productivity increases rather than by increases in the use of capital and labour. Still, the rapid increase in real wages in a situation where the labour market is depressed and there is large scale open unemployment is quite remarkable and raises a series of questions. One could have expected that the large imbalances in the supply and demand for labour on the domestic labour market would have exerted a downward pressure on wages, even in a situation where labour productivity was increasing.

There are several plausible explanations to this apparent paradox. It seems likely that access to employment opportunities overseas has brought up the reservation wage. In other words, that the option of moving abroad where income opportunities are much higher has resulted in an unwillingness to work for low wages at home.[58] High costs of living in urban areas may also serve to push up wage levels. Aspirations to attain a modern 'Western' style and level of living, fuelled by intense exposure to the West, may also play a roles in exerting upward pressure on wages. Another important factor behind the high rates of real wage increases amidst high unemployment is likely to be severe mismatches between the supply and demand with regard to the qualifications and skills of the labour force. In other words, much of the unemployment is structural and shortages of skills exist along with high unemployment. There is a concern that the educational system is out of tune with the demands of the economy for skills and professional qualifications. As discussed further below, the degree of unionisation of

[54] De Zwager, et al (2005: 4).

[55] De Zwager, et al (2005: 49). In Greece 49 percent of men work in construction and 21 percent in agriculture, while 63 percent of the women work as housekeepers. In Italy 43 percent of the men work in construction, 19 percent in manufacturing and 16 percent in services, while 56 percent of the women work as housekeepers.

[56] Carletto *et.al.* (2004: 22). Real wages almost doubled between 1992 and 1996.

[57] INSTAT (2006).

[58] The majority of the respondents in a migration survey in 2005 declared that they had a monthly income of 1,000 to 2,500 Euros (De Zwager *et.al.* [2005: 4]).

labour is low and there is little collective wage bargaining. Hence, the increases in real wages can hardly be ascribed to strong unions or successful collective bargaining.

Table 4.8: Net average wages in selected Balkan countries. Euros.

	2000	2001	2002	2003	2004	% change 2000–04
Croatia	435	474	502	521	557	28
Bosnia & Herzegovina	191	227	228	253	258	35
Macedonia	172	174	191	194	201	17
Montenegro	96	108	142	174	196	103
Serbia	45	98	152	176	193	325
Albania	*99*	*117*	*129*	*134*	*169*	*71*
Romania	107	116	121	129	147	37
Bulgaria	95	100	111	115	123	29

Source: World Bank (2006: 33).

When measured in dollar terms, the impact of the rapid increases in real wages has been compounded by an appreciation of the Lek. When put in a regional perspective, it can be seen that real wages in Albania has increased at twice the rate or more of those registered in other countries on the Balkans (Table 4.8).[59] Average wages increased in dollar terms by 70 percent in Albania between 2000 and 2004, as against 39 percent in Romania, 29 percent in Bulgaria and 17 percent in Macedonia. By 2004, the average wage in Albania stood at 169 Euros, which is considerably higher than the corresponding wages in EU succession countries such as Bulgaria and Romania. While this development clearly has been laudable from the perspective of those employed, it does raise concern about the development of Albanian international competitiveness, not least in a European and EU context. Expansion of domestic employment opportunities will have to go hand in hand with continued increases in labour productivity, implying a need for very high rates of investments and economic growth.

4.2 Employability and Labour Market Access

4.2.1 Employability

Education has emerged as the arguably most crucial factor for employability in Albania. It presents problems in terms of quantity, nature and quality as well as in terms of availability and affordability. This may appear as something of a paradox as the development of education was one of the few areas where impressive and indisputable achievements were made during the socialist period. On the eve of World War II the Albanian population was 80 percent illiterate.[60] The socialist regime made education a top priority. The introduction of free compulsory basic education and a rapid expansion of secondary education, primarily through the establishment of vocational schools together with a system of adult education to combat illiteracy resulted in a virtual eradication of illiteracy, except for the oldest age groups, and in a rapid increase in the average years of education for the population as a whole. Furthermore, the educational development efforts were guided by a policy to ensure

[59] Serbia and Montenegro presents something of an anomaly. The increases in these countries were largely due to extremely depressed wage levels in dollar terms in 2000.

[60] Census (2001e: 13).

equal access to education. There was a strong emphasis on developing education in rural areas, on eliminating gender disparities in access to education and on providing equal educational opportunities for all irrespective of economic and social background. By 1980 about three quarters of those graduated from primary education went on to secondary education.[61] At the secondary level, there was a strong emphasis on technical and vocational education at the expense of more general, theoretical education. This was consonant with the paramount importance attached to creating an educated and skilled working class as part of a social transformation towards communism and to ensure a supply of labour with the skills and qualifications needed to build an industrial economy. Thus, by 1990 there were 1,726 primary schools and 466 secondary vocational schools, but only 47 schools providing general, more theoretical education in the country (Table 4.9).[62]

Table 4.9: Enrolment in education by level. Number of students (1,000).

	1950	1970	1990	2003–04
Primary	171	555	557	491 a)
Secondary, general	2	30	68	135
Secondary, vocational	5	50	138	22
Tertiary	0.3	26	27	53

a) 2002–2003.

Source: Census (2001e: 14), INSTAT (2006).

The educational system suffered badly from severely reduced resource allocations in the 1990s, resulting primarily from the sharp contraction of the economy, but also as educational expenditures declined as a share of GDP. As a consequence, access to education as well as quality has suffered and much needed reforms of the educational system to make it in tune with the needs of the emerging new market-based economy and society have been hamstrung and delayed. Net enrolment rates in primary school are still high, but have fallen to 92 percent in rural areas while dropout rates have increased.[63] The vocational secondary education has all but collapsed. By 2003 there were only 53 vocational schools left, as against 454 in 1989. This dramatic decline can largely be explained by a lack of demand for this type of education resulting from the deindustrialisation in the 1990s, and from a failure to adapt vocational education to the changes in the economy and in the demand for labour. While the past system of vocational education was oversized and out of proportion, there will clearly be a need for different types of vocational education also in the future. There will be a need for nurses, plumbers and mechanics also in the future, at the same time as there is a need to maintain educational options beyond the primary level also for those who are inclined towards a more practical than theoretical orientation. There is growing concern that shortages of skilled labour is emerging as a constraint on economic development and that this may impede future increases in total factor productivity as well as the international competitiveness of the Albanian economy.[64]

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[61] Census (2001e: 13).

[62] Census (2001e: 14).

[63] Census (2001e: 18).

[64] Verbal communications during visit to Albania September – October, 2006.

Table 4.10: Enrolment and graduation in different types of education.

	1990–91	1998–99	2003–04
Secondary total			
– enrolment	205,774	102,161	134,745
– graduates	31,364	17,097	24,840
Secondary vocational			
– enrolment	138,185	15,133	21,952
– graduates	21,116	3,493	3,492
Secondary general			
– enrolment	67,589	87,028	112,793
– graduates	10,518	13,604	21,348
Tertiary education			
– enrolment	27,461	38,502	52,609
– graduates	4,647	3,997	5,229

Sources: Vjetari Statistikor 1991–1999 (2002: 1154–161); INSTAT (2006).

Parallel to this development there has been an expansion of general secondary education from the very low levels registered during the socialist period (Table 4.10) However, as the expansion of general secondary education has been much slower than the pace of decline of vocational education, the net result has been an overall decline in net enrolment in secondary education. Net enrolment in (in all forms of) secondary education have fallen from 80 percent in at the end of the socialist period, in 1990, to only 43 percent in 2004.[65] This implies than more than half of the young in Albania today leave the educational system with no more than 8 to 9 years of primary education. They are clearly ill-equipped to meet the requirements of the emerging modern economy and their disadvantaged position on the labour market is not only a problem of the present, but will most likely extend far into the future. It is also notable that while the educational gap between Albania and the countries of the EU narrowed throughout the socialist period (at least in terms of years of education), it is now widening at the same time as Albania is being integrated into European economic structures and has aspirations to become an EU member country.

It would also seem as though the expansion of general secondary education has taken place at the expense of quality, as student/teacher ratios and class sizes have increased. Access to tertiary education remained very limited during the socialist period, but has expanded considerably in the past decade. This follows logically from the shift in focus from vocational and technical skills to more general and theoretical knowledge in secondary education as well as from an understanding that a university degree provides an entry ticket to attractive employment opportunities. However, a comparison between enrolment and the number of graduates suggests that the tertiary education is far from efficient (Table 4.10).

Large differences in access to education have also developed over the past decade. Place of residence and income status have emerged as major determining factors for access to education. The chances that a child growing up in rural or peri-urban areas or coming from an income-poor household will be able to complete both primary and secondary education are much worse than if he or she comes from an urban and relative-

[65] Census (2001e: 16–18).

ly well-off family. Net enrolment rates in secondary education are three times higher in urban than in rural areas (75 versus 22 percent in 2002–2003) and more than twice as high for children from non-poor families as for children from poor families (47 and 20 percent, respectively). [66] On the positive side, it can be noted that gender-based differences in access to education remain small. Nor, somewhat surprisingly, does the educational level of the parents seem to matter much for the educational attainment of the offspring's.

