



# **Problems of Employment Aspects in the Active Processing Regime (Facon) in Albania through the Lens of Employees and Employers**

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**Prepared by: Brunilda Kosta**

## Table of contents

<b>1. Introduction.....</b>	<b>3</b>
<b>2. Performance of facon sector in Albania .....</b>	<b>4</b>
<b>3. Concerns in facon sector through the lens of employees .....</b>	<b>5</b>
3.1 <i>The prevalence of undeclared work.....</i>	6
3.2 <i>Determination of salary and production rate .....</i>	6
3.3 <i>Working hours and permit requirements .....</i>	7
3.4 <i>Occupational Safety and Health.....</i>	8
3.5 <i>Verbal abuses in the workplace .....</i>	8
<b>4. Concerns in facon sector through the lens of employers .....</b>	<b>8</b>
4.1 <i>Lack of a specialized workforce .....</i>	9
4.2 <i>Transport and electricity problems .....</i>	9
4.3 <i>Lack of sectorial incentives .....</i>	9
4.4 <i>The subcontractors VAT.....</i>	10
<b>5. Some priorities for intervention.....</b>	<b>10</b>
<b>Methodology .....</b>	<b>11</b>

## 1. Introduction

During the recent years, the Albanian economy has experienced encouraging growth rates, but without generating the same growth in the labour market. The Albanian labour market suffers from quantitative and qualitative imbalances.<sup>1</sup> Administrative data derived from Public Employment Offices (PES, 2018) show that **registered jobseekers with primary education or lower account for 52%** of the total registered jobseekers, while **only 17.6% of total market demand refers to elementary occupations.**

The active processing regime in Albania (also known as facon) remains substantial in terms of employment, its high export contribution, technical expertise provided in some sectoral profiles and the essential role in fostering cooperation between Albanian and foreign businesses.<sup>2</sup> The data of the Albanian Institute of Statistics (INSTAT) shows that only in 2017, this **sector contributed 45 percent of total exports.** In 2016 **46,615 people were employed in the sector,** accounting for about **49 percent of the total employed in the processing industry** with 83 percent of women (INSTAT, 2018). PES administrative data reveals that during January-May 2018 facon sector posted **6,916 vacancies.** The same source confirms that only **36 percent of this demand was met.** This indicates a high demand-supply imbalance in the sector.

Considering the multidimensional role of the facon sector in the Albanian economy, while being a key employment generator in the economy, especially for vulnerable groups, the National Employment Service (NES) has drafted this document to lay out concerns from both, employer and employee's lens. This NES's effort to formulate this working document stemmed when PES started to face such a problem. The NES used to send the registered jobseekers to get employed in the facon sector to fill the posted vacancies. The jobseekers became employees and stayed for a few months in that business then left their job. The NES aims to deepen this phenomenon and understand the reasons behind it. Having both angles helps to identify the gaps that hamper the creation of a sustainable relationship between the parties and set the scene to provide some priorities for intervention. However, this document is not exhaustive and cannot resolve every identified sector's problem. However, it aims to foster debate among key actors and build an effective dialogue primarily between employers and PES, in order to create sustainability in employment relationships.

For the purpose of this paper, the following data and analysis refer to the facon sector which is defined on the basis of the Statistical Classification of Economic Activities or NACE Rev.2 in accordance with the Albanian legislation in force. Facon is classified as Section C, including division 13, 14, 15.<sup>3</sup>

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<sup>1</sup> Analitika – Center for Social Research (2016), ‘‘Weak Labour Markets, Weak Policy Responses: Active Labour Market Policies in Albania, Bosnia and Herzegovina and Macedonia’’, <http://www.balkanfund.org/publib/thinkandlink/Weak-Labour-Markets-PRINT.pdf>.

<sup>2</sup> The active processing regime allows the processing of non-Albanian goods destined for re-export in the form of compensating products, without payment of customs duties or reimbursement after re-exportation. Article 1, Point 2, <http://www.dogana.gov.al/dokument/845/udhezimi-perpunimit-aktiv>.

