Albania

Growth and Jobs

Policy Implementation Support

Unlocking Jobs and Growth

Through Productivity:

A Firm-Level Diagnostic of Albania

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Executive Summary

This note takes stock of productivity trends of the Albanian non-agricultural private sector using granular firm-level data. To understand better the sources of jobs and productivity growth, this note analyzes firm-level data from the Albanian annual Structural Business Survey (SBS) collected by INSTAT, the national statistical agency, as well as customs data. This dataset covers all firms with more than ten employees and a representative sample of smaller firms, from all sectors, with the exception of agriculture, financial services and public administration (see Box 1).

Despite impressive growth and job creation, both employment and productivity gaps remain. Between 2006 and 2016 the country has seen a doubling of its formal private sector, creating 270,000 jobs. Part of these jobs were genuinely new – total employment in Albania increased by 100,000 jobs in the same time period – while other jobs were the result from people switching from agriculture to manufacturing and services jobs and formalization of informal activities.

Employment gaps with the EU remain, even though they have been narrowing: in Albania, 40% of the labor force works in the formal non-agricultural private sector, against 51% in the European Union. To meet the country’s aspirations, the need to create more and especially better jobs prevails. Wages remain the lowest in the region and many young Albanians move abroad to find better job opportunities.

Boosting firm productivity – currently at 10-15 percent of the level of the EU – is crucial to meet these aspirations. Productivity, representing the efficiency in which firms use its capital and labor to produce, is a strong driver of economic growth and differences in productivity across countries explain more than half of differences in gross domestic product (GDP). In Albania, more productive firms employ more people and pay higher wages. However, compared to the region and the European Union, productivity remains low. An Albanian firm is seven to ten times less productive than the average firm in the EU, and about three to four times less productive than firms in the region. In addition, productivity growth has been low or even negative in certain years.

This analysis suggests that both (i) low productivity growth within firms and (ii) low growth of more productive firms are driving the low growth of aggregate productivity. Aggregate productivity can increase by firms increasing their capabilities through innovating, adopting better management practices and by increasing skills (“within-firm” growth), by making sure the most productive firms are growing in market share (“between-firm” growth) or by entry of productive firms and by exit of unproductive firms (dynamic growth). This analysis suggests that both low productivity growth within firms and a low growth of more productive firms are driving the low growth of productivity.

International linkages are important: foreign-owned firms are 3% of firms, provide 19% of employment, but are responsible for half of exports. There is a clear link between exports and productivity – exporting firms are twice as productive as non-exporters – and between exports and job creation – almost all new (net) jobs in manufacturing firms were created by exporting firms. Policies that facilitate exports or attract FDI are likely to have a positive impact on productivity and employment.

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1 The data does not allow for a separate identification of the dynamic component, due to unreliable registration of exiting firms.
Reforms are needed to encourage and enable firms to become more productive and to support reallocation of the market towards the most productive firms. Policies targeting the productive capabilities of firms, e.g., workforce training, supporting training, innovation or technology adoption, policies that improve the business enabling environment, e.g., improving competition in markets, increasing legal certainty through improving the court system and strengthening the credit infrastructure, and initiatives that support businesses during their startup or growth process, e.g. supporting incubators or accelerators, could help bring about these increases in productivity.

Box 1. Firm-level data in Albania: Sources

This note analyzes productivity trends in Albania, by taking stock of the development and performance of Albania’s non-agricultural private sector using unique firm-level data. To gain a unique insight in how businesses have developed and changed, this analysis uses firm-level microdata of the Structural Business Survey (SBS), collected by INSTAT, the national statistical agency, and detailed customs data from the Albanian General Directorate of Customs.

The Structural Business Survey (SBS) is an annual survey of businesses in Albania, covering all firms with more than 10 employees and a representative sample of smaller firms. The Structural Business Survey is based on a methodology set by the European Commission and follows Eurostat standards. The sampling of firms is based on the Statistical Business Register, which is compiled from the national business register as well as from other administrative sources. This analysis uses Structural Business Survey (SBS) data covering the period between 2002 and 2016 was used. Data for 2017 has recently been released but has not been used for this report.

The SBS covers all enterprises that produces goods or services for the market, except for agriculture, financial and insurance services and public institutions. Also excluded are hunting and fishing activities, compulsory social security and international organizations. The dataset includes all active enterprises of all legal forms that were active in the December of the reference year. Data from the surveys is supplemented with additional administrative data from the taxation authority and the business registry.

In addition, import and export data from customs is used. This data was provided by the General Directorate of Customs and matched with the firm-level data from the Structural Business Survey. The customs data covers the period between 2002 and 2014.
Employment in the formal private sector has more than doubled between 2006 and 2016

During the last decade the formal non-agricultural private sector created 270,000 jobs, which is a doubling from 2006. Between 2006 and 2016, overall employment increased from 935,000 in 2006 to 1,043,000 in 2016. The private sector played an important role in contributing to these new jobs. Excluding agriculture, the number of jobs in the formal private sector almost doubled between 2006-2016, from 200,000 in 2006 to 470,000 jobs in 2016 (Figure 1). Besides newly created jobs, this increase also reflects people switching jobs from agriculture, which still accounts for 38 percent of employment2, and jobs moving from the informal to the formal private sector as the result of formalization.

In 2016, 40 percent of the labor force worked in the formal non-agricultural private sector, narrowing the gap with other Western Balkan countries and the European Union (Figure 2). The share of the labor force working in the formal private sector has been increasing by 16 percentage points over the course of five years between 2011 and 2016 and is now at a similar level as North Macedonia (41%). Nevertheless, the share is still lower than the average in the European Union (51%) and Croatia (51%).