One alarming observation is that the group of emigrants that have a higher education than a high school diploma shows less willingness to return. According to one survey, only 46 percent of this group would like to return (compared to 54 percent in the total sample) and 28 percent would not like to return (compared to 21 percent in the total sample).[67] This brain-drain may accelerate the already decreasing educational levels in Albania.

By way of summing up, it must be concluded that the decline and present state of the educational system give great cause for concern. By and large it fails to provide the young generation with the knowledge and skills needed to access adequate employment and income opportunities at present and in the future. There is also a clear risk that the shortcomings of the educational system will emerge as a binding constraint to the development of a modern and strong domestic economy in Albania and to a successful integration of Albania into European economic and social structures. These shortcomings pertain both to the level of education of the young graduates of the educational system, to the quality of their education and, not least, to the profile and content of their educational. In short, it presents a threat to the prospects for Albania to develop, compete and flourish as an equal partner in Europe.

4.2.2 Access to the domestic labour market

As discussed in some detail above, young people in particular experience great difficulties in accessing the domestic labour market. However, these difficulties are primarily due to a sheer lack of employment opportunities – that is a quantitative discrepancy between the supply and demand for labour – and to a qualitative mismatch between supply and demand. Most of the graduates from the educational system do not possess skills and qualifications for which there is a current or potential demand.

Results from enterprise surveys suggest that formal impediments to labour market access, such as might arise from labour legislation and regulations, are not significant.[68] While rules for hiring labour may appear to be somewhat strict, rules for dismissing labour are not.[69] At 15,000 Leke (in 2005), the minimum wage is only half of the average wage and hardly serves as a disincentive to hire labour. However, the cost of labour is considerably increased by social insurance contributions amounting to about 42 percent of the gross wage. Income tax, on the other hand, is low. The tax wedge, calculated as income taxes and combined employer-employee contributions minus cash benefits as percent of total labour compensation, is 33 percent, that is slightly lower

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[66] Census (2001e: 20, 25).

[67] De Zwager, et al (2005: 59).

[68] World Bank (2006: 42).

[69] Fixed term or temporary employment is only permitted under specific circumstances.

than in other East European and Balkan countries.[70] It seems clear that these additional labour costs serve as a disincentive for both employers and employees to enter the formal economy. It also results in an under-reporting of wages to the authorities. However, it is not clear if they also serve to depress the overall demand for labour to any significant degree.

Formal restrictions on geographic mobility – of such paramount importance in the past, are no longer any impediment to accessing the domestic labour market.[71] However, the severe geographic mismatches between the demand and supply of labour, resulting from the concentration of growth and employment opportunities to a few parts of the country, imply that for many people migration is a prerequisite for accessing the labour market. This does constitute a problem as migration for different reasons is not a feasible option for everybody. The high degree of mobility, while generally conducive to facilitating labour market access by bringing labour to areas where there is a demand for labour, needs to be complemented by a geographically more even development of economic activities that brings jobs to where there is a supply of labour. These geographic discrepancies in the supply and demand for labour may well be the single most important impediment for many to access the labour market.

The analysis of the employment dynamics and the characteristics of the labour force above also suggest that there may be gender-based impediments to accessing the labour market putting women at a disadvantage. However, there is not sufficient statistical information to explore this potentially important aspect in detail. This is an aspect which would warrant further investigation.

70 World Bank (2006: 33–35).

71 However, it does remain an important issue for accessing labour markets abroad.

5 Macroeconomic Analysis

5.1 Domestic Economy

The domestic economy has grown at a steady pace of five to seven percent per year since the recovery from the financial crisis in 1997 (Table 2.11). The growth has primarily been driven by domestic demand, which in its turn has been fuelled by remittances from abroad. Exports have played a negligible role in the growth. Indeed, export of goods make up an exceedingly small part of the economy and show no sign of increasing as a share of the economy. Thus, export-led growth has yet to arrive in Albania.

By and large, construction and the services sectors have accounted for most of the growth. There are indications that the contribution of the industrial sector to GDP is increasing, but from an exceedingly low level. By 2004 the industrial sector (including not only manufacturing, but also mining and power and energy) accounted for a mere 10 per cent of GDP (Table 2.13). Indeed, the extremely small size of the manufacturing sector stands out as a main characteristic and cause of concern in the Albanian economy. Another main feature and problem is the continued large size of the informal economy. The size of the informal or unregistered economy is uncertain. In the national accounts it is estimated that its contribution to GDP is around 30 per cent.[72] The informal economy consists of, mainly small, business that exist outside the legal and regulatory framework while pursuing otherwise legal activities, as well as business that are involved in criminal activities.

The small manufacturing base is a cause of concern for several reasons. It is likely to result in small multiplier effects in the economy. Much of the inflow of remittances into Albania are spent on imports and are thus lost to the economy in the sense that they do not create much domestic growth and employment opportunities. This points to a weak supply-response of the domestic economy to the demand created by remittances. This is both reflected in and due to the small size of the manufacturing sector and suggests severe shortcomings in the overall business environment (discussed in section 6.1, below). The virtual absence of a manufacturing sector also results in poor linkages within the economy. Agriculture suffers from a lack of backward and forward linkages and agro-processing facilities; tourism generates little multiplier effects as most of the goods consumed are imported; much of the beneficial impact of FDIs in terms of

[72] The national accounts system remains weak and the statistics produced suffer from considerable uncertainty and should be interpreted with great caution.

backward and forward linkages and technological spill-over is lost as they remain isolated economic islands in the absence of domestic firms that they can relate to etc. The large informal economy has much the same impact. One reason why formal and informal enterprises find it difficult to engage in business with each other is because while formal enterprises pay and can deduct VAT, the informal enterprises do neither.

A main conclusion emerging from the analysis of the development dynamics (Chapter 2) is the need for sustained and high rates of economic growth and domestic employment creation, which in its turn demand high rates of investment both from domestic sources and in the form of FDIs. Unfortunately, the statistics on investments generated by the national accounts are unreliable.[73] Estimates by IMF suggest that domestic investments amount to slightly less than a quarter of GDP (Table 5.1). Private domestic investments remain slightly below 20 percent of GDP, to which should be added FDIs, which remain small at 3 to 4 percent of GDP. While by no means negligible, considerably higher investment rates are likely to be needed to achieve sustained high rates of growth, particularly in view of the need for a redevelopment of the manufacturing sector.

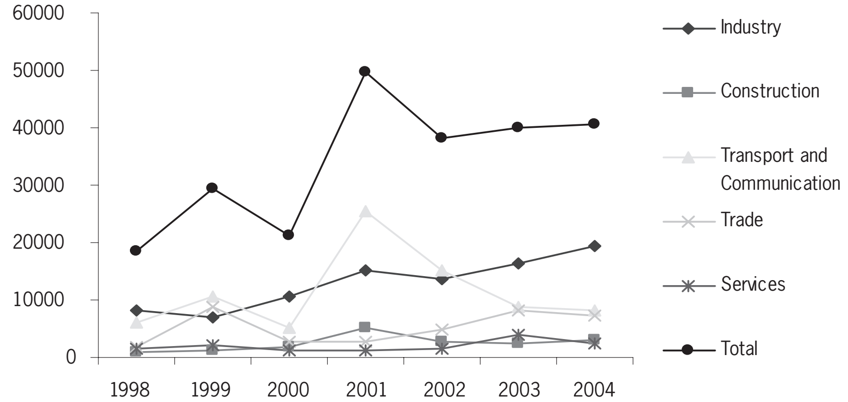
Table 5.1: Development of savings and investments as percent of GDP.

	2001	2002	2003	2004	2005
GDP (billions of Leke at market prices)	587.7	624.7	682.7	766.4	836.9
Domestic Savings	24.8	17.4	17.9	20	16.7
– Public	-0.6	0	-0.1	0.1	1.2
– Private	25.4	17.4	18	19.9	15.5
Domestic Investments	27.6	24.5	23.4	23.8	23.6
– Public	7.3	6.7	4.6	5	4.6
– Private	20.3	17.8	18.8	18.8	19
Foreign Direct Investments	-	*3*	*3.2*	*4.6*	*3.1*
Total Investments (billions of Leke)	-	*171.8*	*181.6*	*217.7*	*223.5*

Source: IMF (2006a: 31)

Investment data derived from annual surveys of domestic, formal enterprises presents a slightly more positive picture (Figure 5.1). According to these data, investments by domestic enterprises have increased substantially since 1998–1999 and investments by enterprises in the industrial sector are increasing, albeit from a very low level.

Figure 5.1: Investments by enterprises by sector 1998–2004. Million Leke.



Source: INSTAT (2006).

[73] There is a large discrepancy between the production side of the GDP and expenditure side.