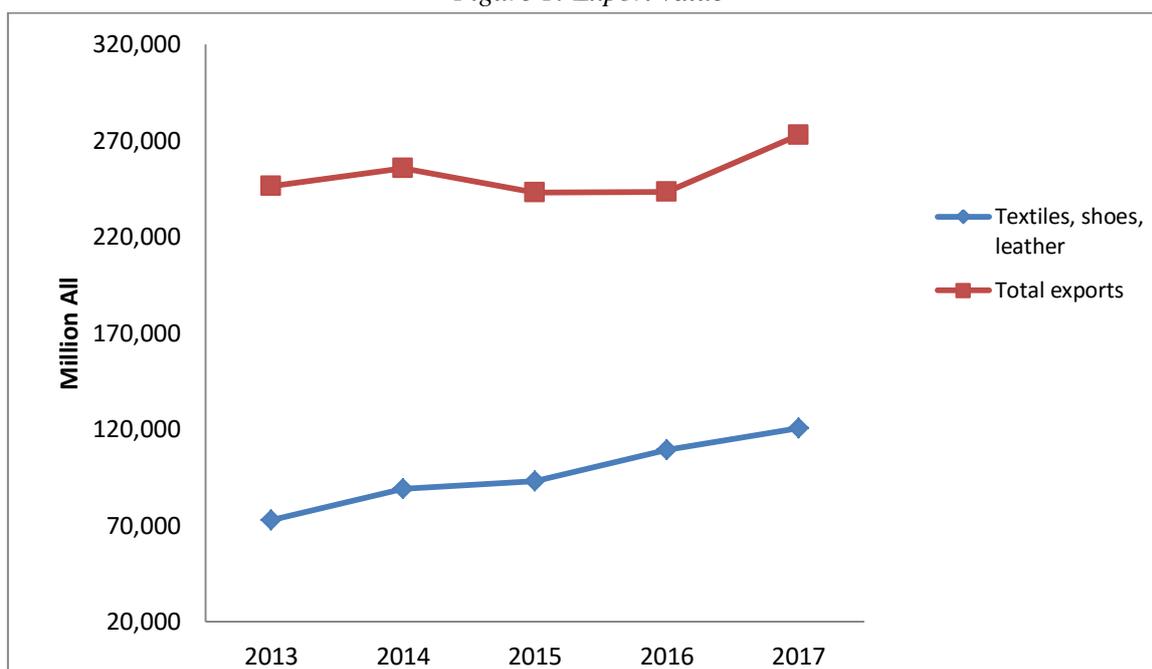
<sup>3</sup> Textile, leather and footwear are included, <http://www.instat.gov.al/media/1838/nve.pdf>.

## 2. Performance of facon sector in Albania

The facon sector is an important contributor to the level of exports in Albania. In 2017, facon sector accounted for **45 percent of total exports**, 7 percent more than a year before.<sup>4</sup>

This indicator has increased since 2013. Despite the large volume this sector has in total exports, its size in real terms in the Albanian economy is modest. This is due to the low value generated by these firms and the competitive pressure coming from outside Albania, to keep contract prices and labour cost as low as possible.<sup>5</sup>

Figure 1: Export value



Source: Author's calculations drawing on INSTAT database, 2018

The facon sector is a key generator when it comes to employment. In 2016, this sector **employed about 46,615 people**, accounting for 49 percent of the total employees in the manufacturing industry.<sup>6</sup> This sector has played an important role in women employment, especially those coming from relatively poor layers and largely from rural areas. **83 percent of all employees in the facon sector are women.** In 2016, this sector employed 84 percent more people than in 2010.<sup>7</sup>

<sup>4</sup> Author's calculations based on INSTAT database, 2018.

