

## **IMPLEMENTATION OF PUBLIC POLICIES FOR THE POVERTY REDUCTION IN ALBANIA**

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### **—Abstract —**

Poverty is a result of different processes and for this reason it is difficult to evidence the proper measures to fight it. As a complex phenomenon it shows different effects. Albania, as a country in long transition is really suffering its negative effects too.

This paper examines data gathered from sample surveys until February 2009. The aim of this paper is to evidence the policy implications that fight this phenomenon and to individualize the fields and subjects of poverty risks.

Interesting implication are explored for public authorities and policy makers in order to reduce the negative effects of poverty.

**Key Words:** *poverty, measures, effects*

**JEL Classification:** I32, I38, D78

## **1. INTRODUCTION**

### **1.1. The nature of poverty in Albania**

The roots of poverty in Albania lie deep in the previous system, but they have also been nourished by developments accompanying the transition process. In spite of its massive incidence in the previous system, poverty was officially recognized only after 1991. Several surveys related to poverty have been conducted. The first was on the family budget and included only Tirana in 1993-1994. Other surveys followed. Despite their value, they suffer from methodological differences that make comparison of their results difficult. The most comprehensive one is the 2002 Living Standard Measurement Survey (LSMS) in which the calculation of poverty indicators

is based on consumption. Because of this it is considered a robust line upon which to base future monitoring of policy impact. The diagnosis outlines the high incidence and depth of income poverty; rural/urban and regional poverty disparities; employment and unemployment levels; ownership of assets; risk determinants; and the role of remittances in supporting many households, particularly female headed households. Some female-headed households—widows with children and women living alone—have a higher incidence of poverty, and unemployment is higher among women. The diagnosis discusses Albania's weak and deteriorating infrastructure and services and the lack of access for many families to basic necessities such as water, sanitation, basic education, and heating. The diagnosis further outlines the national and rural/urban health and education status, including the relationship between poverty and low education and the imperiled health of children. The Qualitative Poverty Assessment confirmed that Albanians see poverty as a multidimensional phenomenon, with poor infrastructure, weak institutions, and insufficient security as major contributing factors.

### **1.2. Structural reforms to be undertaken by government**

Speeding up structural reforms, is crucial for making effective any policies addressing poverty reduction. As a measure of the scale and effectiveness of market functioning, structural reforms require the success and effectiveness of other policies undertaken by government, including those addressing poverty. The flourishing — and then demolishing — of pyramid schemes in the years 1996-1997, with the resulting destruction of economic, political and social values, were in a synthesized form a testimony of the failure to implement structural reforms seriously. Steps forward were taken later but, as the European Commission reported, "Although some progress was registered in structural reforms, much remains to be done" to create market-friendly institutions and an enabling environment for businesses and investments. Poverty reduction requires stronger public and private sector institutions that can operate in a transparent and accountable fashion and that are accessible to the entire population, including the poor. Economic activities in Albania have been severely constrained by the weak institutional capacity for enforcement and the lack of transparency in administration which have fostered the development of corrupt practices. Since the 1997 crisis, progress has been made in building a framework for improved and transparent public organizations in cooperation with the World Bank. In recognition of the important role that the public sector must play in ensuring sustainable growth through improved human capital, the government is taking a number of actions aimed at enhancing the inclusiveness and citizen-responsiveness of Albania's public institutions. Also, complementary measures are being taken to improve the delivery of health, education and social services. In addition to supporting public sector reform, the government's strategy focuses on building institutions rooted in local culture, enjoying the full trust and ownership of the community and community-driven programs. These programs would stimulate growth and alleviate poverty in rural areas. In line with this view that strong growth remains the main instrument for sustained improvement in the living conditions of the population.