5.2 External Economic Relations

5.2.1 Balance of payments, trade and capital flows

The virtual absence of a manufacturing sector in Albania comes out very clearly in the balance of payments. Export of goods amount to a mere 8 percent of GDP, while imports amount to about 30 percent of GDP, resulting in a trade deficit equivalent to more than 20 percent of GDP (Table 5.2).[74] This huge trade deficit is largely neutralised by the inflow of remittances, which are estimated to be around 13–15 percent of GDP.[75] The resulting current account deficits, which in recent years as oscillated between 5 and 8 percent of GDP, have been covered by FDI and, to a lesser degree, ODA. Hence, the deficit has not been debt-generating. At least from a short term perspective it can be concluded that there are no major imbalances in the external accounts. However, in a more long term perspective, it is clear that there are serious structural weaknesses. The huge trade imbalance and the very low level of exports underscore how dependent the external balance as well as the economy as a whole is on a continued, steady high inflow of remittances. While the likelihood of abrupt changes in remittances is low, it is reasonable to expect that the inflow of remittances will eventually level off and probably also begin to decline. The only way to compensate for this and to secure future growth is through a development of the domestic economy, where increased exports and FDI need to play a key role.

Table 5.2: Balance of Payment.

	Euros (million)				**Percent of GDP**			
	2002	**2003**	**2004**	**2005**	**2002**	**2003**	**2004**	**2005**
- Export of goods	349	396	486	530	7.4	8.0	8.1	7.9
- Import goods	1555	1572	1752	2007	33.1	31.6	29.1	29.7
Trade balance	-1206	-1176	-1266	-1477	-25.7	-23.6	-21	-21.8
- Export of services	613	635	808	930	13.1	12.8	13.4	13.8
- Import of services	622	708	848	1083	13.2	14.2	14.1	16.0
Service balance	-9	-73	-40	-153	-0.1	-1.4	-0.7	-2.2
Balance of goods and services	-1215	-1249	-1306	-1630	-25.8	-25.0	-21.7	-24.0
Income balance	134	152	146	119	2.8	3.1	2.4	1.8
Private transfers	612	693	830	984	13.0	14.0	13.8	14.6
Current account	*-469*	*-404*	*-330*	*-527*	*-10.0*	*-7.9*	*-5.5*	*-7.6*
Official transfers	132	129	103	62	2.8	2.6	1.7	0.9
Foreign direct investments	142	158	277	212	3.0	3.2	4.6	3.1
Other capital	113	42	-13	41	2.4	0.8	-0.2	0.6
Official lending	95	75	68	64	2.0	1.5	1.1	0.9
Capital account	*482*	*404*	*435*	*379*	*10.2*	*8.1*	*7.2*	*5.5*
Error and omission	-12	26	73	187	-0.3	0.5	1.2	2.8
Net balance	-1	-27	-177	-39	0.0	-0.6	-3.0	-0.6

Sources IMF (2006a:37–38)

[74] Due to under-invoicing of imports actual imports are higher than recorded. Efforts to improve the functioning of the customs are believed to have reduced under-invoicing and non-declaration of imports in the past year and may well be the main reason behind the increased *recorded* imports in 2005.

[75] The role of remittances is discussed in some detail below (section 4.2.2).

5.2.2 Trade and capital flows

The immature development of exports is further underscored by a heavy dependence on a few types of commodities and on a few countries of destination. Italy is the destination of almost three quarters of all exports, followed by Greece as a distant second (Table 5.3). Textiles and shoes dominate the exports entirely, although its share has fallen slightly in recent years. It seems safe to conclude that the predominance of exports of textiles and shoes to Italy in Albania's total exports is the result of a number of Italian and joint Albanian-Italian investments in manufacturing in Albania.

Table 5.3: Structure of trade by groups of commodities and by countries. Percentages.

	2000	2001	2002	2003	2004	2005
Exports						
Food	10.3	9.1	9.5	8.3	8.2	8.2
Fuels and minerals	2.7	1.8	2.7	2.6	4.0	5.3
Chemicals	0.8	1.4	0.6	0.7	0.6	1.1
Leather products	3.2	3.6	4.4	2.6	2.3	2.0
Textile and foot wear	65.1	65.3	64.6	64.6	61.0	57.9
Construction material	8.6	8.6	9.7	11.6	14.7	15.8
Machineries	1.9	3.4	2.7	3.5	3.9	4.1
Others	7.3	6.8	5.7	6.2	5.3	5.6
Imports						
Food	22.3	19.4	20.4	19.9	19.5	17.6
Fuels and minerals	13.2	13.7	12.8	11.9	10.6	12.0
Chemicals	8.5	8.3	8.7	9.2	9.6	10.2
Leather products	1.7	2.1	2.5	3.0	2.6	2.1
Textile and foot wear	14.4	14.0	14.7	14.5	13.4	12.3
Construction material	11.8	12.4	12.8	13.1	13.0	14.9
Machineries	21.1	23.7	21.4	21.7	23.6	23.6
Others	6.9	6.5	6.7	6.8	7.7	7.3
Destination of export						
Italy	71.4	70.5	72.4	74.9	73.1	72.3
Greece	12.7	12.9	12.6	12.8	11.9	10.5
Origin of imports						
Italy	35.1	31.9	34.5	33.5	32.5	29.3
Greece	26.4	25.7	21.7	20.0	18.5	16.4

Source: INSTAT (2006).

However, the poor export performance is not only due to weaknesses in the domestic economy, but also to formal and informal trade barriers. Although Albania has a free trade agreement with EU as well as with the neighbouring Balkan counties, significant non-tariff barriers remain. A recent study on linkages between economic development and the process of alignment to the institutional and regulatory frameworks of EU concludes that poor productions standards, lack of standard-related legislation, inadequate standard-related certification and control capacity, and not least the non-extension of the pan-European agreement on rules of origin to Albania and the other countries in the Western Balkans, are main constraints on the development of exports to EU.[76] Furthermore, many of the main Albanian export products are exempted from free trade agreement with EU and subject to 'managed' trade in order to protect 'vital' EU economic interests. A study in 2003 concluded that no less than 62 percent of the Albanian exports to EU fell under the concept of 'managed' trade and, thus, subject to restrictions incompatible with the principles of free trade.[77]

As might be expected, imports display a much more diverse picture than exports. Construction material and machinery account for 35 – 40 percent of all inputs. At least a part of this import is no doubt used for domestic investments and for a development of the domestic productive capacity. On the other hand, it can be noted that food imports amount to about a fifth of all imports, reflecting the sorrow state of the Albanian agriculture considering that the country was self-sufficient in food only twenty years ago. Albania also imports about as much textiles and footwear as it exports

5.2.3 Remittances

Data on remittances are very approximate and information on savings and transfer patterns is patchy. A very high, but declining, share of the remittances is sent through informal channels (Table 5.4). In addition to remittances in cash, durables, electronic equipment and other goods bought by migrants abroad are sent or brought back to Albania. The value of these goods has been estimated to about one sixth of the remittances of money.[78] Furthermore, many migrant keep much of their savings in the host country and bring them back when, and if, they return to Albania. Table 5.4 presents the volume of remittances as estimated by the Bank of Albania and the distribution by channels of transfer.

Table 5.4: Development of GDP and Remittances. Million USD at current prices.

Year	Remittances	Informal channels as% of total	Remittances as% of GDP
1991	8	-	0.5
1992	148	-	9.4
1993	275	-	15.6
1994	378	92.5	19.4
1995	385	84.5	15.5
1996	500	88.0	16.6
1997	267	68.7	12.3
1998	452	74.9	16.5
1999	368	75.8	10.7
2000	439	69.3	11.9
2001	543	60.3	13.2
2002	612	55.3	13.0
2003	693	60.1	14.9
2004	830	54.3	13.8

Sources: IMF (2006a: 37–38); UNSTAT (http://unstats.un.org); World Bank (2004: 8); INSTAT (http://www.instat.gov.al); Zwager, et al (2006:21).

[76] DRN (2005: vi, 50–61).

[77] Gressani and Michalopoulos (2003), quoted in DRN (2005: 55).

[78] Zwager, et al (2006: 21).

Albanian migrants are notable by their propensity to save and have accumulated a substantial pool of savings abroad. One study estimates that Albanians in Italy save 55 per cent of their earnings and remit 66 per cent of their savings, suggesting that about a third of the savings are kept abroad.[79] Some 74 percent of the respondent in a survey in 2005 reported that they kept at least some of their savings in a bank account in the host country. Surveys suggest that most Albanians working abroad have the intention to return home some day. According to one survey, about half of the migrants intended to return and the majority of them planned to return in five to ten years time.[80] Still, relatively few have so far returned.[81] If and when these migrants return they are likely to bring with them their savings. These savings, which are a potential pool of investment, have been estimated to amount to 4.8 to 5.4 billion Euros, which is almost the equivalent of Albania's GDP in 2003.[82] To what extent these accumulated savings actually will be invested in Albania will not least depend on the perception of the economic outlook for Albania and the business environment affecting the returns of investments. In-depth interviews with migrant reveal that much would have to change before they would decide to return and invest in Albania. Lack of security, poor infrastructure, political instability and lack of long-term credits are perceived as main constraints (see further chapter 6.1).[83]

There are both positive and negative macroeconomic impacts of remittances in general, but there is little information on their effects in Albania. Most research has focused on the multiplier effect, the effect on the foreign exchange reserves and current account balance, and exchange rate effects. Inflows of foreign currency exert an upward pressure on the exchange rate but the ultimate effect of this pressure depends on to what extent the remittances are used for imports and hence flow out of the country. The extent to which such an upward pressure on the exchange rate caused by remittances will hurt the competitiveness of the economy depends in turn on a variety of factors. Several studies argue that remittances have resulted in an appreciation of the Lek, which has affected the competitiveness of Albanian exporters and subjected producers for the domestic market to increased competition from imports. It has also affected the demand for non-tradable goods, such as buildings.[84] Still, it may be concluded that while the impact of remittances on the exchange rate so far may have been modest – since most remittances have been used on imported goods – this impact will increase if remittances increasingly begin to be used for consumption of domestic goods and for investment.