The formal private sector has seen a rapid expansion in the last decade across all sectors (Figure 3). Between 2006 and 2016, the number of jobs in the formal manufacturing sector doubled, while the number of jobs in the formal service sector almost quadrupled. As Figure 3 shows, this growth continued in recent years. Within the manufacturing sector, the industries with the highest employment growth were machines and equipment (+32 percent), food and beverage production (+17 percent) and textiles, apparel and leather (+14 percent). In the service sector, the sectors with the highest employment growth

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2 INSTAT 2017 data
were IT and consulting (+44 percent), administrative and business support (+23 percent), restaurants and cafés (+17 percent), as well as “other” services (+24 percent).^3

**Figure 3.** Employment has increased across all sectors between 2002 and 2016. (Employment by sector)

**Figure 4.** Between 2014 and 2016, employment growth has been the highest in IT, computers & machinery, accommodation, restaurants & cafés and administrative and business support services. (Average annual growth in employment, 2014-16)

**Figure 5.** Relative to the European Union, employment shares are lower in the manufacturing, commerce, transport, ICT and other services sector (Employment by sector as share of the total active labor force)


A reduction in informality contributed to the growth of the formal private sector. Part of the observed increase in jobs and firm registration has been the consequence of decreasing informality. In 2015, the government embarked on a large-scale effort to encourage business registration and compliance with employment and taxation laws, leading to a sharp increase in the number of formal firms and employment in the formal private sector (see Box 2). The firm-level data does not differentiate between new registrations due to formalization and new registration due to a genuine new business activity.

Relative to the European Union (EU28), significant employment gaps remain, most notably in the manufacturing, commerce, transport, ICT and other services sector (Figure 5). In the EU, the

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3 “Other” services include personal services, repair activities not classified as manufacturing, creative industries, gambling and betting as well as sports and recreation-related services.
manufacturing sector provides employment to 12% of the active labor force⁴, while in Albania the corresponding figure is 8%. The differences are more striking for the ICT and transport: the share of employment provided in these sectors in Albania is respectively two and three times lower than in the European Union.

**As Albania is completing its transition to a market-based economy, the formal private sector has matured.** Less than 1 percent of the firms in the firm-level dataset were founded before 1992⁵, meaning that in 2002 most employment was in young and medium-aged firms. As Figure 6 shows, this has now changed: firms older than 15 years employed about 30 percent of workers in the manufacturing sector and about 25 percent of workers in the services sector.

Despite this, **young firms that are less than five years old create almost half of net job creation in the formal sector (Figure 7).** In 2016, 48 percent of the net job creation in the manufacturing sector and 49 percent of those in the service sector were created by firms of less than five years old. Firms older than 15 years created 12 percent and 15 percent of new jobs in respectively the manufacturing and service sector, despite comprising about 30 percent and 25 percent of total employment.

**Figure 6. While more and more workers work in older firms ...**
(employment share by firm age)

**Figure 7. ...it is young firms that create most of the new jobs**
(net job creation by firm age, 2016)

Source: Staff calculations based on INSTAT firm-level SBS survey data.

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⁴ The active labor force includes those who are employed and those who are looking for a job, but excludes the inactive population (e.g. those who are still in education, who are unfit to work or for other reasons not in employment or looking for employment). The labor force participation rate (the size of the labor force as share of the working-age population, between 15 and 64 years old) is 66.8 percent in Albania and 73.3 percent in the EU. (Source: INSTAT and Eurostat)

⁵ Most of the firms founded before 1992 are firms in the semi-public sector (e.g., waste disposal, electricity, utilities, cultural sector).
Box 2. Informality in Albania and the 2015 anti-informality campaign

Traditionally, informality has been commonplace in Albania. In 2014, more than half of the labor force was employed informally, by working for an unregistered firm or by informally working for a registered firm. Key sectors with high degrees of informality are the agricultural sector (which employs more than a third of the labor force), hospitality (hotels, restaurants and cafés), retail and construction.

In 2015, as part of a wider effort to clamp down on tax evasion, the Albanian government embarked on a large-scale campaign to enforce business registration and formalization of employees. The campaign consisted of a large-scale publicity campaign, the waiving of penalties through a voluntary disclosure scheme, increased penalties for those not voluntarily disclosing and increased enforcement. An additional 500 inspectors were recruited in support of a door-to-door campaign, in which enterprises across the country were systematically visited and audited. Firms that lacked a registration certificate were shut down until the owner registered their business.

Figure 8. In 2015, during the high point of the anti-informality campaign, net firm registration went up by 40000 firms registered, about 38000 more than in the previous year (Net firm registrations by year)

Figure 9. Most of the new registrations were in agriculture, commerce and other services (Net firm registrations in 2015 and 2014, by 2-digit NACE industry)

This campaign did not only target business registration, but also other forms of informality and tax evasion. Informality can take on many forms. For example, a firm might not be registered (informality at the “extensive” margin), a formal firm might hire some workers informally, underreport salaries or underreport sales (informality at the “intensive” margin). The 2015 campaign tackled different forms of informality and tax evasion. As part of the audit, inspectors checked whether a firm was formally

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6 The data does not allow to differentiate between different modes of informality. Labor force survey estimates suggest that 51.3% of employment was informal in 2014 (Source: World Bank/WIIW Jobs Gateway, based on INSTAT labor force survey data).
registered, whether workers were registered and tax contributions were paid for them as well as auditing invoices.

**This campaign led to an increase in the number of registered firms.** In 2015, the number of registered firms went up by 35 percent, most likely as a result of this campaign (Figure 8). Net firm registration went up by 39744 firms – which was 38293 firms more than in 2014, the previous year. Almost half of this increase was in the service sector, while most of the other half was in the agricultural sector (which is not covered in the Structural Business Survey used for the analysis in this note). In the services sector, the industries that saw the largest increase in net firm registrations were retail, hotels and restaurants, wholesale, personal services and other services (Figure 9).

