

**DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT**

STRATEGY FOR ALBANIA

As approved by the Board of Directors on 6 April 2004

I. EXECUTIVE SUMMARY	1
II. COUNTRY STRATEGY	4
1. THE BANK'S PORTFOLIO	4
1.1 Overview of Activities to Date	4
1.2 Implementation of the Past Strategy	5
1.3 Transition Impact and Lessons Learned	7
1.4 Portfolio Ratio and Quality	10
2. OPERATIONAL ENVIRONMENT	12
2.1 General Reform Environment	12
2.2 The Economic Environment	16
3. TRANSITION PROGRESS AND CHALLENGES	20
3.1 Private Sector Development	20
3.2 Financial Sector	21
3.3 Infrastructure Sector	21
4. STRATEGIC ORIENTATIONS	23
4.1 Bank's Priorities for the Strategy Period	23
4.2 Private Sector Development	23
4.3 Financial Sector	24
4.4 Infrastructure Sector	25
5. COOPERATION WITH DONORS AND OTHER IFIs	28
III. ANNEXES	30
ANNEX 1: POLITICAL ASSESSMENT	30
ANNEX 2: LEGAL TRANSITION	31
ANNEX 3: SELECTED ECONOMIC INDICATORS	37
ANNEX 4: APPROVED BANK OPERATIONS	38
ANNEX 5: EBRD TECHNICAL COOPERATION PROGRAMMES	39
ANNEX 6: MULTILATERAL AND BILATERAL ASSISTANCE	42

I. EXECUTIVE SUMMARY

Albania continues to fulfil the conditions specified in Article 1 of the Agreement Establishing the Bank. The conduct of recent elections, including the local elections in October 2003, improved markedly compared to the 1990s, but significant irregularities still occurred. The recent local elections had to be repeated in many areas, including in more than a third of the districts in the capital, Tirana. The opposition Democratic Party has abandoned its previous policy of boycotting parliament, but it continues to organise regular street demonstrations against the government, which have been attracting ever larger numbers of participants, reflecting widespread anti-corruption sentiment and growing discontent with price rises and other aspects of the government's economic policy that affect living standards. Fatos Nano secured re-election as Socialist Party leader in December 2003 and successfully re-shuffled the government in January 2004. However, continuing tensions within the ruling Socialist Party have introduced additional uncertainty into day-to-day operations of the public administration.

On the international scene, Albania continues to play a constructive role in South-Eastern Europe. The country has signed, and in most cases implemented, free trade agreements with all neighbouring countries in the region and with Kosovo. Albania has also shown restraint in its official policies towards Serbia and Montenegro and FYR Macedonia over the issue of ethnic Albanians in those countries. In January 2003, the country began formal negotiations with the EU on a Stabilisation and Association Agreement, but progress has been very slow.

Although starting from a low base, Albania has made significant progress in all fields since 1997. From 1998 to 2001, the economy grew at annual rates of 7-8 per cent. After a temporary slowdown in 2002, caused by the energy crisis and autumn floods, real GDP growth in 2003 has returned to an annual rate of about 6 per cent. Small-scale privatisation is virtually complete and the private sector now accounts for about 80 per cent of employment. Inflation is low, the exchange rate is stable and foreign reserves are maintained at comfortable levels of more than four months of imports. The fiscal deficit remains high at an estimated 5.6 per cent of GDP (excluding grants) as of end-2003, but has decreased in the past year as a result of a notable increase in revenues through improvements in the efficiency of the tax and customs administration. The past two years have also seen progress in structural reforms, an improvement in the dialogue between the government and the business community, advances in the commercialisation of public utilities and serious steps to revitalise the privatisation of large enterprises.

Nevertheless, Albania continues to suffer from problems such as a high level of corruption and organised crime, poor law enforcement and weak administrative and institutional capacity. Notwithstanding the rapid economic growth in recent years, income per capita at around USD 1800 is still among the lowest in Europe. Poverty levels remain high, especially in rural areas, and about a quarter of the population lives below the poverty line of USD 2 per capita a day. Poverty reduction and improvements to health and education are key priorities under the government's Poverty Reduction and Growth Strategy, adopted in November 2001 and supported by

the IMF, the World Bank and the international donor community. The sustainability of public debt remains a concern. The external debt level is relatively low at about 23 per cent of GDP, but domestic debt is high, currently around 38 per cent of GDP. Concessional debt from international organisations remains the main source of external borrowing for the government. The annual non-concessional debt ceiling agreed with the IMF for end-2003 was increased from the previous year's level of USD 100 million to USD 130 million. Despite the recent privatisation of the largest and last state-owned bank in the country, the Savings Bank, the level of cumulative foreign direct investment (FDI) at USD 1.128 billion (USD 330 per capita) at end-2003 was among the lowest in the region.

The main transition challenges for Albania are: (i) to encourage private sector development, particularly of SMEs, and bring much of the large informal sector into the formal economy. This will require increased access to finance, but most importantly, further improvements of the investment climate through a stronger and better enforced legal framework, sustained efforts to fight corruption and tackle organised crime, and strengthened institutional and administrative capacity; (ii) to continue to pursue commercialisation and privatisation in utilities and in the financial sector in order to increase competition, improve services and bring new management skills; and (iii) to undertake essential investments in the country's dilapidated infrastructure, including further work to resolve the energy crisis, improve provision of municipal services and strengthen local and international transport networks.

The Bank is committed to support the country's efforts in addressing these challenges. Over the forthcoming strategy period, the Bank will focus its efforts on the development of the private sector, carefully balanced with support for critical public infrastructure. This will be complemented by policy dialogue to support institutional building, enhance absorption capacity and promote improvements of the administrative and legal frameworks. The Bank will focus both on the implementation of existing projects, aimed at boosting disbursements, and on carrying out new projects, according to the following operational priorities:

Private Sector Development. The Bank will renew its efforts in playing a major role in promoting private sector development through its involvement in privatised and green-field enterprises, with a particular focus on general industry and agri-business. In parallel, the Bank will offer to support forthcoming privatisations, such as in the utilities sector (telecom), through the provision of pre- or post-privatisation long term financing.

Financial Sector. The Bank will seek to support the strengthening of the financial sector as a key factor for the development of SMEs. It will focus on the development of products and facilities already operating in other countries, such as donor-supported risk-sharing facilities and SME lending frameworks combined with technical assistance funds aimed at enhancing the capacity of local banks and boosting financial intermediation. The Bank will also work on the completion of the privatisation of the insurance company INSIG.

Infrastructure. Supporting the rehabilitation of the country's infrastructure and its integration within the region will remain a key priority for the Bank. Sovereign-guaranteed financing will be envisaged with due consideration to the country's

borrowing limits and continued emphasis will be put on co-financing and blending of resources with donors. The Bank will focus on the following areas:

- **Energy** - The Bank will provide financing for new power generation capacities and support the rehabilitation and extension of the transmission system through regional integration. The implementation of the existing power transmission and distribution projects will also continue to be a priority.
- **Transport** - The Bank's priority will be the upgrading of a new segment of the main road network (regional link with Greece) in addition to the implementation of the existing road rehabilitation project. The Bank will offer to support the private concession for the Tirana airport and will explore co-financing possibilities with other IFIs in other areas such as ports.
- **Municipal and environmental infrastructure** - The development of a viable project pipeline in the municipal and environmental infrastructure sector, focusing mainly on water supply and possibly urban transport and solid waste management, will be a priority.

The Bank will pursue the proposed operational objectives and the associated policy dialogue in close co-operation with the World Bank, the EU, the EIB and other IFIs and donors in order to ensure the successful implementation of its strategy.

II. COUNTRY STRATEGY

1. THE BANK'S PORTFOLIO

1.1 Overview of Activities to Date

As of end-December 2003, the Bank had achieved a cumulative business volume of EUR 172.5 million (for a total project cost of EUR 499 million) in sectors such as energy, infrastructure, financial institutions, telecoms, property and general industry (see Annex 4). The current portfolio amounts to EUR 132 million (13 projects), of which EUR 39 million are operating assets. The net portfolio has grown by 48 per cent over the last two years. The growth is significant despite the cancellation of the Elbasan Cement Project (EUR 16.9 million), which was re-designed by the Sponsor and is being examined by the Bank for financing on a new basis. Growth was mainly generated by projects in the infrastructure sector (energy and transport, 39 per cent of new business volume) and telecommunications (financing of Vodafone Albania, 54 per cent of new business volume). Operating assets represent only 29 per cent of the current portfolio. The very low disbursement factor is firstly due to the recent (December 2003) signing of the loan to Vodafone Albania which has not started disbursing yet, and secondly due to delays in the implementation of two projects in the energy sector with the Albanian power company (KESH) and of one project in the road sector, for which it was necessary to re-do the technical design and commit additional funding. All three projects have now started disbursing normally, and the operating assets ratio is expected to improve significantly over the next two years.

Table 1.1 Bank portfolio in Albania

Sector Name	CUMULATIVE PORTFOLIO						NET PORTFOLIO		
	Num. of projects	Total Project Cost	EBRD Signed	EBRD signed % by sector	Disbursed	% of signed	Num. of projects	Portfolio	%
Financial Institutions	8	43.5	18.2	10.6%	9.7	53%	6	13	10%
<i>Banks</i>	4	28	10.7	6.2%	7.1	66%	4	6.4	5%
<i>Equity Funds</i>	1	6.1	2.8	1.6%	2.6	93%	1	1.9	1%
<i>Non Bank</i>	1	9.4	4.7	2.8%	0	0%	1	4.7	4%
Infrastructure	3	278.5	71	41.2%	25.5	36%	3	65	49%
<i>Power and Energy</i>	2	253.6	54	31.3%	22	41%	2	48	36%
<i>Transport</i>	1	24.9	17	9.9%	3.5	21%	1	17	13%
Specialised Industries	5	177.2	83.3	48.3%	40.8	49%	4	53.9	41%
<i>Telecommunications</i>	2	124.1	50.3	29.2%	7.8	16%	2	45	34%
<i>Agribusiness</i>	1	10.9	3.2	1.9%	3.2	100%	0	0	0%
<i>Property, Tourism & Shipping</i>	2	42.2	29.8	17.2%	29.8	100%	2	8.9	7%
Country Total	16	499.2	172.5	100.0%	76	44%	13	131.9	100%

The Bank's portfolio in Albania is concentrated in infrastructure and telecommunications with 83 per cent of the total current portfolio. In relative terms, the largest exposures are in power (36 per cent of total portfolio), telecommunications (34 per cent) and transport (13 per cent). The concentration in volume terms is a result of the significantly larger size of infrastructure and telecommunications projects compared to projects in other sectors. The portfolio is generally well distributed in

terms of number of projects in different sectors. Debt of EUR 124 million represents 94 per cent of the portfolio and equity of EUR 8 million represents 6 per cent.

EUR 327 million were mobilised as co-investment from sponsors, co-financiers and donors in EBRD projects, representing a multiplier of 1.9. Donor funds and concessional financing was raised for a number of projects such as the *Road Rehabilitation* project (Italy, CEI), the *Power Distribution Rehabilitation* project (Italy, EIB, WB, Spain, Switzerland, Austria, Japan JBIC), *Albtelecom* (Norway, Switzerland, Italy) or the *Albanian Reconstruction Equity Fund* (Italy).

Working with various donors, the Bank has mobilised funding for 77 technical cooperation (TC) projects mainly in the banking sector, telecommunications, energy, transport, insurance, and manufacturing industries. The total TC funds committed amount to EUR 16 million, representing a ratio of 1:10 relative to the size of the portfolio. Disbursement of TC funds as of end-2003 stood at EUR 12 million (see Annex 6).

1.2 Implementation of the Past Strategy

The last country strategy, approved in April 2002, outlined the following strategic priorities for the Bank in Albania: (i) promote private sector development in particular SMEs, through direct investments in privatised or green-field operations, through support to the strengthening of the banking sector and enhancement of credit and trade facilities, and through continued implementation of existing investment vehicles (equity fund); (ii) facilitate and provide direct support for the completion of strategic large-scale privatisations; (iii) provide further support for the development of key infrastructure projects in energy, transport, and telecommunications.

Over the past two years (Jan. 2002 – Dec. 2003), the EBRD has committed EUR 89.3 million in 4 new projects and in sub-investments through an existing fund. Overall, the Bank has been successful in meeting its objectives in the infrastructure and telecom sectors and in supporting privatisation, but has faced more difficulties in the private sector development activities.

In 2003, the EBRD signed two new operations (EUR 47.2 million). The Bank committed EUR 42.5 million (of which EUR 7.5 million syndicated through local banks) of financing for the mobile telephony network of *Vodafone Albania*, the second GSM operator in the country, and acquired a 19 per cent stake (EUR 4.7 million) in the first stage of the privatisation of INSIG, the state-owned insurance company. Both projects are high visibility private sector oriented transactions that are signalling the country's progress with company restructuring and privatisation (*INSIG pre-privatisation* transaction) and openness as an FDI destination (green-field investment by Vodafone).

In addition in the SME sector, through the *Albania Reconstruction Equity Fund*, the Bank extended financing to five local companies for a total of EUR 1.1 million (co-financed with Italian Treasury – total investment of EUR 2.2 million). However, the pace of investment of the Fund remained slow compared to expectations and the

Fund's investment period expired in November 2003. Going forward, the Fund will monitor the portfolio and focus on good corporate governance and investment exits.

No further disbursements or commitments were made under the *SME Recovery Credit Line* or the *Trade Facilitation Programme* with local banks, due to a combination of factors including: issues with ownership and management of client banks (discussed in Chapter 1.3 below), the difficult operational environment with limited financially sound projects, the local banking sector's risk averse approach towards smaller enterprises (partly a heritage of the pyramid scheme crisis of 1997 and partly a result of stringent Central Bank regulations), the availability of less expensive donor-supported financing sources, the high liquidity of the banks and the dominance of cash-based economic transactions, which left little room for use of banking products and made the EBRD's facilities less competitive. Simultaneously, lack of effective land registries and cadastres precludes firms from using property as collateral, while commercial banks require high levels of collateral, thus affecting the ability of firms to borrow from formal channels.