## **2. HUMAN DEVELOPEMENT**

### **2.1. Health**

The Government recognizes that economic growth that does not translate into improvements in the standard of living for everyone is socially, politically, economically and environmentally unsustainable. To ensure that sustainable economic growth is inclusive in Albania, the government will therefore promote human development through the design and implementation of comprehensive and integrated strategies in health, education, child poverty, and social protection sectors. The country inherited an inadequate health structure. The medical apparatuses and equipment in the health institutions were very outdated and depreciated, whereas the qualification level of the personnel was very low. A number of processes that accompanied the transition, such as the internal and regional political instability, the spontaneous massive displacement of the population, the damage and pollution of the environment, the drastic changes in the lifestyle etc. had also their negative effects on the health condition of the population. Some ills of the modern society, such as abuses with drugs and alcohol, are assuming serious proportions. Growing insecurity for broad sections of the population has led to a perceptible rise in stress, which is a source of many health problems. Some of the health indicators have deteriorated. The positive trend in infant and maternal mortality rates and in vaccination coverage levels in recent years have had only a limited effect on closing the gap between Albania's health indicators and those in the developed countries. The health policies applied in the years of the transition have aimed to reform the health system. The emphasis has been laid on the rehabilitation of the infrastructure of the institutions, the completion of the sanitary map in compliance with acceptable norms, the expanded scope and improved quality of services to the population and the prevention of the epidemics and infective diseases. The Health Insurance Institute has been set up, but it covers only the family doctor and the reimbursement of a number of drugs. The share of funds allocated for the health sector in the state budget has increased in recent years. However, the public expenditures share of the GDP is very low compared not only to the average level of the European countries, but also to that of the developing countries. Despite the positive achievements, the health system still suffers from serious problems. The reformation process has been slow and characterized by significant incoherencies. Marked management and administration shortcomings are noted. The distribution of the health institutions does not fully respond to the actual needs of the population. The situation is especially grave in the ambulatory service in the rural areas, where there are significant shortages in clinics and medical personnel. To the extent it is available, the primary service in these areas is incapable of doing its job and there is a massive influx of patients to the hospitals and mainly to Tirana University Hospital Center. The quality of the health services at all levels is relatively low. The inadequate infrastructure and equipment, the inappropriate motivation of the health personnel and the absence of this personnel in some parts of the country, the absence of medical protocols, the weaknesses of the information system, necessary for the decision-making process at all levels, the management weaknesses are considered as the main factors for the existing low quality of health services. Corruption has become a worrisome phenomenon in the health sector. There are also problems with the regulation and the monitoring of the private health sector. Against the background of unsatisfactory health outcomes—in particular for children—and poor access of the population to health services, the government's objectives are to improve the health status of the Albanian population, to ensure full access to primary health care regardless of

income level, and to ensure comparability in access to health services between rural and urban areas. Priority will therefore be given to reforms in the health sector, particularly in public health measures and preventive and primary care services. The Ministry of Health's program calls for undertaking measures to improve institutional capacity in the provision of public health services, particularly in ensuring full coverage of vaccination programs and in improving the monitoring and treatment of infectious diseases. The government will also develop a program that will provide better family planning and reproductive health services in order to improve the health status of women and children. The government will give high priority to increasing the level and effectiveness of public health expenditures which have fallen significantly in recent years. It will also finalize, in cooperation with WHO and the World Bank, the National Health Policy and Strategy document which deals with all aspects of the Albanian health sector, e.g. financing, management, institutional arrangements, etc. over the short- and medium-term.

## **2.2. Education**

The educational system has gone through a process of reformation, even though at a slow pace. This process has especially affected the teaching plans and programs, with the aim of adjusting the country's educational system to the requirements of a democratic society, based on the market economy. The government has faced acute problems in educational infrastructure due to the legacy from the past, the demographic changes, especially the internal movements of the population, and, to a considerable extent, the damages inflicted on this infrastructure in 1991 and 1997. Transition related problems has led to serious proportions of the dropout rate or the children' failure to enroll in schools, causing a further deterioration of average schooling and enrollment indicators. These indicators are especially low in the poorest areas and in the poorest groups of the population. The quality of teaching has declined considerably, especially in the rural and remote areas of the country. During the last 10 years public financing for education has hovered over 10 percent of budget expenditures, but its share of the GDP, despite some fluctuations, has been constantly decreasing. Local government's financial contribution is insignificant and community contribution has been even lower.

The international community has made a most important contribution by financing investments to improve the educational infrastructure as well as by giving support for the reformation of the curricula, especially for higher education. Despite the achievements, the developments in the educational sector show that the reformation process has been characterized by incoherencies and weaknesses. The educational system suffers from considerable management weaknesses and, particularly, by excessive centralization. The financial effectiveness is low. The employees of the educational system are not financially motivated, especially those working in the rural and remote areas of the country. The professional education has not adjusted well to the requirements of the market and accounts for only a small share of secondary education. It has a low level of diversification and centralized curricula. There is inequality in opportunities between urban areas and suburban and rural areas. The level of financial state support is still low. The initiatives and the participation of the private sector and the community support are still weak. Some progress can be reported in the area of education. The education budget for 2008 was increased by 12% in comparison with the previous year. According to the plans, this trend will continue over the period 2009-2011. Salaries for pre-university teachers were raised and further increases of teachers'