**More productive firms provide more and higher paid jobs**

**The challenge to create better paid and higher quality jobs remains significant.** Much of the growth in employment in Albania has been in traditionally low wage sectors (Figure 10), such as retail, restaurants and cafés and the textiles sector. Net job creation has been more limited in higher wage sectors, such as professional and technical services, IT or publishing and media. Wages in Albania remain the lowest in the region, and despite an increase in 2014, real wages have stagnated recently (Figure 11). A worker in Albania earns on average only a quarter of what a worker in Austria earns, and about a third less than the average worker in the non-EU Western Balkan countries. Despite an increase in 2014, wages have recently stagnated.

**Figure 10.** Most new jobs have been created in low wage industries. (Average nominal wages in million LEK, 2016, and net job creation between 2014 and 2016; the size of the bubble represents employment in that industry)

**Figure 11.** Wages have stagnated after an increase in 2014 and remain lower than in the region. (Average gross wages, Austria = 100, PPP Euro-based)

7 Albania, Bosnia-Herzegovina, Kosovo, Macedonia, Montenegro and Serbia.
Globally, growth in productivity has been a main driver of economic development, creating better and more sustainable jobs. Productivity represents the efficiency with which societies combine their people, resources, and tools (see Box 3). Productivity growth is the main driver of the development process: half of the observed differences in GDP can be attributed to differences in GDP. Sustained productivity growth creates employment and livelihoods and can foster wage increases, facilitating the shift from informality. In addition, cost reduction driven by productivity push down prices, contributing to poverty reduction and welfare.

In Albania, high-productivity firms employ more people and pay higher wages (Figure 12). The top 20% more productive firms in both the manufacturing and the services sector employ more people and pay on average higher wages than lower productivity firms. This effect is more pronounced in the services sector. This could suggest that higher productivity firms pay a premium for the skilled workers that contribute to productivity or pay higher wages to attract talent. Figure 13 shows nevertheless that the wage growth in the highest productivity segment has not been higher than in lower segments. Also, employment in the top 20% productive group of firms has decreased in the manufacturing sector.

Figure 12. Firms with higher productivity employ more people and pay higher wages. (Employment and wages by TFP Productivity quintile, 2016)

Figure 13. In manufacturing, most of the employment growth happened in firms with intermediate levels of productivity. (Net job creation and real wage growth by TFP quintile, 2014-16)

Source: Staff calculations based on INSTAT firm-level SBS survey data.

Source: Staff calculations based on INSTAT firm-level SBS survey data.

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8 Cusolito & Maloney (2018).
Box 3. Measuring productivity

Productivity is the efficiency of how the economy transforms the factors of production (capital and labor) to production output. Productivity is an important driver of growth: cross-country studies have shown that productivity growth may account for up to 60 percent of economic growth.\textsuperscript{9}

This analysis relies on two measures of productivity, value added per worker and total factor productivity. \textbf{Value added per worker} (a measure of labor productivity\textsuperscript{10}) is calculated by dividing the value of firm production – measured by value added – by the number of employees (both permanent and temporary). In capital-intensive firms, labor productivity is expected to high, because employees have more capital at their disposal. The advantage of value added per worker is that it can be easily compared across sectors and countries.

While labor productivity only measures the productivity of one factor of production, \textbf{total factor productivity (TFP)} measures how efficiently multiple factors of production are employed. TFP is estimated by calculating the share of output that is not explained by the quantity of factors of production used the production (the “residual”). In a production function $Y = A K^\alpha L^\beta$, in which $Y$ is output, $K$ is the amount of capital and $L$ the amount of labor, TFP is equal to $A$.

\textbf{Figure 14.} Total factor productivity estimates the efficiency of use of multiple factors of production, while labor productivity and capital productivity only measure the efficiency of use of one factor.

\begin{align*}
\text{Labor productivity} &= \frac{\text{Firm production}}{\text{Number of workers}} \\
\text{Capital productivity} &= \frac{\text{Firm production}}{\text{Amount of capital}}
\end{align*}

\begin{align*}
\text{TFP} &= \frac{\text{Firm production}}{(\text{Amount of capital})^\alpha \times (\text{No. of workers})^\beta}
\end{align*}

\textsuperscript{10} Common alternative measures for labor productivity are sales per employee, or at a macro level, GDP per worker.
The productivity gap with neighboring countries and the EU has widened

**Figure 15.** Productivity of Albanian firms is 10-15% of the average productivity of an EU firm. (Value added per worker, 2016, EU28 = 100%)

Source: Staff calculations based on SBS, business registry data and Eurostat data.

**Figure 16.** Productivity growth – both measured as value added per worker and total factor productivity (TFP) – declined between 2014 and 2016. (VA per worker and TFP growth, 2005-2016)

Source: Staff calculations based on INSTAT firm-level SBS survey data.

The firm-level data confirms that productivity in Albania is low compared to the EU and neighboring countries. Using value added per worker as a measure for productivity (see Box 3), Albanian firms are about three times less productive as North Macedonian firms, and between seven to ten times less productive than the average EU firm (Figure 15). Relative productivity is especially low in the manufacturing (value added per worker is 8% of the average EU firm) and hospitality (hotels/restaurants) sectors (where average value added per worker is 9% of the average EU firm). Commerce, transport and ICT see higher levels of relative productivity, but nevertheless remain low compared to the region and the EU. When correcting for differences in purchasing power, Albanian firms are between 2.4 to 4.9 times less productive than the average EU country.

Estimates of productivity suggest that between 2014 and 2016, productivity growth was low or negative. Both value added per worker, and TFP (see Box 3 for definitions) have seen a decline between 2014 and 2016, with value added per worker declining by six percent in manufacturing and by two percent in services. TFP declined similarly, with a decline of one percent in manufacturing and six percent in services.
Employment growth has been higher in sectors with lower value added. Except for IT, the sectors that have seen the largest growth rates in employment are sectors with lower value added per worker, such as restaurants and cafés, accommodation, textiles and apparel and business support services (Figure 17). IT, programming and consulting have been a notable exception, with high levels of value added and high levels of employment growth, but in absolute terms, employment in this sector remains low.