Furthermore, the relatively small size and trade-oriented nature of many local businesses, lack of managerial skills and capabilities, and often inappropriate business and governance standards, have hindered the Bank's direct financing in the local private (non-SME) corporate sector.

In 2002, the EBRD signed two operations (EUR 41 million). Both operations were in the public infrastructure sector: financing for the rehabilitation of the power distribution system and new, restructured, financing for the rehabilitation of the Elbasan-Librazhd road segment. These operations were associated with intense efforts in resolving previous implementation issues in the respective sectors. In the power sector, concluding the *Power Distribution Rehabilitation* project (EUR 24 million) was made conditional on resolving the situation of the previous *Power Sector Reconstruction* project, which was stalled due to disputes between the client and contractors. In the road sector, the new *Road Rehabilitation II* project (EUR 17 million) has allowed to correct (and replace) a previous project, which was deficient because of design and costing flaws. The implementation of all these projects is now proceeding.

Regarding portfolio management, the EBRD, in cooperation with the IFC and the Bank of Albania, has put significant efforts in resolving the situation of the National Commercial Bank, privatised with EBRD's participation in 2000, where the Sponsor failed due to the Turkish banking crisis. The issue is now nearing resolution with the introduction of a new Turkish strategic investor. The Bank has also focused intensively on recovering the distressed *Tirana Hotel* investment. These efforts are bearing fruit: a proposal to privatise the company through an auction sale of its assets has been agreed with the Government. This will have a useful demonstration effect in terms of enforcing financial discipline and creditor rights. Finally, in agreement with the Sponsor, the Bank cancelled the undisbursed loan to Seament Albania for the rehabilitation of the *Elbasan Cement Factory*. The Sponsor has acquired a second plant in Albania and has consequently updated the overall investment strategy in the country. The Bank is now considering the possibility to provide financing for a new re-designed cement project by the Sponsor.

1.3 Transition Impact and Lessons Learned

The Bank has played a major role in promoting and supporting transition in Albania, through investments both in the private and public sector. The role of the Bank has evolved over time in response to the challenges faced by the country. The Bank's investments have had valuable demonstration effect and transition impact, especially in the financial, telecommunications, and power sector, and to a lesser extent, in the industrial and transport sector.

Private Corporate Sector

The Bank has supported the transition in Albania through direct investment in private ventures. Investments in the private sector (Coca Cola Albania, Vodafone Albania) have significant demonstration effect and provide major encouragement to private FDI in the country. However, more efforts and involvement are needed to support the development of the private sector, including investing with local sponsors.

Financial Sector

Banking – The Bank has made a significant initial contribution to the development of the banking system through equity investments and direct involvement in bank privatisation. The Bank's participation has been key to the establishment of Banca Italo-Albanese (BIA) in 1994, the first private bank in Albania, established as a joint-venture between the National Commercial Bank and Banca di Roma. In 1999, the Bank became a founding shareholder of FEFAD Bank, a micro-finance institution, renamed "ProCredit Bank Albania" in 2003. In 2000, the EBRD's contribution in the banking sector was further extended through participation (together with the IFC) in the privatisation of the National Commercial Bank (NCB) to Kentbank of Turkey, the first sale of a national coverage bank in the country.

However, in two of the above investments, the transition impact of the Bank's investments was subsequently reduced. Serious problems with the internal management of BIA hampered the development of the activities of this bank. The EBRD participation (also through its representation on the board) has been crucial in resolving the situation. In the case of NCB, the bankruptcy of Kentbank during the Turkish financial crisis of 2001 left the bank without a strategic owner for over two years. The EBRD has been working actively with the Turkish Banking Regulation and Supervision Agency in order to secure a new owner (now being finalised) and has contributed to the stability and well-functioning of NCB in the meantime.

SME Financing – The Bank has established an SME credit line with one bank and trade facility programmes (TFP) with two local banks. Both facilities had a satisfactory demonstration effect in restoring confidence in the banking system in the aftermath of the 1997 socio-economic crisis. They also had the potential for an excellent transition impact. However, their utilisation was considerably lower than expected due to several factors listed above (1.2 Implementation of Past Strategy). Therefore, the direct impact on the real economy of the EBRD SME lines or TFP was marginal, but these products contributed to help the participating banks to enhance their lending capacities in terms of upgrading their operational standards, credit

procedures, staff training etc. The Bank is currently exploring the feasibility of better tailored approaches, in order to overcome local economic obstacles and promote SME financing.

Comparatively, ProCredit Bank Albania has been very successful in reaching out and serving the needs of smaller businesses and entrepreneurs that had otherwise very limited access to credit. As of the end of January 2004, and while maintaining a portfolio of good quality, ProCredit Bank had extended over 14,000 loans for a total amount of USD 112 million (average loan size USD 7,900). Therefore ProCredit Bank has not only had a strong impact in the real economy, but has been demonstrating the viability of this market segment to the other commercial banks.

In its efforts to support SME development, the Bank also established an equity fund in Albania in 1998. The Fund had invested 37 per cent of available resources by the end of its investment period (November 2003), much less than anticipated, thus lessening the transition impact of the project. Its activities were hindered by a weak investment climate and difficulties in completing straight equity investments in the country. In order to cope with these difficulties, the Fund introduced novel financial instruments (debt-like financing with participation in company profits). Despite setbacks, the Fund succeeded in providing medium and long term financing to local businesses at a time when financing from the local banking system remained limited. In addition, the Fund introduced local businesses to novel financing instruments and affected positively corporate governance and business standards of local companies.

Non Bank Financial Institutions – The EBRD has further extended its impact on the transition of the Albanian financial sector through the recent participation in the pre-privatisation of INSIG, the state-owned insurance company in order to improve its management and prepare it for a better and more profitable full scale privatisation.

Infrastructure

Telecommunications – Through its investment in Albtelecom, the Bank played an important role both in expanding and modernising the fixed network and institutionally, in improving the company's financial systems. The TC programme for the legal framework of the telecommunications sector led to the introduction of a new Telecommunications Law and the successful development of an independent regulatory authority. The company's privatisation, attempted twice, has however failed due to depressed market conditions and the perceived weak commercial prospects for a fixed line operator in Albania.

Energy – The Bank, through considerable investment in rehabilitation and restructuring of the power sector, is playing a major role in the resolution of the country's energy crisis, a serious impediment to private sector development and FDI inflow. The Bank has committed EUR 54 million in two projects in the sector for the financing of the rehabilitation of power production facilities and the rehabilitation of the power transmission and distribution grids, in order to improve energy production efficiency, and reduce technical and non-technical losses. Simultaneously, the Bank is endorsing the reform of the sector by supporting unbundling and restructuring of the Albanian Power Company (KESH), in order to prepare for its privatisation in the medium term. The Bank also initiated the co-management of KESH with an expert

team from a reputable international player (ENEL of Italy was selected), improving the management of the company (indeed, KESH has made good progress over the last three years in the areas of collections and losses) and increasing its implementation capacities.

Transport – In 2000, the EBRD committed EUR 10 million for the rehabilitation of the Elbasan – Librazhd road segment, part of the East – West corridor between the Port of Durres and the border with FYR Macedonia. The implementation of the project would conclude the rehabilitation of the East – West corridor and significantly improve the communications with neighbouring countries. The operation suffered major delays as the original project specifications and cost estimates were flawed, partly due to poorly prepared design, and partly due to the time elapsed from the completion of the design to the signing of the project which resulted in higher project cost. The Bank asked for preparation of new detailed design and cost estimates and, subsequently, a new loan of EUR 17 million was signed in 2002 to replace the previous loan and cover increased costs. Implementation of the project started in 2003. Besides the direct impact on the improvement of the road network, a major transition impact was achieved through strengthening of the technical capabilities of the Albanian General Road Directorate and Ministry of Transport and Telecommunications, and through the preparation of appropriate design and tender documents, and transparent procurement procedures.

The Bank has also drawn a number of valuable lessons from its past operations that remain particularly relevant in the context of the Bank's future strategy in Albania:

Implementation of public sector projects – Experience to date shows that the institutional weaknesses, inefficient management and budgetary constraints can severely hinder the implementation of projects and, in some cases, can even make them unfeasible. Specific lessons learnt by the Bank in dealing with public projects include:

In the energy sector, the main lesson learned from the Bank's first project (*Power Sector Reconstruction Project*) with KESH is that project implementation may suffer severe delays due to borrower's inexperience with the Bank's *Procurement Policies and Rules* and the time required for approving tender specifications by the borrower. Lessons were also learnt from the problems arising from the implementation of several interdependent contracts not financed by the Bank. These include (i) the importance of stand-alone components to minimise completion risk due to delays in other contracts; (ii) the importance of single responsibility contracts to minimise co-ordination between foreign suppliers and local contractors; (iii) advance arrangements to ensure availability of local contribution to the funding of the project; and (iv) clear reporting and monitoring requirements.

As explained above, the Bank's first transport project in Albania (*Emergency Road Rehabilitation*) suffered serious delays due to design mistakes, but also due to delays with land expropriations. The lessons learned include (i) the need for preparing high standards detailed engineering documents before a project starts; (ii) requirement of land use and transport master plans before detailed designs can be prepared; (iii) the need for land expropriation arrangements to be completed before civil works contracts start; and (iv) reasonable conditionality and strict monitoring of Bank loans.

Financing SMEs through the banking sector – The Albanian banking system, as mentioned above, is highly liquid and benefits from cheap financial resources. In addition, the local economy is widely based on cash transactions. In addition to ownership and management problems mentioned above, such economic features proved big barriers to the successful implementation of financial products such as SME credit lines or trade facilitation programmes that have proven successful elsewhere. Renewed efforts, with instruments better tailored to local needs and offering stronger incentives for banks to engage with SMEs (through risk sharing schemes, technical assistance, and/or well targeted incentive fees) will be developed during this strategy period.

Working with local companies through equity funds - The use of flexible instruments such as quasi-equity or profit sharing structures, implemented through equity funds, can prove an efficient way of supporting the local private sector in a difficult and unsophisticated operational environment. However, such financing schemes remain highly risky and may be associated with abuse by local companies. They need to be coupled with intense monitoring both at the Bank level (Bank towards fund management) and at the local level (bank and fund manager towards the local investee company).

Corporate governance and management structure – Experience shows that the existence of foreign sponsors or other international co-financiers is not necessarily sufficient to ensure that the company is run properly. In order to ensure adherence to good corporate governance, it is important that the Bank's representatives play an active role in the governance bodies of the investee companies. In addition, a thorough due diligence of the sponsors' corporate governance track record is essential. Corporate governance has also been an acute issue in joint-ventures with the state, or state-owned entities, particularly when state shareholders hold a controlling stake in the company. Problems arise when the operation is run as a state company, with staff inherited from formerly state-owned operations and state shareholders having different priorities and commitments from those of the private shareholders, while the Bank has no recourse to the State. The Bank should avoid projects where the State, or state-owned entities, hold the controlling majority, or otherwise ensure that the operation is run as a private sector one.

TC projects - The Bank has invested considerable resources in TC projects to help address institutional deficiencies, sometimes on a stand alone basis, with a mixed record of success. Experience, especially in the telecommunications and infrastructure sectors, confirms that, in order for the Bank to enhance the transition impact of its operations, TC programmes aimed at institutional building must be tied with specific investment projects and related conditionalities.

1.4 Portfolio Ratio and Quality

Based on the current outstanding portfolio of EUR 132 million, the private/public ratio stands at 49/51 per cent. Going forward, the pipeline stands at EUR 127 million, 46 per cent of which is private. While the Bank's clear objective is to boost its private sector portfolio in Albania, public sector infrastructure projects will continue to remain a high priority, as reflected in the pipeline. The dilapidated state of most

infrastructure remains a major obstacle to private sector investment, domestic or foreign, and is imposing significant additional costs on businesses. Further private sector development will therefore go hand in hand with additional infrastructure investments (notwithstanding the need for other enabling conditions). Due to the large size of infrastructure projects relative to most private sector operations, the private sector share in the portfolio is unlikely to reach the 60 per cent target over the strategy period.

In view of the difficult operating environment in Albania, the overall risk rating of the portfolio (6.07) is slightly worse than average and one project in property and tourism is having problems. The impaired assets total EUR 5 million, and represent 13 per cent of operating assets. As noted above, as a result of the significant restructuring work undertaken to remedy the situation, the impaired operation is now very close to privatisation (through sale of the assets) which will allow the Bank to partly recover its investment.

2. OPERATIONAL ENVIRONMENT

2.1 General Reform Environment

2.1.1 Political Developments

The Socialist Party has been in power continuously since mid-1997. It retained power in the parliamentary elections in summer 2001 and gained a slight majority over its biggest rival, the Democratic Party, in the October 2003 municipal elections. The Democratic Party, led by former President Sali Berisha, has abandoned its previous policy of boycotting parliament till its grievances are fully met, but it is still staging mass public demonstrations, which occasionally escalate into violence. They are aimed at exploiting current popular dissatisfaction over corruption scandals and price rises. Political infighting within the ruling Socialist Party has led to several changes in government in the last three years. The most important occurred in July 2002, bringing Fatos Nano back to the post of Prime Minister for the third time. Nano's government came under attack from within the party in July 2003, with Foreign Minister (and former Prime Minister) Ilir Meta leaving the government. Nano managed to regain the support of the majority among the Socialist Party, was reconfirmed as chairman at the party congress held in mid-December 2003, and successfully reshuffled the government in January 2004, but turmoil in the Socialist Party continues.