More importantly, however, is that there is a wide agreement in Albania that remittances contributed greatly to the financial recovery of the economy in the 1990s. It has also been conducive to macroeconomic stability, even though the trade deficit is very large. The current account deficit has remained manageable owing to the inflow of remittances (Table 5.2). Moreover, remittances have been less vola-

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79 Conti, et al (2003).

80 Gedeshi et al (2003) found that 66 per cent would like to return, while Zwager, et al (2005) found that 54 per cent expressed a readiness to return.

81 Zwager, et al (2005: 57–58). The few returning migrants are farm workers trying to find job during the winter season or persons who migrated to accumulate capital to start a micro business.

82 Zwager, et al (2005: 52,63).

83 Zwager, et al (2005: 62–63).

84 Zwager et al (2005: 46–47).

tile that FDI and development assistance, which also has contributed to macroeconomic stability.

A crucial factor affecting the economic impact of remittances in Albania is if remittances are consumed or invested and, if invested, in what. The most common use of remittances has so far been to finance daily consumption needs, followed by building, up-grading and furnishing the domestic dwelling. The next category of use of remittances is investment in real estate.[85] However this may change in the future as construction and reconstruction reaches a saturation level and if the environment for other investments improves. A study on return migrants argued that remittances commonly provide the start-up capital for micro businesses or are used to buy equipment to improve the productivity of existing businesses.[86] This picture is confirmed in the BEEPS survey of 2005, which concludes that 40 per cent of start-up capital for new enterprises, 40 percent of new investments in existing enterprises and 10 percent of working capital come from internal sources.[87] A survey in 1999 found that 17 per cent of all investment in Albania came from migrants' savings[88]. In the survey from 2005, migrants stated that they planned to invest their remittances in, firstly, retail trade and restaurants, secondly in construction, thirdly in real estate, fourthly in tourism and fifthly in agriculture. Very few were inclined to invest in manufacturing.[89] Another indication that remittances increase small business activity is that the percent of owner-occupier dwellings increased from 85 to 92 percent upon return of migrants, and a larger proportion became employers. The probability that the return migrant became business owners increased with the duration abroad.[90]

Remittances have had a direct positive effect on poverty reduction in Albania. Remittances are person-to-person transfers and add directly to the household income. Moreover, they tend to be counter-cyclical which means that they decrease the effect of economic fluctuations though consumption smoothing. A household survey from 2000 indicates that in 1999 some 26 percent of the rural households had received remittances from relatives and for 62 percent of these households, remittances was the main source of income.[91] Another qualitative study by the World Bank in 2002 concluded that remittances were by far the most important factor distinguishing poor and non-poor households, and that households receiving remittances were more likely to be non-poor. The living conditions for those who did not receive remittances were often very bad.[92] For many families in Albania, migration and the resulting remittances is considered as the most viable means to escape poverty.[93] In a migration survey from 2005 only 3.7 percent of the households receiving remittances reported that their financial situation had not improved, while no less than 59 percent of the households without income from remittances

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85 Zwager et al (2005: 51).

86 Labrianidis and Kazazi (2006: 61).

87 2006 Transition Report. For micro firms: 33 per cent of start-up, 40 percent of new investments and 20 percent of working capital. For small firms: 45 per cent of start-up, 35 percent of new investments and 10 percent of working capital.

88 Kule et al. (1999: 8–9).

89 Zwager, et al (2005: 51,62).

90 Labrianidis and Kazazi (2006: 61).

91 Zwager, et al (2005: 39).

92 De Soto, *et al* (2002).

93 IMF (2005).

claimed that their financial situation had not improved.[94]

It is often believed that there is a U-shaped between household income and the propensity to migrate. In other words, the poorest and the richest are less inclined to migrate than those in between. The poorest lack the means and resources to migrate and cannot afford the risks involved, while the richest see no need to migrate.[95] A migration survey in 2004 suggested that this pattern may apply also on Albania. It was found that the poorest and most marginalised households were less inclined to be involved in migration.[96] However, two important reservations to this conclusion need to be made. First, it is possible that the households with very low income levels still received remittances from relatives abroad even though no immediate family member from the household has migrated. Secondly, migration is often stepwise. In poor households, migration for work within the country can be used to generate savings that are subsequently used for migration to a neighbouring country such as Greece, where additional savings are made, making in possible to migrate to more distant countries, such as Italy or Great Britain, where the income possibilities are higher. Empirical studies suggest that such a stepwise pattern may indeed be common also in Albania.[97]

5.3 Public Sector

Tight fiscal policies have brought down the budget deficit from 7.5 percent of GDP in 2000 to less than half of that level in 2005, at the same time as net domestic borrowing has been reduced and the public debt has been brought down from 67 percent of GDP in 2001 to below 56 percent in 2005.[98] This improvement in the fiscal balance has been achieved through a relative contraction of public expenditures (as share of GDP) rather than through any increase in the share of public revenues in GDP, which have remained constant at slightly below a quarter of GDP. The domestic public revenues are primarily made up of indirect taxes. VAT, excise taxes and customs duties accounted for slightly more than half of the tax revenues in 2005. Taxes on business made up some 13 – 14 per cent of the tax revenues, while taxes on labour – primarily in the form of social fund contributions – accounted for about a quarter of the taxes. The emphasis on indirect taxes, i.e. mainly taxes on consumption – rather than on taxes on production, i.e. on labour and on enterprises, is reasonable given the importance of remittances in the economy and the need to create a better balance between domestic production and consumption. Although not high by the standards of Western Europe, the combined taxes on labour is somewhat disconcerting in view of the still severe shortfall of employment opportunities.

Grants play an insignificant role in public revenue, reflecting the fact that Albania is not dependent on ODA. Most of the, decreasing, budget deficit has been covered by domestic borrowing rather than from borrowing from foreign sources.

The expenditure side of the budget give some cause for concern. Expenditures on education and health care are by any standards very low; at 3.1 and 2.5 percent of GDP respectively. Expenditures on these crucial sectors are low compared to those of other European countries.

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94 Zwager, et al (2005: 40).

95 Germenji and Swinnen (2005).

96 Labrianidis and Kazazi (2006: 63).

97 Carletto *et.al.* (2004); King (2004),(2005).

98 IMF (2006a: 5).

Table 5.5: Government revenue and expenditure as percentage of GDP.

	2000	2001	2002	2003	2004	2005
Total Revenue	24.5	24.7	24.5	23.4	24.4	24.4
– Revenue excl. grants	22.6	22.9	23.8	23.1	24.1	23.7
– Grants	1.9	1.7	0.6	0.4	0.3	0.7
Total expenditures	32.0	31.5	30.5	28.2	29.4	28.0
– Current	25.0	23.9	24.5	23.8	24.4	23.2
– Capital	6.8	7.4	6.0	4.4	5.1	4.6
Budget deficit	-7.5	-6.8	-6.0	-4.8	-5.0	-3.6

Source: INSTAT (2006) and IMF (2006a: 39–40). 2005 figures are estimations.

By comparison, it may be noted that public expenditures of education as a share of GDP was 5.2 per cent in the countries of the European Union in 2004. For most of the new member countries, the share was even higher, e.g. Poland 5.6 per cent, Hungary 5.5 per cent and for the three Baltic countries 5.7 per cent.[99] This discrepancy becomes even more remarkable when one considers that these EU countries have a much larger GDP than Albania as well as, in most instances, a smaller share of the population in school age. The expenditures on education and health care are also low compared to expenditures on other sectors (viz. 'social security' 7.4 per cent of GDP and 'defence and police' 2.9 per cent of GDP) and, in particular, very low in the light of the need for Albania to invest it human resources and to begin to close the large educational gap vis-à-vis the countries of the European Union. Another cause of concern is the declining share of capital expenditures in total government expenditures (Table 5.5). It seems as though the reduction of the fiscal deficit has mainly taken place at the expense of public capital expenditures, which have gone down from a peak of 7.4 percent in 2001 to no more than 4.6 percent in 2005. Both the downward trend and the low level of public investments are worrying in view of the very large needs for public investments in physical infrastructure, such as roads, electricity and sewage systems. It is hard to escape an impression that austere fiscal policy in combination with a need for large public expenditures on areas directly connected to the EU integration agenda is exerting a squeeze on other areas that are vital from a development perspective, but not necessarily in the focus of the EU integration agenda, such as education, health care and physical infrastructure.