salaries are planned in the years ahead. The National Council of Pre-University Education was set up, including independent experts and representatives from the national and local administrations. It aims at providing advice on national programmes and strategies, curriculum reform, budgets and evaluation standards. A new digital central system for university admissions has been established and career counseling for higher education applicants has been introduced. Programmes to develop teachers' professional qualifications have continued. Legislation to liberalize the textbook market has been approved. A scheme for subsidising purchases of textbooks was introduced for students from vulnerable groups and families receiving social assistance. Work on development of the Albanian qualifications framework has continued. Parliament approved an extension of the duration of compulsory education from eight to nine years. A master plan has been prepared for implementation of an e-school programme to enhance use of information technologies in schools. The government is taking measures to increase enrolment in secondary education. Efforts are also being made to make vocational education and training (VET) more attractive and to involve potential employers in the preparation of programmes. However, enrolment in secondary education in rural areas is still lagging behind. Continued efforts are required on vocational training. Poor VET infrastructure is hampering development of this sector. Efforts are needed to consolidate and expand the network of vocational education centers and to foster closer links between education and the labor market. The budget for research and development doubled in 2008. However, its share of the total budget (0.16%) is still very low. For the entire education system, the government will adopt more appropriate curriculum standards, improve arrangements for the supply of textbooks, and address issues of the quality of teaching staff. It will also explore how to improve the integration of internal migrants into the education system. Furthermore, the government will use its school mapping database to rationalize the allocation of resources for school rehabilitation and construction.

### **2.3. Child Poverty**

The government will pay particular attention to alleviating poverty and vulnerability among children. The LSMS indicates that incidence of poverty among children, particularly in rural areas, is high. Moreover, other evidence indicates that in north-eastern areas, malnutrition is observed in around one quarter of children. In urban areas, the growing number of street children needs to be addressed. The government intends to address child poverty and vulnerability through its programs in education, health and social protection. In the area of social protection, the government will take steps to ensure adequate income support to poor families with children. Introduction of other programs, such as school feeding, food supplements for infants and pregnant women, and assistance in kind to children from poor families will also be considered. The government will pay particular attention to protection of children without parental care. As an alternative to their institutionalization, foster care arrangements will be developed, including necessary legislation, financial support to foster care providers and appropriate monitoring and supervision institutions and mechanisms. The government will prepare a plan for the introduction of community based social care services (daily care centers, family counseling centers, respite care centers, etc.) in order to provide assistance and support to handicapped children and their families, dysfunctional families, children and youth with disturbed behavior and other vulnerable groups.

#### **2.4. Labor Market and Social Protection**

There has been some progress in the area of employment policy. The Employment and Vocational Training Strategy for 2008-2013 was adopted. Its main objective is to reduce the level of unemployment to a level comparable to that in EU countries by 2013. New employment promotion programmes have been adopted, providing subsidies to employers for training and/or hiring jobless persons. One of the programmes specifically targets jobless women. Measures to promote employment of young graduates have been stepped up. However, monitoring and assessment of the impact of such programmes are still lacking. Minimum wages and pensions continued to increase and legislation increasing the base level of unemployment benefit was approved. A computer-based information system is being developed in the head office of the national employment service and in two regional offices. Databases on vacancies, jobseekers and training activities have been established. However, the system is not yet extended to all offices. In general, the link between the vocational training offered and labor market demand is not sufficient, and the capacity of the labor offices to carry out labor market surveys is not strong enough. Also the capacity of regional labor offices remains limited.

Regarding health and safety at work, some progress has been made in the legislative area. In March 2008 the Council of Ministers adopted a decision on the determination of dangerous substances. A working group has been set up to draft the national strategy for health and safety at work. The staff of the State Labor Inspectorate was increased from 130 to 167 and 12 regional directorates have now been established, although they lack adequate physical resources. The Directorate for Health and Safety at Work was reorganized and strengthened, but it does not have adequate capacity to assess risks at work and its technical resources are poor. The Gerdec incident in March 2008 illustrates Albania's shortcomings on occupational health and safety at work and the need for enhanced cooperation between the labor inspectorate and the tax administration. The social protection and social inclusion strategy for 2008-2013 was adopted. It aims at reforming the economic assistance scheme for poor families and cash payments for groups in need, setting up community social services, protecting children and ensuring social inclusion of minorities, the disabled and the elderly. The 2008 budget provides for 1.3% of the GDP to support the poor and vulnerable. Improvements in the method of determination of the number of poor families have already resulted in an increase in the economic assistance provided. The Inspectorate of Social Services has been set up to supervise, at central and local levels, the implementation of standards applicable to social care services. However, analyses of poverty and social exclusion are not sufficiently developed, including enhanced poverty monitoring.