2.1.2 Regional Integration

P.M. Nano's government has adhered to Albania's by now well-established policy of improving the international reputation of the country. Albania has signed and in most cases implemented free trade agreements with all neighbouring countries in south-eastern Europe and with Kosovo. The country has shown restraint in its official policies towards Serbia and Montenegro and FYR Macedonia over the issue of ethnic Albanians in those countries, though some strain appeared in relations with Serbia/Montenegro after the free-trade agreement was signed in July 2003 between Albania and, on behalf of Kosovo, by UNMIK (United Nations Interim Administration in Kosovo). Albania fully cooperates with the international community in its attempts to calm down the currently unsettled political situation in Kosovo. Albania has strengthened its ties with the USA by supporting the war in Iraq and agreeing not to extradite US citizens to the International Criminal Court. In June 2003 the country signed the US-Adriatic Partnership Charter as a step towards joining the NATO alliance. The Thessaloniki summit for the western Balkans in May 2003 did not provide a target date for Albania's EU accession, but in January 2003 the country began formal negotiations with the EU on a Stabilisation and Association Agreement. Some progress in negotiations has occurred, but the pace has been constrained by the country's limited capacity to implement EU standards. Reaching the ambitious target of signing the Agreement in 2004 will require full attention to the reform process.

2.1.3 Integrity Issues

Albania has made some progress regarding general respect for the rule of law. However, this is an area which, according to a European Commission's paper on Albania published in March 2003, remains deficient, notably due to weak law enforcement institutions, generally poor public administrative capacity and widespread corruption and organised crime. Corruption and improper professional behaviour within the judicial system continue to constitute a serious problem. According to the Albanian authorities, during 2002, 12 prosecutors were dismissed and various disciplinary measures were taken against a further 23. Five judges were dismissed and two reprimanded. However, no prosecutions took place. Of the 213 cases opened against traffickers over the first nine months of 2002, only 37 were put on trial and 176 were released due to insufficient evidence or procedural errors in courts. Transparency International's 2003 Corruption Perceptions Index placed Albania in the 92nd place out of 133 countries (among transition countries, Albania is ranked ahead of ten other countries).

Despite improved cooperation between Albanian and Italian security authorities, organised smuggling of people into Italy across the Adriatic continues. Albania is both a source and a transit country for trafficking, according to a March 2003 US State Department report on human rights practices in Albania. In January 2004, 21 Albanians trying to reach the Italian coast were drowned when their boat capsized. Several officials, including the local police chief in the port of Vlore, have been arrested and many others sacked. Although the number of Albanians subjected to trafficking to other countries has decreased, the country remains a significant point of origin. Most trafficked young women were transported to Italy, Greece and, to a lesser extent, other European countries. Most of those victims were taken to Vlore for transport by speedboats to Italy, although the port of Durres is also increasingly used. Foreign women in transit mostly originate from Moldova, Romania and, to a lesser extent, Ukraine, Russia, Kosovo and Bulgaria.

2.1.4 Social conditions

Albania's GDP per capita, at about USD 1,800, is one of the lowest in Europe. Despite relatively strong growth in recent years, poverty levels remain high with 25 per cent of the population living on less than USD 2 per day, according to a study conducted in 2002 by the Institute of Statistics (INSTAT). About 57 per cent of people live in rural areas and about a third of GDP is generated in agriculture. The country's population decreased after the collapse of communism and the 2001 census put it at 3,069,000 people, with about 60 per cent of population under the age of 34. About 600,000 Albanians are estimated to be working abroad, mostly in Greece and Italy.

Albanian national minorities, the most important of which is the Greek one, made up 2 per cent of the total population in 1989. The Roma are recognised as a linguistic rather than a national minority, which prevents Roma children from qualifying for education in their native language and perpetuates illiteracy within the community. Albania's society is highly secular and religious affiliation has not been measured for a number of decades. According to estimates, about 70 per cent of the population is Moslem, some 20 per cent Greek Orthodox and 10 per cent Roman Catholic.

Education in Albania is compulsory for children between 6 and 14 and free until the age of 18. Literacy rates were high in the communist era, and the illiteracy rate has continued to fall, from 7.3 per cent in 1989 to 1.4 per cent in 2001. Nevertheless, only 4.8 per cent of the population had completed tertiary education in 2001 and, according to a 2001 study, about 40 per cent of Albania's recent graduates had left the country in the 1990s, while most Albanian students at Western universities do not return home. Education claimed 3.4 per cent of GDP, or 12.3 per cent of total state expenditure, in 2003.

Albania's health system suffers from serious shortages in capacity (especially in rural areas), with 1.3 doctors per 1000 people, less than half the EU rate of 3 per 1,000. Infant mortality fell from 45.4 per 1000 live births in 1990 to 17.5 per 1000 in 2002, but remains the highest in Europe. Healthcare relies on a mixture of mandatory and voluntary funding, based on contributions from employers and employees. Government spending on health in 2002 was 2 per cent of GDP, with 2.5 percent allocated in the 2003 budget.

2.1.5 Labour issues

According to the World Bank classification, Albania is a lower middle income emerging economy. The private sector accounts for about 75 per cent of GDP (EBRD, Transition Report 2003) and employs about 80 per cent of the labour force (INSTAT). The labour force in Albania was estimated at about 1 million people in the third quarter of 2003 (about 35 per cent of population). This low level is partly explained by the large percentage of the population in productive age being employed in Italy and Greece. Although employment in non-agricultural private sector is increasing, more than 50 per cent of the labour force are employed in the labour intensive agriculture sector. Registered unemployment in the third quarter of 2003 decreased slightly to 15 per cent. According to the World Bank's "Doing business in 2004" report, 33.4 per cent of income in Albania is produced in the informal economy.

Workers have a right to form independent trade unions. Two major federations act as umbrella organisations for the country's unions: the Independent Confederation of Trade unions (about 75,000 members) and the Albanian Confederation of Trade Union (about 100,000 members). Due to increasing unemployment, both organisation have experienced a drop in membership in the past few years. Some unions do not belong to either of the two federations. No union has an official political affiliation and the government does not provide any financial support for the unions. Due to the unions' weak position, strikes are rare.

2.1.6 Legal reform

Since the beginning of the 1990s, when Albania started its transition towards establishing a market economy, the legal framework of the country has developed substantially. However, this progress has been severely hampered by internal political instability, a major financial sector collapse in 1997, the Kosovo crisis of 1999 and endemic corruption.

Albania is a parliamentary republic with a constitution, which recognises division of powers, independence of the judiciary and human rights. Although the legal framework provides for an independent judiciary, major deficiencies regarding training, resources and low levels of pay for judges have made corruption in the courts a frequent phenomenon and have generated a lack of confidence from the business community. Human rights and personal freedoms, although generally recognised and respected, constitute a concern for human rights groups, especially as regards the inadequate provision of fair trials.

Albania has several agreements with the EU for the provision of technical assistance and the approximation of legislation. Positive developments have been noted in coordinating Albanian legislative standards with those of the EU. Nevertheless, an overall assessment of Albania's commercial laws reveals that Albania still needs to develop a legal system that conforms to international standards. Some of the factors that have contributed to this poor performance include uncertainties in the legal regime for secured transactions, poor standards of corporate governance and deficiencies in the financial markets legislation. These factors, accompanied by the poor state of the judicial system and the lack of respect for the rule of law in the country, have served as deterrents for foreign and domestic investors.

There have been however some improvements in the legal framework: an important amendment to the Code of Civil Procedures was passed in May 2001; a new pledge law was adopted in 1999; a Telecommunications Regulatory Entity was established in 1998 and an Electricity Regulatory Authority has been operating since 1999; a bill for a new competition law, introducing European Union norms and stipulating the creation of an independent Competition Authority, was approved in the summer 2003. The law reform was also recently boosted by the creation of the new Serious Crimes Court, which opened on 1 January 2004. While implementation remains the challenge, these are encouraging indicators that Albania is moving forward in developing legislation that will assist it in its transition towards a market economy.

2.1.7 Environmental issues

The key environmental issues facing Albania include illegal logging, overgrazing, air and water pollution, and uncontrolled garbage disposal. Coastal erosion is a result of uncontrolled illegal building construction. Dilapidated infrastructure and inadequate waste water management and solid waste treatment also contribute towards unfavourable environmental conditions. The precise characterisation of the environmental issues and challenges facing Albania is, nevertheless, hampered by inadequate data in many areas, including sector-level information on air emissions and effluent discharges.

In an attempt to address these challenges, Albania has developed comprehensive environmental policy supported by relevant legal framework. The National Environmental Action Plan, adopted in 1994, was followed by series of national strategies for a range of specific areas, including waste management, national health, biodiversity and forestry. The establishment of the Ministry of Environment in 2001 and the development of a comprehensive Law on Environmental Protection in 2002

consolidated the environmental regulatory reform process. The recently adopted Environmental Impact Assessment Law has facilitated an environmental safeguarding mechanism in investment decision making. During 2003, the World Bank assisted Albania in developing a National Water Strategy and is now providing an on-going project-based assistance in this sector. The Albanian government is also working with the World Bank to update the National Environment Action Plan. Nevertheless, further progress is required and capacities to implement new policies and law remain extremely deficient. The United Nations Economic Commission for Europe (UNECE) Environmental Review Report (2002) notes that strengthening institutional capacities and further development of environmental procedural law are on-going priorities for Albania. The environmental monitoring capacities of local environmental agencies and inter-agency co-ordination also need to be enhanced.

EBRD operations in Albania adhere to the Bank's Environmental Policy and support the country's sustainable development objectives. EBRD projects will need to be structured to take into account both inadequacies in the current regulatory regime and pertinent environmental issues. It may be appropriate in environmentally medium and high risk sectors for projects to include an element of robust self performance monitoring supported by a more proactive approach to monitoring by Bank staff. Also, where appropriate, technical co-operation to address institutional capacity issues may be considered by co-ordinating with other IFIs and donors in order to avoid duplication and create synergies.

2.2 The Economic Environment

2.2.1 Macroeconomic conditions for Bank operations

The Albanian economy has experienced strong growth since 1998 (an average 9 per cent per year during 1998-2001). Despite a temporary slowdown to 4.7 per cent GDP growth in 2002, the 2003 growth rate climbed back to an estimated 6 per cent. The re-establishment of electricity supply in the second half of 2002 has stimulated growth in industrial activity, while repairs of the irrigation system, which had been damaged by floods, helped to put agricultural growth back on track. The Albanian economy remains however vulnerable to power shortages, low quality of infrastructure, including utility services and transport facilities, and poor business environment.

The cautious monetary policy of the Central Bank, exemplified by an increase in policy rates from 7 per cent to 8.5 per cent in 2002, was critical to limiting inflationary risks. The 2003 inflation rate, at an estimated 3.3 per cent, was safely within the 2-4 per cent target interval and allowed the lowering of policy rate back to 6.5 per cent. The central bank operates within a managed float exchange rate regime. Interventions on the exchange market in 2003 were relatively large, with Bank of Albania purchases of foreign currency amounting to USD 46 million between January and August 2003 to contain appreciation pressure. As a result, the Lek maintained its parity against the Euro in 2003 and appreciated against the US Dollar. The stability of the local currency is underpinned by significant inflows of remittances, some foreign direct investments (FDI), growing exports, and relatively low inflation.

The budget deficit, although still high, is gradually decreasing from above 11 per cent of GDP in 1999 to an estimated 5.6 per cent of GDP (excluding grants) in 2003¹. The reduction of fiscal deficit in 2003 is largely due to revenue increases and savings on expenditures including subsidies, operations and maintenance and personnel. Tax revenues and customs collections, although significantly improved, are still falling behind the ambitiously set budgeted levels, because of ongoing problems of corruption, tax evasion and incomplete reporting. Public debt is estimated at about 61.3 per cent of GDP in 2003, down from 67.7 per cent in 2001 and 63.2 per cent in 2002. The domestic debt component amounts to 38 per cent of GDP and remains an important concern, owing mainly to relatively high interest rates. The yield on 3-month treasury bills had decreased to about 7.5 per cent and the rate on 12-month treasury bills had fallen below 10 per cent by the end of 2003.

The external debt amounts to 23.3 per cent of GDP (USD 1.4 billion). The service on external debt was about 6.4 per cent of exports of goods and non-factor services in 2002 and is expected to increase to a maximum of 10 per cent by 2010. This medium term increase reflects larger amortisation payments on bilateral debt in 2004, rescheduling of outstanding arrears and reduced access to concessional borrowing. The external debt appears manageable, particularly given the stable inflow of remittances into the country (about USD 700 million in 2003). Albania has successfully rescheduled arrears to Paris Club creditors (the arrears dropped from 9.8 per cent of GDP in 2001 to about 2.3 per cent of GDP in 2003) and reached restructuring agreements with a number of former communist countries. While prudence remains necessary, the government debt capacity does not appear to be a major constraint for Bank's sovereign lending in support of economically viable projects.

The current account deficit, driven mostly by high demand for consumption of imported goods, reached in 2003 an estimated 8.5 per cent of GDP (excluding official transfers)². This is less than the 9.1 per cent figure in 2002, but still above the levels from 1998-2001. Gross international reserves increased in 2003 to about USD 974 million and cover about 4.4 months of imports of goods and services. The trade deficit, at an estimated \$1.371 billion in 2003, remains at a stable 23 per cent of GDP. The deficit is structural, with exports covering only about a quarter of imports and largely limited to labour intensive products, such as clothing and shoe production. It is mainly financed by remittances from Albanians working abroad, moderate foreign investment inflows and foreign financial assistance. The FDI inflows (USD 192 million in 2003), however, are still among to the lowest in the region in per capita terms.

Over the short term, annual GDP growth is likely to be about 6 per cent with an inflation rate of about 3 per cent. According to the IMF projections, FDI is expected to pick up to above USD 200 million annually. Administration reform and improved tax and customs collection rates should decrease the budget deficit to below 5 per cent of GDP. Growing exports should narrow the trade deficit, resulting in gradual

¹ The central government deficit inclusive of grants was about 5% of GDP in 2003. The budgetary support grants are expected to remain stable in the medium term.