<sup>5</sup> The key success factors of the textile and shoe sector are the small distance with the European markets, the low labor cost and the low operating cost in Albania (UNDP & EU, 2005).

<sup>6</sup> INSTAT (2016), Structural Survey of Economic Enterprises, <http://www.instat.gov.al/media/3777/asn-sbs-2016.pdf>.

<sup>7</sup> INSTAT (2018), Economic indicators according to the economic section, [http://databaza.instat.gov.al/pxweb/sq/DST/START\\_EE/ASN4\\_new/table/tableViewLayout2/?rxid=ef9a41f5-a54a-43bf-bcbc-a8ffe95799c0](http://databaza.instat.gov.al/pxweb/sq/DST/START_EE/ASN4_new/table/tableViewLayout2/?rxid=ef9a41f5-a54a-43bf-bcbc-a8ffe95799c0).

In 2016, the average monthly wage in the facon sector was about 28 thousand ALL.<sup>8</sup> This sector largely relates to labour-intensive staff costs accounting for about 40 percent of the total expenses. Other basic indicators of this sector are displayed in Table 1.

*Table 1: Basic indicators in facon sector*

Basic indicators	2010	2011	2012	2013	2014	2015	2016
<b>Number of enterprises</b>	991	990	1,058	904	901	1,078	1,189
<b>Total employees at the end of the year (no)</b>	25,286	27,371	28,057	30,587	35,648	40,610	46,615
<b>Female employees (No.)</b>	19,848	21,282	20,561	20,792	31,273	31,241	38,751
<b>Total Income (ALL mln)</b>	26,288	29,877	28,961	32,408	37,360	38,469	46,086
<b>Total Expenses (ALL mln)</b>	21,519	24,832	25,646	28,511	32,490	34,135	40,687
<b>Personnel expenses (ALL mln)</b>	7,138	8,537	8,839	10,093	11,455	13,769	16,566
<b>Personnel expenses (ALL mln)</b>	4,770	5,045	3,314	3,897	4,870	4,334	5,399

*Source: Enterprise Structural Survey 2016, INSTAT (latest available data)*

These indicators assume that the facon sector is increasingly improving in terms of its export value and income generation. In addition, it remains an essential employer in Albania. Hence, the government should design friendly policies in order to facilitate and encourage employment and help enhance the sustainability of employees in this sector, which appears to be a fundamental issue.

### **3. Concerns in the facon sector through the lens of employees**

In Albania, the facon sector and its benefits/concerns were treated in few studies. The absence of statistical data and the high level of informality that accompanies this particular sector, constrains the realisation of realistic analysis in order to identify the challenges, as well as some potential solutions/remedies. However, data provided by INSTAT and some surveys (few of them) conducted over the past few years help to create an initial panorama.

The following sections elaborate the main issues that employees face in this sector.

<sup>8</sup> INSTAT (2018), Monthly average salary for an employee by economic activity, [http://databaza.instat.gov.al/pxweb/sq/DST/START\\_PKP/PKP133/table/tableViewLayout2/?rxid=2d74c9b5-e5d3-4164-8705-69a28ff68eda](http://databaza.instat.gov.al/pxweb/sq/DST/START_PKP/PKP133/table/tableViewLayout2/?rxid=2d74c9b5-e5d3-4164-8705-69a28ff68eda).