Similarly, employment growth in many sectors was not accompanied by productivity growth (Figure 18). Even though practically all sectors have seen employment growth, not all sectors have seen an increase in productivity. Between 2014 and 2016, the sectors with the largest negative productivity growth – as measured by total factor productivity – were food and beverages manufacturing, constructing, accommodation, wholesale and other manufacturing. Sectors with both positive employment growth and positive productivity growth have been other services, retail and business admin and support services.

These two patterns mean that between 2014 and 2016, productivity declined in Albania. Positive employment growth combined with negative productive growth could mean that these jobs are created by less productive firms (a between-firm effect) or that firms that take on these additional employees are decreasing their overall productivity, by using their current and new workers less efficiently than before (a within-firm effect). The between firm effect can be suggestive of misallocation of production factors, meaning that capital and labor are not flowing to the most productive firms. The within-firm effect is closely associated with firms innovating, adopting better managerial practices and increasing worker and managerial skills (see Box 4).
Box 4. The three pillars of productivity growth

To understand the sources of productivity increases or decreases, growth is often decomposed in three components: a “between” component reflecting whether the factors of production are flowing to more productive firms (relocation of production factors), a “within” component reflecting firms increasing their capabilities and a “dynamic” component reflecting the productivity gains and losses from firm entry and exit.\textsuperscript{11}

Table 1 summarizes these three components and their links with policy. Most policies are not exclusively associated with only component: for example, reforming business regulations can both facilitate entry of new firms (“dynamic”) as well as facilitate the growth of firms that were previously restricted (“between”).

Table 1. The sources of growth and links with policy

<table>
<thead>
<tr>
<th>“Within”</th>
<th>“Between”</th>
<th>“Dynamic”\textsuperscript{12}</th>
</tr>
</thead>
<tbody>
<tr>
<td>Firms increasing their capabilities</td>
<td>Allocating resources to more productive firms</td>
<td>Entry of productive and exit of unproductive firms</td>
</tr>
<tr>
<td>Capabilities include: human capital skills, management and organizational practices, the use and adoption of technology, innovation by the firm.</td>
<td>Misallocation of resources indicate barriers that prevent the movement of capital, labor and other production factors to the most productive firms in the economy.</td>
<td>Entry of highly productive, fast-growing firms (gazelles) and the exit of less productive firms that are not growing (laggards)</td>
</tr>
<tr>
<td>Links with policy: improving education / technical skills, encouraging entrepreneurship, technology adoption and innovation, regulatory constraints to firm growth</td>
<td>Links with policy: product market regulations, distortions in access to financing / SME financing, labor market frictions, removing protections of certain industries</td>
<td>Links with policy: barriers to entry of new firms (e.g., costly licensing), competition policy, encouraging entrepreneurship</td>
</tr>
</tbody>
</table>

Decompositions suggest that the lack of growth is driven both by productive firms not expanding relative to less productive firms and firms declining productivity. A decomposition of productivity into a within and between-firm component suggest that both components have contributed little or negatively to aggregate productivity growth between 2011 and 2016 (Figure 19 and 20). This is a stark contrast to the period between 2005 and 2010, when the between-firm component was generally large and positive (with a more muted contribution of the within-firm component). The negative or low between and within-firm components suggest that productivity gains can be made from firms upgrading their capabilities and from removing constraints that productive firms face from growing.

\textsuperscript{11} See e.g., Olley & Pakes (1996).
\textsuperscript{12} Firm exit is not reliably recorded in the Structural Business Survey, which means that the “dynamic” component cannot be identified separately from the “within” and “between” components.
A decomposition of productivity suggests negative or low between and within effects contributing to value added per worker growth... (Olley-Pakes decomposition of value added per worker growth)

... and to total factor productivity growth as well. (Olley-Pakes decomposition of TFP)

Compared to countries in the region, Albania lacks employment in industries with higher and more sophisticated technological intensity (Figure 21). Eighty percent of the workforce in the formal manufacturing sector works in sectors with low technological intensity (e.g., food and beverages manufacturing, textiles and apparel, wood manufacturing and furniture) and 17% in the medium-low tech industry (e.g., metals, materials, minerals, installation of equipment). Employment in medium-high technology (e.g., motor vehicles, chemicals, machineries and equipment) and high technology industries (e.g., computers and electronics, pharmaceutical) is negligible. The share of employment in the medium-high and high tech industries is significantly higher in Croatia, Northern Macedonia and Serbia.

Increasing formalization likely contributed to part – but likely not all – of this observed decrease in productivity. Experience from other countries suggest that informal firms are likely to be less productive than formally registered enterprises. While the data does not allow for the identification of formerly informal enterprises, there is some evidence that registration of informal enterprises contributed negatively to productivity. In 2015, the year of a large-scale formalization campaign (see Box 2), the average productivity of a new firm was about a third (32%) lower than the productivity of an entrant firm...

13 La Porta & Shleifer (2014).
in the previous year. Nevertheless, productivity patterns when excluding small firms or firms founded in 2015—which are more likely to have been informal—are relatively similar.  

Furthermore, the trend of low or negative productivity was already visible before the start of the 2015 formalization campaign.

**Box 5. Moving up the value-added ladder**

Albania’s production is targeted towards activities that are lower value added and less knowledge and technologically intensive compared to firms in the region and Europe. Only 3 percent of jobs are in medium-high tech industries (as classified by the OECD) and practically none in high-tech sector, which is much lower than other countries in the region. This is also reflected in Albania’s export basket: it contains few sophisticated products and quality of exports—reflected in the prices charged—is low.

**Promoting economic diversification** into activities that are more knowledge and technically intensive or more complex are likely to contribute to productivity growth. To achieve economic diversification, upgrading of firm capabilities (see Box 7), investment in skills and encouraging innovation and technology adoption is crucial.

The region has seen several examples of new industries that led to both job creation and productivity growth. Serbia and North Macedonia have successfully attracted foreign direct investment in the motor vehicles industry, providing employment to more than 40,000 people in both countries (Figure 22). In Albania, the call center industry has brought about transformative changes in jobs and productivity (see Box 10), although it has been facing challenges recently.