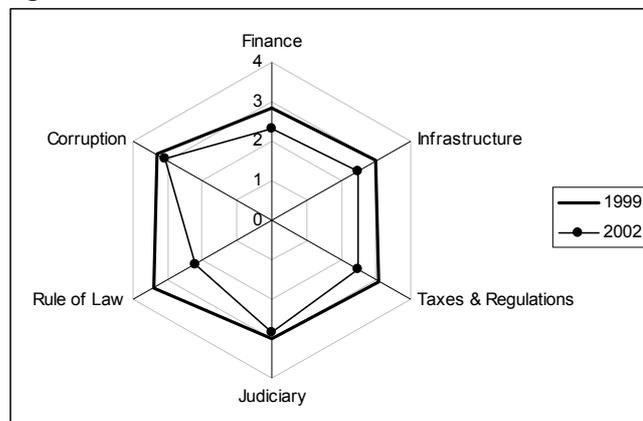
² The current account deficit inclusive of official transfers was about 6.1% of GDP in 2003. The official transfers, spent mainly on capital investments, are expected to remain at about 2% of GDP in the medium term.

lowering of the current account deficit. Downside risks include threats to political stability, still uncertain electricity supply, sluggish growth in trading partner's economies, corruption and slow implementation of structural reforms.

2.2.2 Investment climate

The perception of business climate in Albania has improved since 1999 (see Figure 1), however, private enterprises, and particularly SMEs, still encounter many obstacles. The perceived hurdles, as measured by the 2002 Business Environment and Enterprise Performance Survey (BEEPS) study, decreased in several categories, though little improvement was achieved in reducing corruption and improving standards of the judiciary.

Figure 1: Obstacles to business in Albania: 1999 and 2002



The values range from 1 to 4, with 1 indicating no obstacles to business growth and operations and 4 indicating major obstacles. The extremity of each axis represents a score of 4, indicating a less favourable investment climate. Source: Business Environment and Enterprise Performance Survey (BEEPS), 1999 and 2002

Private sector development and foreign direct investment is hindered not only by crumbling infrastructure and chronic energy problems, but also by a weak administration and prevalent corruption, which lead to poor law enforcement and unfair competition from the informal economy, as well as from illegal practices of registered companies (smuggling, tax evasion, illegal imports, counterfeit and unlicensed production). Weak corporate governance, both at the macro and at the enterprise levels, and lack of management skills as well as an underdeveloped banking system are other major impediments to the development of the private economy and foreign direct investments. Reforming the judicial system, strengthening the rule of law and public order, fighting corruption and deepening public administration reform remain key challenges for the government in the medium term. Other important issues include implementation of the new competition law, including establishment of an independent Competition Authority, strengthening and increasing transparency of industry regulations, introducing new insurance law, and reinforcing financial regulation and consumer protection. It is also essential to develop stronger capacity to absorb the international assistance and implement public sector projects. Institutional improvements are necessary both to improve efficiency of government operation and to achieve the implementation capacity needed to finalise negotiations on the Stabilisation and Association Agreements with the EU.

2.2.3 Access to capital

Notwithstanding recent improvements in banking and the increased confidence in the financial sector as shown by the significant increase in deposits, access to finance for Albanian enterprises from formal sources remains very limited. Domestic credit to the private sector at end-2002 was below 5 per cent of GDP, well below other countries in the region such as Bosnia and Herzegovina and FYR Macedonia. Survey evidence from the BEEPS in 2002 shows that SMEs rely heavily on internal funds and remittances from abroad to finance new investments. The privatisation of Savings Bank and its intention to lend to private sector, rather than to channel all local currency deposits to government bonds, may increase the supply of private credit. However, the stringent regulation of private bank lending by the central bank, first introduced after the pyramid scheme collapse in 1997, limits the lending possibilities and imposes a very conservative approach on commercial banks, including through very large collateral requirements.

A stock exchange established in 1996, was trading in treasury bills only and was subsequently closed at the beginning of 2000. Although it recently re-opened, it is not yet fully functional and its influence as a source of fresh capital for companies is expected to be negligible. Poor contract enforcement, limited protection of shareholders rights and a weak judiciary also hamper the development of equity markets.

3. TRANSITION PROGRESS AND CHALLENGES

Despite domestic political problems, Albania remains committed to reforms and, in some areas, especially trade liberalisation and small scale privatisation is at the forefront of transition in the region (see Table 3.1). The country has largely completed small-scale privatisation and moved most assets in housing, transport and retail trade to the private sector, which now accounts for about 80 per cent of employment. After a temporary slowdown, Albania also managed to revive large-scale privatisation. In July 2003, the EBRD and the IFC each bought a 19 per cent stake in the large state insurance company INSIG and in December 2003 the government approved the sale of the last and largest state-owned bank in the country, the Savings Bank, to the Raiffeisen Group. In an attempt to support an increase in non-privatisation FDI, the government created in December 2002 a Foreign Investment Promotion Agency, which intends to become a “one stop investment shop” agency.

Table 3.1: Transition Indicators of selected SEE countries, 2003

	Albania	Bosnia and Herzegovina	FYR Macedonia	Serbia and Montenegro
Price liberalisation	3.7	4.0	4.0	4.0
Forex and trade liberalisation	4.3	3.7	4.3	3.3
Small-scale privatisation	4.0	3.0	4.0	3.0
Large-scale privatisation	2.3	2.3	3.0	2.3
Enterprise reform	2.0	2.0	2.3	2.0
Competition policy	1.7	1.0	2.0	1.0
Infrastructure	2.0	2.3	2.0	2.0
Banking sector	2.3	2.3	3.0	2.3
Non-banking financial institutions	1.7	1.7	1.7	2.0

The index ranges from 1, indicating little or no progress to 4.3 pointing to standards similar to advanced economies

Source: EBRD Transition Report, 2003

The key transition challenges for Albania that the Bank can help to address are:

3.1 Private Sector Development

The main challenges associated with the development of the private sector, as indicated above, are related to the poor investment climate and the level of corruption. Key priorities include strengthening of the institutional framework for promotion of FDI and SMEs, improving the enforcement of commercial laws, rules and regulations, as well as reduction in organised crime and corruption. Further improvements in tax and customs collection by reducing the widespread tax evasion and the significant grey economy would help to ensure a level playing field between private firms.

Despite unfavourable conditions, there are local private companies (agribusiness and other industries) that have managed to survive through the various crises, and compete well on a national level, and to a lesser extent on export markets. These companies could benefit from direct and indirect (via local banks) medium and long-term financing for investment in capacity and upgrade in quality.

In the telecommunications sector, the privatisation of the state-owned mobile operator, AMC, and award of a second GSM mobile licence to Vodafone, has created a competitive and rapidly expanding mobile telephone market. However,

the Government's failed attempts to privatise Albtelecom, the national fixed-line incumbent, have resulted in limited fixed-line development and this market now significantly lags other countries in the region. The Government has attempted to stimulate development in rural areas by awarding local telephone network operating licences to small private operators but this is unlikely to have a major impact in the near future. Further progress is needed in legal and regulatory reform. The Government needs to take action to accelerate the implementation of a stable legal and regulatory framework for the sector to stimulate further competition within a liberalised environment. Improvements in transparency, operational and financial performance of Albtelecom are necessary if future privatisation attempts are to be successful.

In the natural resources sector, Albania should complete the privatisation and restructuring of oil and gas enterprises, to allow rationalisation, increase private sector participation and promote direct foreign investment. A major challenge is the encouragement of regional collaboration and ensuring of transparency and stability in oil and gas transportation projects to reduce transport bottlenecks and ensure competitive market access. In addition, Albania should improve the sector's regulatory and institutional framework, and set high standards of business conduct, transparency, corporate governance and environmental protection.

3.2 Financial Sector

Broad access to finance is essential for the development of private entrepreneurship. Without credit, companies cannot grow and develop, and innovative ideas may never be implemented. As discussed in section 1 above, while there are 16 banks operating in the market, only half of them are somewhat active in lending to the economy, thus the low level of financial intermediation remains an important impediment to the development of private sector in Albania. Increasing domestic bank lending to private sector, particularly to SMEs is an important challenge in the financial sector. Within the same framework, another important challenge, in view of the limited lending experience, is increasing the banking skills of local bankers, particularly in cash-flow based lending.

Other challenges include the promotion of non-cash transactions, strengthening of property rights, improvement of land registries and cadastres in order to facilitate the use of property as collateral by local firms, enforcement of contractual obligations, and broader availability of creditor information. Lowering the administrative barriers and costs to transfer emigrants' remittances from abroad into the Albanian banking system is also important to increasing access to finance for new investments.

Promotion of new financial instruments (including e.g. introduction of leasing) and increasing efficiency and improving market standards in the insurance sector through the completion of the privatisation of INSIG to a strategic investor are the greatest challenges for the development of non-bank financial institutions in Albania.

3.3 Infrastructure Sector

Despite increasing investment, infrastructure is still severely dilapidated due to chronic underinvestment and its poor state constitutes an important obstacle to the

development of the enterprise sector. Improvements in infrastructure are essential for Albania's regional and European integration. Commercialisation and privatisation of public utilities are also crucial to attract FDI, and improve efficiency and sustainability of the provision of public services.

Energy – The situation in the energy sector since the beginning of the transition process has rapidly deteriorated. Technical and non-technical losses (non payment or theft of electricity) increased sharply after the 1997 crisis, reaching over 60 per cent of the energy supply. Despite improvements, corporate governance of the state power company (KESH) has remained very poor, with limited powers and responsibilities from the management, a vertically integrated structure combining several functions, and deficient internal information systems. A crucial challenge is the full commercialisation of KESH, including unbundling, reduction in theft and non-payment losses, and gradual privatisation of distribution and generation assets.

Although Albania can benefit from cheap hydropower, heavy reliance on hydropower puts electricity supply at risk during periods of low rainfall, which necessitates the diversification of power supply.

Regional integration is also an important challenge, as it will allow greater efficiency in the planning for and use of assets. The standard for regional integration has been set by the Athens process for the creation of a Southeast Europe Regional Energy Market ("SEEREM"). Under the Athens process, the countries of Southeast Europe have committed themselves to a fully operational regionalised market (with open borders) by 2007 and this has been enshrined in the Athens Memorandum of Understanding, which is harmonised with the EU Directives for Electricity.

Transport – A number of IFIs (including EBRD) and bilateral donors have provided financing for the sector but there are still many areas that need urgent intervention. The sector is in need of major rehabilitation and modernisation, particularly in the context of the regional East-West and North-South transport corridors (roads, ports, railways) and civil aviation. Institutional and administrative strengthening as well as higher budget allocations are needed for road repair and maintenance, in line with the urgent need for improvement of road safety. An increase in private involvement in ports, airports, and railway services is also a key challenge, which may benefit from IFI involvement.

The main transition challenge in the airport sector will be the successful privatisation of Tirana Airport on a commercial and transparent basis. The Bank has already had a positive effect on the structuring of the tender process for the privatisation.

Municipal and environmental infrastructure – The sector suffers from lack of investment and deferred maintenance. Municipal services such as water supply, wastewater, urban transport and solid waste require significant investments and upgrading. However, much of the investment would need to be linked to institutional, legal and regulatory reforms to ensure that municipalities have predictable sources of independent revenues against which it is possible to borrow, and that principles of cost recovery are observed at the level of the operating company.

4. STRATEGIC ORIENTATIONS

4.1 Bank's Priorities for the Strategy Period

The Bank is well positioned and fully committed to help Albania meet its transition challenges. Over the strategy period, the Bank will support the government's efforts towards fostering of reforms and improvement of the country's investment climate. The Bank will seek to carefully balance new private sector investments with support for critical public sector infrastructure as key factors to promote foreign direct investments. The current project pipeline amounts to an expected EUR 127 million. Priority will be also given to speedy and successful implementation of existing projects, especially those in the infrastructure sector. Accordingly, the Bank will focus on the following operational priorities:

- Private sector development through direct investment in private or privatised enterprises and, where possible, support to forthcoming privatisations.
- Financial sector strengthening and boosting of financial intermediation as a key factor for the development of SMEs.
- Support for priority infrastructure investment, particularly in the energy and transport sectors.

In order to maximise the transition impact, these actions will be accompanied by a close policy dialogue with the Government on key topics, such as infrastructure regulatory frameworks, particularly in the energy sector. The Bank will continue to maintain a constructive dialogue with the local business community and with foreign investors. Particular importance will be placed on the co-operation with other co-financiers and bilateral donors aiming at raising complementary concessional and grant funds for public infrastructure projects.

All EBRD operations in Albania will continue to be subject to the Bank's Environmental Policy and incorporate, where appropriate, Environmental Action Plans, in line with the Bank's mandate to actively support environmentally sound and sustainable development through its investment projects.

Over the coming two years the Bank will focus on the following specific priorities:

4.2 Private Sector Development

Support for the private sector has been at the centre of the Bank's efforts in Albania and today 49 per cent per cent of the portfolio is in the private sector. The Bank will continue to play a major role in promoting private sector development over the strategy period through direct investments in the private sector, an increased involvement in agribusiness, and support to privatisation of utilities (telecoms).

Operational Objectives

The Bank will seek to support the development of private sector through involvement in:

General Industries & Agribusiness – The Bank will support through direct involvement projects in greenfield and existing private companies. The Bank will also increase its efforts to support the development of the agribusiness sector by reaching out to private companies and SMEs, either directly or indirectly. The Bank’s operational priorities for the strategy period include:

- Financing the rehabilitation and expansion of the Fushe Kruje Cement Factory, which would replace imports of clinker and cement in Albania.
- Financing of a food packaging plant with an existing Bank client already present in the region.
- The Bank is also in discussions with two separate consortiums to finance a possible greenfield investment in the beer industry in Albania. Consultations are on-going and it is expected that such an investment would feature a major strategic investor in this sector as a shareholder and managing partner.
- Additionally, the Bank will intensify discussions already held with various local banks on co-financing for short-term commodity based lending.
- Further opportunities will be explored in the natural resources sector (regional pipeline – if it materialises) and in the commercial real estate sector.

Telecommunications – The Bank will continue to seek opportunities to promote sector development by:

- Considering further technical assistance to help the implementation of a modern legal and regulatory framework, conditional on clear commitment and actions by the Government to implement necessary changes.
- Considering privatisation or pre-privatisation financing for Albtelecom, conditional on steps being taken to improve corporate governance, transparency, operational and financial performance of the company to international standards.