The budget presents a mixed picture from a poverty and equity perspective. Taxes on labour are more or less proportional and contain only a small element of progressiveness. Indirect taxes, too, are likely to be more or less proportional, although those with a high content of goods procured in the informal economy in their consumption basket are relatively more lightly taxed. On the expenditure side, the high share of expenditure used for social security and welfare has an important redistributive impact and its importance for reducing consumption poverty is well-documented.[100] However, the low shares of expenditures devoted to education and health point to a failure to devote sufficient resources for investment in human resources, which in particularly hurts the prospects

[99] Europe in Figures (2005: 102).

[100] IMF (2005); World Bank (2003).

of the poor. Put in different terms, the budget displays a focus of redistribution in support of the immediate needs of the poor at the expense of investing in human resources and in creating better prospects for the future of the poor.

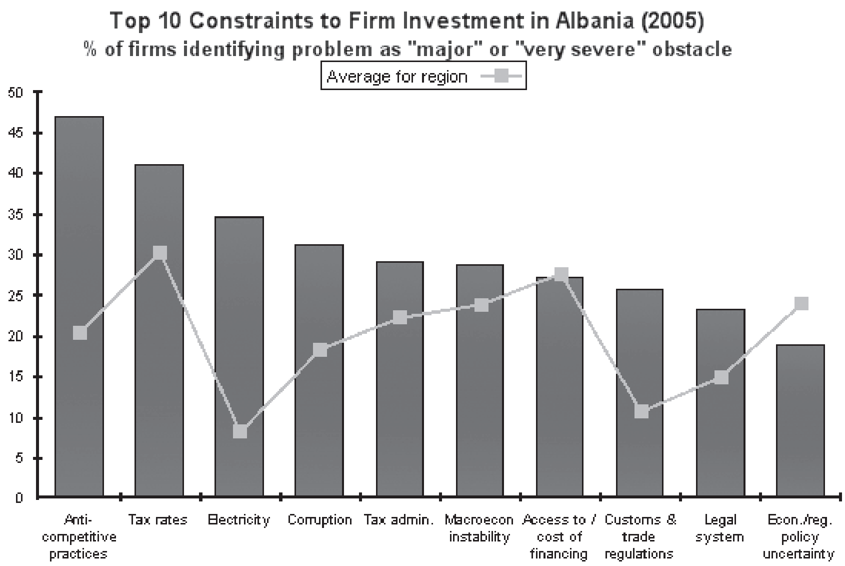
Another important dimension in an assessment of the 'pro-poorness' of the budget is the inadequate coverage of the fiscal system and the widespread tax evasion. As long as those with sufficient money, connections and power can avoid taxes with impunity it is difficult to claim that the fiscal system is pro-poor.

6 Business Environment Analysis

6.1 The Domestic Environment

The main constraints for businesses in Albania according to the Investment Climate Survey (ICS) of the World Bank in 2005 are presented and compared to an average in the Eastern Europe and Central Asia region, in Figure 6.1. The ICS is based on data collected through the EBRD-World Bank Business Environment and Enterprise Performance Survey (BEEPS).[101]

Figure 6.1: Constraints in the business environment in Albania.



Source: World Bank (2006b).

Remark: Data from 2005. The "region" refers to Eastern Europe and Central Asia (ECA).

The low level of economic activity and capital stock *per se* affects the incentives for further business development. Albania's economy is very small, and as a result domestic backward and forward linkages are weak. There is a lack of both sources of input (raw material, machineries, maintenance services, etc) and possibilities to further process the output

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[101] For an overview of previous studies on the Albanian business environment, see Tanburn and Lati (2005).

of a specific business. This has several implications. Fist of all, it affects the incentives for private investors who are faced with high costs of inputs and a lack of demand for the products. The low level of economic activity also limits the number of enterprises that would benefit from public investments and creates few multiplier effects in general. This decreases the incentives for public investments which may be crucial for private sector development. It also affects the development of financing and marketing services, which need a minimum market size in order to be profitable. Albania is not an exception to these common problems of less developed economies. However, little can be done policy-wise other than encouraging capital formation by creating incentives for foreign direct investments and domestic investments. A first question is if the problem of low levels of investments in Albania is connected to high costs of investments (cost and access of credits) or low returns to investments.

Access to and the cost of finance does not seem to be a binding constraint for the private sector development in Albania today. In the ICS it was listed as the seventh major constraint to business, but the number of respondent referring to this as a major problem is comparable to other countries in Eastern Europe and Central Asia. Some 23 percent indicated that access to finance was a major problem, while 15 percent indicated that the cost of finance was a problem. The financial sector is dynamic and there are currently 16 banks, of which 14 are foreign, in Albania, and micro-finance institutions are expanding. The legal rights of borrowers and lenders in Albania also score high compared to other countries. This does not mean that there are no problems in the financial system, which is still affected by low trust after the pyramid games, lacks public credit information, etc. However, as mentioned in section 5.2.3, the median share of business costs financed by remittances was 40 percent of start-up capital for establishing new enterprises, 40 percent of new investments in existing enterprises and 10 percent of working capital, which clearly shows that there are alternative financial sources to bank credits.[102] This is also mentioned in the ICS, which concludes that 80 percent of the small, 75 percent of the medium and 73 percent of the large firms' investments were financed by internal sources. On the question why a firm did not apply for a loan, more than 70 percent answered that they simply did not need a loan.[103] By way of concluding, the main reasons for lack of investments in Albania are not due to limited access to or cost of credits but to low returns to investments as a result of a non-attractive business environment.

There have been improvements when it comes to the administrative costs of starting, running and closing a business in Albania. A task force and a reform agenda on the direct administrative costs of doing business has resulted from a survey by FIAS in 2002. Many of these procedures have been simplified and the time devoted to applications, interpretation of regulations, etc. has decreased.[104] For example, the time to start a business and the number of procedures is just slightly higher than in the average for the region (39 days compared to 32 days, and 11 compared to 9.2 procedures).[105] However, the cost in terms of percent of GDP is almost the double (22 percent compared to 14 percent), reflecting the low level of GDP in Albania. Even though reforms removing these types of constraints need

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[102] EBRD (2006).

[103] BEEPS (2006: 12)

[104] For detailed information, see http://www.doingbusiness.org/ExploreEconomies/Default.aspx?economyid=3

[105] Eastern Europe and Central Asia.

to continue, there is nothing to suggest that Albania stands out in a regional comparison and it would be hard to argue that they are the current binding constraint for the private sector. The main reasons for low investment activities lie elsewhere in the business environment.

Anti-competitive practices are the most commonly stated obstacle for business, both in formal surveys and in informal interviews. An uneven playing field for business can be a result of a large informal sector that escapes some constraints in the formal business environment. In such a case, the statement that anti-competitive practices are the major constraint can be interpreted as an indicator of a generally bad investment climate. The size of the informal sector, and hence anti-competitive practices, would then decrease as the benefits of becoming formal increase, i.e. as the business environment improves and the informal sector decreases. However, in the case of Albania there are reasons to believe that the anti-competitive practices are not only a consequence of a large informal sector, but, much more importantly, a consequence of private captures of the state and state capture of the economy. That is, an environment where politics and business are intertwined. In fact, the size of the informal sector is to large extent a result of trying to cope with an uneven playing field created by the unsavoury practices of politicians and not only a result of trying to escape formal rules. The fact that politicians favour some businesses over others when it comes to public procurement, property rights, etc. does not only distort the environment for private businesses directly (monopoly situations in some markets, unequal legal rights, etc.), but also indirectly through inefficient use of public resources (resources are allocated according to political connections instead of efficiency criteria). The strong links between politics and business creates low trust in the state as a major actor in the market, as discussed below, and a lack of willingness to pay taxes resulting in low levels of public resources. Hence, there is a lack of resources and the resources available are inefficiently used. It is difficult to break the unsound connections between business and politics. Yet, it is crucial to develop transparent public financial systems at all levels of the government, making politicians accountable to people active in all types of business and employment. As is clear from Figure 6.1, the problem of anti-competitive practices is perceived as a major constraint by almost half of the enterprises in Albania, which is more than double the average figure for the region.[106] Improvements in this area could most probably also have a significant impact on the level of return migrants, who with their international experiences might in their turn fuel the public debate on these important issues.