### ***3.1 The prevalence of undeclared work***

The 2018 Report of the European Commission emphasizes that the high level of undeclared work especially for females in the textiles sector, remains a major concern in the country. This is accompanied by unfavourable working conditions and absence of social protection.<sup>9</sup> However, it is worth mentioning the latest legal changes in the Labour Code which intend to prevent the widespread of undeclared work. In 2016, the Labour Code was amended and now the employer has a legal obligation to channel its employee's wages only through the banking system.<sup>10/11</sup> However, employers managed to find manoeuvres to avoid accomplishing this obligation, while hiding a part of the employee's salary to skip taxes. A recent survey conducted among 250 employees in facon sector, reveals that only **3 out of 5 employees receive the entire wage through the banking system**. The same survey shows that there are other types of concealment of wage, such as wages in the envelope.<sup>12</sup> Crosscutting data with the Social Insurance Institute confirms that employees claiming to receive the entire wage through the banking system are more likely to receive the minimum wage. Thus, around 83 percent in the sector are actually paid with the minimum wage.<sup>13</sup> The same survey reveals other typologies of informal employment. 68 percent of employees in facon sector admit that contributions are paid based on the minimum wage, even though for the majority part this does not correspond with the real wage, whereas 14 percent state that contributions are paid on the basis of minimal wage, even though their real salary is lower.

Lastly, another typology which is very rare to be tracked (only through inspections) is the case where the employee is not registered as such. Studies show that unregistered employees (especially youth and people who have just started their job) earn 14,000 – 18,000 ALL/month, whereas registered employees usually tend to earn 22,000 – 24,000 ALL/month.<sup>14</sup>

### ***3.2 Determination of salary and production rate***

The wage level of the employees in the facon sector in most cases does not meet the basic living needs. 68 percent of respondents in this sector claim that their monthly wage hardly meets the needs of their family (IDM, 2016). The minimum official wage in Albania is 24,000 ALL for both, public and private sector.<sup>15</sup> However, the IMF (2016) recommends that the process of minimum wage determination should be depoliticised and its minimum level should be determined / revised considering certain vulnerable groups or specific sectors.<sup>16</sup> In

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<sup>9</sup> EC (2018), Commission Staff Working Document Albania, Strasbourg, 17.4.2018, <https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/20180417-albania-report.pdf>.

<sup>10</sup> Article 118.

<sup>11</sup> Exceptions in special cases or foreseen in the collective contract or arbitration award.

<sup>12</sup> Institute for Democracy and Mediation (2016), Labor Standards in Albania, [http://idmalbania.org/wp-content/uploads/2017/02/IDM\\_Standardetpunes.pdf](http://idmalbania.org/wp-content/uploads/2017/02/IDM_Standardetpunes.pdf).

<sup>13</sup> Ibid.

<sup>14</sup> Gender Alliance for Development Center (2016), Wage and Labour Conditions of Shoe and Garment Workers in Albania, <http://library.fes.de/pdf-files/bueros/albanien/13137.pdf>.

<sup>15</sup> Decision Nr. 399, dated 3.5.2017 For determining the minimum wage at national level, <https://www.tatime.gov.al/shkarko.php?id=1046>.

<sup>16</sup> IMF report (2016), no. 16/151. Report on Minimal Wage, [www.imf.org/external/pubs/t/scr/2016/cr16151.pdf](http://www.imf.org/external/pubs/t/scr/2016/cr16151.pdf).

this regard, the social partners are making constant efforts to determine a minimum subsistence in the economy, as the calibration of the minimum wage would take into account changes in economic and social conditions.<sup>17</sup> One of the fundamental questions in this sector is how the employer's wage is determined. Most employees admit that their wages remain relatively low, considering the workload. 66 percent of respondents say their wage is low / too low (IDM, 2016). This is also confirmed by a study conducted by the Gender Alliance for Development Centre (2016).<sup>18</sup> The Gender Alliance for Development Centre conducted a survey in 2016 and found that different factories use different methods for calculating their employees' wage. First is the pay-based production unit (rate). Some companies in this sector require employees to produce 500-600 pairs of shoes per day and the salary is calculated depending on the daily rate. In another larger factory, workers had to meet a daily rate of 700-800 pairs of shoes with 80 pairs of shoes per hour. To sum it up, the following table displays several options used by the facon sector to calculate employee's wage:<sup>19</sup>

- ✓ **120 ALL/hour, 1000 pair/day**
- ✓ **Depending on the production rate**
- ✓ **8 hour are paid with 1,000 ALL**
- ✓ **100 ALL/hour**