On the policy dialogue front, the potential for offering technical assistance to support institutional building and private sector development, through targeted improvement of the administrative and legal framework will be explored.

4.3 Financial Sector

Through equity investments, the Bank has had an initial strong impact in the financial sector in Albania. External factors (the financial crisis of 1997, a poor investment climate) and internal factors (lack of sponsor or deficient management, delays in privatisation of the Savings Bank) have prevented further development of the sector and limited the ability of banks to efficiently channel funds to the economy (with some exceptions such as ProCredit Bank Albania). In order to boost financial intermediation and better serve the needs of SMEs and of the enterprise sector in

general, renewed efforts to better tailor the Bank's approach in the financial sector will be necessary. The Banks will also actively look at the non-bank financial sector.

Operational Objectives

The Bank will focus on:

- Exploring the possibility of replicating the experience gained in the accession countries in providing dedicated SME financing facilities through local banks by combining EBRD credit lines with donor/EU-financed technical assistance and performance fees targeted towards the achievement of specific objectives in terms of SME portfolio development.
- Establishment of donor sponsored risk sharing facilities with local banks to support and enhance their lending activity (with Italian support, on a similar principle as already operating in Serbia and Montenegro).
- Exploring the possibility of providing post-privatisation support through new instruments to the Savings Bank and to the National Commercial Bank, once the new strategic investor is in place.
- Continuing to support the development of ProCredit Bank Albania. A further capital increase to support the bank's growth is envisaged during the strategy period.
- Promoting and offering to support the consolidation of the banking sector through mergers and acquisitions among local banks.
- Facilitating the full privatisation of INSIG through a successful restructuring under the pre-privatisation investment scheme.

The Bank will seek to couple its investments with appropriate technical assistance whenever possible to strengthen the local banks' capability in these products. The Bank will also explore the possibility to support the improvement of the legislative frameworks to allow for introduction of new instruments (such as leasing), subject to appropriate commitment by the relevant authorities.

4.4 Infrastructure Sector

Infrastructure development will be a key priority for the coming strategy period. In providing support for infrastructure in the public sector, the Bank will, as in the past, work very closely together with potential co-financiers and donors in order to limit the additional burden on the country's public debt, as well as to mobilise support to address institutional capacity issues.

Operational Objectives

Energy – The Bank will initiate projects which address the technical issues of the energy sector, and which support the restructuring efforts of the electricity sector and its regional integration. The Bank has already committed itself to two projects in the area of transmission and distribution, and these are now disbursing regularly. While the implementation of these projects will continue to be a key priority for the Bank, other priorities are listed below:

- The Bank will focus on the power generation side, with a thermal power project being next on the agenda. A feasibility study has confirmed that an approximately 100 MW oil-fired project, to be located on the coast in southwest Albania, is the best next step to reduce the dependence on hydropower (while optimising its usage), reduce losses in the power plant's region and meet the necessary reserve requirement guidelines for integration into the UCTE. The Bank is considering co-financing the project (with up to EUR 40 million), together with the World Bank and the European Investment Bank.
- In addition, the Bank will consider further transmission investments aimed at building a new regional interconnection with FYR Macedonia, possibly extending it also to Italy, a project that would also benefit the broader south-eastern Europe region. The Bank intends to launch a feasibility study for this potential investment in the near future.
- In the private sector, the Bank is closely monitoring the process for the possible construction on a BOOT scheme of a new hydropower plant in south Albania dedicated to electricity exports towards Italy.

In parallel, the Bank will continue to mobilise appropriate technical assistance for KESH to support continued institutional strengthening and improvement of governance. Through policy dialogue, the Bank will continue to support the restructuring of the Albanian Power Company and the reform in the sector, including due consideration for all environmental aspects.

Transport – The Bank has been active in the road sector in Albania, providing financing for the rehabilitation of a 30 km section of the East-West Road Corridor VIII, and the regular implementation of that project will remain a priority for the Bank. In addition, over the strategy period the Bank is considering the following:

- The Bank's role in the road sector will continue through financing, together with the EIB, of the rehabilitation and new construction of an 82 km section of the main road network between Fier and Tepelene, which is part of the north-south axis, leading to the Greek border. The upgrading of this road network constitutes a high government priority and the signing is expected to be achieved by the end of 2004 year. The project (Fier-Tepelene) will provide an opportunity to launch broader reform of the road sector, with policy rather than technical matters being the focus of the transition. This investment will be linked to improvements in road sector financing (funding of road maintenance and cost recovery) and institutional reform.
- The EBRD is currently supporting two of the bidders for the Tirana Airport concession. It has been instrumental in promoting changes to the tender process to lead to a more transparent evaluation and assisting in procuring comparable bids. The concession is expected to be awarded in mid 2004.
- In the port sector, the Bank will continue to encourage commercialisation, restructuring and transparency through its involvement in the Port of Durres master plan, and will explore during the strategy period, possibilities for co-financing with the EIB and EU of projects related to regional integration and development, such as the ferry terminal in the port of Durres.
- The Bank has identified the construction of an oil and gas storage terminal at the port of Vlore as a potential project, subject to a concession granted by the government. The project is sponsored by a foreign private company that has

already approached the Bank for financing. The project will provide storage facilities to local oil and gas distributors.

Municipal and environmental infrastructure – The development of a viable project pipeline in the municipal and environmental infrastructure sector will be a new key objective for the Bank during the strategy period:

- Initial investments will focus on the water supply sector, where cost recovery is typically possible through appropriate tariff reform, which also entails efficient water use.
- Urban transport and solid waste investments will also be considered on a case by case basis. The Bank will look into the possibility of initiating pilot projects under a sovereign guarantee and then, depending on the quality of the company and the nature of support from municipal or central government authorities, it may consider financing on a sub-sovereign basis.
- Finally, Albania has significant high quality and abundant water resources particularly in the south of the country, which would benefit from a comprehensive water management strategy. Subject to hydro-geological studies confirming that quantities are sufficient on a long-term basis, projects to sell water to neighbouring countries with a water deficit (Italy, Greece) may be considered.

5. COOPERATION WITH DONORS AND OTHER IFIs

The Bank will continue to pursue the proposed operational objectives in close co-operation with other donors active in Albania, in order to achieve a successful implementation of its strategy and optimise the transition impact.

The Bank is already actively co-operating with multi and bilateral donors in reaching a long term solution to the country's energy crisis. Co-operation continues in the transport sector, with the Bank co-financing the rehabilitation of the Elbasan-Librazhd road segment with Italy. Besides co-financing physical rehabilitation projects, the Bank is actively working with other donors to co-ordinate policy dialogue in order to provide a stronger and more efficient impetus to the reform process in the relevant infrastructure sectors. While co-operation in the public sector is working well, more has to be done in jointly pushing forward the implementation of projects and improving implementation capacities, given the systemic weakness of the country and past experience with public projects.

The Bank has extended the co-operation with other IFIs in Albania in the private sector through co-financing large private corporate and financial sector projects with the IFC.

The Bank also takes active part in the broader policy dialogue in Albania. While the long-term policy objectives of the Albanian government are set in the National Strategy for Socio-Economic Development, expressed in the Poverty Reduction Strategy Paper (PRSP), the medium term operational objectives are summarised in the Medium Term Budget Programmes (MTBP), covering three-year periods and updated annually. The MTBP is published by the Albanian Ministry of Finance, after consultations with IFIs, interested donors and international organisations, to ensure sufficient resources are earmarked for the proposed undertakings. It includes a list of priority projects and reforms, along with partners supporting their implementation. The MTBP reflects the long-term goals of the PRSP and is co-ordinated with the strategy documents published by IFIs, including the World Bank / IDA Country Assistance Strategy, the EU Annual Programmes, and the EBRD Country Strategy.

The EBRD also participates in regular sector coordination meetings with government representatives, the EU, the World Bank and bilateral donors. The budgetary debate and the regular consultations led by the IMF form an additional platform for dialogue with the government and other IFIs to set investment priorities, coordinate donor activities, and consult proposed sovereign guaranteed investment projects. The Donors' Roundtable, which replaced the "Friends of Albania" group formed after the Kosovo crisis, serves as a platform to share information on available donor resources and activity plans. Finally, high level political dialogue also takes place within the various initiatives of the Stability Pact for South Eastern Europe.

In line with the Bank's priorities for the next two years, the following specific objectives will be pursued for the co-operation with the EU, other IFIs and donors:

- The Bank will maintain a close co-operation with the World Bank, the EU and other institutions in continuing a policy dialogue with the government on issues concerning the improvement of the investment climate. The Bank will also work with the business community work to identify the existing impediments to private sector and especially SME development and to gain direct feedback on government policy and actions.
- The Bank will continue its close co-operation with the IFC in the banking sector as well as in major private sector projects.
- Continue the co-operation with the World Bank, the EIB and bilateral donors for the restructuring and rehabilitation of the power sector.
- Continue close co-operation with the EU, EIB, World Bank, Italy, Germany, and other potential donors in the transport infrastructure sector (roads, ports and airport).
- The involvement of private investors in developing and operating key areas of infrastructure and the assistance in sectorial reforms will in particular be closely co-ordinated with the World Bank and the EU, as well as with other entities actively involved in policy dialogue with Albania's authorities.

III. ANNEXES

ANNEX 1: POLITICAL ASSESSMENT

Albania became an independent republic in November 1912 and had its present borders fixed in 1921. From 1939 to 1943, Albania was under Italian occupation and from 1943 to 1944 under the German one. In 1945, under its new Communist regime, Albania reverted to its pre-1939 borders. An uprising in Kosovo aimed at union with Albania and western Macedonia was put down by the Yugoslav authorities in Belgrade. Under the leadership of Enver Hoxha, Albania was at first aligned with Yugoslavia, later with Russia and then China, to end up in international isolation that lasted until Hoxha's death in 1985.

Albania's first multiparty election, held in March 1991, was won by the Socialist Party (former Communists who had renounced Hoxha). A fresh election in March 1992 produced a landslide victory for the Democratic Party led by Sali Berisha, who became President. Support for Berisha declined due to a combination of growing corruption in the public administration and of Berisha's authoritarian style. The main opposition parties boycotted the May 1996 parliamentary election in protest at electoral fraud and Berisha's party won by a landslide. Despite strong international criticism, the result was allowed to stand. Berisha was brought down by general unrest in 1997 following the collapse of a number of controversial 'pyramid' investment schemes. A massive popular uprising took place. An Italian-led international force helped restore order. An interim coalition government held an election in June 1997 which led to the formation of a Socialist led coalition under Fatos Nano. Nano was replaced as Prime Minister in 1998. The Socialists won the mid-2001 election. The Democratic Party at first refused to take up its seats but eventually returned to parliament in January 2002.

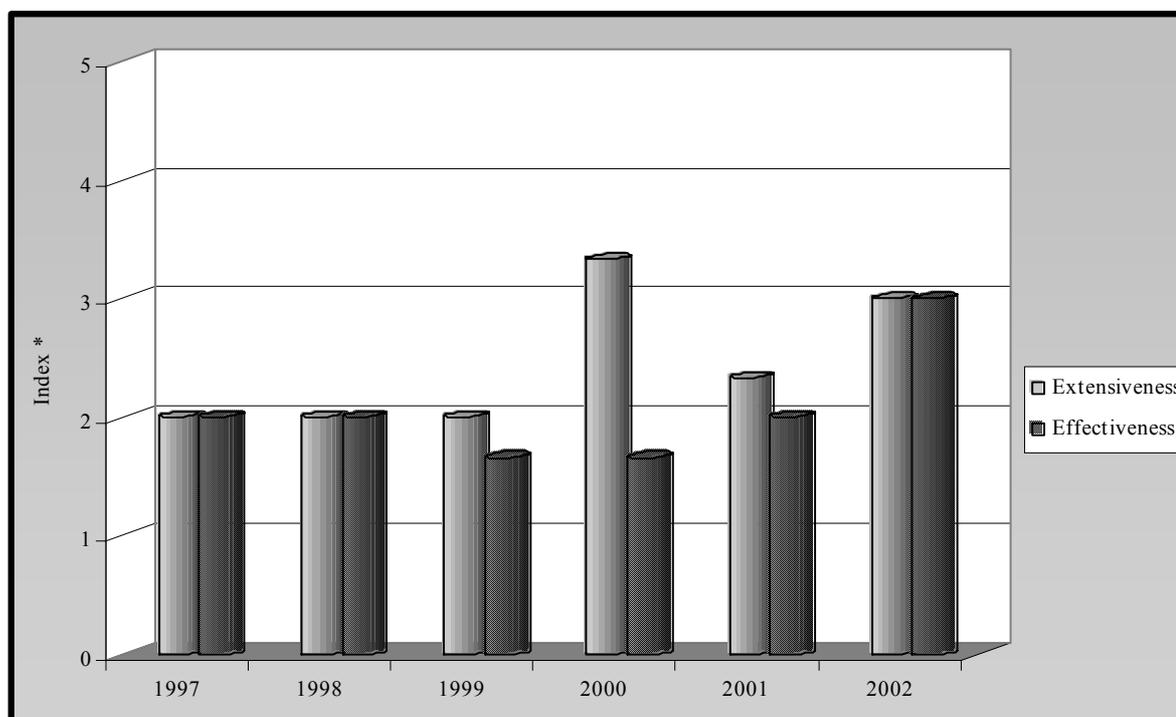
Berisha and Nano reached an agreement which paved the way for the election as President in June 2002 of Alfred Moisiu, a retired army general, to replace Rexhep Meidani. Nano became Prime Minister again in July 2002. Following disagreements within the Socialist Party, several ministers left the government in mid-July 2003. In December 2003 Nano was re-elected leader of the Socialist Party. In January 2004 following an agreement with smaller left-wing parties, he carried out a government reshuffle. However, the Socialists remain divided. The opposition Democratic Party had made gains in the local elections in October 2003 despite numerous irregularities registered by foreign observers. It is being helped by the growing public outcry against the government's perceived failure in the struggle against organised crime, notably people-smuggling. The parliamentary elections are scheduled for 2005.