The Ministry of Labor and Social Affairs will examine the possibility of implementing public works programs focusing on poor communities, particularly in rural areas, and strengthening job counseling and job search assistance for the unemployed. Well targeted, demand driven training programs will continue to be implemented, with special focus on training and retraining of workers who have been made redundant by privatization, structural changes, etc. In addition, efforts will be undertaken to improve labor statistics. The government will develop a plan for restructuring its unemployment insurance program to improve its targeting consistent with Albania's level of social and economic development. The government will also review its social insurance programs, with particular emphasis on pensions. The government will review, its cash-benefit social assistance

program, with particular emphasis on the assessment of its poverty impact in order to improve its targeting effectiveness. In addition to cash social assistance programs, the government will prepare a plan for the development of a system of community-based social care services in order to improve the well-being of vulnerable groups, such as children deprived of parental care, the disabled, single mothers, frail elderly people living alone and dysfunctional families.

### **2.5. Rural and Urban Development and Access to Basic Services**

The condition of the inherited infrastructure was inadequate and incapable of meeting the requirements of an open market-orientated economy. This condition was worsened by the serious damages during the transition process. Without considering the damages, only 39 percent of the roads were asphalted and, despite the improvements in recent years, they continue to be in a bad shape. The railway network is also in a difficult situation, mainly due to the damages at the beginning of the transition period and in 1997 as well as due to the technical backwardness of the network. The same situation has characterized the water supply system. The illegal connections with the supply system and the high depreciation level of the system have not only led to cuts in the population's supply with water, but also to a worsening water quality. There are many cases of potable and sewage water merging, becoming a source of infective diseases. The sewage networks in many urban centers are very depreciated and damaged and are in a critical condition. The tangible increase of family consumption of foodstuff articles and the unauthorized constructions have led to the increase of urban waste. The urban waste, the serious damages to the sewage pipes, the gas emission by old cars, the dust raised in the damaged or un asphalted roads, the unauthorized constructions in public places, the drastic reduction of the green areas, the pollution of domestic waters, the damage of forests etc. have all combined to increase environmental pollution to a critical point. The supply with electric power has been very restricted in both urban and rural areas during the last years. The limited and depreciated capacities of the electric power distribution system had to cope with both a vigorous increase of family consumption demand and the unauthorized connections with the network. The problem was especially aggravated by the migration of the population from rural to urban areas. The increased energy supply cost with selling prices being kept fixed, the high number of consumers failing to pay electricity invoices in some parts of the country (partly due to, until recently, some sort of tolerance by the relevant administration authorities), and the problems related to power supply administration and management led to a further degradation of the situation. The aforementioned problems were aggravated by a very unfavorable weather. The low production capacities, relying almost entirely (95 percent) on water resources and decisively depending on the weather forecast, were strained even further by limited capacities for energy importation. The investment policy in the sector has mainly focused on repairing the defects in the distribution system.

The rural infrastructure is in an even worse condition with many areas being isolated during winter. The road network does not meet even the minimal technical requirements. The water and power supply and the sewage network are in a worse condition than in the urban areas. All of this creates serious difficulties for the efforts to reduce poverty in these areas and integrate them into the national economy. The improvement of the infrastructure has been one of the government's main concerns during transition. Public investments in infrastructure have been the main item in budgetary investment expenditures during the entire period. The railways have been subsidized by

the state budget. The air transport has been financed from external resources. The experience in the telecommunications sector is considered exceptionally positive.

The Poverty Reduction Strategy will aim to identify incentives for inclusive and sustainable economic development in order to ensure that all sections of Albanian society benefit from growth, and broaden income and employment opportunities for both the rural and urban poor. Specifically, the government aims to increase access to basic services (e.g. water, sewerage) for the entire population and to improve the quality of these services. While a fully-fledged policy to address rural poverty will be developed, the government has already begun to address some of these issues. Moreover, the government will remain committed to improving efficiency in the agricultural sector, focusing on land consolidation and the development of a rural land market. It will also continue with the project for small-scale local infrastructure improvements. The government will improve the enabling environment for village savings and credit associations and will expand the micro-credit rural savings scheme, which has proved to be a very effective instrument. The rural poor are particularly vulnerable to natural resource degradation. Therefore, the government will promote sustainable use and management of natural resources, especially water, forests, pastures, and fisheries. It will explore possibilities for expanding community-based activities that have proven effective, such as community forest and pasture management, water users associations, and community-based institutional frameworks for their operation and maintenance. It will also facilitate fishermen's associations in order to introduce community-based marine resource management. The National Environmental Action Plan will be completed providing the framework for sustainable natural resource use. In addition, it will develop a plan to address the linkage between energy and poverty, with the intention of improving the targeting of subsidized energy and increasing access of the poor to competitive sources of energy. The government will take steps to tackle problems associated with rapid urbanization that has occurred since 1991. Massive internal migration to urban areas has caused large informal settlements on suburban public land. Additional problems have resulted such as degradation of the urban environment due to free discharge of sewage and disposal of solid waste. Pockets of urban poverty have appeared as migrant families tend to be excluded from the formal urban fabric. Through initiatives such as the ongoing Urban Land Management Project as well as community-based social services, the government will provide essential infrastructure networks in informal settlements with community participation and ownership; develop and implement clear rules to regularize and legalize informal settlements to achieve social cohesion in urban areas; and nurture partnership among central and local governments, and communities to set up effective institutional frameworks for the urban sector.