### ***3.3 Working hours and permit requirements***

Employees admit that two main problems of the facon sector remain the long working hours and lack of work permits. According to the IDM survey (2016), **59 percent of employees in the sector say they work regularly on Saturday, while 4 out of 10 employees declare that they work regularly or sometimes even on Sunday.**<sup>20</sup> Extra hours and weekend working hours are not paid as overtime, but as normal working hours, although the Labour Code specifically stipulates the opposite.<sup>21</sup> Another issue that employees face is related to difficulties in obtaining permission for emergency cases or for health reasons. Obtaining a permit is practically impossible and may in some cases it can cause the employees to lose their job. Employees express a deep dissatisfaction with this situation, as it often makes it impossible for them to deal with personal, family and health problems.<sup>22</sup>

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<sup>17</sup> Decent Work Country Programme for Albania 2012-2015. In April 2016, the National Chamber of Garments Manufacturers proposed to the Albanian Government to consider its proposal that the minimum wage should be different depending on the sector, <https://www.ata.gov.al/fasonet-leter-ames-ritje-te-pages-minimale-me-1-mije-leke/>.

<sup>18</sup> Gender Alliance for Development Center (2016), Wage and Labour Conditions of Shoe and Garment Workers in Albania, <http://library.fes.de/pdf-files/bueros/albanien/13137.pdf>.

<sup>19</sup> Ibid.

<sup>20</sup> According to the Labor Code (Article 83), the normal duration per week must not exceed 40 hours.

<sup>21</sup> Gender Alliance for Development Center (2016), Wage and Labour Conditions of Shoe and Garment Workers in Albania, <http://library.fes.de/pdf-files/bueros/albanien/13137.pdf>.

<sup>22</sup> Ibid.

### **3.4 Occupational Safety and Health**

In 2003, Albania ratified the ILO Convention no. 155 for *Occupational Safety and Health*. Some other national laws cover the safety and health requirements in various sectors related to high risk exposure. Also, the Albanian government has drafted a new strategy for *Occupational Safety and Health and Action Plan for 2016-2020*.<sup>23</sup> Despite the improvements in the legal framework, the facon sector still encounters problems in implementation. There are public cases of health problems in this sector as a result of the chemicals employees use during the production processes.<sup>24</sup> 29 percent of employees in the facon sector admit to work at a high or very high-risk workplace. In addition, 25 percent admit that their employer does not inform / seldom inform them about the health and safety risks at the workplace.<sup>25</sup> Employees complain on other issues as well. They accept that their workplace lacks heating and cooling systems, which makes it very hot in the summer and very cold during the winter, to work in decent conditions. Also, a strong wind of chemical substances and direct contact with these substances often cause physical problems such as headache, stomach problems, allergies, skin problems, etc.<sup>26</sup>

### **3.5 Verbal abuses in the workplace**

The phenomenon of verbal abuse appears to be widespread in the facon sector. This was accepted by 68 percent of respondents in this sector (IDM, 2016). Employees state that the employers generally continue to ignore trade unions. However, they believe that better organisation of trade unions would significantly improve working conditions.

## **4. Concerns in the facon sector through the lens of employers**

The facon sector is labour intensive. To this end, the labour factor is fundamental for guaranteeing the level of production required. Despite the increase in external demand, businesses in this sector admit that they have a shortage of production capacity and fail to meet a demand. Low productivity remains a key reason.<sup>27</sup> According to representatives of the facon sector in Albania, the issue of productivity is related to two aspects. *First is* the lack of appropriate skills of employees (especially those newly employed). Employment of new staff is a challenge due to the lack of specialised people and the lack of motivation of young people to work in this sector.<sup>28</sup> *Second* issue is the lack of investment in technology. Sector representatives admit that they are reluctant to invest in technology because their investment

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<sup>23</sup> CoM No. 371, dated 18.05.2016.