The role given to and taken by the government in building a good business environment is very limited. Public goods, such as infrastructure and a reliable legal system, that are needed for a functioning free market economy are clearly under-provided in Albania. The Albanian state at present serves mainly as an institution for income redistribution and provider of some social services and not a provider of a sound framework for a market economy. There is a tendency to believe that a free market will solve all bottlenecks and there is a lack of confidence in the capacity of the state to take the role as provider of public goods, which by their very nature will not be spontaneously provided by the market itself. A development without any planning and coordination mechanism is neither good for the private sector, nor for the development of Albania as

[106] Eastern Europe and Central Asia.

a whole. It boils down to a lack of agreement on the role and responsibilities – where they start and where they end – of the state and the citizens. An improved public-private dialogue may be one way to increase the confidence and understanding of the role of the government, and to improve the efficiency and relevance of the business environment policies provided by the government. The trust in the government as coordinator and strategic planner is also linked to the functioning of the fiscal system.

The nature of corruption is changing in Albania. Corruption is still perceived as an obstacle to do business and is ranked as the forth most severe constraint according to the ICS. An Action Plan on Prevention and Fight against Corruption was adopted in 2003 and the new government came to power on their promises to fight corruption aggressively, which may have affected the decrease of bribes as a share of annual sales from 2002 to 2005. However, the number of firms stating that unofficial payments are frequent has increased. Decomposing this into sectors a clear picture emerges. The frequency of corruption has decreased slightly in the fields of tax collections and customs, but has increased significantly when it comes to dealing with courts, obtaining a government contract and obtaining a business licence or permit.[107] According to a USAID survey, 64.3 percent of the procurements involved bribes at some level. The same study concludes that there was a decline 2004–2005 in the number of respondents who had been asked for bribes from public officials and police, as well as from doctors or nurses. However, the levels are still very high. When looking at the trust in Albania's institutions, the highest trust was for the Armed Forces, while political parties and trade unions got the lowest scores. The trust in public institutions is slightly higher among those who work there but it is till very low. [108]

Property right issues, especially connected to land, and a reliable legal system are also important constraints to development in Albania, not least for FDI. It covers problems with registration but also legalisation and its implementation, and the right to compensation at expropriation. The property right issue is more severe in the urban areas and along the coast; about 80 percent of rural land is registered but only 20 percent of urban land.[109] Since disputes on rights to assets are related to the economic value of the asset, the problem will accelerate in urban areas where land is becoming more and more attractive and prices increase. The problem of property rights is closely related to problems in the judicial system which is ranked as ninth major constraint by Albanian businesses in the ICS survey. Even if you have a registered property right or a signed business contract, this may be of little value without efficient legal protection in case it is violated. The percentage of firms in Albania that use courts to solve overdue payments is less than half compared to the region. When asking firms in general there has been an increase from 2002 to 2005 in the number of firms agreeing that the judicial system is able to enforce decisions, affordable, quick, honest/uncorrupted, and fair and impartial. However, when asking the firms who have actually used the system, there is only an increase in the number of firms who think the judicial system is

[107] BEEPS (2006).

[108] USAID (2005: 7, 10, 16).

[109] The concern of property rights issues as a major constraint for the private sector differs. This probably reflects that more than 90 percent of the enterprises in Albania are micro or small enterprises and for those, there are other constraints that are more acute. However, in order for Albania to attract the amount of foreign or migrant investment needed to enhance productivity and arrive at a level of economic activity needed to compete with its neighbouring countries, the property right issues are crucial.

affordable, but fewer agrees on the other dimensions.[110] As mentioned above, corruption in courts seems to have increased from 2002 to 2005. Another survey finds that the trust in that the legal system will punish criminals decreased from 36 to 32 from 2004 to 2005 on a scale from 0 to 100.[111] Hence, there seems to be few signs of improvement when it comes to trust and efficiency in the legal system.

Government revenues and the tax system need to be reviewed and anchored. Businesses in Albania complain of frequent changes in rules and rates when it comes to taxes.[112] It is therefore important to look at the tax system as a whole and to create a transparent and sustainable system. According to the ICS, tax rates are the second most severe constraint to business and tax administration the fifth. The tax rates are the second most severe constraint for small businesses and the first for medium-sized businesses, while large businesses state that tax administration is the most severe constraint for their development.[113] While many other cost of doing business indicators are decreasing for Albania, the percentage of firms indicating tax rates and tax administration as a problem is increasing.[114] The decentralisation process, if combined with increased transparency and more efficiently used public resources, may improve the relation between economic actors and government authorities and thereby the willingness to pay as well as the incentives to collect taxes.[115] Even though the VAT is a tax on consumption and as such does not affect firms directly, the malfunctioning VAT system has for long been working against the domestic production. Businesses must wait a long time for VAT reimbursement; most enterprises report that they have had to wait between 181 days and one year, but about 20 percent of the enterprises have had to wait for several years.[116] Since imports can be exempted from VAT, there are incentives to use imported rather than domestic raw material.

Infrastructure is a major business constraint in Albania, especially for manufacturing and the tourism sector. Public investments in infrastructure mirror the limited expenditures of the government on the productive economy overall (see section 5.3). The lack of infrastructure is especially severe in the rural areas, which hinders not only the development of agro-business and other manufacturing industry but also the potential for tourism in these areas. Electricity is rated as the third major obstacle to business by the ICS, and it is especially severe for small and medium sized enterprises.[117] On average 11.2 percent of sales is lost due to power outages, which is very high compared to 3.4 percent in the region and 4.5 percent in lower middle income countries. Another remarkable figure is the days per year of insufficient water supply which is as high as 90.5 days in Albania compared to 4.4 in the region and 13.9 in lower middle income countries. Transportation is not identified as a major constraint in the ICS. However, this is most probably due to the fact that only existing firms were included in the sample and not the potential of new businesses that have not been started since they are

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110 BEEPS (2006).

111 USAID (2005: 14).

112 The ARCS study referred to in Tanburn and Lati (2005: 10).

113 World Bank (2006b).

114 BEEPS (2006).

115 The community taxes were not collected by the community authorities before due to fear of corruption. However, the lack of incentives for central tax authorities has been a major problem.

116 The ARCS study referred to in Tanburn and Lati (2005).

117 Large firms have usually alternatives sources at hand when there is a power outage, such as diesel engines.

dependent on efficient transportation. There are as mentioned large differences in the infrastructure of roads between the major cities and the smaller towns and villages in the rural area. The perception of both electricity and transportation as constraints to business has decreased since 2002[118], but there is still a need for huge investments if Albania is to become a country exporting not only labour but also goods. Another crucial dimension of infrastructure in Albania is the failure to deal with the increasing urban environmental problems. Clean water systems, waste management, sewage treatment, etc. are not sufficient but necessary factors where there are potentials for tourism and, second to anti-competitive practices, these issues are the most often mentioned constraints on economic development for these areas.

The labour supply in Albania is not a constraint to business development when it comes to access to labour but rather when it comes to the employability of the labour force. The issues related to the supply of labour are discussed at some length in section 4.2 above. As discussed, labour legislation and other factors affecting labour market access do not constitute any major constraints in Albania. However, there is strong evidence of a mismatch between the supply and demand for specific qualifications and skills. As discussed, this can result in shortages of skilled labour and labour with specific qualifications or training at the same time as there is large open unemployment. The impact of skill shortages on business development can be insidious, as businesses are likely to adapt their nature of activities and level of technology to the availability of qualified labour. Shortcomings in this field may therefore not appear in enterprise surveys.

The constraint to private sector development due to low confidence among citizens is not often discussed. This affects the willingness to form association but also to run a business or create a business by joint efforts, as well as the willingness to make business together. An indication of the importance of this issue is found in a survey of emigrants in 2005, which concluded that return migrants preferred to invest individually or with other family members rather than exploring other kinds of partnership.[119] The totalitarian nature of the socialist regime destroyed much of the trust that existed between people as well as the cohesive role played by common religious or ethic values.[120] The main basis for social capital and trust before the collapse in 1990 was the villages and the clans. However, some argue that Albania went from village values to nothing as migration took off. New social capital may be accumulated among the younger generation or among return migrants, which could improve the level of trust between economic actors. Different measures to strengthen civil society should be considered given the indispensable role of trust and cooperation for a functioning market economy.

6.2 The Migration Environment

A decision to temporarily migrate for work abroad can be seen as an investment decision, which is part of a household strategy. For the individual or household concerned, overseas migration for work implies costs and risks, which must be weighted against the prospects of improved incomes, much like a decision to invest in an enterprise. The lower the costs and risks involved, the higher the returns to the individual as well

[118] BEEPS (2006).

[119] De Zwager, et al. (2006: 52).

[120] The destructive forces that may result from affinity base on common ethnicity is not an issue in Albania.

as the net economic contribution to the country (in the form of remittances and secondary effects on the domestic economy).

The costs and risks involved can vary greatly depending on the access to legal migration channels, access to information, and direct costs such as transport, visa fees etc. In Albania there are a number of options which all have their costs and risks. The costs and risks involved are negatively correlated; the cheapest and most risky option being over the mountains to Greece on foot, and the most costly and less risky being the black market for genuine visa.[121] The risks will also depend on the position of and legal protection of migrant labour in the destination country. Interestingly, payment to the smuggler is often only made after the migrant from Albania has arrived safely at the destination, but the risk premium can then be expected to be included in the price.[122]

The costs and risks associated with migration decrease over time as information becomes available, as potential migrants increasingly can depend on and receive support from relatives and friends who already reside abroad, and as one may expect some level of competition among middlemen. At the same time, the EU countries are imposing increasingly more stringent immigration policies, and in Albania there is a clear up-ward pressure on the informal price of different visas.