### **3. POLICIES FOR POVERTY REDUCTION**

#### **3.1. Macro Economic Stability**

Considering the implementation of the transition reforms as insufficient to address poverty issues, the government has focused on some factors that have more direct effects on the living standard. The (i) the macroeconomic stabilization, and (ii) the implementation of adequate policies for revenue allocation and reallocation, with mitigating effects on poverty, have been two of the main directions on which the government has focused its attention during all this period. Attention has



also been attached to (iii) the promotion of economic growth and (iv) the development of the sectors that contribute directly to the increase of the living standards.

The restoration and the maintenance of the macroeconomic stability, perceived above all as price stability, has been a central priority for the government. The government has considered the macroeconomic stability as a condition for progress in economic reforms and for an effective implementation of poverty reduction policies. The macroeconomic stability, in itself, contributes directly to the protection of the living standard, especially for the poor sections of the society. As the Albanian experience shows, the transition is accompanied with destabilizing pressures, which were partly inherited from the past system, partly an outcome of skyrocketing prices after the liberalization reforms at the beginning of the transition, and partly an inevitable, temporary product of the structural reforms. But, to a great extent, the destabilizing pressures on the Albanian economy are also due to the internal shocks suffered by the system. The periods from 1991 to 1992 and in 1997 are a testimony to the inflationary effects of these shocks. Inflation rose to 104 percent in 1991 and to 236.6 percent in 1992. The inflation rate in 1997 was 42.1 percent. The inflation fell again with the restoration of the country's political stability. Inflation was only 4.2 percent by the end of 2000, with an annual average rate of almost 0 percent. The central bank continued to implement a policy of implicit inflation targeting and an independent float. The objective of maintaining consumer price inflation at 3 % with a fluctuation band of  $\pm 1$  percentage point was met, with inflation averaging 2.9 % in 2007. In the first three quarters of 2008, inflation remained within the target range (measured as a 12-month average annual inflation), although in some months it exceeded 4% (year-on-year). The main contributors to annual inflation were food and energy prices, with the increase in food prices accounting for up to two thirds of annual inflation. The impact of domestic demand pressures was limited, despite a strong (though decelerating) credit growth and extensive remittances inflows. The increase in money supply remained relatively high (14% year-on-year in July 2008). Exchange rate fluctuations against the euro remained limited, with some temporary small-scale depreciation in March 2008. Overall, monetary policy remained sound, maintaining price stability.

The fiscal and monetary policies are directed at the macroeconomic stability of the country. The fiscal policy has aimed to increase the level of revenues and the public expenditures, so that the government could achieve its reallocation and allocation objectives. However, the attention has been focused on keeping the fiscal deficit under control. External balances deteriorated, resulting in a current account deficit of 10.6% of GDP in 2007 - up from 6.5% in 2006. The deficit widened, mainly due to an increase in the merchandise trade deficit (26.8% of GDP in 2007), in spite of strong growth in exports. The fiscal deficit has been covered with domestic financing (treasury bills, Bank of Albania credits and privatization revenues) and the external financing (mainly grants and concessionary borrowing). The monetary policy applied by the Bank of Albania has also aimed to achieve and maintain the stability of prices. The direct objective of the Bank of Albania has been to keep the monetary supply under control. Until 2000 the Bank of Albania used direct instruments to achieve this objective. In the second half of 2000 the Bank of Albania began to control the money supply by using indirect instruments, such as the repurchase auctions, through which the Bank tries to convey its interest rate policy to the banking market. This policy is still in use. Since the application of this instrument (in July 2000), the interest rates have decreased consistently from 9 to 6.5 percent by the end of 2000, and up to 5.5 percent by the