ANNEX 2: LEGAL TRANSITION

COMPARATIVE ASSESSMENT OF ALBANIA'S COMMERCIAL LAW

I - Assessment Over Time

Extensiveness and Effectiveness of Albania's Commercial Law³



Source: OGC Legal Indicator Surveys; 1997 - 2002

*Note: Indicators along the y axis range from 1 (little progress) to 5 (substantial progress)

According to the annual EBRD Legal Indicator Surveys conducted since 1997, the commercial laws in Albania still have a considerable way to go to reach the standards generally acceptable internationally. Yet, the trend reported by local legal practitioners surveyed since 2000 is an increase of commercial laws effectiveness and generally a closing of the gap between extensiveness and effectiveness of the laws.

II - Situation in Other Transition Countries

The quality of Albania's commercial laws is generally comparable to that of other countries in the Western Balkans. According to the 2002 EBRD Legal Indicator

³ From 1997 to 2002, the EBRD has conducted a Legal Indicator Survey each year to measure the progress in legal reform in Central and Eastern Europe, the Baltic States and the Commonwealth of Independent States, as viewed by local lawyers and academics. The results of such survey are based on responses to the questionnaire sent out to lawyers practising in any given country. The survey represented their perception of the country's legal system and, in particular, the degree to which key commercial and financial laws have reached internationally acceptable standards (extensiveness) and to which extent these laws are implemented and enforced (effectiveness). The survey is based purely on local lawyers' perception of their own country legislation and does not represent EBRD's own view on these legal systems. In addition, it must be noted that each respondent is asked to answer the questionnaire for his/her country only, and not on a comparative basis.

Survey, which measures the perception of local lawyers, the commercial laws of Albania are characterised as “barely adequate” for supporting investment and other commercial activity in the country.

According to the 2002 LIS, among the reasons perceived for the poor performance of Albanian legislation were uncertainties in the (then applicable) bankruptcy and secured transactions regimes, and deficiencies in banking and capital markets legislation.

LEGAL SECTOR ASSESSMENT

Bankruptcy

The main legislation governing insolvency procedures in Albania is now the Law on Insolvency Proceedings of 2002 (the “Insolvency Law”). The Insolvency Law replaces the previous Law on Bankruptcy Procedures of 1995.

A recently conducted EBRD insolvency law assessment survey (the “Assessment Survey”)⁴ included an analysis of Albania’s legal system, assessing the Insolvency Law as mature and comprehensive. The Assessment Survey also noted that the provisions relating to commencement, hearing and determination of initiating applications, involvement of creditors and avoidance of pre-bankruptcy transactions were perceived to be particularly clear and helpful.

Whilst acknowledging Albania’s efforts to foster bankruptcy legislation, the Assessment Survey also revealed some areas falling short of compliance with relevant international standards. Among deficiencies detected were the following:

- i) the absence of sufficient appropriate qualifications for persons who might be appointed as insolvency administrators;
- ii) the absence of appropriate obligations and responsibilities on both debtors and relevant third parties to provide information;
- iii) the exclusion of cases of insolvency where the assets are insufficient to meet the costs of the insolvency process;
- iv) the absence of an appropriate evidentiary provision enabling a creditor to establish the inability of a debtor to pay a mature debt.

Additionally, the assessment revealed the absence of a clear statement concerning the control and management of a debtor who seeks to propose a plan of reorganisation or adequate provisions concerning the financing of a debtor during the early stages of a possible reorganisation.

Capital Markets

The main legislation governing the securities market is the Law on Securities of 1996, as amended in February 2001 (the “Law on Securities”). The principal regulator of the securities market is the Albania Securities Commission (“ASC”), established according to the Law on Securities. The ASC consists of seven commissioners, appointed by the People’s Assembly for a five year term. Two of the commissioners

⁴ See <http://www.ebrd.com/country/sector/law/insolve/assess/albania.pdf>

are proposed by the President of the Republic, two by the People's Assembly, one by the Council of Ministers, one by the Chamber of Commerce and Industry and one by the (Central) Bank of Albania. The ASC has authority to license any person or legal entity intending to organise a securities market or carry out securities investment business. In addition to the Law on Securities, according to the ASC the Government is currently considering a draft law "On Collective Investments in Securities Funds", the main goal of which is said to be to establish a more complete regulatory framework governing collective investments and to ensure a greater protection of investors through prohibition of promotion in public of illegal collective investments in securities.

The Tirana Stock Exchange ("TSE") was established in 1996, although it has had very limited trading activity (mainly treasury bonds and privatisation vouchers). A regulation promulgated in April 1999 formerly defined the functions and activities of the supervising board of the TSE, providing for all the activities of the TSE to be run by the Supervising Council of the Bank of Albania, which is presided over by the Governor of the Bank of Albania. The 2001 amendments to the Law on Securities overhauled this arrangement, stipulating instead a six-month period under the direction of the Ministry of Finance and the Ministry of Privatisation for the transformation of the TSE to a joint stock company.

The insurance market is governed by the Law on Insurance and Reinsurance Activity of 1996, which liberalised the insurance market by permitting domestic and foreign insurance and reinsurance companies to operate in the country. In addition, foreign companies may invest directly, taking up to a 40 per cent share in local insurance companies. Licences for insurance and reinsurance companies are granted by the Insurance Supervisory Commission, which has general supervisory authority over the insurance sector.

Company Law and Corporate Governance

The Law on Commercial Companies (the "Company Law") was promulgated in 1992 and most recently amended in 1995. According to the Company Law, business organisations can be established in the following forms: general partnership, limited partnership, limited liability company, joint stock company and limited partnership by shares.

The minimum capital required for a limited liability company is LEK 100,000; LEK 10,000,000 is required for a joint stock company with public offering of shares and LEK 2,000,000 is required for a joint stock company without public offering of shares. A joint stock company is required to have two or more shareholders at incorporation. The general meeting of shareholders is the supreme decision-making body. The general meeting of shareholders appoints a supervisory board consisting of 3 to 21 members to supervise the daily operations of the company. Members of the board are not required to be Albanian nationals. Proxy voting at the general meeting of shareholders is permitted. The Company Law also gives shareholders the right to bring an action to set aside a shareholders' resolution in the case of a violation of the rules relating to the holding of the relevant general meeting of shareholders. There are also disclosure requirements and other provisions in the Company Law dealing with the situation where a company transaction involves conflict of interest issues.

According to the 2003 results of the EBRD's Corporate Governance Sector Assessment Project⁵, Albania is a country whose existing corporate governance related laws (i.e., "law on the books", as opposed to implementation of the relevant legislation) when compared to the OECD *Principles of Corporate Governance* were rated among "medium compliance" countries. General reform priorities for countries in this category are to improve effective implementation and enforcement of existing legislation, while continuing to refine their existing laws.

Concessions

Concessions and Public-Private Partnerships are regulated by the Law on Concessions and Private Sector Participation in Public Services and Infrastructure of 1995, as amended in 1996 (the "Concessions Law"). Under the Concessions Law, a company or an individual, domestic or foreign as well as a group thereof, may be a concessionaire. In addition to the Concessions Law, concession matters are also governed by several sector laws and regulations.

The Concessions Law provides for an exhaustive list of sectors that may be developed on a concession basis. Under the Concessions Law, leasing is regarded as a "method" of concession. Other arrangements for private sector participation in public infrastructure and services include: management contracts, service contracts and BOT/BOO/BOOT-type contracts.

The Concessions Law can be viewed as lacking comprehensiveness, particularly where procedures are concerned. Specifically, it does not provide any detailed rules regarding tendering or concession agreements. Rules governing selection process are currently rather ambiguous and incomplete with there being no requirements for a pre-selection or shortlisting of bidders, publication of the criteria, evaluation of proposals or publication of the notice on the concession award. Notwithstanding these deficiencies, since its enactment, a notable number of concessions have been granted under the Concessions Law, in particular at a municipal level, including to foreigners.

The Concessions Law largely leaves it to the parties negotiate and determine arrangements for the concession agreement. The law does not specifically provide for any compensation in case of termination of the contract by the contracting authority, nor does it contain a stability clause against worsening of laws after a concession agreement has commenced. The Concessions Law provides for a choice of arbitration or submission to the Albanian court system for dispute resolution, though it is not clear whether foreign arbitration is possible.

Secured Transactions

Security over movable assets is governed primarily by the Law on Securing Charges, enacted in October 1999 and fully implemented since 2001. The Civil Code (Art. 530-558, 601-607) is also applicable, particularly the recently amended Article 605 relating to priorities. The Law on Securing Charges applies to "all transactions,

⁵ See <http://www.ebrd.com/country/sector/law/corpgov/assess/albania.pdf>

regardless of their form and classification, that create a securing charge, whether by transfer of ownership, possession as in the case of a pledge, or otherwise”, with regard to movable things, intangible property or rights, as well as "serial numbered goods" such as agricultural machinery, aircraft, aircraft engines, automobiles, boats, construction machines, motorcycles, motor vehicles, trailers and trolleys. The Central Registry for Securing Charges began operating in February 2001 and promotion of the system has been undertaken with the support of the World Bank, S.E.E.D (Southeast Europe Enterprise Development) and the IFC. The number of registrations (5000 per year in 2002) shows that there is users’ interest in the institution.

Taking security over immovable assets is governed by the Civil Code (Arts. 560-607), with charges over immovable property required to be registered in the local registry for immovable property.

The current legal framework presents a number of uncertainties or deficiencies, which may create problems when parties are preparing their transactions. This can be particularly so when a charge is taken over inventory, which includes "serial numbered goods" - since such goods need to be registered individually by serial number as soon as they cease to be part of the inventory. Similarly, the question of priority is dealt with in a somewhat complex fashion, by distinguishing between the attachment of the securing charge and its completion. Completed charges will have a better priority rank than uncompleted, though uncompleted charges could still be valid against third parties in certain circumstances. Additionally, state claims for obligations to the state budget and social security claims for mandatory insurance could have priority above securing chargeholders in certain circumstances.

The provisions on enforcement aim to create a quick creditor-oriented system, giving the chargeholder an automatic right to request, upon order of the competent court, that an execution officer take possession of the assets upon default of the chargor. To realise collateral, charged assets may be disposed of by private or public sale (including public auction or closed tender), as a whole in commercial units or in part, but always in a commercially reasonable manner, thus leaving great flexibility to the chargeholder. In the EBRD’s New Legal Indicators Survey 2003⁶, Albania scored just above average on efficiency of the charge enforcement process. The main problems identified stemmed from the institutional context, where courts were reported to be slow and not particularly experienced in handling enforcement cases and to have a high potential for corruption.

Telecommunications

The telecommunications sector is currently regulated by the Telecommunications Regulatory Authority (“ERT”) and is governed by the Laws on Telecommunications of 1995 and 2000. ERT reports to and carries out the policies set by the Ministry of Transport and Communications (the “Ministry”). ERT was formed in 1998 as an independent self-financing entity, designed to promote transparency and investment within the sector. A 1999 government policy document provides the framework for the future development of the sector, including modernisation of telecommunications infrastructure and extension of access to public services throughout the country. The

⁶ See Annex 2.1, EBRD Transition Report, 2003.

basic principles upon which the government seeks to develop the sector include access to basic telephone services at an affordable price, competition and choice for users, and improved protection of consumers. The Law on Telecommunications of 2000, which was drafted with the assistance of the EBRD, provides a modern framework for the implementation of the government policy and lays out the key requirements for development and minimum standards within the sector, including radio frequency allocation, payments for licences and provides an environment for competitive provision of service.

While policy and legislative developments have brought Albania closer to modern standards, the implementation of this policy and legislation by the government falls disappointingly short. More particularly, while the privatisation of the state-owned mobile operator, AMC, and the award of a second GSM mobile licence to Vodafone have created a competitive and rapidly expanding mobile telephone market, the failure by the government to follow through on implementation and enforcement of key areas of the regulatory environment hinders further development in this area and in the sector as a whole.

Although the monopoly of Albtelecom (the incumbent fixed line operator) was lifted at the beginning of 2003, failure to implement a modern regulatory framework has resulted in Albtelecom remaining the sole operator of local long-distance and international telecommunications services. In this respect, the government's decision to request a temporary suspension of its commitment to liberalisation, agreed as part of its membership of WTO, is unlikely to advance matters.

While an independent regulatory authority exists formally in Albania, in the form of ERT, its capacity to implement, enforce and administer the modern framework envisaged by policy and law is severely constrained by the absence of adequate expertise and resources and the apparently insufficient commitment from the government to address these issues and support the implementation of necessary reforms (e.g. interconnection, tariff reform and universal access). Full implementation of a modern regime for telecommunications, as envisaged in policy and law, would make a significant contribution to the improvement of the environment for both mobile and fixed services. The government must now provide immediate support and appropriate resources for ERT in their efforts to fully implement a modern regulatory framework.