The economic complexity methodology used by Harvard’s Center for International Development is one approach to identify opportunities. This methodology identifies products that are technologically close to existing manufacturing products, but at the same time more sophisticated. The idea is that the manufacturing of these products can benefit from existing technology and know-how, but the higher sophistication means that a higher value added can be achieved. For Albania they identify plastics and rubbers as well as food manufacturing as sectors with high potential.

Nevertheless, targeting particular “winning” sectors or firms is difficult and has often proven unsuccessful. Studies of existing approaches to identify high-potential firms or entrepreneurs have shown that the predictive power of such approaches are low. Even venture capitalists trying to identify high-potential businesses get many of their “bets” wrong.

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14 Other types of formalization, e.g. formalizing workers that were previously informally employed, are likely also affecting this low or negative trend, by upward biasing productivity estimates for former years (unregistered workers will make a firm appear more efficient in the past).


18 See e.g., Kerr, Nanda & Rhodes-Dropf (2014).
Albanian firms need to grow and become more productive

On average, the productivity of an Albanian firm stagnated, or even declined. The negative “within” component in the decomposition suggest that between 2008 and 2016 average productivity of a firm stagnated or declined (Figure 19 and 20). Productivity of Albanian firms are below those of firms in the region and in the European Union. This suggest that there is scope for improvement in productivity by Albanian firms through increasing their production efficiency.

Low firm capabilities, e.g. lacking skills, low levels of innovation and a bad use of management practices, are a likely driver of this low productivity. A negative “within” component can be related to a lack of growth in firm capabilities. Firm capabilities refer to the ability and capacity of firms to optimally use their factors of production in the production process and include those competences that firms cannot buy “off the shelf”: worker and management skills, innovation competencies (including the adoption of new technologies) and organizational practices (see Box 6). Firm capabilities have been shown to be important drivers of productivity differences: for example, in the United States, firm capabilities explain almost half (44 percent) of the observed differences productivity in the country.

Box 6. Management practices as driver for productivity

Firm capabilities are important drivers of productivity. Firm capabilities refer to the ability and capacity of firms to optimally use their factors of production in the production process and includes whether a firm adopts good managerial and organizational practices, whether a firm adopts new technologies as well as the skills of the management and the workforce.

Management and organizational practices have a positive impact on the productivity of firms. Cross-country studies of management and organizational practices suggest that differences in managerial quality can explain up to a third of differences in cross-country productivity, and also within countries, management quality is strongly correlated with productivity and firm performance.

Good management practices include careful monitoring, the setting of targets, motivating and incentivizing workers and continuously improving the production process. For example, firm-level studies have shown that changing the payment structure in an American firm from a time-rate to a piece-rates improved productivity by 44% and that firms with better recruitment and training practices improved team interactions and problem-solving.

Data on the adoption of good management practices in Albania is lacking. The two largest scale surveys of management quality, the World Management Survey and the Management and Organizational Practices Survey (MOPS) have not been conducted yet in Albania. Nevertheless, other data suggest that Albanian firms score badly in some relevant metrics compared to the average firm in Europe and Central Asia: data from the 2013 Enterprise Survey suggests that Albanian firm managers

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20 Bloom & Van Reenen (2010)
21 Lazear (2002)
22 Ichniowski & Shaw (2009)
tend to be less experienced than managers in ECA (an average of 11.2 years against 16.9 in ECA), less likely to offer their employees formal training (23.6% against 36.6%) and less likely to innovate through the introduction of a new product or service (8.4% against 27.0%) or changing the process (2.9% against 22.8%).

Albanian firms are smaller than similar firms in the region and in the European Union (Figure 23). The average manufacturing firm in Albania is almost a third smaller than the average manufacturing firm in the EU, and this ratio is even worse for the commerce, transport and hospitality sectors. This suggests that compared to firms in the region, Albanian firms tend to operate at a smaller scale. In Albania, larger firms are more productive than smaller firms, as they are more likely to reap the benefits of scale economies.

Small firms relative to the EU and the region can especially be found in food manufacturing (agribusiness), restaurants and cafés, vehicles trade and retail (Figure 23). The average agribusiness firm engaged in food manufacturing is three times smaller than the average food manufacturing firm in the EU (Figure 24). Meanwhile, firms in sectors that are dominated by foreign direct investment, such as apparel, leather, construction and business support services are larger than the EU average.

Many jobs are in small firms. One fifth of jobs in manufacturing firms and almost half of jobs in the services sector are in “micro” firms with fewer than ten employees (Figure 25). This share is much higher compared to countries in the region, such as Serbia (8% of manufacturing jobs and 19% of services jobs are in “micro” firms) or North Macedonia (12% of manufacturing jobs and 39% of services jobs).

Low levels of innovation and technology adoption seems to be driving the low productivity of firms. Innovation and the adoption of better technologies are important driving forces behind the upgrading of productivity, allowing firms to climb the “capabilities escalator”\(^{23}\). But innovation indicators suggest that innovation is low. The World Bank Enterprise Survey – conducted in cooperation with the EBRD – suggests

\(^{23}\) Cirera & Maloney (2018).
that in 2013 only 8% of Albanian firms introduced a new product or service, that only 3% introduced a process innovation and that only 1% spent on R&D, much lower than other firms in Europe and Central Asia (Figure 25). International comparisons of innovation suggest that innovation and technology adoption by Albanian firms has increased since 2013, but nevertheless remain at low levels compared to countries in the region.24

Figure 25. Albanian workers are more likely to work in “micro” firms (with less than 10 employees) compared to the region (Employment by firm size, 2016)

<table>
<thead>
<tr>
<th></th>
<th>ALB</th>
<th>HRV</th>
<th>MKD</th>
<th>SRB</th>
<th>ALB</th>
<th>HRV</th>
<th>MKD</th>
<th>SRB</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>25%</td>
<td>39%</td>
<td>36%</td>
<td>46%</td>
<td>17%</td>
<td>32%</td>
<td>21%</td>
<td>41%</td>
</tr>
<tr>
<td>Services</td>
<td>17%</td>
<td>22%</td>
<td>20%</td>
<td>10%</td>
<td>8%</td>
<td>12%</td>
<td>17%</td>
<td>18%</td>
</tr>
</tbody>
</table>

Source: Staff calculations based on INSTAT firm-level SBS survey data.