As mentioned in 4.3.3, most remittances are hand-carried by the migrant or a relative to Albania, especially when coming from Italy and Greece due to the geographical proximity. This may imply a high risk, but since many migrant still prefer this informal channel it can be assumed that this risk is still perceived to be lower than the direct costs of using the banking sector or a money transfer office.

It has been estimated that 15 to 20 percent of the value of remittances is lost due to different transfer costs such as high fees and poor exchange rate offerings.[123] The amount of remittances that is transferred through formal channels has increased in both absolute and relative terms (see Table 5.4). However, according to a survey in 2005 the banking system is only preferred by, or accessible to, 9 percent of the migrants making it the least used formal channel. The main part of the formally transferred remittances is delivered by money transfer offices, even though they charge more than the banks.[124] This is to some extent an indication of low trust in the Albanian banking system, which was revealed by the 2005 survey. However it is also affected by the fact that only 45 percent of the Albanian households have access to a bank account, the amount of paper work asked for by the banks and the inconvenient working hours of the banks. The money transfer offices have agent offices throughout the country and have the reputation of being very fast.[125]

The expected returns to migration will obviously depend on differences in wage levels between the source and the destination country (adjusted for cost of living).[126] The wage of an Albanian migrant according to the 2005 survey is between 1,000 and 2,500 Euro per months.[127] However, there seems to be substantial differences depending on the host

[121] Nicholson (2002: 4).

[122] Nicholson (2002: 4).

[123] De Zwager et al (2005: 25).

[124] The fees charged by major money transfer enterprises such as Western Union range from 7 to 10 percent of the amount remitted.

[125] De Zwager, et al (2005: 27–34).

[126] Migrant can be assumed to live on a minimum level and send most of their earnings home.

[127] De Zwager et al (2005: 50).

country. According to the poverty assessment in 2002, the average sum of remittances from Italy was 83 percent and from Greece only 48 percent of the average sum from non-European countries, which can be assumed to reflect wage differences.[128] Moreover, the possibilities to rent out the domestic assets and hence continue to get income from them in Albania should be added to the potential returns of migration.

The migration survey of 2005 confirms that higher education do have an affect on the income level of migrants. Emigrants living in Italy seems to have achieved a higher educational standard that those living in Greece.[129] Hence, the labour market in the host countries does not seem strictly limited to a certain sector or a certain kind of employment, even though access is constrained by formal regulations and ethnic discrimination.

Other benefits that should be considered in the investment decision are for example gaining of ideas and techniques as well as personal contacts for import and export business.[130] Hence, it is not only accumulated financial capital that returning migrants takes home, but also accumulated human and social capital that may be crucial for starting a business or getting wage-employed in Albania. A survey conducted in 2004 revealed that the educational level of emigrants before leaving Albania was high. Some 49 percent of men and 22 percent of women were graduates from technical college or universities, while the incidence of illiteracy was insignificant.[131]

By way of concluding, it is clear that the costs and risks of migration are sensitive to the ability to legal channels of migration. Improving the possibilities legal migration though bilateral negotiations would not only transfer welfare from illegal rent activities to the migrants trying to use their labour resources productively, but would also benefit Albania as a country through increased inflows of remittances.

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[128] World Bank (2003: 132).

[129] De Zwager et al (2005: 48).

[130] One example is the technique to growth vegetables under plastic, learnt in Greece, which is increasingly used in Albania (Nicholson (2002: 5)).

[131] Labrianidis and Kazazi (2006: 63).

7 Binding Constraints for Pro-poor Growth

It has been estimated that during the 1990s half of the young people moving out of their parental home ended up abroad. This is an enormous loss for a country that is trying to build a new future on the ruins of a failed economic and political system. Albania's future will be undermined if migration abroad were to continue at this massive scale with little return migration; demographically as well as economically and socially. On the other hand, Albania today has an enormous asset abroad. Some 800,000 Albanian's, most of them young and in their most formative and productive age, are living and working in other European countries in the European union, which Albania aspires to become an integrated part of. They possess not only language skills, but more importantly they have been exposed to and have gained profound knowledge of societies and economies that serve as role models for Albania. This pertains to a wide range of aspects that are important to Albania today; the role and functioning of formal and informal political and social institutions, work ethics, political ethics etc. If a major share of the migrants can be induced to return to Albania, they will bring with them not only human resources (skills, knowledge etc.) and large amounts of capital, but also social capital in the form of contacts abroad and knowledge about neighbouring countries in the EU function and, not least, a vision of what Albania could be like and of the changes required to put Albania on a sound path of economic, political and social development. These are assets that are absolutely crucial for the economic, political and social development and for its successful integration into the European Union.

The issue is not to stop out-migration, although a reduction of the magnitude of emigration is needed and most probably also already happening. However, migration tends to become self-perpetuating ones migration has taken root as a way of life, migration channels have been well developed and there is large Diaspora abroad that provide information to and can help new migrants with accommodation, jobs, contacts etc. For reasons discussed above, the really important issue is if migrants abroad can be induced to return. Despite the still very large differences in income opportunities between Albania and the neighbouring EU countries, the prospects for increased return migration are not necessarily poor. Migration abroad entails very large costs and sacrifices, in particular when it is irregular and takes place outside of legal channels. The migrants inevitably find themselves at the bottom of the labour market and society, subject to all kinds of discriminatory practices, with little or no legal and labour rights and with poor prospects of advancement in the host societies and labour markets. For married migrants, migration often implies a separation from their families for very long periods indeed. For those unmarried, it often implies that marriage, having children and building up a family have to be postponed for years. Thus, a decision to return depends on a great many factors, apart from present wage differences. Decisions to return or to seek a more permanent future abroad are likely to primarily depend on the perception of future prospects. If these prospects are perceived to be good at home, then migrants abroad are likely to begin to return in larger numbers. At the same time, as discussed above, the return of large numbers of the migrants presently working abroad could also have a fundamental positive impact on Albania's future development.

Several fundamental and, arguably, binding, constraints on sound market-based economic development and pro-poor growth can be identified.[132]

The binding constraints for the private sector in Albania, i.e. the engine for generation of employment and income opportunities, do not seem to be connected to the cost or access to capital, mainly due to the inflow of remittances. The main problems are rather to be found in the poor business environment which results in low returns to investments returns. The major concerns are connected to two underlying factors: the limited size of the economy in itself and the inadequate role played by the government in creating a good investment climate.

Governance issues, the lack of a formal and informal institutional framework conducive to a sound market-based economic development and an unsound and much to close relationship between politics and business stand out as a fundamental constraint. This comes through in the analysis of the business environment, where 'anti-competitive practices' and 'corruption' score high in surveys on main constraints to doing business, as well in discussions with Albanians from different walks of life. Close and unsound links between politics and business prevents the development of a 'level playing field' for all economic actors, based on transparent, predictable and fair 'rules of the game' that apply equally to all. Corruption can be seen as part of and as an expression of this evil, but the issue goes deeper than that. At the heart of the matter is a need to clearly define and confine the realm of politics and to clearly demarcate the boundaries between politics and business. Closely linked to this is also the issue of developing and of both defining and enforcing the role of other institutions in society, such as the judiciary. By the end of the day, some kind of social contract, based on an understanding of and respect for each others roles, rights and obligations and on (at least a certain amount of) trust, needs to be established between the political establishment and state institutions on the one hand and the business community, the economic actors and the population at large on the other hand. The socialist period left Albania with a very poor legacy in this regard and far too little has been achieved in subsequent years to develop such a contract. Yet, such a contract is needed for a democracy and for a market economy to function well.

The present decentralisation of government functions to the local levels has the potential to play a positive role in such a development as

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132 See chapters three to six above.

well as for promoting (a more balanced) regional and local economic and social development. After all, the distance between those elected to power and the electorate, and between civil servants and those they are expected to serve is closer at the local level than at the national level. However, the success of the decentralisation will depend crucially on forceful efforts to foster good governance based on accountability, transparency, clear rules and well-defined roles and enforceable sanctions when these are broken.

Poor physical infrastructure has been identified as another fundamental constraint on economic development in general, and on pro-poor growth and a regionally more balanced economic development in particular. The poor state of roads and other means of communication, the availability and predictability of access to electricity and lack of environmental infrastructure, in particular regarding waste disposal, sewage systems and access to clean water are clear examples on constraints on sustainable economic development as well as on a more balanced regional development. This is obviously a question of public investments and financial resources, where external donors will need to play an important role. However, it is also very much linked to the need strengthen, consolidate and broaden the fiscal system, which in its turn is linked to governance issues discussed above.