<sup>24</sup> Opinion, May 2018, <http://opinion.al/helmimi-i-grave-sindikata-akuzon-inspektoret-e-punes-marrin-honorare-nga-kompani-private/>.

<sup>25</sup> Institute for Democracy and Mediation (2016), Labor Standards in Albania, [http://idmalbania.org/wp-content/uploads/2017/02/IDM\\_Standardetpunes.pdf](http://idmalbania.org/wp-content/uploads/2017/02/IDM_Standardetpunes.pdf).

<sup>26</sup> Gender Alliance for Development Center (2016), Wage and Labour Conditions of Shoe and Garment Workers in Albania, <http://library.fes.de/pdf-files/bueros/albanien/13137.pdf>.

<sup>27</sup> Shehi, E. (2016), Textiles and Confections, <http://skillsforjobs.al/wp-content/uploads/2016/11/Textile-and-Garment-sector-study-by-Ermira-Shehi-ALB.pdf>.

<sup>28</sup> Ibid.

will not pay off in the short term. This means that any increase in their costs should be borne by the producers with a reduction in the profit margins.<sup>29</sup>

The previous analysis has summarised the fundamental concerns from the perspective of an employee. However, employers of the facon sector bring out several issues which in their perspectives undermine the long-term relationship between them and PES.

#### ***4.1 Lack of a specialized workforce***

During an in-depth interview with the chairman of facon chamber in Albania, Gjergji Gjika, he confirms that last year's labor supply was higher than the labor demand. He adds that one of the biggest problems faced by the sector is the lack of specialised workforce. Despite the establishment of vocational training centers for training of employees, they are not always effective due to the lack of updating the curriculum with the needs of the sector.

#### ***4.2 Transport and electricity problems***

From the in-depth interview with Mr. Gjika, it was concluded that the Albanian companies in facon sector have problems with the transport of employees (there are no special transport lines of transport to the locations where the companies operate). Due to the geographical distances and because most companies are located in remote areas, they are not attractive to the workforce. He adds that creating a transport line (when possible) would facilitate and help employees as well as businesses themselves.

Another problem which increases the cost of doing business in the facon sector is the continuous interruption in the supply of electricity (in some districts, interruption in electricity supply takes hours and days). This makes the fulfilment of daily production rates impossible and lost working hours are not paid. There are often problems with electrical voltage, which can cause problems in machine malfunction as well.

#### ***4.3 Lack of sectorial incentives***

Generally, the business community in Albania has maintained the costs of frequent legal changes, which hinder the design of their business strategies.<sup>30</sup> The facon sector representatives note that they lack special government incentives which could foster the employment of vulnerable groups. In addition, the lack of special fiscal incentives for new employees is highlighted as another non-motivating aspect for the sector. In 2014, the facon sector was encouraged to create a specialised package. Despite the fact that the package was promoted as one of the greatest achievements of that time, its major part has not been implemented and most of the problems raised continue to hamper the sector.<sup>31</sup> In addition, sector representatives consider the profit-tax very high and not comparable with other economies in the region.<sup>32</sup>

With regard to the minimum wage, the recent increase does not concern the sector. However, under the circumstances of a high tax burden, coupled with the lack of productivity and the

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<sup>29</sup> Ibid.

<sup>30</sup> Kosta, B. et al (2017), National Business Agenda for Albania, [https://www.researchgate.net/publication/323116469\\_National\\_Business\\_Agenda\\_for\\_Albania](https://www.researchgate.net/publication/323116469_National_Business_Agenda_for_Albania).

<sup>31</sup> In-depth interview with Mr. Gjergji Gjika, Chairman of Facon Chamber in Albania, July 2018.

<sup>32</sup> Ibid.

lack of governmental incentives, an increase of the minimum wage will affect profits and reduce investment. It should be noted that the cheap labour force has been a strong point of the sector in Albania.<sup>33</sup>

#### **4.4 The subcontractors VAT**

An important concern for this industry is the subcontractor's VAT rate. According to the previous VAT law, the services of facon industry subcontractors were exempt from VAT.<sup>34</sup> This exemption has been applied for 12 years and was considered effective by the facon industry players. A transparent procedure was developed to administer this policy, which was implemented by both, the contractor and subcontractor.