Figure 26. Albanian firms are less likely to innovate or spend on research and development (R&D) (Innovation indicators, 2013)

<table>
<thead>
<tr>
<th>Percentage of firms</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td>Using technology licensed from foreign companies</td>
</tr>
<tr>
<td>With their own Web site</td>
</tr>
<tr>
<td>Using e-mail to interact with clients/suppliers</td>
</tr>
<tr>
<td>Who introduced a new product/service</td>
</tr>
<tr>
<td>Whose new product/service is also new to the main market</td>
</tr>
<tr>
<td>Who introduced a process innovation</td>
</tr>
<tr>
<td>With R&amp;D expenditure</td>
</tr>
</tbody>
</table>

Source: WB-EBRD BEEPS/Enterprise Survey

In addition, firms have trouble attracting skilled employees. The World Bank Skills Towards Employment and Productivity (STEP) survey reports that in 2017 more than half of firms report that they experience difficulties in hiring because of the applicant’s lack of skills and work experience.25 This is even more problematic for firms requiring the recruitment of high-skilled workers. In the survey, more than 90 percent of firms that tried to recruit a worker for a high-skilled job reported at least one problem in their attempts to fill the vacancy. Recruitment is easier for medium and lower-skilled occupations (e.g., production workers, drivers, plant operators and assemblers).

These skill constraints are the most binding for large, innovative and foreign-owned firms. The 2017 STEP survey suggests that firms reporting to engage in innovative activities are twice as likely as non-innovative firms to face difficulties in recruiting high-skilled workers. Large firms (with more than 100 employees) are twice as likely to report difficulties, while foreign firms are six to seven times more likely to report difficulties in recruitment. This suggest that the firms that are expected to be the most productive, are also the most likely to be affected by difficulties in attracting skills.

24 For example, Albania ranked 129 in the Global Innovation Index in 2015, but increased their ranking to 83 in 2018.
Policies or support programs that improve firm capabilities can be expected to have a positive impact. Governments can pursue a variety of policies to support the capabilities of firms, such as offering financial incentives (e.g., vouchers, matching grants, tax incentives and loan guarantees), technical support and advisory services (e.g., consultancy, workforce training, advice on technology transfer) or supporting new firms through incubators and accelerators. While the effectiveness of such interventions depends on their targeting and implementation and not all interventions met their stated goals, some interventions have had positive and significant impacts (see Box 7).

Box 7. Improving firm capabilities: evidence from randomized controlled trials around the world

Interventions can increase firm capabilities. Governments, international organizations and donors can facilitate businesses in their growth through a variety of policies varying from providing startup finance (e.g., vouchers and grants) to offering or facilitating training and consulting (see Figure 27).  

One such intervention is business skills trainings. Many programs have been set up offering business skill trainings to firms, often including components on accounting, financial planning, costing and business financing. The World Bank flagship publication *High Growth Firms: Facts, Fiction and Policy Options for Emerging Economies* reviewed 15 randomized controlled trials (RCTs) conducted around the world (none in Albania) and found positive impacts on sales in 8 of them, while the remaining 7 had insignificant impacts.  

Figure 27. Governments can support firm capabilities and the business environment through a variety of policy instruments

Source: Adapted from Grover Goswami, Medvedev & Olafsen (2018) and Cirera & Maloney (2017).

Offering consulting has shown to have positive effects. Evidence from India and Mexico shows that consulting services can have lasting positive effects. A program that offered consultancy services to large Indian firms in the textiles industry increased management practices and subsequently productivity by 17 percent and many of these improvements lasted even after nine year. Similarly, a

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26 A more extensive discussion of policies supporting the growth of firm capabilities can be found in Cirera, Frias & Hill (2018).
28 Bloom et al. (2013, 2018)
program that offered consulting to 432 small and medium enterprises in Mexico also led to an increase in the adoption of good management practices as well as increases in revenue and productivity. More of such consultancy programs are currently being piloted in Mexico and Colombia.

But, they face constraints in doing so

More productive firms in Albania do not grow more than less productive firms. Besides firm upgrading, a second channel to achieve productivity growth is for productive firms to grow by taking on additional capital and labor and to expand their market share. The negative “between” component suggest that this was not the case in Albania between 2013 and 2016. Figure 13 shows that most employment growth was in firms with intermediate levels of productivity and not in firms with the highest levels of productivity.

This suggests the potential presence of obstacles to productive firm growth and misallocation of resources. Misallocation of resources means that the factors of production, such as capital and labor, are not being allocated to the most productive firms, but instead are employed in less productive firms. Such misallocation can be a sign of the presence of distortions that constrain growth of productive firms. Examples of distortions are lack of competitive pressures, lack of access to finance, labor market frictions and insufficient product market regulations. Even though international comparisons of business environment show that Albania is doing well, challenges nevertheless remain.

This lack of growth of productive firms is especially prevalent in specific sectors. Figure 28 shows the decomposition of productivity specified by sector. Sectors with large negative between components are education, health, electricity and gas, mining, professional and technical services and publishing and media. There are also a few sectors with positive contributions of the between component, including tour agencies, other services, telecom and computer and machines manufacturing.