end of 2008. In general, the absence of a developed, flexible, and competitive banking market, the existence of a primary, very concentrated treasury bill market and a credit market, in which borrowing, to a great extent, is done in hard currency, makes it very difficult for the Bank to convey effectively its monetary policy decisions to the economy. The economy experienced strong growth despite a severe drought in the summer of 2007 and continuous electricity shortages. Extensive investments and high consumption led to a 6% growth in real terms in 2007 – the highest since 2002. Economic activity was fuelled by a robust, though slowing credit growth and continuing large-scale remittances inflows (12 % of GDP). Unreliable electricity supply continued to pose a heightened risk to sustainable economic growth. Overall, economic growth remained strong and speeded up, while the general income level remained low. Merchandise exports remained more than 3.5 times lower than imports, despite a strong increase in mineral exports. The trade deficit continued to deepen in the first half of 2008 due to high imports. The surplus in services trade remained limited and surpluses of income flows and other transfers (including remittances) were lower (relative to GDP) than in the previous year. Overall, external imbalances remained high and continued to widen. Net capital inflows increased, covering the current account deficit in 2007. Net foreign direct investment reached 5.9 % of GDP in 2007 (up from 3.5 % in 2006), with strong inflows from a large-scale privatization in the telecommunication sector. Other capital inflows (mainly foreign borrowing by the private sector and non-residents' deposits) rose, reaching 3.2 % of GDP in 2007. However, from the fourth quarter of 2007 onwards the current account deficit exceeded net capital inflows, leading to a decrease in reserve assets. The external debt to GDP ratio fell to 24.8 % at end-2007 (down from 25.1 % in 2006), with the public external debt ratio falling to 15.4 % of GDP. The financial sector external debt increased strongly (by 50 %) due to short-term loans and non-residents' deposits. Corporate sector foreign borrowing remained limited (with stock falling below 5 % of GDP). In total, net capital inflows increased, but remained relatively low.

Labor market conditions improved in 2007. The number of registered unemployed decreased, resulting in a drop in the unemployment rate (13.4 % in 2007 and 13 % in 2008 - down from 13.9 % in 2006). The number of employed persons increased as a result of higher employment in the non-agricultural private sector. In total, the labor force (the sum of employed and unemployed) decreased by around 0.4 %, indicating some movement of unemployed persons to inactivity. Wages in the public sector increased by 17.1 % on average in 2007, significantly more than in 2006 (7.5 %), but did not add significantly to domestic demand pressures on inflation. Overall, the labor market performance slightly improved, but rigidities remained relatively high. However, due to the significant informal economy, labor market data may not correctly reflect the actual dynamics of the labor market. Potential demand pressures and pressures due to price increases in the global commodities markets were addressed by raising the key monetary policy interest rate. In the second half of 2007, the central bank raised the policy rate three times (cumulatively by 0.75 percentage points to 6.25 %).

The fiscal stance loosened somewhat in 2007, despite a strengthening of economic growth. Fiscal balances deteriorated, with the general government deficit increasing to 3.5 % of GDP in 2007 – up from 3.3% in 2006. Fiscal policy remained expansionary, with the budget plans projecting even higher deficits, mainly due to plans for high public investment. However, strong economic growth made it possible to reduce the public sector indebtedness (as a ratio of GDP), despite a delayed

fiscal consolidation. The public debt ratio fell to 53 % at end-2007 from 56 % in 2006, with domestic public debt falling to 37.6 % of GDP. The management of public finances improved, especially in 2008, supported by large-scale tax administration measures that also contributed to the extension of the tax base. The introduction of a 10 % flat personal income tax was accompanied by an increase in income tax revenues. The management of local government finances remained poor, resulting in low revenue collection and limited spending. Public spending followed the strategic priorities of higher public investments, keeping the increase in current expenditures constrained. Personnel expenditures were maintained at 6 % of GDP, and interest expenditures were reduced to 2.6 % of GDP in 2007, partly as a result of more efficient debt management. Government investments increased to 5.8 % of GDP, but weak implementation kept capital expenditures significantly below projections. Regarding fiscal strategies, the 2008 budget projected a sharp deterioration of fiscal balances with a fiscal deficit of 7.9 % of GDP, due to extensive capital expenditures amounting to 9.8 % of GDP. A mid-2008 budget revision reduced the deficit projection to 5.2 % by increasing revenue projections and cutting public investments. On the revenue side, the reduction of corporate profit tax from 20 % to 10 % in January 2008 brought about a change in the public revenue structure. Corporate tax revenues decreased, compensated by an increase in excise duties. Overall, the administration of public finances improved, but the fiscal stance loosened owing to ambitious public investment plans. The macroeconomic policy mix was broadly adequate, with an increased emphasis on structural reforms. Monetary policy remained sound, while fiscal strategies prioritized higher public investments over further fiscal consolidation. Widening fiscal imbalances may lead to instabilities and prevent fiscal policies from playing their role. Vulnerabilities of external balances increased, requiring swift measures to ensure electricity supply, the broadening of the export base and a more attractive investment environment.