ANNEX 3: SELECTED ECONOMIC INDICATORS

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
										<i>Est.</i>	<i>Proj.</i>
Output and Expenditure	<i>(Percentage change in real terms)</i>										
GDP	8.3	13.3	9.1	-7.0	12.7	8.9	7.7	6.8	4.7	6.0	6.0
Industrial gross output	-2.0	6.0	13.6	-5.6	4.1	6.4	5.0	6.5	2.0	na	na
Agricultural gross output	8.3	13.2	3.0	1.0	5.0	3.7	4.5	1.4	2.1	na	na
Employment	<i>(Percentage Change)</i>										
Labour force (annual average)	1.3	1.8	1.8	-23.6	1.5	-1.1	-1.8	-2.7	-12.3	-0.2	na
Employment (annual average)	9.7	5.7	-2.5	-0.8	-2.0	-0.4	-1.3	-0.2	-13.5	0.8	na
	<i>(In per cent of labour force)</i>										
Unemployment (annual average) 1/	16.1	13.9	9.3	14.9	17.8	18.0	16.8	14.6	15.8	15.0	na
Prices and Wages	<i>(Percentage change)</i>										
Consumer prices (annual average)	22.6	7.8	12.7	33.2	20.6	0.4	0.1	3.1	5.4	3.3	3.0
Consumer prices (end-year)	15.8	6.0	17.4	42.1	8.7	-1.0	4.2	3.5	1.7	3.6	3.0
Gross average monthly earnings in economy (annual average)	46.9	25.6	20.0	0.0	26.1	-0.3	14.3	13.0	28.1	na	na
Government Sector 2/	<i>(In per cent of GDP)</i>										
General government balance	-12.6	-10.1	-12.1	-12.9	-9.7	-9.1	-7.9	-7.6	-6.3	-5.6	-6.0
General government expenditure	36.4	33.4	30.3	30.2	33.2	33.9	30.7	30.4	29.0	28.5	29.34
General government debt	na	57.5	55.2	75.6	70.9	67.5	71.6	67.7	63.2	61.3	59.7
Monetary Sector	<i>(Percentage Change)</i>										
Broad money (M3, end-year)	40.6	51.8	43.8	28.5	20.6	22.3	12.1	20.1	3.5	9.0	10.6
Domestic credit (end-year)	17.8	-10.0	47.2	42.2	20.2	9.8	39.0	4.1	6.7	11.0	12.1
	<i>(In per cent of GDP)</i>										
Broad money (M3, end-year)	38.4	46.8	55.0	59.6	58.1	61.8	61.8	64.4	61.5	59.8	59.9
Interest and Exchange Rates	<i>(In per cent per annum end-year)</i>										
Refinancing rate	25.0	20.5	24.0	32.0	22.9	17.8	10.8	7.0	8.5	6.5	na
Treasury bill rate (3-month maturity)	na	13.8	17.8	32.6	27.5	17.5	10.8	8.0	11.2	7.4	na
Deposit rate (one year) 3/	16.5	13.7	19.1	28.5	16.5	9.1	7.7	7.7	9.3	7.6	na
Lending rate (one year) 4/	20.0	21.0	28.8	43.0	25.0	25.8	23.7	11.9	16.0	11.1	na
	<i>(Leks per US Dollar)</i>										
Exchange rate (end-year)	95.0	94.5	103.7	149.8	141.4	135.2	142.6	137.0	135.0	108.7	na
Exchange rate (annual average)	94.7	92.8	104.5	148.9	150.6	137.5	143.7	143.8	140.2	123.1	na
External Sector	<i>(In millions of US Dollars)</i>										
Current account	-279	-177	-245	-276	-186	-265	-274	-263	-435	-509	-555
Trade balance	-460	-475	-692	-518	-621	-846	-824	-1,028	-1,155	-1,371	-1,469
Merchandise exports	141	205	229	167	205	275	255	305	330	426	490
Merchandise imports	601	680	921	685	826	1,121	1,076	1,333	1,485	1,797	1,959
Foreign direct investment, net	65	89	97	42	45	51	143	204	135	192	217
Gross reserves (end-year), excluding gold	204	240	275	306	384	485	620	754	860	974	1,019
External debt stock	1,074	787	845	877	1,007	1,108	1,173	1,198	1,178	1,405	1,540
	<i>(In months of imports of goods and services)</i>										
Gross reserves (end-year), excluding gold	2.9	2.7	4.0	3.8	3.7	3.8	4.2	4.3	4.3	4.4	4.4
	<i>(In per cent of exports of goods and services)</i>										
Debt service	19.7	2.5	6.0	6.1	6.2	3.8	4.0	4.2	6.4	5.1	6.2
Memorandum Items	<i>(Denominations as indicated)</i>										
Population (annual average, millions)	3.2	3.2	3.3	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4
GDP (in millions of lek)	184,393	229,793	280,998	333,071	425,356	488,611	551,282	611,622	677,272	744,600	821,600
GDP per capita (in US dollars)	608	762	819	667	837	1,045	1,119	1,241	1,409	1,765	2,205
Share of industry in GDP (in per cent)	12.5	11.7	12.2	12.4	11.9	11.9	11.5	11.7	11.4	na	na
Share of agriculture in GDP (in per cent)	54.6	54.6	51.5	56.0	54.4	52.6	51.0	49.0	48.1	na	na
Current account/GDP (in per cent)	-14.3	-7.1	-9.1	-12.3	-6.6	-7.5	-7.1	-6.2	-9.0	-8.4	-7.3
External Debt - Reserves, in USD millions	870	547	570	571	623	624	553	444	318	431	521
External Debt/GDP (in per cent)	55.1	31.8	31.4	39.2	35.7	31.2	30.6	28.2	24.4	23.2	20.4
External Debt/Exports of goods (in per cent)	487.3	259.1	235.9	380.0	345.4	203.6	166.8	142.7	128.7	129.5	129.7

1/ Figures do not account for emigrant workers abroad who accounted for an estimated 18 per cent of the total labour force in 1995.

2/ General government includes the state, municipalities and extra budgetary funds. Budget balance on a commitment basis.

3/ Until 1995 the figures show the floor of the band set by the central bank. Thereafter data refer to weighted average interest rates on new 1-year deposits in commercial banks.

4/ Until 1995 data refer to the guideline rate announced by the central bank. Thereafter data refer to weighted average interest rates for 1-year loans by commercial banks.

ANNEX 4: APPROVED BANK OPERATIONS

Albania Portfolio Status (as of 31 December 2003, EUR millions)

Operation name	Debt	Equity	Trade Guaran.	EBRD Signed	Undrawn Commitment	Operating Assets	Net Portfolio
Financial Institutions							
Banca Italo-Albanese		2.6		2.6	0	2.6	2.6
Albania Reconstruction Equity Fund		2.8		2.8	0	1.7	1.9
ProCredit Bank		1.1		1.1	0	1.1	1.1
SME Recovery Credit Line	1.1			1.1	0	0.4	0.4
National Commercial Bank		2.3		2.3	0.0	2.3	2.3
INSIG		4.7		4.7	4.7	0	4.7
TFP: American Bank of Albania			2.0	2.0		0	0
TFP: Banca Italo-Albanese			1.6	1.6		0	0
Infrastructure							
<i>Energy</i>							
Power Sector Reconstruction	30.0			30.0	8.4	15.6	24.0
Power Distribution Rehabilitation	24.0			24.0	23.6	0.4	24.0
<i>Transport</i>							
Road Rehabilitation	17.0			17.0	13.5	3.5	17.0
Industry and Commerce							
<i>Telecommunications</i>							
Albanian Telecom	7.8			7.8	0	2.5	2.5
Vodafone Albania	42.5			42.5	42.5	0	42.5
<i>Agribusiness</i>							
Coca-Cola Tirana		3.2		3.2	0	0	0
<i>Property, Tourism & Shipping</i>							
Tirana Hotel	10.1	0.8		10.9	0.0	5.1	5.1
Hotel Rogner	16.9	2.0		18.9	0.0	3.8	3.8
Country Total	149.4	19.5	3.6	172.5	92.9	39.0	131.9

ANNEX 5: EBRD TECHNICAL COOPERATION PROGRAMMES

(Cumulative Summary as at 31 December 2003)

Commitment By Sector	€	€
	Committed	Disbursed
Agriculture, Forestry	154,013	154,013
Community / Social Services	499,002	278,934
Energy	4,270,660	3,055,271
Finance, Business	5,538,966	4,998,372
Extractive Industries	243,090	243,090
Manufacturing	59,123	59,123
Telecommunications	1,970,039	1,970,039
Tourism	222,763	222,763
Transport / Construction	2,762,836	1,002,585
GRAND TOTAL (72 commitments)	15,720,492	11,984,190

(Detailed list of Operations as at 31 December 2003)

Nr	Year	Commitment Name	Euro Committed	Euro Disbursed	Commit. Stage Name	Sector
1	1993	Forest industries feasibility study	154,013	154,013	Closed	Agriculture, Forestry, Fishing
2	1993	Tourism development advice	63,430	63,430	Closed	Commerce, Tourism
3	1992	Tourism development - tourism studies	103,422	103,422	Closed	Commerce, Tourism
4	1992	Tourism development - legal and institutional changes	55,911	55,911	Closed	Commerce, Tourism
5	2002	Privatisation advisor for Tirana Hotel	39,686	33,733	Disbursing	Community/Social Services
6	1995	Co-financing advisory services	22,827	22,827	Closed	Community/Social Services
7	1996	Durres industrial park assistance to task force	62,269	62,269	Closed	Community/Social Services
8	1999	Annual Meeting 1999 -Accommodation for Albanian Delegation	1,306	1,306	Closed	Community/Social Services
9	1997	Durres industrial park - technical assistance to the task force	46,149	46,149	Closed	Community/Social Services
10	1992	Environmental analysis	49,187	49,187	Closed	Community/Social Services
11	1993	Parliamentary workshop	26,912	26,912	Closed	Community/Social Services
12	2001	Tirana Hotel	250,665	36,550	Committed	Community/Social Services
13	2001	CEI Road Rehabilitation of Corridor VIII in Albania	1,700,000	0	Committed	Construction
14	1993	Establishment of industrial parks - pre-feasibility study	91,805	91,805	Closed	Construction
15	1998	Albania Road Rehabilitation Project	679,410	679,410	Closed	Construction
16	1994	Establishment of industrial parks - pre-feasibility study	30,000	30,000	Closed	Construction
17	2000	Road Rehabilitation Project - Lender's Monitoring Consultant	105,000	44,749	Disbursing	Construction
18	1994	Energy sector investment planning - Drin river (small hydro rehabilitation)	47,267	47,267	Closed	Energy
19	1994	Denmark environmental project financing	130,593	130,593	Closed	Energy
20	1993	Hydro-power plant upgrading and rehabilitation study	161,437	161,437	Closed	Energy
21	1995	Power transmission feasibility study	204,267	204,267	Closed	Energy
22	2000	Assistance to KESH Management	1,946,899	1,896,862	Disbursing	Energy
23	2003	Kesh Management Assistance	1,165,352	0	Committed	Energy
24	1994	Drin river cascade rehabilitation - engineering and project management	363,694	363,694	Closed	Energy
25	1992	On-shore oil - evaluation and negotiation of foreign bids	130,223	130,223	Closed	Energy
26	1993	Turbine efficiency metering study	79,741	79,741	Closed	Energy
27	1992	Energy sector rehabilitation	16,964	16,964	Closed	Energy
28	1992	Briquetting plant	24,223	24,223	Closed	Energy
29	1992	Privatisation of Albchrome - mining advice	90,285	90,285	Closed	Extractive Industries
30	1992	Legal assistance - on-shore oil	61,839	61,839	Closed	Extractive Industries
31	1992	Chromium industry adviser	90,966	90,966	Closed	Extractive Industries
32	1998	Albania Reconstruction Equity Fund	2,381,141	2,018,439	Disbursing	Finance, Business
33	2003	Albania Reconstruction Equity Fund	152,393	0	Committed	Finance, Business
34	2000	CEI Loans for Small Entrepreneurs in Albania	268,586	268,586	Closed	Finance, Business
35	1993	Bank Training Centre	127,923	127,923	Closed	Finance, Business
36	1993	Bank training centre	60,320	60,320	Closed	Finance, Business
37	1993	Bank training centre	31,715	31,715	Closed	Finance, Business
38	1993	Accounting advisor for commercial banks	131,231	131,231	Closed	Finance, Business
39	1993	Establishment of business promotion centre	39,602	39,602	Closed	Finance, Business
40	1995	Mortgage bank - legal advice	25,654	25,654	Closed	Finance, Business
41	1995	Mortgage bank - market analysis	25,654	25,654	Closed	Finance, Business
42	1992	Commercial banking - establishment of accounting systems	193,200	193,200	Closed	Finance, Business
43	1992	Development of banking system	27,144	27,144	Closed	Finance, Business
44	1993	Training for commercial banks	147,692	147,692	Closed	Finance, Business
45	1991	Bank restructuring techniques/training	11,364	11,364	Closed	Finance, Business
46	1992	Commercial banking accounting	27,270	27,270	Closed	Finance, Business

47	1992	Commercial banking - computer equipment for accounting systems (tied portion)	149,466	149,466	Closed	Finance, Business
48	1992	Negotiations with external creditors	77,364	77,364	Closed	Finance, Business
49	2003	INSIG - Insurance Advisor to the General Manager	42,340	16,842	Disbursing	Finance, Business
50	2000	FEFAD Bank - Branch Expansion	1,041,163	1,041,163	Closed	Finance, Business
51	2001	FEFAD Bank - Support of Branch Expansion	577,743	577,743	Closed	Finance, Business
52	2001	TAM Programme - Ajka	11,226	11,226	Closed	Manufacturing
53	1996	TurnAround Management Programme - Instituti I Sigurimeve	29,990	29,990	Closed	Manufacturing
54	1996	TurnAround Management Programme - advisory services contract - Alb-Baker	17,907	17,907	Closed	Manufacturing
55	1992	Institutional Development Programme - evaluation of management development requirements	48,000	48,000	Closed	Telecommunications
56	1993	Institutional development programme - accounting and finance	258,901	258,901	Closed	Telecommunications
57	1993	Institutional Development Programme - operation and maintenance	390,660	390,660	Closed	Telecommunications
58	1993	Institutional Development Programme - Project Management and Implementation	0	0	Closed	Telecommunications
59	1993	Institutional Development Programme - strategic and organisational diagnosis study	49,000	49,000	Closed	Telecommunications
60	1993	Institutional Development Programme - organisation and management implementation	383,726	383,726	Closed	Telecommunications
61	1993	Institutional Development Programme - initial operation and maintenance - Component IV (i)	0	0	Closed	Telecommunications
62	1993	Detailed design of subscriber networks	50,470	50,470	Closed	Telecommunications
63	1998	Telecommunications Administrative and Regulatory Development Programme	64,250	64,250	Closed	Telecommunications
64	1993	Institutional Development Programme - project management and implementation	43,809	43,809	Closed	Telecommunications
65	1995	Albanian telecommunications - advice to project implementation unit	31,025	31,025	Closed	Telecommunications
66	1995	Telecommunications privatisation - legal advice	12,819	12,819	Closed	Telecommunications
67	1992	Telecommunications master plan	197,708	197,708	Closed	Telecommunications
68	1992	Preparation of tender specifications	154,907	154,907	Closed	Telecommunications
69	1995	Albanian Telecommunications - sector policy development	44,972	44,972	Closed	Telecommunications
70	1996	Feasibility study for rural telecommunications development	12,996	12,996	Closed	Telecommunications
71	1992	Utilisation container exchanges	65,889	65,889	Closed	Telecommunications
72	1998	Telecommunications Administrative and Regulatory Development Programme	25,058	25,058	Closed	Telecommunications
73	1995	Review of draft telecommunications law	9,810	9,810	Closed	Telecommunications
74	1998	Telecoms administrative and regulatory development programme	80,185	80,185	Closed	Telecommunications
75	1999	Telecoms Administrative and Regulatory Development Programme	15,911	15,911	Closed	Telecommunications
76	1999	Assistance for the selection process of the 2nd GSM operator	29,945	29,945	Closed	Telecommunications
77	1994	Central European Initiative - transport information reporting project (design and supervision)	156,621	156,621	Closed	Transport, Storage
Report Total Euro Amount:			15,720,491	11,984,190		
No of Commitments:			77			

ANNEX 6: MULTILATERAL AND BILATERAL ASSISTANCE

I. MULTILATERAL ASSISTANCE

The main multilateral donors in Albania, listed alphabetically, are:

EU – PHARE / CARDS

The PHARE Programme started to operate in Albania in 1991. Between the period 1991-2000, Albania has received over EUR 500 million in PHARE assistance and almost EUR 300 million through other programs such as ECHO (humanitarian aid), FEOGA (agriculture) and EDHIR (actions in democracy and human rights). The EU support has covered a large number of sectors, including humanitarian aid, infrastructure, agriculture, health, education, public administration reform, judiciary and law enforcement, democracy and human rights, and cross-border co-operation.