A high degree of dispersion in productivity is a further sign of an inefficient allocation of production factors. Figure 29 shows the ratio of productivity of a firm in the 90th productivity percentile compared with a firm in the 10th percentile. Even though the dispersion can be result of factors such as differences between firms in technology adoption, worker skills, management, product quality and market power, a high dispersion suggest that productivity gains can be achieved by moving production factors from less productive to more productive firms. In advanced economies like the United States, firms in the 90th productivity percentile are only twice as productive as firms in the 10th percentile, while in emerging economies like China and India dispersion ratios were between 2.5 and 3.1. The Albanian dispersion ratios are close to these found in other emerging economies, and are particular high in the wholesale, retail and transport industries.

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29 Bruhn, Karlan & Schoar (2018)
30 Source: Table 2, Hsieh & Klenow 2009.
Figure 28. In most industries, the “between” component representing misallocation dragged down productivity growth (Olley-Pakes decomposition of productivity growth by industry, 2014-2016)

Figure 29. Productivity dispersions are high in the commerce, transport, telecom and metals industries, suggesting that misallocation is high in these sectors (Total factor productivity dispersion, ratio 90th-10th percentile and 80th-20th percentile)

Source: Staff calculations based on INSTAT firm-level SBS survey data.

This evidence suggests a need to further improve the business environment. Even though Albania has been steadily increasing in international rankings of the business environment, and is now ranked in the 63rd in the 2019 edition of the Doing Business ranking, businesses nevertheless still report obstacles, including legal uncertainty, lacking property rights, uncertainty in regulation and difficulties when importing and exporting (Box 8).

Lack of access to finance constrains firm growth, especially for micro, small and medium-sized enterprises (MSMEs). European Commission figures show that only 17 percent of Albanian MSMEs do not see financing as problematic, which is much lower than in neighboring countries (e.g., the corresponding figures are 28 percent in Croatia and 33 percent in Serbia). World Bank surveys have shown that Albanian MSMEs are about twice less likely to have a bank loan or line of credit than firms in Croatia or Montenegro. Albanian MSMEs are three times more likely than firms in the region (Serbia, Montenegro, Bulgaria and Croatia) to rely on financing from own funds or from family or friends. Furthermore, pushed by high levels of non-performing loans, banks in Albania require higher levels of collateral than banks in the region. Private equity and venture capital is practically non-existent.

34 World Bank (2018).
Box 8. Obstacles to enterprises: what firms say

As part of this study, the World Bank team conducted interviews with firms, business associations and other private sector stakeholders. These interviews suggest that entrepreneurs see a large potential for producing in Albania, but that obstacles in the business environment nevertheless remain, harming their possibilities to grow and expand as well as selling on international markets.

Common constraints mentioned by firms include:

- Lacking legal certainty around land property rights can prevent firms from acquiring new land to expand operations or from selling land they own.
- Uncertainty in regulation, for example frequent changes in taxation policy, make it difficult for firms to anticipate and plan in advance.
- Difficulties in attracting skilled workers, especially for specific technical positions, mean that firms have to spend extensive amounts of time and resources on training their workforce.
- Difficulties in obtaining access to finance, combined with unawareness of credit opportunities, mean that enterprises have limited finances to expand operations.
- Long delays in paying VAT refunds mean that exporting firms face even further limits disposable working capital.
- While infrastructure around and between cities has improved, it remains difficult to access more remote and rural areas.
- Export constraints remain, such as difficulties in obtaining certification to sell on the European market, export licenses that are needed for certain exports or long scanning delays of exports at the port of Durrës.

Box 9. Are procurement markets competitive enough?

The government is one of the most important customers for Albanian firms. In 2016, the construction sector represented 28% of all sales made to the government, followed by retail (15%), telecom (12%) and wholesale trade (10%; see Figure 30). In many sectors government sales represent between 20 and 40 percent of overall revenue in that sector. The sectors with the highest government dependence – measured by the share of government sales as part of total revenue – are telecom (63% of revenue), health (46%), construction (40%) and IT (33%). However, some sectors with a high level of government dependence see a high level of concentration (Figure 31). For example, in IT, half of sales go to only three companies and two-third of sales go to only five companies, while in construction the top five firms only account for a third of government sales. While for certain sectors, due to their size or type of product they sell, there might be a rationale for concentrating sales, the high concentration of government sales in sectors that rely on the government as a customer can also be a sign that procurement markets are not open enough, not creating a level playing field in which the most competitive firms can thrive.
Figure 30. Most government sales are in construction, retail and telecom. (Share of sales, 2016)

<table>
<thead>
<tr>
<th>Sector</th>
<th>Share of Sales to Government</th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction</td>
<td>28%</td>
</tr>
<tr>
<td>Retail</td>
<td>15%</td>
</tr>
<tr>
<td>Telecomm...</td>
<td>12%</td>
</tr>
<tr>
<td>Wholesale...</td>
<td>10%</td>
</tr>
<tr>
<td>Electricity...</td>
<td>6%</td>
</tr>
<tr>
<td>Transport</td>
<td>4%</td>
</tr>
<tr>
<td>Administrat...</td>
<td>3%</td>
</tr>
<tr>
<td>Professiona...</td>
<td>3%</td>
</tr>
<tr>
<td>Metals,...</td>
<td>3%</td>
</tr>
<tr>
<td>Health</td>
<td>2%</td>
</tr>
</tbody>
</table>

Source: Staff calculations based on INSTAT Structural Business Survey data.

Figure 31. Some sectors with high levels of government dependence also see high levels of concentration of procurement market share (Government dependence and concentration, 2016)

<table>
<thead>
<tr>
<th>Sector</th>
<th>Concentration (Share of Sales to Government)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction</td>
<td></td>
</tr>
<tr>
<td>Retail</td>
<td></td>
</tr>
<tr>
<td>Telecomm...</td>
<td></td>
</tr>
<tr>
<td>Wholesale...</td>
<td></td>
</tr>
<tr>
<td>Electricity...</td>
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<tr>
<td>Transport</td>
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<td>Administrat...</td>
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<td>Professiona...</td>
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<tr>
<td>Metals,...</td>
<td></td>
</tr>
<tr>
<td>Health</td>
<td></td>
</tr>
</tbody>
</table>

Note: Government dependence is defined as the share of government sales as part of total revenue. Concentration is defined as the share of government sales by the top 5 companies that sell the most to the government. The size of the bubble represents overall government sales in that industry. Source: Staff calculations based on INSTAT Structural Business Survey data.