The educational system stands out as another major Achilles' heel and constraint on sustainable economic development and poverty reduction in Albania. A good educational system is also fundamental for a deepening of the democracy and the development of a civil society. The level, quality and relevance of education among the young who graduate from the educational system deteriorated sharply during the 1990s and while some improvements may have been registered in the past few years, it is still arguably below the level of that attained during the socialist period and the gap when compared to other countries in Europe has widened. At the same time, the human resource base of in particular young people has been depleted through migration. In other words, in terms of its human resources Albania has burnt the candle at both ends. Strong efforts to improve both the delivery and the coverage of the educational system are needed as a matter of urgency in order not to compromise the prospects for sustainable economic, and societal, development in coming years. For reasons pertaining to access to overseas labour markets, Albania has no future as a low wage/low cost economy in Europe. Furthermore, a genuine and successful integration in the EU will require that educational standards are brought up to levels found elsewhere in Europe. Both the aspects of delivery and of coverage are important. Improvements in the quality and relevance of education would seem to be particularly important. Secondary education needs special attention. Vocational training needs to be re-developed and secondary education in general needs to be made in tune with the demands of the economy and the labour market. The coverage of education has declined, with high dropout rates and low rates of continuation into secondary and tertiary education among children from poor and from rural households emerging as a particularly disturbing phenomenon. This trend needs to be broken in order to prevent poverty in Albania from becoming chronic and intergenerational. Good educational and health system are also likely to be important factors for the decisions of migrants working abroad to return home and invest in a future for themselves and their children at home.

The present concentration of economic growth and employment and income opportunities to a small part of the country, with large parts of the country experience economic stagnation at a very low level and a severe shortage of employment and income opportunities is a main constraint on pro-poor growth and, possibly, on the sustainability of growth overall. It leaves large parts of the population in poverty and with little opportunity to take control over and improve their lives through a more productive use of their resources. Hence, the regional dimensions deserve prominence in the overall efforts to create enabling conditions for sustainable pro-poor economic development. Improved physical infrastructure and a focus on linking the present policy of decentralisation of many state functions and responsibilities to the local level with forceful efforts to foster good governance – in the senses discussed at some length above – at the regional and local level are perhaps the two most fundamental instruments for reducing the large regional imbalances in economic and social development and in economic opportunities for poor people. There may be a call for other measures as well, but then as a complement to rather than as a substitute for the two highlighted above.

7.1 EU Integration in the Context of the Binding Constraints

From the perspective of pro-poor economic development in Albania, the binding constraints identified above may serve as points of reference against which the EU integration agenda may be assessed. There is a general consensus that Albania has no future outside of these structures and that EU integration, aimed at a future EU membership, is a central and indispensable aspect of Albania's overall development. EU integration is a prerequisite for sustainable development in Albania, just as development is a prerequisite for genuine EU integration. However, these two processes are not the same and should not be regarded as such. Thus, several questions arise.

- In what fields and to what extent is the EU integration agenda genuinely part and parcel of the development requirements and address/make it more difficult to address the binding constraints?
- To what extent does a focus on the EU integration agenda detract attention and resources from crucial development aspects that fall outside this focus?
- Are there areas where there is genuine discord between the EU integration agenda and the needs and requirements from a development perspective?

The EU integration agenda addresses some of Albania's key development challenges; primarily the establishment of the rule of law based on the respect for human rights and the creation of an institutional framework in line with the needs of a modern democracy and market economy. As discussed above, shortcomings in these fields impose a major constraint on Albania's development and the EU provides both a role model in this regard and a roadmap. Furthermore, EU is probably the only institution with sufficient power, both in the form of carrots and whips, to exert a sufficiently forceful influence to achieve change even in areas or situations where there may be strong vested domestic interest against change. However, for this to happen there must be a focus on the content rather than the formality of institution building.

While adequate and well-functioning institutions are a necessary condition for sustainable development, they are not a sufficient one. Good institutions alone do not create or result in economic or social development; they merely provide the conditions for such development.

Other fundamental constraints on development, discussed above, must also be addressed. The deterioration of the educational system and of educational standards must be forcefully broken, public social services in general must be improved, acute inadequacies in the physical infrastructure (roads, electricity, sewage facilities etc) must be addressed, as must the strong regional imbalances in economic development. None of these constraints on development in Albania are at the fore of the EU integration agenda, and in a situation where both the human and the financial resources for development in Albania are scarce, a lopsided focus on the institutional aspects of development will by necessity take place at the expense of sufficient focus on other aspects.

There are indications that the focus on the EU integration agenda is indeed diverting resources from other core development areas. At 3.1 and 2.5 per cent of GDP, respectively, expenditures on education and health care are very low compared to those of other European countries. This discrepancy becomes even more remarkable when one considers that these EU countries have a much larger GDP than Albania as well as, in most instances, a smaller share of the population in school age. Another cause of concern is the declining share of capital expenditures in total government expenditures. It seems as though the reduction of the fiscal deficit has mainly taken place through cuts in public capital expenditures, which have gone down from a peak of 7.4 percent in 2001 to no more than 4.6 percent in 2005. Both the downward trend and the low level of public investments are worrying in view of the very large needs for public investments in physical infrastructure, such as roads, electricity and sewage systems. As discussed in Chapter 5.3, it is hard to escape an impression that austere fiscal policy in combination with a need for large public expenditures on areas directly connected to the EU integration agenda is exerting a squeeze on other areas that are vital from a development perspective, but not necessarily in the focus of the EU integration agenda, such as education, health care and physical infrastructure.

There is also a question of the level of sophistication with regard to institutions, standards etc. required by the EU integration agenda as part of the Acquis Communautaire are appropriate, affordable or, indeed, even feasible for Albania at its present level of development. By being required to aim very high in these regards, and to shoulder the accompanying costs in terms of money and human resource capacity, other more vital and fundamental development needs are neglected.

Trade is an area where there is a disharmony between development interests of Albania and the regulatory framework laid down by the EU. The countries of the European Union are by far Albania's most important trading partners. However, while imports have developed rapidly and account for the equivalent of 30 per cent of Albania's GDP, Albania exports no more than 8 per cent of its GDP. This is even less than during the period of extreme autarky under socialism. An important reason behind Albania's extremely poor export performance is clearly to be found in weaknesses in the domestic economy. The Albanian manufacturing sector, in particular, still remains very small. This is something of a chicken and egg situation, as possibilities of export-led growth would speed up re-industrialisation and economic growth.

However, the poor export performance is not only due to weaknesses in the domestic economy, but also to formal and informal trade barriers. Although Albania has a free trade agreement with EU as well as with the neighbouring Balkan counties, significant non-tariff barriers remain. A recent study on linkages between economic development and the process of alignment to the institutional and regulatory frameworks of EU concludes that poor productions standards, lack of standard-related legislation, inadequate standard-related certification and control capacity, and not least the non-extension of the pan-European agreement on rules of origin to Albania and the other countries in the Western Balkans, are main constraints on the development of exports to EU.[133] Furthermore, many of the main Albanian export products are exempted from free trade agreement with EU and subject to 'managed' trade in order to protect 'vital' EU economic interests. A study in 2003 concluded that no less than 62 percent of the Albanian exports to EU fell under the concept of 'managed' trade and, thus, subject to restrictions incompatible with the principles of free trade.[134]

The failure of the EU integration agenda to pay adequate attention to development issues has been subject to attention for some time. Indeed, a recent study on the linkages between the economic development of the countries of the Western Balkans and the institutional reform process, commissioned by the European Commission, concludes *inter alia* that:

- 'An irreversible EU integration framework should be established. The opportunities for 'potential' accession to the EU, as provided by the EU Council in Thessaloniki in 2003, should be transformed into a path to accession with target dates, subject to close monitoring but agreed upon now, country by country'.
- The European Commission should define its own social strategy for the Western Balkans to support employment and regional cohesion. It should launch a high level regional initiative on poverty and inclusion with other international partners to establish a common framework for action and identify the respective roles. Poverty and social exclusion feed discontent and opposition to the reform. Poverty targets should be included in the European Partnerships.
- A regional mechanism should be established to support key facilitation actions in the field of investment and trade.
- Two principles should be ensured in the allocation of future assistance to the region: (i) avoid any drastic declines, and (ii) ensure a balance between institutional support and investment facilitation.
- Together with the review of the path to EU integration, access to pre-structural funds should be ensured relatively soon for the countries in the Western Balkans, in order to benefit from an instrument that has proved very useful for supporting the weakest social groups get on board in the reform process.

This study stops short of analysing the specificities of EU integration and its possible implications for economic development in Albania, but hopefully it will provide a basis for assessing the developmental consequences, costs and benefits of this integration, at least from an economic perspective. There is clearly a need to dig deeper into these issues. In particular, there is a need to:

- Estimate the costs, in terms of money and human resource capacity, of the implementation of various aspects of the EU integration agenda, and set these against the available domestic resources for development in Albania and the prospects for external support to help cover these costs.

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133 DRN (2005).

134 DRN (2005: 55.

– Estimate the implications for Albania's trade relations with EU of all the trade-related requirements laid down by EU, the informal as well as formal trade barriers, and the tariff and non-tariff barriers for accessing the EU markets.

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