### **3.2. Revenue allocation and reallocation policies and living standard**

The application of appropriate revenue allocation policies with mitigating effects on poverty has been one of the objectives of the government during the entire period of the transition. (i) The reforms and the recurrent rises of public sector wages, (ii) the reformation of the social insurance system, (iii) the unemployment payments, (iv) the economic assistance and (v) the social care have been some of the main components of these policies. In the preparation of the schemes for the unemployment payments, the economic assistance, and the social care, the government has duly taken into account the available budget funds and, in general, the passive character of these schemes.

The government thinks that the importance of public sector wage policy exceeds the sector's actual share of total employment, because the level of wages in this sector is, to a certain extent, a point of reference for wages in the private sector, too. During the first transition years the wages of a great number of the employees, whose enterprises had stopped being operational, were practically a form of social support. The wages in the public sector have increased recurrently, first of all to counter the inflationary effects and to provide a better remuneration to the employees in this sector. In the period from 1993 to 2000 the nominal wage increase rate has been, on average, higher than the general price increase rate. The decrease of real wages until 1993 was followed by its increase in the years 1994, 1995, and 1996. The year 1997 witnessed a considerable decline,

followed by a slight decrease in 1998. The increasing tendency was restored in 1999 and 2000. In 2000 the average and minimum wage levels were 14,963 Lek / month and 7,000 are Lek / month, respectively (INSTAT). During 2000-2008, in Albania there were defined 9 minimum wages by the government with a growing tendency. The minimum wages are applied both in the public and private sector. The wages are especially low in the sectors of education and health. The reformation of the social insurance has been one of the objectives of the government. This system covers about 1/6 of the country's population. In addition to obligatory social insurances, the government has also introduced the schemes of voluntary insurance and supplementary insurance. The ground has been prepared for the establishment of the private social insurance institutions that are established only these two last years. However, the social insurance system suffers from a number of problems. Despite the low level of pensions (which remains low in spite of its frequent increases), the social insurance system is being subsidized by the state budget to a considerable degree. The number of retired people is higher than the number of contributors. The number of the contributors from the private sector, and, especially in the rural areas, is very low. As a result, the pensions in these areas have assumed the form of social protection. The contribution rate is considered high. The unemployment insurance program has aimed to mitigate the economic and social consequences of the unemployment. It has been observed that the program's contribution has been very modest; it has suffered from ineffectiveness and has loopholes for abuses.

The economic assistance program financed by the state budget has consisted in delivery of assistance in money to the families without incomes or with low incomes. The program currently covers 85.000 families from 150,114 families during 2000. The level of the economic assistance depends on the conditions of the family receiving the assistance, but in any case it does not exceed 250 percent of the unemployment payment. In 2000, compared to 1993, the number of beneficiary families has fallen by 2 percent, and in 2009 compared to 2000, the number of beneficiary families has fallen by 56.6 percent, whereas the economic assistance annual budget has increased. The highest number of families receiving economic assistance is in the northeastern regions of the country (20-40 percent of the population). The economic assistance program suffers from inability to take stock of the specific conditions of the poor families, a non balanced regional distribution, its merely passive character, a low level of monitoring etc. The social care program has aimed to support and integrate the disabled individuals, give protection to the orphaned children and the elderly living alone. However, the program has not been able to cover all the categories of the persons needing its services and the network of the relevant institutions does not cover all the regions of the country. The services are delivered only in national residential centers and have a limited scope. As a result, the program is incapable of achieving the social integration of these groups. The service quality is also far from required standards.

### **3.3. Growth and living standard**

Growth has been one of the government's objectives. In addition to its contribution to more jobs and higher personal incomes, growth also increases the possibility to undertake more direct policies for poverty reduction. After two years of paralysis, the year 1993 witnessed the beginning of the economic recovery driven by a 10-per-cent growth over the previous year. The growth continued in 1994, 1995, and 1996 at a rate of 8.3, 13.3 and 9.1 percent, respectively. These growth rates are mainly due to the extensive recovery of the agriculture after the land privatization,