Linking in with global value chains brings growth

Only 13% of manufacturing firms export, but they created practically all (net) jobs between 2010 and 2014 (Figure 32). In this time period, exporting firms were responsible for creating approximately 14,000 jobs, which is equivalent to overall net job creation by the manufacturing sector in this time period. Net job creation by non-exporting firms remained more or less stagnant in this time period. This strongly suggests that selling to customers abroad is indispensable for many Albanian firms to grow.

Firms that export are twice as productive as non-exporters (Figure 33). Exporters have double the value added per worker and total factor productivity of firms that do not export. Exports and productivity can reinforce each other in two ways. First, in order to compete on the international marketplace, firms need to be more productive to be more competitive. In many cases, firms need to upgrade their production facilities or adopt international practices or certification in order to be able to sell competitively to international clients. Second, selling in international markets can encourage the productivity of those firms doing so (“learning by exporting”). By being exposed to clients and competitors, firms gain new insights and knowledge, allowing them to improve quality, introduce new state-of-the-art technologies and further enhance productivity.35

Exporting firms play an important role in the creation of new jobs. (Net job creation by exporting status of manufacturing firms, 2010-14)

Exporting firms are more productive than non-exporting firms (Value added per worker and total factor productivity, 2005-2014)

Source: Structural Business Survey (INSTAT), customs data.

Source: Structural Business Survey (INSTAT), customs data.

Foreign direct investment (FDI) is crucial for export: foreign-owned firms (3% of firms and 19% of employment) represent almost half of exports in 2017 (Figure 36). Foreign-owned firms and partially foreign-owned firms play an important role in linking Albania with global value chains. The largest source of FDI, Italy (47.2% of foreign-owned firms in 201636), is the largest export market (54.6% of export value in 2016).

FDI has been critical in the creation of jobs, but job creation by foreign-owned firms has declined between 2012 and 2016 (Figure 35). The recent slowdown in FDI is also reflected in a declining number of jobs being created by foreign-owned enterprises. While in 2012 foreign-owned firms contributed to about 13,000 new net jobs, in 2016 this figure declined to close to 500 jobs. Now that two large-scale FDI-led projects, the Trans Adriatic Pipeline (TAP) and the Dovell Hydropower Plant, are scheduled to finish soon, this trend is expected to continue further.

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36 INSTAT (2017).
Box 10. Call centers – an experience to be replicated?

In Italy, if you make a phone call to a company, chances are that you are being connected with a phone operator in Albania. Thanks to the excellent command of Italian by many Albanians – a legacy of the communist era when Italian television channels were among the few available foreign channels Albanians could receive – Italian companies have started to outsource their call center operations to Albania.

The first call centers were established in 2008 and it did not take long before the sector took off. In 2009, the industry only employed about 500 people, but in 2016 this had already increased to almost 24000 employees. This has had a positive impact on productivity: the call center industry is among non-high-skilled services one of the sectors with higher – even though still intermediate – levels of productivity and its growth has therefore boosted overall productivity.

Could call centers pave the way for the successful development of higher value-added service activities, such as IT? In some ways, yes. The lessons learnt from the experiences of the call center industry as well as the links and relationships that have been established could very well stimulate the development of other, higher value-added industries. However, many challenges remain: a sector like IT relies much more on scarce high-skilled labor than the call center industry, meaning that it will be difficult to scale up in the same way that call centers did.

For the call center industry, the road ahead looks bumpy. An Italian law introduced at the end of 2016 that requires phone operators to disclose what country they are located in and that introduces further limits on outsourcing of call centers to non-EU countries have already led to the closing of several firms and a reduction in employment in the sector. Also, the younger generation of Albanians is less likely to speak Italian. However, this generation has now become much more fluent in English, meaning that different opportunities might very well lie ahead.
Conclusion

For Albania to meet its aspirations of more jobs and better jobs, productivity growth is needed. More productive firms employ more people and pay higher wages. However, productivity growth has been low or negative between 2014 and 2016. The productivity gap with countries in the region and the EU remains wide. The 2015 anti-informality campaign contributed to some of the observed decline in productivity, but likely not all.

Reforms are needed to encourage and enable firms to become more productive and to support reallocation of the market towards the most productive firms. The low productivity growth in Albania is the result of a lack of upgrading of productivity of firms through innovation and technology adoption as well as lacking growth of more productive firms relative to less productive firms. To increase productivity, reforms are needed that target these two sources of lacking productivity growth.

Policies that target the productive and innovative capabilities of firms can lead to productive upgrading as well as economic diversification. Innovation indicators show that Albanian firms are less likely to use information and communication technologies (ICT), less likely to introduce a new product, adopt a new production process or invest in research and development (R&D). Policy instruments that increase the absorptive capacity and production and management capabilities, such as management extension programs, advisory services and consultancy, workforce training, supporting early stage firms, can be expected to have positive impacts on productivity.

Strengthening the business environment is needed to remove barriers to growth. The lack of growth of productive firms can point towards deficiencies in the business enabling environment. Even though international rankings show that Albania has made significant process, firms report that obstacles prevail. Removing constraints that firms face to obtain resources, for example improving access to credit or land, fostering competition to create a level-playing field, for example through improving product market
regulations, and increasing legal certainty by strengthening the court system will allow more productive firms to expand.

**Selling abroad is key for Albanian firms.** The participation of Albanian firms in global value chains has resulted in both job creation and productivity growth. Foreign direct investment has played a large role in linking Albania with firms and customers abroad. Policies that encourage further exports and investment from abroad, such as reforming the VAT refund system, investing in export promotion, the upgrading of the quality of exports and the elimination of tariff and non-tariff barriers, can be expected to bring productivity growth.

**References**