Since 2001, the Community Assistance for Reconstruction, Development and Stabilisation (**CARDS**) programme has been the main EC financial instrument for co-operation in the Balkan countries. For the period 2001-2004, € 187.4 million has been earmarked under the CARDS national programme for Albania.

The main priorities for financing under the CARDS programme emerge from the Albania Country Strategy Paper (CSP) which was issued in 2001. These priorities are: **Justice and Home Affairs** – including the strengthening of the judiciary, enhancing public order, improving border management, and fighting organised crime, fraud and corruption; **Administrative Capacity Building** – including the improvement of the overall implementing and enforcement capacity of the Albanian public administration, particularly as regards specific areas of the future Stabilisation and Association Agreement; **Economic and Social Development** - including certain key areas such trade, education and local infrastructures; **Environment and Natural Resources** – including institutional strengthening (with particular emphasis on implementation and enforcement issues), improved monitoring of pollution indicators and better urban and regional planning; **Democratic Stabilisation** – addressing particularly the strengthening of civil society in Albania.

In addition Albania benefits from the CARDS Regional Programme. The EC also provides some limited funding under specific budget lines in the fields of environment, human rights, Justice and Home Affairs, and the VI Framework programme in Research from which Albania can benefit on a case-by-case basis.

EUROPEAN INVESTMENT BANK

The primary focus of the EIB in the Western Balkans, to date, has been on financing basic infrastructure reconstruction - considered a key component in the early development of the region. The EIB has complemented this focus with projects designed to stimulate the private sector and SMEs in particular.

Starting in 1994, the EIB has committed EUR 164 million in Albania. In the last years the EIB committed EUR 34 million for the rehabilitation of the North – South corridor, EUR 30 million for Power Transmission and Distribution (a project co-financed by the EBRD, WB, and other bilateral donors), EUR 17 million for the rehabilitation of the Port of Durres, and EUR 15 million for the rehabilitation of water facilities in five cities of Albania under a concessional scheme by EC and other donors.

The medium-term strategy of the EIB for the Western Balkans identifies as priority areas of investment transport, energy, and communications. In accordance with these priorities the EIB is co-operating with the EBRD to co-finance a segment of the North – South Corridor and the construction of a ferry terminal in the Port of Durres. In addition, in co-operation with the EBRD and the WB, the EIB is working to finance a thermal power plant in Vlore.

INTERNATIONAL MONETARY FUND

Albania joined the International Monetary Fund in October 1991. Since then it has benefited from four IMF programmes supporting the government's economic adjustment reforms. A three-year IMF's Enhanced Structural Adjustment Facility (ESAF) programme, which was approved by the IMF's Executive Board in May 1998, expired in July 2001. Backed by lending totalling USD 60 million, it supported Albania's fiscal and monetary policies as well as major institutional reforms, such as privatisation of strategic and small-and medium-sized enterprises and the reform of public administration to restrict opportunities for corruption and increase transparency.

On 21 June 2002, the IMF approved a new three-year economic programme, to be supported by a USD equivalent 41.5 million concessional Poverty Reduction and Growth Facility (PRGF). So far, Albania has drawn about USD 17.8 million under its current PRGF arrangement from the IMF. The PRGF is the IMF's most concessional facility for low-income countries. PRGF-supported programmes are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners, and articulated in a Poverty Reduction Strategy Paper (PRSP). On 23 January 2004, the Executive Board of the IMF completed the third review of Albania's economic performance under the PRGF arrangement, which resulted in the disbursement of the equivalent of USD 5.9 million to Albania.

THE WORLD BANK GROUP / IDA

Albania joined the World Bank and the International Development Association (IDA) in October 1991. The World's Bank central objectives have been to reduce poverty, and promote growth and private sector development in the country. IDA concentrated its resources in areas critical to growth and poverty reduction. To date IDA has approved 52 projects in Albania totaling USD 719 million, of which 23 are under implementation. A total of USD 495 million has been disbursed.

In fiscal year 2002, IDA financed several projects: Fishery Development Project (USD 5.6 million); Power Sector Rehabilitation and Restructuring (USD 29.9 million) as part of a large project co-financed by the EBRD, EIB, the Italian Government, and other donor countries; Financial Sector Adjustment Credit (USD 15 million); Road Maintenance (USD 17 million). In fiscal year 2003 IDA approved USD 18 million of financing under the Second Poverty Reduction Support Credit together with other projects: Municipal Water and Wastewater (USD 15 million); Road Maintenance Supplemental (USD 13 million); Community Works II (USD 15 million).

The IDA Country Assistance Strategy (CAS) for fiscal years 2003-05 was approved in June 2002. It provides the framework to support Albania's National Strategy for Socio-Economic Development (NSSD) under the view that Albania has an opportunity to move from short-term crisis management to a long-term vision of sustainable development. Its strategic priorities are to (i) improve governance and strengthen institutions, (ii) promote sustainable private sector growth, and (iii) foster human development through better education, healthcare, and other social facilities.

THE WORLD BANK GROUP / IFC

Albania became a member of the International Finance Corporation in 1991. IFC is stepping up its involvement in Albania to:

- Increase support of the financial sector including privatisation, investment and restructuring of the financial market sector.
- Seek opportunities to finance private sector investments in infrastructure and undertake selective financing of critical infrastructure investments.
- Provide financial and technical assistance to small and medium-sized enterprises in the post-privatisation stage.
- Rehabilitate the key industrial sectors such as oil and gas, mining and related industries, and construction materials.
- Support the development of different sectors where Albania has comparative advantages such as light manufacturing, fishing and tourism.

IFC's portfolio for the country so far amounts to USD 130.5 million. The IFC and EBRD have co-financed projects in the financial sector (ProCredit Bank, National Commercial Bank, INSIG) and in the private corporate sector in Albania (Vodafone Albania). The Bank and IFC are currently co-operating in financing the rehabilitation and expansion of the Fushe-Kruje Cement Factory.

II. BILATERAL ASSISTANCE

The largest bilateral donors in Albania (more than EUR 50 million disbursed cumulatively) listed alphabetically are:

GERMANY

The German government, as one of the most important partners of Albania in development co-operation, has committed to date a cumulative amount of EUR 320

million, of which EUR 248 million in financial co-operation and EUR 72 million in technical assistance.

The financial co-operation projects are implemented by KfW on behalf of the German Federal Government and concentrate on the following sectors:

- *Water supply and sewerage* – EUR 114 million have been committed to date in several cities including both investment for rehabilitation of water supply systems and implementation of institutional support measures at municipality level.
- *Financial sector* - the main project is ProCredit Bank, Albania's leading micro-finance institution, where EBRD and IFC are also shareholders.
- *Energy sector* - the funding volume for the sector stands at EUR 31 million, which is mainly designated for a regional hydropower generation and distribution programme in the south of Albania. Parallel institutional and financial improvements in the sector are being addressed in close co-ordination with other IFIs and donors.
- *Infrastructure* - one of the most important interventions in the sector has been the reconstruction of the Tirana's Airport runway, a project of EUR 25 million.
- *Small-scale Social Infrastructure and Housing* – have been provided with commitments of EUR 15 million emphasizing labour-intensive approaches and participatory implementation.

Technical assistance programs are being implemented by the governmental agency GTZ and focus more on education/vocational training, promotion of rural development, strengthening of the legal system.

Co-operation in 2004-5 will continue to focus on the energy and water supply sectors. Other priority areas will be small-scale social infrastructure development and environment protection.

GREECE

Besides being Albania's second largest trade partner and one of the main FDI originators, Greece has also provided grant assistance and technical co-operation funds mostly concentrated in agriculture, urban and rural housing infrastructure, and social services (health, education).

Greece has signed a five year (2002-2006) development co-operation programme with Albania under the Hellenic Plan for Economic Reconstruction of the Balkans for a total commitment of EUR 50 million. The development programme focuses on: (i) modernisation of infrastructure, particularly energy and transport; (ii) promotion of productive investments; (iii) modernisation of public administration and self-government; (iv) support of democratic institutions; (v) support to the rule of law and welfare state; (vi) addressing economic inequalities; and (vii) support to education and vocational training, to the administrative and scientific potential.

ITALY

Italy is by far the largest bilateral donor to Albania with cumulative disbursed funds over 1991-2002 amounting to USD 353 million. Italy's assistance to Albania has evolved from emergency aid in the early stages of transition and crisis times, to a longer-run development approach. The 2002-2004 assistance programme for Albania envisages further support for a total of EUR 202 million. The assistance programme for 2002-2004 focuses on:

- *Electric power sector* - this has been the main support area since 1994 where substantial funds were provided for emergency interventions as well as rehabilitation of several components of the power transmission and distribution system. Italy is one of the active players in the current international structural support for the energy sector in Albania along with EBRD, World Bank and other donors.
- *Water supply facilities* - the financing for this sector have been mainly focused on the area around Tirana and includes assistance for a structural programme to support the local utility company.
- *Road infrastructure* - Italy has been actively involved in this sector through financing for the rehabilitation of several urban and national road segments, technical assistance for structural improvements in the Road Directorate and support for road maintenance and repair. It is also co-financing the Road Rehabilitation project of EBRD.
- *Other transport sector* projects which Italy has been focusing on include railway and ports. Italy is considering contributing in the joint efforts of EU, EIB, EBRD and other donors to support restructuring and rehabilitation of Durres and Vlora ports.
- *Social services*, mainly health and education systems, have also benefited from Italian support. Reconstruction of schools, university exchange programmes, rehabilitation of health care centres and management support have been some of the main areas of assistance.

JAPAN

Japan is another important donor to Albania. Japanese bilateral assistance commenced in 1990, and total disbursements had reached USD 52.4 million at the end of 2000. This consisted of USD 11.4 million (22%) of grants, USD 11.1 million (21%) of technical assistance and USD 29.9 million (57%) of loans. Japan ranked fourth among bilateral donors in 1997.

The largest projects committed have been a JPY 2.2 billion yen (USD 20 million equivalent) loan in 1994 for agriculture sector adjustment, a JPY 1.7 billion yen loan in 1995 for the rehabilitation of the Drin River hydropower station, and a JPY 3.1 billion yen loan in 1996 for a power transmission and distribution project. The latter loan was co-financed with the EBRD.

Grant assistance and technical assistance have included:

- Emergency relief assistance during the disturbances of March 1997;
- Donation of medical equipment and facilities as well as assistance in the areas food production and budget and balance of payments in 1999-2000 in response to the Kosovo crisis.

SWITZERLAND

In the framework of bilateral co-operation between Albania and Switzerland several projects have been approved since 1991 in the fields of energy (alongside the EBRD and other IFIs), agriculture, transport, telecommunications, privatisation and private sector development through promotion of micro-credit facilities for local communities.

USA / USAID

The USAID programme in Albania supports economic growth and modernisation of the agricultural sector, democratic development, and social stability. The objectives of the USAID programme are defined in the US Strategic Plan for International Affairs: promote broad-based economic growth, increase foreign governments' adherence to democratic practices and respect for human rights, protect human health, and ensure that local and regional instabilities do not threaten the security and well-being of the United States and its allies.

The USAID assistance for years 2003 – 2004 concentrates on: (i) economic growth and agricultural sector development by increasing private investment, improving the availability of credit, and strengthening the banking system; (ii) democratic reform to support civil society, assistance to elections, strengthening of legal institutions, support to the government's decentralisation programme; and (iii) health reform to improve primary health care by developing and implementing quality primary health care models, strengthening management capacity at the primary health care level, and encouraging community participation to ensure better health care.

The USAID is the fourth largest donor overall and the second largest bilateral donor in Albania with a total commitment of USD 368 million as at the end of 2003, of which USD 21 million were committed in 2003. The USAID plans to commit an additional USD 24 million in 2004 in projects covering its strategic priorities.

In addition, some donors have indicated future plans to significantly increase their support to Albania. In particular, **the Netherlands** have decided to increase the volume of bilateral assistance. Environmental assistance is one of the main priorities. Environmental support will include institutional projects on a regional, central and municipal level as well as include co financing of World Bank environmental projects to clean up environmental hot spots. In 2003 EUR 1 million has been committed. A total amount of around EUR 9 million will be available for the period 2003-2006. Another EUR 10 million will be spent over the same period for promoting good governance in the public domain.