This practice continued until December 31, 2014. The new VAT Law, which was introduced and came into force on January 1, 2015, stipulates that:

- a. **A VAT rate of 0 percent for non-Albanian goods processed as 'active processing'** shall be applied to the invoice issued by the exporting operator and attached to re-exportation customs declaration for these goods.
- b. If processing of non-Albanian goods intended for re-exportation is provided by a subcontractor on behalf of the active processing company (exporting company), this service is taxable at a **VAT rate of 20 percent.**

The new tax approach divides active processing into two categories. According to this approach, the added value created by the main service contractor is taxed at 0 percent, while the added value created by subcontractors is considered a taxable service and is taxed at a standard 20 percent rate. The artificial increase in the tax rate increases the cost and sometimes forces employers *to* leave the industry.<sup>35</sup>

## **5. Some priorities for intervention**

The above-mentioned evidences and analysis show that there is a lot of room for improvement both, in improving the working conditions of facon business itself, as well as in designing and implementing friendly policies in order to improve the situation. Here are listed some priorities for interventions. .

- **Improve the curriculum in vocational training courses**, reflecting the needs of facon sector. This could be achieved through an effective and continuous communication between the representatives of facon sector and vocational training centers.

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<sup>33</sup> Ibid.

<sup>34</sup> Article 25/6\*, Paragraph 1 reads: "Subcontractors who supply non-Albanian materials for processing and re-exportation in the form of finished products to taxable persons authorized, on the basis of provisions of the Customs Code, for operations under the active processing regime, are excluded from the VAT."

<sup>35</sup> Kosta, B. et al (2017), National Business Agenda for Albania, [https://www.researchgate.net/publication/323116469\\_National\\_Business\\_Agenda\\_for\\_Albania](https://www.researchgate.net/publication/323116469_National_Business_Agenda_for_Albania).

- **Establish agreements with existing public transport lines** to facilitate the transport of workers to certain areas. This should also be accompanied by financial support from the facon businesses. Another solution may come from the business itself which can provide transportation to their employees at a certain distance.
- **Full implementation of the facon package designed in 2014.** A revision of the profit tax should also be considered. This requires a thorough study by sector representatives and representatives of the Ministry of Finance and Economy in order to make a rational choice.
- Design **local incentive packages** from the local government to support the facon sector.
- All services provided by subcontractors to the contractors in the facon sector, should have a VAR rate of **0 percent**. Financially, such a recommendation will have a positive impact on subcontractors. In this way, the subcontractors will save a large amount of money, as long as they do not have deductible VAT (this is due to the fact that subcontractors have no deductible expenses), and can reinvest this money in technology, employee training, etc.
- **Unification of production rates for facon businesses.** There is no single way of calculating employees' wages, but it is usually based on the production rate. It is necessary to carry out a more in-depth study of the best models in EU countries, in order to create an appropriate model in Albania.
- The Albanian government should **prepare a strategy for tackling undeclared work** and a sectorial one for the facon sector, due to peculiarities of this sector.
- **Improve physical conditions and increase workplace safety.** This should be accompanied by continuous monitoring by the State Labor Inspectorate.

## **Methodology**

For the preparation of this paper, a thorough review of existing studies related to the facon sector has been conducted. Also, a review of government strategies and policies has been carried out in order to describe the sector's progress over the years and its role in the Albanian economy. An analysis of the legal, institutional, and labour standards policies was needed to understand legal changes and implementation problems. In order to understand the challenges of the facon sector from the employers' point of view, in addition to reviewing the existing studies, an in-depth interview was conducted with Mr. Gjergji Gjika, Chairman of the Chamber of facon in Albania.