the positive effects of the privatization of small and medium-sized enterprises and the introduction of trade liberalization policies. The GDP declined by 7 percent in 1997 as a result of the crisis caused by the collapse of the pyramid schemes. The government thinks that both the crisis and the phenomenon of the pyramid schemes have had considerable negative effects on long-term growth. Large amounts of population's savings, especially the emigrants, were embezzled. The people created a distorted view of the market economy and the opportunities it offers to increase their well being. Negative, parasitic ideas were cultivated about the work and the economic activity, in general. The 1998-2000 period was characterized by a rapid and stable growth at a 7-8 percent rate, and the 2000-2008 period was characterized by 6-7 percent rate. However, if we refer to the whole period of transition in general, the economic growth can be characterized as being unstable. The economic recovery and growth have been based on the extensive mobilization of the fundamental production factors: workforce, capital, and land. However, the current utilization level of these factors indicates that there are still broad, extensive possibilities for further growth. A part of agricultural land and other natural resources have still remained excluded from economic use. The emigration and the internal migration of the population, the continued existence of ambiguities over land ownership rights, and the failure to establish a functional land market are some of the factors for the current prevailing situation. The private and public investments have increased considerably. The growth of investments has been especially significant in sectors such as transport, telecommunications, services, and construction, exceeding the increase of economic activity level in these sectors. These sectors have also had a higher added value in relation to other sectors. The relatively high volatility of foreign investments is another indicator of existing unexplored possibilities. Albania inherited an ineffective resource allocation process, very backward technologies and low work productivity. In the past, large economic resources were used in the heavy industry with the objective "to achieve self-reliance", irrespective of the cost. Efforts were made to overcome the underdevelopment problems by forcing the largest part of the population to remain in the countryside and by keeping productivity at very low levels. The progress in structural reforms and the enhancement of the market's allocation role during the transition has led to the reallocation of production resources. The industry is being subjected to a radical readjustment process as a result of investment initiatives of the private businesses, while the structural reforms in this sector dictated "from the top" have made rather slow progress. Meanwhile, the industry's share of the country's economy has fallen radically. High rates of growth have been observed in the sectors of construction, transport, and services. Efforts have been evident in these sectors for the application of advanced technologies, but the Albanian economy still suffers from the use of backward technology, especially in the countryside. The government thinks that despite the repeated shocks experienced by the economic system in Albania, the structural reforms and, especially, the privatization of the economy have had a central effect on the economic recovery and growth. The growth has been mainly fueled by the private sector. The free entrepreneurship has been the driving force behind this growth. The events in 1997 showed that the economic system, which was already dominated by the private sector, had acquired a level of immunity from the negative political and security developments. While in the 1991-1992 period the country was totally dependent on the humanitarian aid, during the 1997 unrests the demand for humanitarian aid was very low. The Albanian businessmen and traders kept the trade routes opened and kept up the supply of the market with the most necessary goods. The

reformation of the banking system and, generally, the financial market, has been slow, but it is still contributing to business financing.

Even though directed at keeping inflation under control, the monetary policies have also had a positive effect on the creation of a favorable environment for growth. The main objective of the fiscal policies has been to safeguard fiscal consolidation and maintain budget deficit within set limits, but they have also had a considerable impact on economic growth. However, the level of expenditures with a direct effect on growth has been relatively low. The opening up of Albania to the international economy has been a factor of critical importance for all transformation processes in the country. It has helped Albania not merely and only to cope with the emergency situations, but also to achieve macroeconomic stability and support the economic recovery and growth. The imports account for about one third of the goods and services delivered to the Albanian consumers. With exports amounting to only one fourth of import financing, the economic opening has helped to ensure that most of the imports are financed through one-sided private (emigrants' remittances) and official transfers and the support programs of the international institutions. The temporary emigration, the links of the businesses with foreign partners, the technical assistance delivered by the international community, the education and training of many people in Western schools and the reformation of the schools and training centers on basis of Western experience have made a tangible contribution to the formation of the human capital. The IMF and World Bank technical and financial support has been particularly important for the country.

#### **4. CONCLUSIONS**

Reducing poverty also requires community-based activities that develop institutions and social cohesion from the bottom up, and build on the traditions and social conventions that govern the behavior and actions of individuals. The absence of these institutions impedes economic development and increases poverty. The Law on health care has not yet been adopted. Overall, administrative capacity in the field of public health remains weak and inequalities persist in rural areas. Preparations in this area are not very advanced. Unemployment is high. In order to create a flexible labor market that promotes employment opportunities, the government must review and, where necessary, revise its labor market legislation and regulations, labor market policies and social insurance programs. We also highlight the importance of attaining macroeconomic stability and obtaining an adequate social protection network as pre-conditions to growth and poverty reduction. To diminish regional disparities in Albania, a careful regional policy agenda must be designed. Public expenditure policy for poor regions should not simply be income transfers but rather investment in physical and human capital in order to improve their underlying economic performance by increasing their competitiveness. The positive experience with the micro-credit schemes should be enforced and further develop. More institutional and financial support should be given to encourage family businesses, create new firms and grow small ones, and to back partnerships.

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